BANK FAILURES
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AN OVERVIEW OF FINANCIAL INSTITUTION
CONSERVATORSHIP, RECEIVERSHIP
AND LIQUIDATION ARRANGEMENTS

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I. Introduction

This outline is intended to set forth a basic summary of the principal statutory and regulatory provisions and related administrative arrangements applicable to financial institution insolencies. Included below is a discussion of the role of the various Federal and State banking agencies in addressing insolencies of particular types of financial institutions, alternative approaches to resolving insolencies and the general powers and duties of the receiver, conservator, or liquidator under the Financial Institutions Reform, Recovery and Enforcement Act of 1989, Pub. L. No. 101-73, 103 Stat. 183 (August 9, 1989) ("FIRREA"). Copies of Sections 11 and 13 of the Federal Deposit Insurance Act, as amended by FIRREA, are attached hereto as Appendix A.

II. Legal Framework Applicable to Financial Institution Insolvencies

A. General. At least since the enactment of the National Bank Act of 1864, the process of closing and winding up the affairs of financial institutions has generally been entrusted to the relevant bank regulatory authorities, rather than to the courts. This approach to closing and liquidation has been taken to expedite the process, in view of the vital role which depository institutions play in the nation's economy and is a reflection of their highly regulated, quasi-public character. Consistent with this approach, Section 109(b)(2) of the Bankruptcy Code excludes from Chapter 7 and Chapter 11 filings:
"a domestic insurance company, bank, savings bank, cooperative bank, savings and loan association, building and loan association, homestead association, credit union or industrial bank or similar institution which is an insured bank as defined in Section 3(b) of the Federal Deposit Insurance Act (12 U.S.C. §1813(h))"

Court review of a banking agency's actions as receiver are generally limited to those circumstances prescribed by statute. Similarly, legal questions relating to the validity of the acts of a banking agency acting as receiver are covered by the statutory provisions under which the receiver operates.

B. Administrative Framework Under Federal Banking Law. FIRREA substantially modified the administrative framework under the Federal Deposit Insurance Act ("FDIA") for addressing financial institution insolvencies and significantly enhanced the authority of the federal banking agencies in addressing both pre- and post-insolvency matters.

1. FDIC and RTC as Conservator or Receiver Under FIRREA. Under Section 11(c) of the FDIA, as amended by FIRREA, the FDIC is authorized to act as receiver and, at the discretion of the principal supervisory authority, conservator, for any "insured depositary institution" (including national banks, state-chartered, FDIC-insured trust companies, savings banks, and most co-operative banks), except for insured "savings associations" (including federal savings and loan associations and federal savings banks) for which the FSLIC was appointed as receiver or conservator after January 1, 1989 or which fail prior to August 9, 1992. These institutions fall under the jurisdiction of the Resolution Trust Corporation ("RTC"). See §8(4) below.

2. State-Chartered Depository Institutions. Under Section 11(c) of the FDIA, as amended by FIRREA, the FDIC is authorized to appoint itself as sole conservator or receiver for a state depository institution, provided that the appropriate state regulatory authority has first acted to take custody of the institution and has either closed it or taken custody of it for 15 consecutive days and depositors are unable to withdraw insured deposits. Further, as under prior law, the FDIC may be appointed receiver or conservator of a state-chartered depository institution by the appropriate state regulatory authority. Under Section 5(d)(2) of the Home Owners' Loan Act, as amended by FIRREA, the Director of the Office of Thrift Supervision ("OTS") may appoint a conservator of a state-chartered entity with respect to which OTS is the primary federal regulator, without consent of the state supervisory authority after 30 days notice.

3. Bank Conservation Act ("BCA"). FIRREA amended the BCA to expand significantly the circumstances under which the OCC may appoint the FDIC as conservator for a national bank. A copy of the BCA, 12 U.S.C. §§ 201-212, is attached as Appendix B.

4. RTC as Receiver or Conservator. The RTC assumed the role formerly played by the FSLIC as receiver of failed savings associations placed into receivership or conservatorship after January 1, 1989 and those savings associations which are placed into receivership or conservatorship prior to August 9, 1992. The RTC's powers as conservator or receiver are substantially equivalent to those of the FDIC in performing such functions. See 12 U.S.C. §1441a(b)(4).

III. Approaches to Addressing Financial Institution Insolvencies

A. General. It is important to understand the types of transactions which can be
used to address a financial institution's insolvency, since such transactions can affect the status of rights, claims and defenses involving the insolvent institution's assets and liabilities.

1. Policy Considerations. When faced with a failing or failed insured bank or savings association, the FDIC or the RTC must determine which approach will result in the least cost to the relevant insurance fund of the FDIC, consistent with the safety and soundness of the banking system generally, as well as the banking needs of the markets affected specifically. Under Section 13(c) of the FDIA, the FDIC can provide "operating bank" assistance to keep a failing bank open, or to merge that bank with a healthy bank. The FDIC may also facilitate a number of transactions with a failed bank to limit the impact of the failure on the community served.

2. Alternative Transactions. Generally, regardless of the approach taken by the FDIC, when a financial institution is closed, certain assets and liabilities of that institution will be transferred to another entity. To the extent possible, the FDIC attempts to have healthy banks assume all of a failed bank's loans, including troubled loans, frequently subject to the right of the assuming bank to put such assets back to the FDIC within a specified period. As a result, after a failed bank transaction is implemented, a bank loan or other asset may be held by a healthy bank which acquired the failed bank's business or the loan may remain with the FDIC as the failed bank's receiver. The loan can also be transferred by the FDIC as receiver of the bank to the FDIC in its corporate capacity. The loan may also be transferred in a bulk sale arranged by the FDIC after the bank's failure.

B. Operating Bank Assistance. As indicated above, if a bank is in danger of failing, the FDIC may provide assistance under Section 13(c)(1) of the FDIA to prevent it from failing. The FDIC may also assist a merger between a failing bank and a healthy open bank. Such a merger can involve institutions across state lines if certain conditions are met. See FDIA Section 13(j)(1). Under federal law, the FDIC can generally provide assistance from the deposit insurance fund only if its cost of doing so will be less than the cost of a straight liquidation. FDIA Section 13(c)(4)(A).

However, this limitation does not apply in the rare instance in which the FDIC determines that the continued existence of an insured bank is essential to the community it serves.

C. FDIC Resolution of Bank Insolvencies.

(1) Depositor Payoff and Liquidation. When a bank fails, the FDIC as receiver may simply liquidate the bank. The FDIC as deposit insurer pays off secured liabilities and depositors up to the $100,000 deposit insurance limit, and is subrogated to the claims of these depositors against the failed bank's estate. Such a resolution can involve a loan from the FDIC's insurance fund to the receiver for the purpose of paying an immediate advance dividend to all creditors of the failed bank. The amount of the dividend is based on the FDIC's estimate of the total amount creditors would receive over the life of the receivership. The dividend, which is paid immediately after a bank's failure, helps ameliorate the adverse effect of the failure on creditors. In return for its loan, the FDIC, as corporate insurer, obtains a security interest in all assets held by the FDIC as receiver. An example of such a transaction is the liquidation of Capitol Bank and Trust Company, Boston, Massachusetts, December 28, 1990. See Exhibit 1.

(2) Deposit Insurance Transfer Agreement. A resolution pursuant to a deposit insurance transfer agreement is similar to a straight liquidation, as described above, except
that a healthy bank pays a premium to be selected as the FDIC's agent for purposes of paying deposit insurance. The healthy bank undertakes this responsibility in the hope of acquiring the failed bank's depositors as its own customers.

(3) Deposit Insurance Transfer Asset Purchase Agreement. A resolution pursuant to a deposit insurance transfer asset purchase agreement is similar to a resolution pursuant to a deposit insurance transfer agreement, except that in addition to acting as the FDIC's agent in paying deposit insurance, the agent bank also buys assets from the failed bank's estate. The acquisition on November 9, 1990 of Home Federal Savings Bank, Worcester, Massachusetts, by Worcester County Institution for Savings, (except to the extent the RTC paid off insured deposits in certain branches), is an example of such a transaction. See Exhibit 2.

(4) Purchase and Assumption Transaction (P&A). In a traditional P&A transaction, the FDIC as receiver of a failed bank transfers a bank's "good" assets (collectible loans, securities, etc.) to a healthy bank in return for that bank's assumption of all the failed bank's deposit liabilities, even those that exceed the $100,000 insurance limit. The FDIC, in its corporate capacity, purchases the failed bank's "bad" assets (loans of dubious collectibility, negligence claims against officers and directors, etc.) for an amount sufficient to induce the healthy bank to enter into the transaction. The FDIC receives a premium from the healthy bank based on the going-concern value of the franchise. This type of transaction is also referred to as a "Clean Bank P&A," to distinguish it from a resolution pursuant to a total asset purchase and assumption transaction described below. Also, the FDIC may enter into a P&A transaction whereby the acquirer will manage most of the assets of a failed bank for a period of time, subject to an option to return the undesirable assets of the bank to the FDIC. Many of these transactions resemble a Clean Bank P&A, because the acquiring bank usually will retain the failed bank's "good" assets. The acquisition of Home National Bank, Milford, Massachusetts, by BayBank Middlesex, Burlington, Massachusetts, on June 1, 1990, is an example of such a transaction. See Exhibit 3.

(5) Total Asset Purchase & Assumption Transaction. This transaction is similar to a P&A transaction, except that the healthy bank acquires almost all of the assets of the failed bank, including its bad loans. Certain types of assets, such as claims against directors and officers, may still be assigned to the FDIC in its corporate capacity.

(6) Bridge Bank Transactions. The FDIC has the authority to establish a bridge bank (chartered as a national bank by the Office of the Comptroller of the Currency ("OCC")) to assume certain deposit and other liabilities of a failing or failed bank and acquire some of its assets. See FDIA Section 11(n). A bridge bank may be established by the FDIC and run by officers appointed by the FDIC in order to give the FDIC sufficient time to find a purchaser for the bank's estate. The bridge bank statute may also be used to facilitate large transactions involving multi-bank holding companies, as in the case of the failure of the First Republic System in Texas, and more recently in the case of the failure on June 6, 1991 of Bank of New England, N.A., and its bank affiliates. See Exhibit 4.

D. RTC Resolution of Thrift Institution Insolvencies. The RTC is authorized to engage in the same kind of transactions as the FDIC. However, RTC thrift transactions have typically followed a different pattern. In addressing an insolvent thrift, the RTC has used a two-stage process. The first stage is the establishment of a "pass-through receivership," pursuant to which the institution is placed in receivership
and management of most of its affairs is passed-through to a new conservatorship operation. The second stage is the “final resolution” of the thrift’s affairs, under which deposit liabilities and certain other assets are transferred to a healthy institution. Examples of this are the RTC’s approaches to resolving (i) Homeowners Federal Savings and Loan Association, Boston, Massachusetts, certain assets and liabilities of which were acquired on September 7, 1990 by United States Trust Company (See Exhibit 5) and (ii) Home Federal Savings Bank, Worcester, Massachusetts, certain assets and liabilities of which were acquired by Worcester County Institution for Savings, Worcester, Massachusetts (See Exhibit 2). See also, Comfed Savings Bank, Lowell, Massachusetts. (Exhibit 6).

(1) Pass-Through Receiverships. In a pass-through receivership, the OTS first places a thrift in receivership. Pursuant to its powers under FIRREA, RTC creates a new thrift institution. The new thrift and the old thrift’s receiver enter into a P&A agreement whereby the old thrift’s assets and deposit liabilities are transferred to the new thrift. The new thrift is then placed into conservatorship by the OTS.

(2) Final Resolution. During the conservatorship phase, bidders are invited to bid for the thrift’s assets and deposit liabilities. Upon acceptance of the winning bid, the thrift is placed into receivership, and the receiver enters into either a P&A transaction or similar transaction with the winning bidder. The remaining assets and liabilities are retained by the receiver. If no viable bid can be obtained, the institution may simply be placed in receivership, and a depositor payoff and liquidation follows.

IV. Receivership Authority

A. General Authority. The FDIC, upon appointment as conservator or receiver, succeeds to all right, title and interest of the institution, including its books and records, by operation of law. In addition, the FDIC specifically authorizes the FDIC to make rules and regulations to govern (a) the conduct of conservatorships and receiverships (FDIA Section 11(d)(1)), (b) the exercise of functions by members or stockholders, directors or officers of a financial institution during a conservatorship or receivership (FDIA Section 11(d)(2)), and (c) the allowance or disallowance of claims by the receiver and the administrative review of such determination made by the receiver (FDIA Section 11(d)(4)).

B. Operational Authority. Under Section 11(d) of the FDIA, the FDIC is authorized, as conservator or receiver, to take control of the assets of the institution and operate its business. This authority encompasses the power to collect all money and other obligations due the institution, to take deposits, and pay all valid obligations.

In addition, Section 11(e)(2) of the FDIA authorizes the receiver to merge a failed institution with another insured institution, transfer its assets and liabilities, or organize a new institution to take over its assets and liabilities, including those associated with any trust business without any further approvals.

C. Other Specific Powers.

a. Conservatorship Powers. As conservator, the FDIC has the power to put the institution in a “sound and solvent condition” and may operate and dispose of the institution as a going concern. FDIA Section 11(d)(2)(D), (G), and to request a stay for up to 45 days in a judicial action or proceeding to which the institution in default is or becomes a party. FDIA Section 11(d)(12)(i).
b. Receivership Powers. As a general matter, the powers of the FDIC as receiver are much broader than its powers as conservator. As receiver, in addition to its power to operate the institution, the FDIC has the power to liquidate the institution and wind up its affairs. FDIA Section 11(d)(2)(E). The receiver also has the power to request a stay of litigation for a period of up to 90 days, FDIA Section 11(d)(1)(A)(ii), and to determine claims is discussed below.

D. Administration of Claims.

(1) FIRREA establishes a claims process which is the exclusive avenue for obtaining relief from the FDIC as receiver. Upon the failure of an institution, the receiver is required to publish promptly a notice to creditors to present their claims by a specified date, which date shall be not less than 90 days after the publication of notice. Claims filed after this date will be disallowed unless 1) the claimant did not receive notice in time to file a claim, and 2) the claim is filed in time to permit payments on the claim. The FDIC and RTC have 180 days from the date a claim is filed to determine if the claim is allowed or disallowed. FDIA Section 11(d)(5)(A). A claimant has 60 days from the earlier of 1) the date of disallowance, or 2) if the receiver does not act, a claimant has 60 days from the end of this 180 day period (240 days after the claim is filed) either to file suit on its claim or seek administrative review of the FDIC's decision. FDIA Section 11(d)(6). If a claim is disallowed, the receiver is required to provide a statement of each reason for disallowance. FDIA Section 11(d)(5). The filing of a claim is treated as a commencement of an action for statutes of limitation purposes. FDIA Section 11(d)(5)(F).

(2) Administrative Review of Disallowance. If a claim is disallowed, the claimant may request an administrative hearing or may request other review procedures which are to be established by the FDIC or RTC. See FDIA Sections 11(d)(6)-(7). In either case, the FDIC or RTC must agree to the claimant's request for administrative review; otherwise, the claimant's only option is to file suit.

V. Principal Rules of Financial Institution Receivership.

A. Transaction Documentation. Under Section 13(e) of the FDIA, generally regarded as a codification of the Supreme Court's decision in the case of D'Oench Duhme & Co. v. FDIC, 315 U.S. 447 (1942), agreements that do not appear in the books and records of an FDIC-insured bank and that do not meet certain other documentation criteria are not enforceable either as claims or as defenses against the FDIC. As amended by FIRREA, Section 13(e) provides:

"(e) Agreements Against Interests of Corporation -- No agreement which tends to diminish or defeat the interest of the Corporation in any asset acquired by it under this section [13] or section 11, either as security for a loan or by purchase or as receiver of any insured depository institution, shall be valid against the Corporation unless such agreement --

(1) is in writing,

(2) was executed by the depository institution and a person claiming an adverse interest thereunder, including the obligor, contemporaneously with the acquisition of the asset by the depository institution,

(3) was approved by the board of directors of the depository institution or its loan committee, which approval shall be reflected in the minutes of said board or committee, and
(4) has been, continuously, from the time of its execution, an official record of the depository institution."

FDIA Section 11(d)(9) effectively applies the same requirement to contingent and other liabilities of the failing institution by providing that no agreement "shall form the basis of, or substantially comprise, a claim against the receiver or the Corporation" unless it meets the requirements of subsection 13(e).

B. Acceleration Clauses. Under Section 11(e)(12) of the FDIA, a receiver or conservator is permitted to "enforce any contract entered into by a depository institution" (except qualified final contracts, director's and officer's liability insurance contracts, depository institution bank and certain other contracts) "notwithstanding any provision of the contract providing for the termination, default, acceleration, or exercise of rights upon, or solely by reason of, insolvency or appointment of a conservator or receiver." 13

C. Repudiation of Contracts. Under Section 11(e)(1) of the FDIA, a conservator or receiver is also empowered to "disaffirm or repudiate any contract or lease --"

"(A) to which [the depository institution] is a party,

"(B) the performance of which the conservator or receiver, in the conservator's or receiver's discretion, determines to be burdensome; and

"(C) the disaffirmance or repudiation of which the conservator or receiver determines, in the conservator's or receiver's discretion, will promote the orderly administration of the institution's affairs.

This Section allows the conservator or receiver a "reasonable period" to exercise this authority, FDIA Section 11(e)(2), and provides that the measure of damages for disaffirmance or repudiation is to be:

"(i) limited to actual direct compensatory damages; and

(ii) determined as of --

(I) the date of the appointment of the conservator or receiver; or

(II) in the case of any [qualified financial contract, see paragraph E. below,] the date of the disaffirmance or repudiation . . . ."

Subsections 11(e)(3)(B)-(C) provide that the term "actual direct compensatory damages" does not include (i) punitive or exemplary damages, (ii) lost profits or opportunity; or (iii) damages for pain and suffering, but may include costs of cover in the case of qualified financial contracts.

FDIA Sections 11(e)(4), (5), (6), and (7) provide additional rules for disaffirmance or repudiation of leases, contracts for the sale of real property, and service contracts.

D. Recognition of Perfected Security Interests. Notwithstanding the power to repudiate contracts, FDIC Section 11(e)(11) provides that such authority does not permit "the avoidance of any legally enforceable or perfected security interest in any of the assets of any depository institution except where such an interest is taken in contemplation of the institution's insolvency or with the intent to hinder, delay or defraud the institution or the creditors of such institution."
E. Qualified Financial Contracts. FDIA Sections 11(e)(8)-(10) create a specific class of contracts that receive special protection upon appointment of a receiver. Such contracts include a "securities contract, commodity contract, forward contract, repurchase agreement, swap agreement, any similar agreement that the Corporation determines by regulation to be" such a contract, called a qualified financial contract." FDIA Section 11(e)(8). Each term, except "swap agreement", is defined by reference to the Bankruptcy Code.

The preferred treatment accorded to Qualified Financial Contracts ("QFC's") includes an override of FDIA Section 11(e)(12), thereby permitting: (i) immediate termination or liquidation of the contract, including exercise of rights to offset, net out, and resort to security arrangements pursuant to agreements between the parties; (ii) limitations on the ability of the receiver to transfer QFC's; (iii) an enhanced measure of damages if the receiver or conservator disaffirms (measuring damages as of the repudiation and allowing cost of cover); all subject to the FDIC's right to transfer all of any person's QFC-related rights and liabilities to a new counter-party within a limited period of time. In a conservatorship, the right to terminate or liquidate is not protected, but all other contractual rights are.

F. Fraudulent Transfers. As a result of enactment of Title XVII of the Crime Control Act of 1990, the conservator or receiver is entitled to avoid and recover any fraudulent transfer by an insider or debtor of an insured depository institution that occurs within five years of the appointment. In addition, that claim is superior to the claim of a trustee or any other person except a federal agency in a bankruptcy case. The transfer must have been intended to hinder, delay or defraud the insured depository institution, or receiver or conservator, rather than the trustee. Recovery may be had from any immediate or mediate transferee unless such transferee took as a good faith purchaser for value.