Anatomy of a Bank Failure

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This article will review the basics of bank insolvency, describe the various methods used by the Federal Deposit Insurance Corporation to resolve bank failures and summarize legal issues that commonly arise in a bank failure.

The recent increase in the number of bank failures has made legal issues associated with these insolvencies a front burner topic for bankers, lawyers representing banks, and those with significant contractual or other relationships with banks. This is not surprising as the failure of a bank can have adverse consequences for account holders with balances in excess of applicable deposit insurance limits, vendors providing services to a failed bank, officers of the failed bank with unfunded deferred compensation arrangements, borrowers with partially funded construction loans or lines of credit from the failed bank, other banks having loan participations with the failed bank, landlords with leases to the failed bank, counterparties with the benefit of continuing contract representations or warranties under asset sale agreements with the failed bank and any counterparty to a contract or with a claim for damages against the failed bank.

In the United States, bank failures are administered by the Federal Deposit Insurance Corporation ("FDIC").[1] This article will review the basics of bank insolvency, describe the various methods used by FDIC to resolve bank failures and summarize legal issues that commonly arise in a bank failure.

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BANK INSOLVENCIES DIFFER FROM OTHER INSOLVENCIES

Bank failures are different from other types of bankruptcies. While the insolvency of individuals and most business entities is covered under the provisions of the Federal Bankruptcy Code, the insolvency of banks is not.[2] The insolvency of a bank (*i.e.,* a federally insured bank or thrift), which is specifically exempted from the Bankruptcy Code, is governed by the Federal Deposit Insurance Act ("FDI Act").[3] Bank insolvencies are administered by the FDIC utilizing a non-judicial, administrative process. The insolvency of a bank or financial holding company and "non-bank" affiliates, however, is governed by the Bankruptcy Code.[4]

Bank insolvencies in the United States are treated differently than other types of bankruptcies due to the importance of banks in the effective functioning of the economy. When a bank fails, it can have a devastating impact not only upon every one of its customers but also upon parties with whom its customers dealt. Simply stated, the failure of any bank (but especially a large one) can damage the economy and undermine public confidence more acutely than the failure of almost any other comparably sized private business enterprise.[5]

THE BANK FAILURE AND CLOSING PROCESS

Objectives of the Resolution Process

The strategic goal of the law governing bank failures is to maintain public confidence in the banking system by "bringing to depositors sound, effective and uninterrupted operation of the banking system with resulting safety and liquidity of bank deposits."[6] This goal is best achieved by assuring depositors timely access to their insured bank deposits. In the United States, this timely access is provided by an administrative rather than a judicial receivership. FDIC, acting as receiver of a failed bank, promptly determines the claims of depositors and, in its corporate capacity, assures that those depositor claims are satisfied. The capacity in which FDIC acts is important. FDIC acts in its "corporate" capacity by providing deposit insurance to insured banks and performing certain regulatory functions. It acts in its capacity "as receiver" by liquidating a failed bank and winding up its affairs.

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Different functions, powers and liabilities apply to FDIC in each capacity.[7]

The FDIC receivership process has been designed to turn the failed bank's assets into cash in the least costly manner and maximize the recovery of its assets to the receivership. FDIC operates receiverships efficiently, spreads common overhead over multiple receiverships and is able to assure more consistent application of rules and regulations. Prompt protection of depositors is valued over more generalized objectives that every creditor is entitled to its day in court.

Why Banks Fail

While a bank can fail for any number of reasons, the FDIC Office of Inspector General has stated the three major causes of bank failures are: (1) inadequate corporate governance; (2) weak risk management; and (3) lack of risk diversification/lending concentrations.[8] The deterioration of a failed bank from solvency to failure seldom occurs precipitously. The FDIC Inspector General has observed that the decline of a troubled bank to failure has four stages:

Stage I — Strategy. The bank has the wrong people leading it, no strategy or the wrong strategy and lax standards and controls.

Stage II — Growth. Those wrong people who lead the bank fail to follow the principles for the safe and sound operation of a bank, make poor lending and investment decisions and exhibit lax oversight of credit practices.

Stage III — Deterioration. Those wrong people become increasingly reluctant to acknowledge the validity of supervisory concerns about management practices, the local economy worsens and bad loan problems emerge.

Stage IV — Failure. The bank is subjected to formal regulatory enforcement action, key players resign, and huge loan losses coupled with the need for massive capital infusion emerge.

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Resolution Process

Regulators Determine Grounds for Closure

The decision to close an insolvent bank is normally made by its primary banking regulator who initiates the closure process by sending a "failing bank letter" about the bank to FDIC. FDIC also has the authority to decide to close a bank in certain circumstances.[9] The decision normally comes after a regulatory examination finds the bank to be in a severely weakened condition. The adverse examination findings are usually accompanied by a formal regulatory enforcement action like a cease and desist order designed to force necessary corrective actions. This is typically followed by a "capital call" or "prompt corrective action" notice from FDIC or the bank's primary regulator to the failing bank. If the bank cannot be returned to a safe and sound condition by its primary regulator and its capital deteriorates to unsafe levels, the bank may be declared insolvent by the primary regulator or FDIC. There is no prior judicial involvement or advance opportunity on the part of the failed bank or its creditors to contest the insolvency and seizure of the bank.[10]

Insolvency and Other Grounds for Receivership

Bank regulators can act quickly to close a troubled bank. A bank need not be determined insolvent under a traditional book value (*i.e.*, the book value of its assets is less than its liabilities) or liquidity (*i.e.*, unable to pay its liabilities or meet withdrawal demands) definition of insolvency. The FDIC Improvement Act of 1991 (Public Law 102-242) ("FDICIA") gave FDIC the authority to close a bank that was "critically undercapitalized" (*i.e.,* had less than two percent equity capital to total assets) but not insolvent under traditional book value or liquidity definitions of insolvency when the bank had no realistic prospect of returning to a safe and sound condition.[11] FDICIA requires FDIC to close a bank within 90 days of sending it a prompt corrective action determination if the bank has not been recapitalized.

In addition, FDIC can be appointed as conservator or receiver for a troubled bank on any number of grounds including:

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- Assets are less than obligations to creditors and others;
- Substantial dissipation of assets or earnings due to violation of statute or regulation or an unsafe or unsound condition;
- Unsafe or unsound condition to transact business;
- Willful violation of a cease-and-desist order which has become final;
- Concealment of the bank's books or refusal to submit to an inspection or examination;
- Inability to meet obligations;
- Incurrence of losses or likelihood of incurring losses that will deplete capital with no reasonable likelihood of becoming adequately capitalized without federal assistance;
- Violation of a law or regulation or an unsafe or unsound practice or condition likely to cause insolvency or weaken the bank's condition or seriously prejudice the interest of depositors or the FDIC insurance fund;
- The bank's board of directors or shareholders vote to consent;
- Termination of deposit insurance coverage;
- The bank is undercapitalized with no reasonable prospect of becoming adequately capitalized; fails to submit an adequate recapitalization plan; or materially fails to implement an acceptable capital restoration plan;
- The bank is critically undercapitalized or has substantially insufficient capital; and
- Upon notice from the Attorney General to the bank's regulators that the bank has been found guilty of a money laundering offense.[12]

FDIC Evaluation of Failing Bank Assets

Once a bank's primary regulator or FDIC has determined to close a bank, FDIC steps in to "resolve" it by accepting appointment as the bank's conservator or receiver. FDIC, acting as conservator or receiver, has the power to "take any action" permitted by law which it deems "in the best interests of the depository institution, its depositors or [FDIC]."[13] The major difference

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between a receivership and a conservatorship is that a bank under a conservatorship continues to be temporarily operated as a going concern by FDIC, as conservator, and is subject to continuing regulation by its primary regulator until it is rehabilitated or closed.[14] With a receivership, the bank is closed with the receiver liquidating the bank and winding up its affairs.[15]

Before being formally appointed receiver of a troubled bank, FDIC normally performs an evaluation to establish the value of its assets and liabilities (including the total amount of its insured deposits), determines appropriate resolution options, solicits bids and ultimately determines the resolution strategy it will use to provide the least cost resolution. The entire FDIC evaluation process can take up to 60 days. The evaluation typically begins by an FDIC planning team contacting the bank's CEO and gathering preliminary information. FDIC resolution specialists then visit the bank to examine the bank's books and records and more carefully determine its condition.[16]

FDIC utilizes valuation models and statistical sampling procedures to estimate the liquidation value of a failing bank's assets. Loans are divided into categories based on the type of loan and further identified as either performing or nonperforming. Each subcategory of loans is given an estimated liquidation value. The estimated value of the bank's assets is used in calculating the loss factor FDIC expects the receivership to incur. FDIC creates a secure website or extranet to which asset and operating information about the failing bank is posted.

Based upon the information gathered, FDIC determines the appropriate resolution structures to offer to potential bidders. An "information package" containing a detailed description of the bank's assets and liabilities is compiled for bidders.

Disposition of the Failing Bank

Once the resolution structure has been determined, FDIC begins the process of finding buyers to purchase the failing bank. This part of the process normally takes about 30 days.

Marketing the Bank

FDIC utilizes its bank examination personnel to identify a list of healthy

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banks as potential bidders. Bank acquirers can also contact FDIC at *FDIC Connect* to express interest in bidding on failing banks. Only other financial institutions or private investors in the process of obtaining a bank charter are allowed to bid on a failing bank prior to closure. Potential bidders must be approved by FDIC and bank regulators to be eligible. Bidders must have a CAMELS composite and management component rating of "1" or "2" and satisfactory Community Reinvestment Act and anti money laundering records. Private investor bidders must have adequate funds and be in the process of obtaining a *de novo* bank charter. Subsequent to closing, FDIC is willing to sell loans or other assets of the failed bank to nonbank buyers who were not bidders for its franchise.

Approved bidders are contacted by FDIC, asked to sign confidentiality agreements and given access to a secure extranet. Through the extranet, bidders have access to the FDIC information package and any other relevant information on the failing bank and its resolution including details about the bank's assets, due diligence procedures and the resolution methods FDIC plans to use (*i.e.*, whole bank purchase and assumption transaction, clean bank purchase and assumption transaction or insured deposit transfer) and other significant terms for the sale (*i.e.*, loss sharing, put back rights).

Bidder Due Diligence and the Reserve Price

Bidders have limited ability to conduct on-site due diligence on a failing bank prior to closure unless the failing bank's board of directors has adopted a resolution to allow bidders the ability to perform on-site due diligence inspection of its assets. This is less of an issue today as FDIC now markets failing banks through secure websites or extranets to which all financial, legal and regulatory information is uploaded and available to authorized bidder representatives. All eligible bidders thus have equal access to the same available information. FDIC often discloses to bidders its "reserve price" determinations for the failing bank's assets (unless a loss sharing arrangement is being offered). The reserve price represents FDIC's estimate of liquidation value (fair market value less disposition and direct marketing costs) of the assets being offered. Estimated liquidation value is expressed as a percentage of book value. It is the linchpin for making the least cost resolution determi-

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nation, which FDIC must utilize when liquidating a failed bank. Disclosure of FDIC's determination of the liquidation value of a failing bank's assets can help the disposition process by giving bidders a reliable reference point for their bids and setting a de facto minimum bid price.

Bid Submission

Bid submission typically occurs approximately 10 days before the scheduled closing of the bank. Each bid consists of two figures. The first is the transaction bid. This is the bidder's estimate of the collectable value of the bank's assets that the bidder is proposing to acquire. The second is the bidder's estimate of the bank's so-called franchise value. Sometimes called a "premium," it is the bidder's estimate of the future value of the failing bank's deposit relationships with customers that the bidder would acquire.[17] Once all bids have been submitted, FDIC evaluates each bid against all other bids and the FDIC's estimated cost of liquidation to determine the least cost resolution.[18]

Selection of Winning Bid

FDIC officials evaluate the bids and recommend the least cost, best method of resolution to the FDIC Board of Directors. The FDIC Board approves the resolution after giving due consideration to the least cost analysis, the impact of the resolution upon uninsured depositors and the advisability of making an advance dividend payment to uninsured depositors. Once the resolution is approved, FDIC notifies the winning bidder, all other bidders and the failing bank's primary regulator. The necessary agreements are then signed with the winning bidder and the logistical arrangements are made with the bidder for a smooth closing of the resolution.

Preparation for the Closing and Receivership

Just prior to its appointment as receiver, FDIC prepares and conducts an on-site analysis of the failing bank during which it estimates the number and dollar amount of uninsured deposits at the bank as of closing, analyzes all contingent liabilities of the bank and investigates the presence of potential fraud.

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Appointment of FDIC as Receiver and Bank Closing

Once FDIC has evaluated the failing bank and determined the least cost resolution strategy, it is officially appointed as the bank's receiver. Upon its appointment, FDIC closes the bank, takes control of its assets, records and premises and terminates any involvement of the bank's officers, directors and shareholders in its operation. FDIC succeeds to all rights of the failed bank and has the general authority to operate its business, exercise all of the failed bank's corporate powers, merge it with another bank or transfer its assets to an existing bank or a new "bridge bank."[19] FDIC, as receiver or conservator, has authority to determine the validity of creditors' claims at a failed bank.[20] The entire resolution process generally takes 90 to 100 days, not including the post-closing settlement period which generally takes between six months and a year, depending on the size of the failed bank.

RESOLUTION STRUCTURES

FDIC can utilize any of a number of structures to resolve a failing bank. They include:

- Open bank assistance;
- Conservatorship;
- Creation of a bridge bank or deposit insurance national bank;
- A purchase and assumption transaction with a healthy bank;
- An insured deposit transfer; and
- A depositor payoff.

In addition, regulatory forbearance accompanied by sale of a controlling or complete interest in a failing bank to outside investors (*i.e.*, a capital infusion for a stock bank or supervisory stock conversion for a mutual) or a capital infusion by the federal government (TARP or similar preferred stock investment) are informal methods to resolve a failing bank without a formal FDIC receivership. The form of resolution selected by FDIC will differ

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depending upon the circumstances of each failed bank. FDIC's options in selecting a resolution structure have been narrowed since the passage of FDICIA in 1991 which requires FDIC to generally select the least costly resolution alternative.[21] FDIC is also required to consider the adverse economic impact of any resolution on the local community served by a failing bank and on the viability of other local banks in the same community.[22]

Purchase and Assumption Transactions

The purchase and assumption transaction ("P&A") is the most frequently used and preferred method for resolving a failed bank. The basic structure is quite simple. FDIC makes an arrangement with a healthy bank to purchase some or all of the failed bank's assets and at the same time assume some or all of the failed bank's deposit (and frequently other) liabilities. Assets or liabilities not sold in the P&A are retained by FDIC in the failed bank receivership and liquidated or resolved separately. Classified assets, fraud related assets and claims against the failed bank's officers and directors or their insurers are retained in the receivership. Brokered deposits and other "non core" deposits are not assumed in P&A transactions where only insured deposits are transferred. FDIC has historically favored use of P&A transactions over liquidations in bank failures because they (a) preserve any going concern value of the failed bank's deposit franchise (*i.e.*, the assuming bank often pays FDIC a premium to obtain the deposit franchise), (b) reduce disruptions to the failed bank's depositors and the local economy, and (c) involve less cash outlay, cost and administrative burden than a full FDIC supervised liquidation.

P&A transactions can be structured in a variety of ways depending on which assets are purchased, which liabilities assumed and what other incentives, if any, FDIC offers to induce the acquirer to enter into the P&A. Such incentives may include giving the acquirer puts or options to return or acquire assets or agreeing to share in future losses and recoveries resulting from a pool of assets.[23] As noted above, the P&A transaction is the most commonly used resolution. From 2000 to August 1, 2008, P&A transactions constituted 34 of the 40 resolutions carried out by FDIC.[24] The most commonly used P&A structures utilize a "whole bank" or "modified"/"clean bank" form.

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Whole Bank P&A Transaction

In a whole bank purchase and assumption transaction, a single healthy bank acquires most of the failed bank's assets and liabilities (including *all* insured and uninsured deposit liabilities at book value) in a single transaction. Whole bank P&A transactions are often favored for their efficiency, convenience to the failed bank's customers and ability to greatly reduce the number of assets held by FDIC for liquidation and their associated liquidation costs.[25]

In 2008 Washington Mutual Bank ("WaMu") was resolved pursuant to a whole bank P&A agreement under which JPMorgan Chase Bank purchased from FDIC as receiver most of WaMu's assets, assumed most of its liabilities and was granted an exclusive option to assume certain other of WaMu's rights and obligations.[26]

Traditionally, purchasers in a whole bank P&A transaction acquired the failed bank's assets, including bad loans, on an "as is" basis at book value. Bids may be negative. Such a resolution process encouraged bidders to bid conservatively to limit their exposure to unexpected deterioration in the loan asset portfolio. FDIC currently addresses this problem by offering loss sharing arrangements in P&A transactions.

In a whole bank P&A transaction, the purchaser assumes *all* deposit liabilities, not just FDIC insured deposit liabilities. This gives 100 percent protection to uninsured depositors and results in unlimited deposit insurance coverage to all depositors at a higher resolution cost to FDIC. For these reasons, whole bank P&A transactions are often not the least cost resolution method for FDIC in comparison to other resolution options.[27] The deposit premium paid to FDIC in a whole bank P&A transaction, however, is based only upon "core" deposits. Brokered deposits transfer to the acquiring bank but no premium is collected for them.

Modified or "Clean Bank" P&A Transaction

In a modified or clean bank P&A transaction, the acquiring bank normally agrees to assume liability only for FDIC insured "core" deposits at the failed bank and pay FDIC a premium for the franchise or going concern value represented by those deposit relationships. In addition, the acquir-

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ing bank also agrees to purchase some portion of the failed bank's "good" assets from the FDIC receivership. Those assets could be limited to the failed bank's securities, cash or cash equivalents or also involve the "clean" portion of its loan portfolio depending upon the transaction. The amount of loans purchased by an assuming bank can be further limited by loan type (*i.e.*, installment loans, owner occupied residential loans), yield, performing status or other factors. FDIC may also sell or grant options to the acquiring bank upon other assets offered by the failed bank like its bank facilities or additional performing loans. Clean bank P&A transactions are often used where there has been little time for the acquiring bank or FDIC to do due diligence prior to bank failure.

Uninsured deposits (*i.e.*, deposits in excess of FDIC limits) and non "core" deposits (*e.g.*, brokered and CDARS deposits) are not assumed by an acquiring bank in a modified P&A transaction. Excess depositors are issued receivership certificates by FDIC as receiver of the failed bank for the amount of their excess deposit claims and paid dividends from the receivership as the failed bank's assets are liquidated. Clean bank P&A transactions involve much more work for FDIC than whole bank P&A transactions because FDIC is left with a much greater proportion of the failed bank's assets to liquidate and the responsibility for administering the receivership certificates issued to uninsured depositors.

Important Mechanisms Frequently Used in P&A Transactions

There are several important mechanisms commonly used by FDIC to make P&A transactions generate higher yields for the disposition of receivership assets and reduce financial risk factors to bidders.

Loss Sharing and Yield Guaranty Agreements

Many P&A transactions utilize a loss sharing component pursuant to which FDIC agrees to share in defined future credit losses and expenses (and recoveries) experienced by the acquiring bank on a fixed pool of assets. In many cases, loss sharing arrangements are limited to the riskier commercial loans and do not include performing consumer loans which are generally of better quality. These arrangements can run for a five year period and be

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expensive and time consuming to administer.

The basic loss sharing arrangement requires the acquiring bank to absorb losses on acquired assets covered by the loss sharing agreement that exceed a stated threshold or "first loss" amount consisting of the amounts bid by the acquiring bank for the failed bank's deposit franchise and net assets. (The stated threshold can be a negative number.) Once the stated threshold is exceeded by losses on the covered assets during the term of the loss share arrangement, FDIC reimburses 80 percent of the losses (and is reimbursed for 80 percent of any net gains) on the covered assets during the term of the agreement. If losses on the covered assets are higher than expected and reach a "second loss" threshold amount, the loss share percentage absorbed by FDIC increases to 95 percent. Recoveries attributable to covered assets are shared with FDIC on the same basis as losses during the coverage term. FDIC has also entered into arrangements with acquiring banks to guaranty the yield on certain assets purchased from its receivership.

Loss sharing encourages bidding based on an accurate valuation of assets, and thus allows FDIC to maximize the bank's value while at the same time disposing its assets efficiently. It discourages unrealistically low bids designed to hedge against the risk of greater than anticipated losses.

Put and Call Options

FDIC formerly granted acquiring banks in P&A transactions significant rights to put back certain bad assets purchased from a receivership within a 30- or 60-day window period or, in the alternative, a call option to purchase additional assets from the FDIC receivership at favorable prices. This practice has been largely discontinued by FDIC for loan assets. Put options, if granted, are for very limited periods to prevent further deterioration of the assets during the put back period. But it does grant an acquiring bank the right to put back a loan to the receivership where the maker's signature was forged or the loan collateral was stolen. It also frequently allows an acquiring bank a 90-day option to purchase bank premises or assume leases of real or personal property or other contracts belonging to the failed bank. If the acquiring bank does not exercise its call option to assume a lease or contract, it will be rejected by FDIC under its power to repudiate leases and contracts.

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Optional Loan Pools

Advances in technology have made it easier for FDIC to market the loan assets of failing banks to a wider market. The ability to make much more information about a failing bank's assets available via a secure extranet significantly expands the pool of eligible bidders and gives FDIC the option to group a failing bank's loan portfolio into homogenous pools to attract more and higher bids from a wider range of bidders. Bidders can bid for the deposit franchise and/or all or certain loan pools. These loan pools are offered with FDIC's reserve prices disclosed. As a practical matter, this means that FDIC can sell individual loan pools segregated by type of loan (*e.g.*, residential, credit card, consumer, commercial) or other criteria to qualified bidders.

Bridge Banks

The Competitive Equality Banking Act of 1987 gave FDIC the authority to establish a "bridge" bank to acquire some or all of a failed bank's assets and liabilities for a temporary period. A bridge bank is a form of P&A transaction in which FDIC serves as the receiver for a failed bank and immediately transfers its assets and insured deposit liabilities to a newly chartered national bank. FDIC then operates the bank free of normal capital and supervisory oversight requirements for up to five years and provides uninterrupted deposit and limited lending service to the failed bank's customers until it can arrange a subsequent P&A transaction with a healthy bank. A bridge bank is a temporary solution designed to "bridge" the gap between a bank's failure and a permanent FDIC solution. It allows for the continuance of banking operations without the disruption of a closure and maintains franchise value. Lending activity at the bridge bank is continued but at a reduced level. Bridge banks are most commonly encountered when there is a sudden failure of a large bank and FDIC needs additional time to resolve it effectively.[28]

Depositor Payoff and Liquidation

If FDIC is unable to find a healthy bank to purchase a failing bank in

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a P&A transaction, it may be required simply to close the bank, liquidate its assets and use the proceeds to pay off its liabilities. FDIC, acting in its corporate capacity, pays depositors the amount of their insured deposits, and is subrogated to the depositor's claims against the failed bank's estate. Deposits in excess of the insured limit are treated as unsecured claims against the failed bank's receivership estate. Uninsured depositors and other general creditors are issued receivership certificates entitling each to a portion of the receiver's collections on the banks assets, if any, in accordance with statutory payment priorities. Uninsured depositors, however, have the same priority as FDIC over other unsecured creditors under the National Depositor Preference Amendment.[29] Depositor payoff and liquidation is the most costly method for resolving a failed bank, as FDIC must liquidate all of the bank's assets, bear the upfront cost of paying off all insured depositors and monitor the estate for the creditors. No franchise value is recovered. This method is therefore only used if FDIC does not receive a bid for a P&A transaction or for a less costly insured deposit transfer transaction.[30]

Insured Deposit Transfer

An insured deposit transfer is similar to a straight depositor payoff and liquidation in that FDIC determines the amount due to each insured depositor. FDIC then makes arrangements for a healthy bank to pay insured deposits to customers of the failed bank. The healthy bank generally bids a negative amount for the failed bank's assets. It also undertakes the task in the hope of acquiring many of the failed bank's depositors as its own. Insured deposit transfers are rarely utilized.

Deposit Insurance National Bank

Where FDIC is unable to find a healthy bank to purchase a failing bank, another option is for FDIC to establish a new deposit insurance national bank in the same community as the bank in default.[31] Upon the closure of the failed bank, FDIC transfers most or all of the failed bank's insured deposits to the deposit insurance national bank, providing depositors with uninterrupted service. The purpose of a deposit insurance national bank

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is to provide customers access to banking services in communities where banking options are limited. Deposit insurance national banks are operated temporarily, either until a purchasing bank is found or until customers have had time to establish relationships with other institutions. By statute, a deposit insurance national bank is authorized to operate for a maximum of two years.[32] Although deposit insurance national banks have been rarely utilized as a resolution structure, FDIC recently established a deposit insurance national bank upon the failure of New Frontier Bank in Greeley, Colorado.[33]

Open Bank Assistance

FDIC may offer financial assistance, called "open bank assistance," to an operating but failing bank in the form of a loan, an assumption of some or all of its liabilities, a purchase of its troubled assets or a direct infusion of capital. The purpose of open bank assistance ("OBA") is to return the bank to solvency and prevent it from failing. There is no FDIC receivership with an OBA transaction.

OBA is rarely used today for a number of reasons. First, there is a general feeling among smaller banks and the public that OBA is inherently unfair because it is extended to help only the largest banks. Second, as further explained below, OBA is rarely the least costly resolution strategy for FDIC and thus can only be used upon a finding that OBA is necessary to mitigate systemic risk to the economic system that might otherwise result.[34] Finally, FDIC is restricted from using its deposit insurance fund in a manner which benefits the shareholders of a failed or troubled bank, further limiting its ability to utilize OBA.[35] OBA does not involve an FDIC receivership.

LEAST COST RESOLUTION AND DEPOSITOR PREFERENCE

Least Cost Resolution Requirement

Since FDICIA was enacted in 1991, FDIC has been under a statutory mandate not to resolve failing banks unless it first determines that (1) the resolution is necessary to protect insured depositors and (2) the method of resolution selected is the "least costly" to FDIC of "all possible methods" for

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meeting its obligations.[36] FDIC may not take action to protect depositors for more than the FDIC insured portion of their deposits or to protect creditors other than depositors.[37] This statutory least cost resolution requirement obligates FDIC to choose the resolution format with the lowest cost to the FDIC deposit insurance fund. FDIC determines lowest cost for a receivership by calculating its total expected expenditure (including both immediate- and long-term obligations and direct or contingent liabilities).

FDIC calculates the cost of each possible resolution on a net present value basis, using a realistic discount rate. The following factors are included in the least cost analysis determination:

- The difference between total book value of assets and liabilities of the bank;
- Operating expenses of the receiver;
- The levels of uninsured and insured liabilities;
- The levels of secured liabilities;
- Recoveries on bond and professional liability claims;
- Losses on contingent claims;
- Any premium paid by the acquirer;
- The realized value of assets placed in liquidation by FDIC; and
- Cross-guarantee provisions against affiliated institutions.

The least cost requirement requires FDIC to review all bids submitted with respect to the resolution of a failed bank and to choose the one that is estimated to be the least costly as compared to all other bids submitted and the estimated cost of a depositor payoff and liquidation. The estimated cost to FDIC of a liquidation and payoff is generally calculated by multiplying the "loss to depositors" by the "loss factor." The loss to depositors is calculated as the total expected loss on all receivership assets plus estimated receivership expenses, minus the amount of any remaining equity and amounts owed to unsecured creditors. The loss factor is defined as the ratio of FDIC insured deposits to total deposits.

The least cost test makes a whole bank P&A transaction in which the ac-

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quiring bank assumes all uninsured deposit liabilities of a failed bank much more difficult to effect. 12 U.S.C. §1823(c)(4)(E)(i) provides that a resolution may not protect uninsured depositors if it would increase the loss to the FDIC deposit insurance fund. But if an acquiring bank pays a sufficiently large premium for the failed bank's deposit franchise, the premium may offset any increased loss to FDIC associated with the transfer and assumption of the uninsured liabilities. This may make the whole bank P&A transaction less costly than a depositor payout and qualify it for the safe harbor exception set forth in 12 U.S.C. §1823(c)(4)(E)(iii).

Exception for Systemically Significant Institutions —"Too Big to Fail"

FDIC can waive the least cost resolution requirement to prevent systemic risk to the financial system if the Secretary of the Treasury in consultation with the president and with the recommendation of FDIC and the Federal Reserve determines that pursuing the least costly strategy would have serious adverse effects on economic conditions or financial stability and that action under the systemic risk exception "would avoid or mitigate such adverse effects."[38] This exception, popularly known as the "too big to fail" exception, provides that FDIC can pursue any resolution strategy, including a direct infusion of capital into a troubled bank or a guaranty in full of its deposit liabilities under a strategy of OBA, if FDIC finds that closing the bank without providing for uninsured depositors and other creditors would have a widespread impact on the financial system.[39]

Impact of Depositor Preference

The cost to FDIC of resolving a failed bank has been positively impacted by the passage in 1993 of the National Depositor Preference Amendment.[40] This provision of the FDI Act grants statutory priority to domestic deposit liabilities over other general creditors of a failed bank. It requires that domestic depositors, insured and uninsured, be paid *in full* before general, unsecured creditors. Because FDIC pays insured depositors, it is subrogated to their claims.[41] This increases FDIC's recovery in a receivership

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because depositor claims get paid before general, unsecured creditors.[42] The National Depositor Preference Amendment overruled cases like *First Empire Bank v. FDIC*,[43] which held that FDIC as receiver had an obligation to treat depositors and unsecured creditors equally.

FDIC RECEIVERSHIP PROCESS

Upon its formal appointment as receiver of a failed bank by its primary regulator, FDIC immediately starts the process to determine the bank's assets and liabilities, liquidate the assets, resolve all claims and liabilities and distribute the proceeds of the asset liquidation to the failed bank's creditors. Congress has given FDIC expansive powers and significant discretion to carry out these functions. In its capacity as receiver of a failed bank, FDIC succeeds to the rights, powers and privileges of the failed bank, its stockholders, officers and directors. It can collect all moneys owed the failed bank and sell its assets without court supervision or oversight of any bank or other regulator. It must maximize the return on a failed bank's assets and minimize any loss to the FDIC deposit insurance fund.

Closures generally occur on Friday night to give FDIC the entire weekend to transition the failed bank's operations to new ownership. A senior FDIC official is appointed as receiver in charge. This official is assisted by an on-site closing manager who oversees all FDIC on-site personnel (*e.g.*, financial, asset management, claims, information resources and settlements) and acts as a liason between the failed bank's employees and the assuming bank, if any.

Custody and Closing the Books

Upon closure, FDIC takes immediate custody of and secures the failed bank's premises, records and assets. Cash is counted, exterior locks changed. FDIC brings all accounts forward to the closing date and posts all necessary entries to the failed bank's general ledger. It begins the process of "balancing the institution" in which a closing pro forma for the failed bank is created. A set of books and recordkeeping system that tracks the disposition of the failed bank's assets and liabilities are prepared.

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Inventory of Assets and Liabilities

FDIC, as receiver, prepares an inventory of the failed bank's records, assets and liabilities following closure of the failed bank. A reconcilement and inventory of the failed bank's cashiers checks and accounts are completed. All advertising materials of the failed bank are destroyed. Credit files, notes and guarantees and non-real estate collateral for loans are located, inventoried and secured. It also commences investigations of any institution affiliated parties believed to have been responsible for the failure of the bank to determine whether claims or charges should be asserted against any of those individuals or under any insurance policies they might have had.

Identification of Insured Depositors and Reconciliation of Accounts

FDIC must promptly determine the insurance coverage for all deposit accounts and reconcile them. This is not a simple task. Owners of multiple accounts aggregating more than FDIC deposit insurance coverages, holders of beneficial interests in "pass through coverage accounts" (*i.e.*, brokered deposits, common pooled trust funds), available setoffs, accounts subject to security interests, closing balances reflecting overdrafts and un-posted deposits and withdrawals must be made promptly and as of resolution. The amount and owners of all uninsured deposits must also be determined. Reconciliation of account balances and ownership is performed expeditiously. FDIC has claims agents on-site to deal with uninsured depositors.

Notice of Bank Failure

After its appointment as receiver of a failed bank, FDIC must promptly publish a notice to creditors of the bank to file their claims by a stated date which must be at least 90 days after the date on which notice is published.[44] The notice must be republished one month and two months after the date of the initial publication.[45] FDIC must also mail the same notice directly to each creditor shown on the bank's books at the time the initial notice is published.[46] If FDIC discovers the existence of a creditor not shown on the failed bank's books, it must also mail notice of the receivership and claim bar date within 30 days of discovery.[47]

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Determination of Claims

12 U.S.C. §1821(d) and (f) give FDIC the power to allow or disallow claims in a bank receivership and set out the *exclusive* process by which unsecured claims in the receivership are to be presented and determined. A proof of claim must ordinarily be submitted by claimants to FDIC within 90 days after FDIC publishes notice of the receivership.[48] There is not a required form. All general creditors, including parties who may have been suing the failed bank in court at the time of the receivership, must file.[49] FDIC has 180 days to allow or disallow the claim.[50] If the claim is disallowed, the creditor has 60 days to file suit or seek administrative review.[51] If the claim is not acted upon by FDIC as receiver within 180 days of filing, it is automatically disallowed.[52]

Claims are allowed if they are timely filed and "proved to the satisfaction of [FDIC as] the receiver."[53] Because of the statutory superpowers granted to FDIC as receiver of a failed bank, discussed more fully below, it may be quite difficult for a party to successfully assert a claim against the receivership estate. For a contract claim to succeed against FDIC as receiver or in its corporate capacity, 12 U.S.C. §§1821(d)(9) and 1823(e) require that the contract:

- Be in writing;
- Be executed by the failed bank and the person claiming an adverse interest under it contemporaneously with the acquisition of the asset (*i.e*. at the time the loan was made);
- Be approved by the board of directors or the loan committee of the failed bank, which approval is reflected in minutes kept by the failed bank; and
- Be continuously from time of execution an official record of the bank.

Thus a claim for breach of an oral contract, which would have otherwise been enforceable against the bank prior to its failure, would not be enforceable against FDIC as receiver of the bank. Tort claims based on breach of contract including fraud, negligent misrepresentation, conspiracy and tortu-

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ous interference with contract will likewise be dismissed where the underlying contract is undocumented.[54]

Damages against FDIC as receiver are generally cut off under the "fixed and certain" rule set forth in 12 U.S.C. §1821(e)(3)(A) as of the date of the receivership. This rule precludes an injured party from succeeding on a claim where the extent of the party's injury has not been quantified as of the date of the receivership. The only damages permitted against the FDIC as receiver are limited to actual compensatory damages. Consequential damages for lost profits or pain and suffering damages are not recognized.[55] A party claiming that a particularly egregious harm has been committed against him will not be able to assert a claim for punitive damages, which cannot be assessed against FDIC as receiver.[56] Any damage claim allowed by FDIC is paid in the form of a "receiver's certificate." Since claims of unsecured creditors are, under the 1993 National Depositor Preference Amendment, subordinate to depositor claims, the likelihood of a dividend being paid out on such a certificate is remote. Thus, even where an unsecured creditor is successful in asserting a claim for damages against FDIC, it is unlikely that the claim will be satisfied.

There is an appeals process with both administrative and judicial review of FDIC determinations on claims.[57] Judicial review is *de novo* and of very limited use.[58] Creditors who fail to follow the statutory claim process set forth in 12 U.S.C. §1821(d)(5) will have their claims barred and have no further recourse against FDIC. Creditors with allowed claims are issued receiver certificates for the amount of the claim with dividends paid out as money is available to the class of claim allowed. Depositors are ordinarily not expected to file claims absent a dispute over ownership or account balance.

Claim Priorities

The National Depositor Preference Amendment fixes statutory priorities FDIC must follow for paying allowed claims in a failed bank receivership.[59] This statute establishes the following order of priority, after payment of secured claims, in an FDIC failed bank receivership:

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- The FDIC's administrative expenses as receiver;
- All deposit liabilities (both insured and uninsured);
- Other general unsecured creditors including contract claims;
- Subordinated obligations; and
- Shareholder claims.

The National Depositor Preference Amendment gives a statutory priority to depositors over other unsecured creditors. This means that FDIC, as subrogree of the depositors up to applicable FDIC insurance limits, and uninsured depositors get their claims paid in full before other unsecured creditors receive any dividend on their allowed claims. These include claims from vendors, servicers, suppliers and counterparties to contracts with the failed bank, claims arising from leases, and claims asserting damages from business decisions of the failed bank or FDIC, as its receiver.

FDIC has the discretionary authority to treat as priority claims certain pre-receivership obligations of a failed bank. These may include certain administrative expenses of the failed bank incurred during the 30 days period prior to the receivership (*i.e.*, fees of attorneys, accountants, property managers providing valuable asset preservation or recovery functions), and certain claims for wages and employee benefits if FDIC finds that they are "necessary and appropriate to facilitate the smooth and orderly liquidation or other resolution of the [failed bank]."[60]

Secured Claims

Secured claims in an FDIC receivership are treated similar to secured claims in bankruptcy. The creditor has recourse against the collateral provided by the failed bank. To the extent the collateral is deficient, the creditor has an unsecured claim for the balance. 12 U.S.C. §1821(e)(12) requires FDIC to recognize a "legally enforceable or perfected security interest" unless the security interest amounts to a fraudulent transfer. There may, however, be legal restrictions on the ability of a bank to collateralize deposits that might prevent or limit its legal power to grant security interests in assets for that purpose.

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FDIC regulations give explicit recognition to blanket security interests taken by a Federal Home Loan Bank in a failed bank.[61] Secured claims against failed banks are most commonly encountered with Federal Home Loan Bank and Federal Reserve Bank borrowings.

Restrictions in Enforcement of Secured Claims

12 U.S.C. §1825(b)(2) states that "[n]o property of [FDIC] shall be subject to levy, attachment, garnishment, foreclosure, or sale without the consent of [FDIC], nor shall any involuntary lien attach to the property of [FDIC]." The "property" to which 12 U.S.C. §1825(b)(2) applies includes any real or personal property in which FDIC, in its corporate capacity or as receiver of a failed bank, has either a security or equity interest.[62]

In order to clarify when FDIC's consent is required under 12 U.S.C. §1825(b)(2) and how it can be obtained, FDIC issued a statement of policy. Pursuant to this statement, FDIC automatically consents to the foreclosure of a bona fide senior consensual mortgage or lien in property covered by §1825(b)(2). In contrast, holders of non-consensual, involuntary liens (*i.e.*, mechanics' liens and tax liens) must obtain the consent of FDIC prior to commencing a foreclosure action if the FDIC's interest is "of record" (as defined in the statement of policy). If the FDIC's interest is not of record, however, FDIC automatically consents to any foreclosure by the holder of any *bona fide* lien on the property.

Lien holders who are required to obtain FDIC's consent must seek such consent by submitting a written request to FDIC in the form set forth as Exhibit A to the statement of policy. FDIC has sole discretion to grant or deny such consent. If the lien holder fails to obtain FDIC's consent prior to foreclosing, the interest of FDIC survives the foreclosure and remains an encumbrance on title, however, the sale is not void or voidable.

Expedited Procedure for Claims of Certain Security Interests

12 U.S.C. §1821(d)(8)(A) provides an expedited claims procedure for claimants aggrieved by FDIC failure to recognize a security interest or otherwise injure a creditor claiming a security interest. Since a secured claimant is also subject to 12 U.S.C. §1825(b)(2), which limits its ability to foreclose

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its collateral without FDIC consent, it may need to obtain that consent by filing a request or claim to get the right to foreclose.

Disposition of Assets

In order to have funds to distribute to allowed claimants, FDIC works to dispose of the bank's assets as quickly as possible through a variety of possible resolution methods, described above. A bid process is commonly used to dispose of these assets in pools. Bidders for these assets need not be banks. Assets that are not sold to an acquirer during the resolution process must be disposed. Assets in the form of personal property (*i.e.*, furniture, automobiles, etc.) are liquidated as quickly as possible. Remaining loan assets are generally more difficult to dispose. FDIC may foreclose on the collateral securing a nonperforming loan. In some cases, FDIC may assist borrowers in refinancing their existing loan with a healthy bank as means of disposing of the loan, and/or may modify the terms of a non-performing loan as an alternative to foreclosure. In rare cases, it may disaffirm its interest in collateral for a loan having no appreciable value.

Certain assets, however, are rarely, if ever, sold by FDIC as receiver to an acquiring bank or other party. These assets include insurance claims, claims against directors and officers of the failed bank, etc. FDIC as receiver typically asserts such claims itself with any recovery going to the receivership estate.

Payment of Dividends

FDIC attempts to liquidate the assets of a failed bank expeditiously. When a receivership has collected enough money, FDIC makes a distribution to creditors in accordance with the statutory priorities set forth in the National Depositor Preference Amendment.[63] Occasionally, FDIC declares an advance dividend in anticipation of a particularly prompt resolution. All data on receivership dividends are publicly available on the FDIC website. In many cases, the total dividend paid out on uninsured depositor claims exceeds 75 percent of the claim. Very seldom do general unsecured creditors receive a dividend in an FDIC receivership.

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Termination of Receivership

Once FDIC has paid all eligible claims and disposed of all receivership assets, it proceeds to terminate the receivership.

FDIC RECEIVERSHIP SPECIAL POWERS

The FDI Act and federal common law grant FDIC a number of special powers which it regularly uses to limit or defeat both affirmative claims and defenses asserted by counterparties to the failed bank or FDIC as its receiver.

Repudiation of Contracts

Once appointed as receiver or conservator of a failed bank, FDIC has a number of special powers to facilitate its resolution. More extensive than the power accorded to a trustee in a bankruptcy proceeding, these special powers may be exercised by FDIC without prior notice, hearing or judicial approval. Among the most important powers granted to FDIC in a receivership or conservatorship is the ability to disaffirm or repudiate contracts of the failed bank.

Scope of FDIC's Repudiation Rights

When acting as conservator or receiver for a troubled bank, FDIC may, within a "reasonable period" following its appointment, repudiate or disaffirm any contract or lease to which the bank is a party if it: (1) deems performance of the contract or lease to be "burdensome;" and (2) finds that repudiation or disaffirmance of the contract or lease would promote the orderly administration of the receivership estate.[64] What constitutes a reasonable period for purposes of repudiation is determined on a case-by-case basis.[65] The power to repudiate contracts and leases granted to FDIC is similar — but broader — than the power of a debtor-in-possession or trustee appointed by the Bankruptcy Court to reject unwanted executory contracts. FDIC may repudiate executory or nonexecutory contracts and disaffirm leases of real or personal property, purchase and sale agreements

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for real or personal property, service contracts, certificates of deposit, and other financial instruments.[66]

Effects of Repudiation

The repudiation of a contract by FDIC as receiver or conservator terminates any obligation to render future performance required under the contract. FDIC's power to repudiate a contract in a bank receivership is a particularly potent weapon for a number of reasons:

- Unlike a traditional Chapter 11 proceeding, FDIC can simply repudiate a contract or lease by letter to the affected counterparty without court approval and with no prior notice.
- In the traditional bankruptcy proceeding, only "executory" contracts can be avoided by a trustee in bankruptcy. FDIC can, however, repudiate any contract it finds "burdensome."[67] This makes it easier for FDIC to repudiate various contractual relationships including revolving lines of credit, partially funded construction loans and standby letters of credit.
- The damages recoverable against FDIC for repudiating a contract in a bank receivership are limited to the counterparty's actual direct, compensatory damages.[68] Consequential damages for lost profits, punitive damages and pain and suffering are barred.[69]
- There is significant authority under case law interpreting Section 365 of the Bankruptcy Code that a trustee in bankruptcy cannot reject one part of a contract and assume the rest. In a bank receivership, FDIC can bifurcate the respective assets and liabilities in a contract by rejecting the unfunded commitment on a construction loan and suing the borrower for funds advanced under the note prior to the date of the receivership.

FDIC uses its power to repudiate contracts frequently and in a number of different contexts. Borrowers frequently learn the hard way that their existing line of credit, construction loan facility or standby letter of credit at a failed bank has been rejected as of the receivership date. Vendors providing

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services to a failed bank can be abruptly terminated with little recourse. If, however, a vendor continues to provide the same services to FDIC subsequent to the receivership, it may have a priority administrative claim under 12 U.S.C. 1821(e)(7)(B) and be paid for those services.[70] Loan participation agreements have previously been repudiated by FDIC although current FDIC policy seems to be not to treat the sale of a participation interest by the failed bank as an unsecured loan provided the transfer meets all sale accounting rules under GAAP.[71] FDIC has recently exhibited more flexibility by indicating a willingness not to exercise automatic stay rights or repudiate covered bond arrangements.[72]

Improperly Documented or Side Agreement Not Binding Upon FDIC as Receiver

FDIC has three separate but related bases for avoiding improperly documented "side" agreements. These are (1) the federal common law *D'Oench, Duhme* doctrine, (2) 12 U.S.C. §1823(e), and (3) 12 U.S.C. §1821(d)(9).

The D'Oench, Duhme Doctrine

In *D'Oench, Duhme & Co. v. FDIC,*[73] the United States Supreme Court held as a matter of federal common law that a side agreement not contained in the records of a failed bank could not serve as the basis of a defense to FDIC's effort to collect an obligation owed to the failed bank. The rationale for the doctrine is that FDIC, as receiver for a failed bank, must be able to rely on its books and records to evaluate its assets and liabilities accurately. Such reliance is critical in resolving the failed bank's affairs for a cost effective resolution transaction. Unless an agreement is properly documented in the failed bank's records, it cannot be enforced against FDIC as receiver either to make a claim or to defend against a claim by FDIC. In *D'Oench*, an argument made by an obligor on a promissory note that an undocumented, unrecorded side agreement changed or released the obligor's duty to repay the loan was barred. In 1997, FDIC issued a policy statement on the use of the *D'Oench, Duhme* doctrine.[74]

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12 U.S.C. § 1823(e)

12 U.S.C. § 1823(e) codified the *D'Oench, Duhme* doctrine and provides that no agreement which tends to defeat or diminish FDIC's interest in an *asset* is valid unless it:

- Was in writing;
- Was executed by the failed bank and the person claiming an adverse interest under it contemporaneously with the acquisition of the asset (*i.e*. at the time of the loan was made);
- Was approved by the board of directors or the loan committee of the failed bank, which approval is reflected in minutes kept by the failed bank; and
- Was continuously from time of execution an official record of the bank. Section 1823(e) also applies to assets acquired by FDIC in a bridge bank.

12 U.S.C. §1821(d)(9)

12 U.S.C. §1821(d)(9) provides that no agreement "shall form the basis of, or substantially comprise, a claim against the receiver or [FDIC]" unless it also satisfies the documentation requirements set forth in 12 U.S.C. §1823(e). This provision extends those documentation requirements to *any* contract claim and not just those claims about assets of the failed bank. 12 U.S.C §1821(d)(9)(A) also extends 12 U.S.C §1823(e) to *liabilities*. Reduced to its essence, 12 USC §§ 1821(d)(9)(A) and 1823(e) do not allow a counterparty to an agreement to make a claim or defend against a claim by FDIC as receiver of a failed bank unless the agreement is properly documented in the bank's records.

Federal Common Law Holder in Due Course Rule

In addition to the *D'Oench, Duhme* doctrine and 12 U.S.C. §1823(e), the federal courts have developed a rule which grants FDIC the rights of a holder in due course.[75] FDIC cannot, under Section 3-302 of the state law

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Uniform Commercial Code, qualify as holder in due course when it acquires a failed bank's promissory notes in bulk, not in the regular course of business of the transferor's business or with knowledge they are in default. But, as a holder in due course under federal common law, FDIC takes those same promissory notes free of "personal" defenses like those specified in Section 3-305 of the Uniform Commercial Code. This holder in due course rule applies to FDIC as receiver or when FDIC acquires a note in its corporate capacity. The holder of a note acquired from FDIC can also utilize the holder in due course doctrine. Since the holder in due course doctrine is a matter of federal common law, FDIC is not required to meet state law requirements for holder in due course status.

Prudential Mootness — Limitation on Liability

12 U.S.C. §1821(i) limits the liability of FDIC as receiver or in any other capacity to a claimant of a failed bank or its receivership to "the amount such claimant would have received if [FDIC] had liquidated the assets and liabilities of [the failed bank]." This provision can bar recovery of monetary damages against FDIC or receivership where it has determined that there will be no assets available for distribution to general, unsecured creditors of the receivership. It also discourages claimants from litigating against FDIC because any "upside" from a recovery will be reduced to the same percentage as other unsecured creditors receive.

Fraudulent Transfers

FDIC, as receiver of a failed bank, has the ability to avoid certain fraudulent transfers. 12 U.S.C. §1821(d)(17)(A) allows FDIC to set aside a transfer of property made by a debtor or institution affiliated party of a failed bank made within five years before or after FDIC's appointment as receiver if the transfer was made with the intention of hindering, delaying or defrauding the failed bank or FDIC as its receiver.

Preferences

Unlike the Bankruptcy Code which has provisions allowing a trustee in

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bankruptcy to avoid a preferential transfer to a creditor within 90 days of filing, the FDI Act has no similar provision to allow FDIC to avoid such a preferential transfer. A depositor with uninsured deposits in excess of FDIC insurance limits appears able to withdraw those funds the day before or otherwise in anticipation of the bank's failure without risk of a "clawback" by FDIC as receiver absent circumstances indicative of a fraudulent transfer.

Recognition of Security Interests

The broad power granted to FDIC to repudiate contracts does not authorize it to set aside a lien given by a failed bank to a counterparty to secure a contractual obligation.[76] Security interests granted to creditors of a failed bank are generally recognized unless the lien has been taken in contemplation of the bank's failure or for the purpose of hindering, delaying or defrauding the failed bank or FDIC as its receiver.[77]

Acceleration Clauses

12 U.S.C. §1821(e)(13)(A) allows FDIC to enforce any contract (other than a qualified financial contract) with a so-called "ipso facto" clause purporting to terminate or accelerate the contract upon the failed bank's insolvency or receivership. This allows FDIC to assign a contract of a failed bank to a third party transferee who is allowed to assume it notwithstanding the ipso facto insolvency clause in the contract and any objection of a non-consenting counterparty.

Cross Guaranties from Affiliated Banks

12 U.S.C. §1825(b)(3) allows FDIC to assess banks controlled by the same bank holding company for any losses FDIC incurs in a receivership of one of its affiliate banks. This allows FDIC to treat all of the banks in a multi-bank holding company as a single unit.

Taxes

12 U.S.C. §1825(b)(1) gives FDIC as receiver a partial immunity from

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state and local taxes except *ad valorem* real estate taxes if assessed according to the property's value. Furthermore, FDIC is not liable for any penalties or fines arising from the failure to pay any real property tax when due.[78] Allowed claims for taxes for periods prior to or during the receivership are paid as priority or as secured claims.[79]

No Attachment

12 U.S.C. §1825(b)(2) provides that no property of FDIC as receiver may be attached, levied or foreclosed upon without FDIC's consent and that no involuntary lien may attach to FDIC property.

No Recording and Filing Fees

12 U.S.C. §1825(b)(3) provides that FDIC is exempt from recording and filing fees and excises. Accordingly, FDIC does not pay recording fees, deed stamp excises or similar impositions. This exemption can be particularly valuable in jurisdictions where recording fees, particularly those related to real property, are a significant expense.

Stays on Litigation and Enforcement of Contracts

12 U.S.C. §1821(d)(12) gives FDIC as receiver authority to stay a judicial action or proceeding to which a failed bank is a party for up to 90 days. FDIC must apply to the appropriate court for the stay, and the court must grant the requested stay. In addition, 12 U.S.C. §1823(c)(2)(C) provides that FDIC is also entitled to a 60-day stay of any action (e.g., judicial foreclosure proceeding) to which FDIC becomes the successor party of a failed bank.

12 U.S.C. §1821(e)(13)(C)(i) prevents a party to a contract with a failed bank from exercising its right to terminate, accelerate, or declare a default under the contract, or otherwise affect any contractual rights of the failed bank, during the 45-day period beginning on the date of the appointment of FDIC as conservator, or during the 90-day period beginning on the

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date of the appointment of FDIC as receiver, unless FDIC's prior consent is obtained.

Federal Court Jurisdiction

12 U.S.C §1819(b) gives FDIC the right to remove any action or lawsuit from a state court to the federal court.

Asset Freezes

U.S.C §1821(d)(18) gives FDIC the authority to seek a court order to freeze the assets of any institution affiliated party prior to obtaining a judgment on the merits of its claims against that institution affiliated party. FDIC is not required to show irreparable or immediate injury as is required for private litigants.

No Injunction Against FDIC

12 U.S.C. §1821(j) prohibits courts from issuing injunctions to restrain FDIC as receiver from completing liquidation activities like conducting foreclosures or selling assets.

NOTES

[1] 12 U.S.C. §§1811-1835.
[2] *See* 11 U.S.C. §109 (b)(2).
[3] 12 U.S.C. §§ 1811-1835.
[4] *See*, *e.g.*, *In re Imperial Credit Industries, Inc. v. FDIC,* 527 F.3d 959 (9th Cir. 2008).
[5] *See* R. Bliss and G. Kaufman, *U.S. Corporate and Bank Insolvency Regimes*, 2 Virginia Law and Business Review 143, 147-49 (2007).
[6] H. Rep. No 2564, 81st Cong., 2d Sess. *reported in* 1950 U.S. Code Cong. & Ad. News 3765, 3765-3766.
[7] *See* Barry Stuart Zisman, *Banks and Thrifts: Government Enforcement and Receivership*, §11.02 (2008).
[8] FDIC Office of Audits, *Observations from FDIC OIG Material Loss Reviews*

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Conducted 1993-2003, Audit Report No. 04-004 (January 22, 2004).
[9] 12 U.S.C. §1821(c)(4).
[10] *See generally* OCC, *Problem Bank Identification, Rehabilitation and Resolution* (January 2001).
[11] 12 U.S.C. §1821(c)(5)(L); 12 U.S.C. §1831o(b)(1)(E).
[12] 12 U.S.C. §1821(c)(5).
[13] 12 U.S.C. §1821(d)(J)(ii).
[14] 12 U.S.C. §1821(c)(2)(D) and (3)(D).
[15] 12 U.S.C. §1821(d).
[16] *See* FDIC, *Resolutions Handbook: Methods for Resolving Troubled Financial Institutions in the United States* at 6-7 (1998) ("*Resolutions Handbook*").
[17] *See* Walter, *Closing Troubled Banks* at 59-60.
[18] *See* FDIC, *Resolutions Handbook* at 13.
[19] 12 U.S.C. 1821(d).
[20] 12 U.S.C. 1821(d)(3).
[21] 12 C.F.R. §360.1.
[22] 12 U.S.C. §1821(k).
[23] *See* FDIC, *Resolutions Handbook* at 19.
[24] *See* David H. Carpenter and M. Maureen Murphy, *Congressional Research Service Report for Congress Financial Institution Insolvency: Federal Authority over Fannie Mae, Freddie Mac, and Depository Institutions* 5-6, n.19 (September 10, 2008).
[25] *See* FDIC, *Resolutions Handbook* 27-29.
[26] *See Purchase and Assumption Agreement by and among WaMu, JP Morgan Chase Bank, National Association and FDIC* (September 25, 2008) *available at* www.fdic.gov.
[27] *See* FDIC, *Resolutions Handbook* at 27-29.
[28] 12 U.S.C. §1821(d)(2)(F).
[29] 12 U.S.C. §1821(d)(11).
[30] 12 U.S.C. §1831(D)(2)(E). *See* FDIC, *Resolutions Handbook* at 5, 41.
[31] *See* 12 U.S.C. §1821(m).
[32] 12 U.S.C. §1821(m)(18).
[33] *See* FDIC Press Release, *FDIC Creates a Deposit Insurance National Bank to Facilitate the Resolution of New Frontier Bank, Greeley, Colorado*, (April 10, 2009) *available at* www.fdic.gov.
[34] 12 U.S.C. §1823(c)(4)(G).
[35] 12 U.S.C.§1821(a)(4)(B).
[36] 12 U.S.C. §1823(c)(4)(A).
[37] 12 U.S.C. §1823(c)(4)(E).
[38] 12 U.S.C. §1823(c)(4)(G).

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[39] *See* Walter, *Closing Troubled Banks* at 65.
[40] 12 U.S.C. §1821(d)(11).
[41] 12 U.S.C. §1821(g)(1) and (2).
[42] *See generally* R.L. Bennett and J.A. Marino, *The Consequences of National Depositor Preference*, 12(2) FDIC Banking Review 19 (1999).
[43] 572 F.2d 1361 (9th Cir. 1978), *cert. den*. 439 U.S. 919 (1978).
[44] 12 U.S.C. §1821(d)(3)(B)(i).
[45] 12 U.S.C. §1821(d)(3)(B)(ii).
[46] 12 U.S.C. §1821(d)(3)(B)(i) and (d)(3)(C).
[47] 12 U.S.C. §1821(d)(3)(C)(ii).
[48] 12 U.S.C. §1821(d)(3)(B)(i).
[49] 12 U.S.C. §1821(d)(12).
[50] 12 U.S.C. §1821(d)(5)(A)(i).
[51] 12 U.S.C. §1821(d)(6)(A).
[52] 12 U.S.C. §1821(d)(5)(C).
[53] 12 U.S.C. §1821(d)(5).
[54] *See* Zisman, *Banks and Thrifts* at §25.04[3].
[55] 12 U.S.C. §1821(e)(3)(B)(ii) and (iii).
[56] 12 U.S.C §1821(e)(3)(B)(i).
[57] *See* 12 U.S.C. §1821(d)(6)A and (d)(7)A).
[58] 12 U.S.C. §1821(d)(13)(C) and (d)(13)(D).
[59] 12 U.S.C. 1821(d)(11).
[60] 12 C.F.R. §360.4.
[61] 12 C.F.R. §360.2.
[62] *See Statement of Policy on Foreclosure Consent and Redemption Rights*, 57 Fed. Reg. 29491 at §4(a)(i) (July 2, 1992).
[63] 12 U.S.C. §1821(d)(11).
[64] 12 U.S.C. §1821(e).
[65] *See Resolution Trust Corp v. CedarMinn Bldg. Ltd. P'ship,* 956 F.2d 1446, 1455 (8th Cir. 1992).
[66] *See Hennessy v. FDIC*, 58 F.3d 908, 919 n. 8 (3d Cir. 1995) (FDIC may repudiate nonexecutory contracts under § 1821(e)); *IBJ Schroeder Bank v. RTC*, 26 F.3d 370 (2d Cir. 1994).
[67] 12 U.S.C. §1821(e)(1).
[68] 12 U.S.C. §1821(e)(3)(A).
[69] 12 U.S.C. §1821(e)(3)(B).
[70] 12 C.F.R. §360.4.
[71] 12 C.F.R. §360.6(b).
[72] 12 C.F.R. §360.6(b).

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[73] 315 U.S. 447 (1942).
[74] *See Statement of Policy Regarding Federal Common Law and Statutory Provisions Protecting FDIC Against Unrecorded Agreements*, 62 Fed. Reg. 5984 (February 10, 1997).
[75] *See Gunter v. Hutcheson*, 674 F.2d 862 (11th Cir. 1981), *cert. den*. 459 U.S.C. 826 (1982).
[76] 12 U.S.C. §1821(e)(12).
[77] 12 U.S.C. §1821(e)(12).
[78] 12 U.S.C. §1825(b)(1).
[79] *See* FDIC, *Managing the Crisis: The FDIC and RTC Experience* at 260-261 (1998).

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