

**Remarks of  
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FDIC at the Symposium  
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**The FDIC's Approach to Large Bank Resolution Implementation Issues**

Good morning, everyone. Thank you, Claudio for your kind welcoming remarks. I would like to thank J.P. Sabourin and Ray LaBrosse for including me on this panel today to discuss cross border resolution issues. These are matters of considerable importance to deposit insurers, central banks, and supervisors around the world, with significant potential consequences for the stability of the global financial system.

The perspective I bring to this discussion is that of a deposit insurer and a bank supervisor. The Federal Deposit Insurance Corporation (FDIC) insures deposits at our nation's 8,700 banks and thrifts. We also are the primary supervisor of over 5,000 of those banks and thrifts and have back-up supervisory responsibilities at all insured institutions in the United States (U.S.). We are the agency also responsible for the resolution of all failed institutions. Clearly the FDIC has a great deal at stake in this issue. We also have considerable experience handling bank failures. Over the past twenty-five years, the FDIC has handled more than 1,600 bank failures. Most of these failures occurred during the savings and loan crises in the 1980s and 1990s.

The consolidation of the banking industry in the U.S. has necessarily focused our attention on resolution issues raised by a potential large complex bank failure. As unlikely as such a scenario may be, should a large complex U.S. bank fail today it could raise significant cross border issues. In my remarks, I will discuss the legal framework under which the FDIC operates in resolving large complex bank failures. I will also discuss actions the FDIC is taking to ensure its readiness for such an event, as well as key international issues that would have to be considered in the event of a large bank failure.

**The FDIC's Legal Framework for Large Bank Resolutions**

The FDIC's approach to a large complex U.S. bank failure is, at the outset, determined by its legal framework. Prior to the savings and loan crises of the 1980s and 1990s, the FDIC had fairly broad discretion to determine whether to extend protection beyond insured depositors in the event of a bank failure. The FDIC often exercised this discretion to protect all creditors – even the subordinated debt holders of the bank's holding company – in order to minimize market disruption. This was the case in the

failure of Continental Illinois in 1984. At that time, Continental, with assets of approximately \$40 billion, ranked as the 5th largest bank in the U.S.

With the passage of the FDIC Improvement Act of 1991, also known as FDICIA, Congress statutorily mandated a new policy for the resolution of failing banks and thrifts under which the FDIC is required to choose the "least costly" resolution method, the method that minimizes expenditures from the deposit insurance fund. The least cost test requires the FDIC to perform cost benefit analysis on all possible resolution alternatives, based on the best-available information at the time, when deciding how to resolve a failed financial institution. The FDIC has developed the capabilities to do this, but accurate information is critical to perform such an analysis accurately. Moreover, the more complex the institution and the shorter the notice prior to the failure, both significant likelihoods in the case of a very large complex bank failure, the more difficult it will be for the FDIC to perform such an analysis quickly and reliably.

Under the law, the FDIC may bypass the least cost test in certain extraordinary circumstances. This is referred to under FDICIA as the "systemic risk exception." This exception allows the FDIC to bypass the least cost method if it "would have serious adverse effects on economic conditions or financial stability" and if bypassing the least cost method would "avoid or mitigate such adverse effects."

A high standard is set in the law in order to exercise this authority. The systemic risk exception requires the approval of two thirds of the members of the FDIC's Board of Directors, two thirds of the members of the Board of Governors of the Federal Reserve System, and the Secretary of the U.S. Treasury, who must first consult with the President. This requires therefore a process for interagency coordination and collaboration, including protocols for communication and the criteria the responsible agencies will use to make such a determination.

### **International Issues Raised by a Large Complex Bank Resolution**

Beyond the systemic risk exception, the resolution of a large complex U.S. bank with significant international operations raises significant information, coordination, security, structural and asset/liability issues beyond those of a bank with only domestic or de minimis foreign operations. The presence of international operations will inject substantial uncertainty about the availability of assets for a resolution because of the interplay of U.S. laws and foreign regulations and laws. For example, the possibility that a foreign regulator may "ring fence"—or hold assets to pay liabilities in its jurisdiction—will affect cost analyses, asset sales, and normal business operations associated with the failure of a large institution in the U.S.

Should a large complex U.S. bank with international operations get into serious difficulties with little or no notice, the planning and implementation strategy for its resolution will involve considerations beyond those for an otherwise comparable bank. Additional information will be needed regarding the location, type of operation, and

business of the bank—that is, which countries the bank is in, how it is chartered or licensed, and what type and how important the business is to the bank.

Obtaining this information will be complicated by the fact that the FDIC will need to deal with jurisdictions that are outside the purview of U.S. laws and regulations. For example, the closure of a large, international bank and the appointment of the FDIC as receiver may automatically trigger host country actions. Locations that process transactions or provide payments facilities will have to be secured, and communications will have to be established between U.S. and foreign regulators, as well perhaps as foreign ministries.

### **The FDIC's Current Efforts to Ensure Its Readiness**

The FDIC is taking steps to ensure that we are prepared to deal with the policy and operational challenges that a large bank failure would raise.

The FDIC has a high level internal committee that meets regularly to review and direct the agency's readiness planning. The task of this committee is to consider issues associated with the prospect of a large bank failure, from ensuring that supervisory personnel are cross-trained in failure resolution to coordinating with other federal agencies and international organizations in the event of a cross border crisis.

Operational readiness requires planning and preparation in a number of areas which the committee has identified as requiring special attention. These include claims determination, complications that could arise due to the blurring of business lines between separate legal entities and third parties, and capital markets activities conducted within the corporate and subsidiary structure of a failing insured depository institution. Should a large complex U.S. bank encounter difficulties, consideration of the systemic risk exception would need to take into account a number of these significant operational factors. Without proper planning, the operational aspects of the resolution itself could exacerbate potential "serious adverse effects" that could then trigger the systemic risk provision.

Over the past few years, the committee has focused a great deal of attention on the FDIC's ability to make timely insurance determinations and to quickly separate insured and uninsured deposits in the event of a large bank failure. Should such an event occur today, the FDIC could face unprecedented operational challenges in sorting out the insured and uninsured deposits. This is due to several factors, including the complexity of the rules governing deposit insurance coverage, the fact that many large banks created by merger have multiple deposit systems that may not be fully integrated, and the fact that most banks do not separately track insured deposits. The FDIC has issued several proposed rulemakings on this issue and we are in the process of evaluating industry comments.

The FDIC also runs simulation exercises to test our readiness to deal with a large complex bank failure. The objective of these exercises is to simulate and stress our decision-making processes, strategies and plans for managing a large bank failure and

identify any gaps in FDIC processes, procedures and skill sets and possible mitigation strategies to enhance success in a large failure situation. To date we are running such exercises internally, but in the future we hope to include other federal agencies to stress test our interagency process for dealing with such an event. Ultimately, it may be beneficial to consider expanding these efforts internationally to enhance our readiness to deal with cross border issues.

Finally, looking forward, consideration may have to be given to the development of international protocols with foreign bank regulatory agencies to deal with operational issues as well as potential market consequences of a large bank failure. It may be that international regulatory groups such as the Basel Committee and IADI can play a constructive role in facilitating the development of such protocols. It is the FDIC's goal to develop domestic and international processes for addressing the many issues involved in responding to a large bank failure, including means for effective communication with foreign governments and their relevant regulatory agencies at the time of such an event.

Thank you.

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