



Library

Room 4047

3

Library

FOR IMMEDIATE RELEASE

(PR-30-75 (4-29-75))

MAY 2 1975

FEDERAL DEPOSIT INSURANCE
CORPORATION

THE FEDERAL RESERVE'S PROPOSAL FOR
INTERSTATE ACQUISITION OF LARGE BANKS
IN TROUBLE: BASIC ISSUES IN A SIMPLE BILL

Address of
Frank Wille, Chairman
Federal Deposit Insurance Corporation

Before the
74th Annual Convention
of the
Conference of State Bank Supervisors

Kansas City, Missouri

April 29, 1975

Earlier this year, the Federal Reserve Board proposed legislation (S. 890, H. R. 4008) which would permit it to approve the acquisition by an out-of-state bank holding company of all or a substantial portion of the assets of any \$500 million bank located in another State if the Board finds either that "an emergency requiring expeditious action exists" with respect to such a bank or some parent holding company or that "immediate action is necessary to prevent the probable failure" of the bank or its parent and if the Board also finds "the public interest would best be served" by such an out-of-state acquisition. ^{*/}

Although presented to the Congress almost solely in terms of the Franklin National Bank experience last summer, this relatively simple, straightforward bill actually raises some very basic issues about the nation's banking system and its future course. While I favor the bill in principle, and believe that in some instances it could be a useful additional tool in the supervisory workshop for dealing with the problems of a large bank in distress, I will urge the Congress not to enact it without thoroughly considering its impact on these underlying

^{*/} The proposed legislation also authorizes the consummation of certain bank holding company acquisitions in designated emergencies without waiting the presently required 30 days (a delay designed to permit an antitrust attack against the proposed acquisition). In this regard, the bill merely proposes to conform emergency procedures under the Bank Holding Company Act with those presently in force under the Bank Merger Act. This provision is noncontroversial and should be enacted promptly.

issues and its relationship to other proposals for statutory change which will undoubtedly be suggested by the Federal Reserve, the FDIC and the Comptroller as a result of our joint experience over the last few years. If the Congress, after such a review, still wishes to pursue the Board's proposal, I hope it will do so only after adopting a number of amendments, the effect of which would be to limit the Board's open-ended discretion to approve emergency acquisitions of the kind contemplated.

As State Supervisors, you are keenly aware that the bill would allow the Board of Governors to override State law provisions that might expressly prohibit such an acquisition. The other basic issues that I see in the bill are these: (i) the future of interstate banking and interstate branching; (ii) the impetus the bill's enactment would give to the concept of 100 percent insurance for all deposits; (iii) the financial and legal capacity of the FDIC to work out the problems of a large bank in distress; (iv) the role of the Federal Reserve in bank regulation generally; and (v) the treatment to be accorded shareholders and debenture holders of the bank in distress.

The deference to be given State law in a matter of this kind is clearly up to the Congress. Its constitutional power to enact the Federal Reserve's proposal is no longer open to question, so the issue becomes purely one of congressional policy. While Federal preemption of State

law can be well documented in other regulatory fields, the Congress up to this point has taken considerable care to accommodate its enactments bearing on commercial bank structure to explicit restrictions found in State law. No doubt this has been largely due to the existence, side by side, of national and State banks, and the congressional conclusion that a viable system of dual chartering requires basic equality between the two systems in a matter as competitively important as the geographic location of the bank's offices. But the matter is hardly this simple. The competitive environment faced by commercial banks, regardless of charter, is just as influenced -- and some observers would say more so -- by important Federal regulations like Q, by the operating powers, including specifically the branching powers, of federally chartered savings and loan associations and by the activities of other nonbank institutions. Federal S&Ls are not bound, as you know, by any McFadden Act or by any strictures about competitive equality laid down by the Supreme Court. In operational areas, national banks may be restrained by State law in only limited situations while State banks frequently find themselves limited to whichever law or regulation, Federal or State, is the more restrictive. Even in structural matters, national antitrust policy may prevent completion of an acquisition which has already passed muster under State law or State administrative decision. Deference to State law is, therefore, a "sometime" thing in congressional policy, and I doubt

that a philosophic appeal pitched on that basis will prove very persuasive if Congress sees a need to override State law in the emergency situations envisaged by the Federal Reserve.

The FRB's bill does make two concessions to State law. First, it would not permit more than one acquisition in the same State by the same out-of-state holding company if State law prohibits multibank holding companies. Second, it would not permit an emergency acquisition by an in-state holding company if State law prohibited such an acquisition. Both concessions are consistent with the Board's concern for a procompetitive result in each potential use of its new authority, although in some factual situations an acquisition of a large bank in distress by an in-state holding company might be just as procompetitive as its acquisition by an out-of-state holding company. However, given the clear trend toward statewide operation of multibank holding companies -- even in hitherto unit banking States -- the Board's recommendation in this regard is not unreasonable. No doubt local emotions will run high if BankAmerica Corporation or Citicorp acquires a major bank outside California or New York when an in-state holding company in the same State as the bank in distress was ready, willing and able to complete the same acquisition -- but that sort of emotion is not much different than the reaction we all hear when a new bank enters a banking market where existing banks

previously had the competition all to themselves. The examples of that type of entry are so widespread, we can hardly fault the Federal Reserve in making the choice it did in drafting the proposal now before Congress.

I have even less trouble with the interstate banking issue which is so obviously a part of the Federal Reserve's proposal. There is significant interstate banking going on today, even if a bank headquartered in one State cannot establish deposit-receiving branches in another State. A number of major banking corporations have "grandfather" rights in other States under the Federal Bank Holding Company Act. Large banks regardless of their headquarters location already compete for any significant commercial, international, correspondent or corporate trust business throughout the nation. The 1970 amendments to the Bank Holding Company Act, and the Board's decisions under those amendments, have given a strong impetus to the acquisition and development of nonbank subsidiaries operating across State lines, many of them in retail as well as wholesale lending activities. The Comptroller's recent rulings on CBCTs, unless checked by the Congress or the courts, are likely to add significant new pressures in the direction of nationwide, or at least interstate, banking. Full interstate banking will come in time, although many banks and bank customers might prefer not to see that evolution take place.

The Federal Reserve's proposal is a very limited, intermediate step in the direction of full interstate banking, and I doubt that Congress will be impressed by any claim that the enactment of the Fed's bill, only occasionally applicable as it would be, will cause irreparable harm to thousands of smaller, community banks across the land. Congress may be concerned that under the bill the percentage of commercial bank assets already held by the largest banks in the country will increase significantly by acquisition rather than internal growth. The largest bank in the country, however, has less than 4 percent of the total domestic assets of the nation's commercial banking system, and the acquisition of even a \$2 billion bank in trouble would not increase that percentage by more than 0.2 percent. The United States has one of the least concentrated commercial banking systems in the world, and the enactment of the Federal Reserve's proposal is not likely, by itself, to change that situation in any substantial way.

I consider the other four issues I have identified in the FRB's bill as more serious and more troublesome.

The clear thrust of the Federal Reserve's proposal is that if a large bank is in failing condition, under no circumstances should there be an FDIC payout of insured deposits up to the statutory ceiling, now \$40,000 for most depositors. Rather, a takeover by some healthy bank should be arranged, at whatever cost, so as to avoid the damage to public

confidence in both national and international markets which might follow an FDIC payoff of a large insured bank. In point of fact, every failure or near-failure in FDIC history of a bank with more than \$100 million in assets has been resolved either by means of a deposit assumption transaction or by means of direct financial assistance to keep the bank going, rather than by an FDIC payoff up to the insured amount. Nonetheless, the net effect of the bill's enactment would be to eliminate any uncertainty as to the safety of deposit funds over \$40,000 so long as the bank in which the deposit is made has more than \$500 million in assets.

We at the FDIC have already stated publicly our determination to explore the possibility of arranging a deposit assumption transaction whenever a bank of any size fails, precisely because the net result of such a transaction is to protect all depositors 100 percent, even if their accounts are over the statutory insurance limit. We have pointed out, however, that arranging such a takeover transaction is never automatic. Under present law, the FDIC's discretion in choosing between the several methods available to it when a large bank fails is not unlimited. Furthermore, if the failing bank presents significant risk of financial loss to an acquiring bank, either in earnings performance or capital exposure, a willing purchaser may not be available or the FDIC may conclude that the price such a purchaser is willing to pay for the transaction is totally

inadequate to compensate the FDIC for the numerous guarantees against loss which the takeover bank may require before proceeding. In other words, under present circumstances, neither large depositors nor a bank's management can be fully confident that in the event of trouble all of the bank's deposits will be 100 percent safe or quickly available.

This uncertainty has been a significant discipline on the management policies of most banks, problem or nonproblem, and corporate treasurers and other suppliers of institutional funds are today reinforcing that discipline in the light of our four large bank failures and near-failures in the past four years.^{*/} At least with respect to banks of the asset size described in the bill, the net effect of its enactment might be to remove that discipline and encourage greater risks in asset and liability management than might otherwise be taken. As a bank regulator who is also concerned with the capacity of the nation's deposit insurance reserves to absorb large bank failures, I would regard any such development as both imprudent and shortsighted.

Moreover, eliminating any uncertainty as to the safety of deposits over the insurance ceiling in banks larger than a specified size will tend

^{*/} Bank of the Commonwealth, Detroit, 1972; United States National Bank, San Diego, 1973; Franklin National Bank, New York, 1974; and Security National Bank of Long Island, 1975.

to make banks of lesser size "second-class citizens" among the nation's banks and will tend to reinforce the trend, clearly evident in 1974, toward a "two-tiered" banking system. By that, I mean the preference of corporate and institutional treasurers, after United States National and Franklin National, for the largest money-center banks in New York, Chicago and San Francisco as compared with perfectly sound banks of lesser size and only regional coverage. This preference showed up in 1974 in deposit withdrawals and liquidity strains at a number of regional banks and in the relatively greater asset growth of the largest money-center banks. As a matter of self-defense, banks with total assets near the size break specified in the bill can be expected to argue for an even lower cutoff point, thereby adding to the impetus for 100 percent insurance of all deposits.

Fortunately, in every review of the deposit insurance program to date, Congress has resisted any general movement towards 100 percent insurance for all deposits and has reaffirmed its initial decision in favor of limited coverage. Since the FRB proposal runs counter to this long-standing policy, insofar as \$500 million banks are concerned, I think Congress will be perfectly justified in looking hard at the dollar cutoff suggested and in seeking to limit the coverage of the bill to the smallest number of banks necessary to remedy some demonstrated shortcoming in the present system of resolving the problems of large banks in distress.

What, then, has the experience of the last few years told us about the capacity of the present system in this regard? First, the FDIC with significant Federal Reserve assistance successfully arranged deposit assumption transactions for the nation's two largest bank failures and direct financial assistance to a third large bank to prevent its failure. These three banks ranged in asset size from something over \$1.2 billion in the case of the Bank of the Commonwealth and United States National Bank to \$3.6 billion in the case of Franklin National Bank. Second, the actual transfer of deposits from the failed bank to the assuming bank took place smoothly and efficiently within hours of the closing of both United States National Bank and Franklin National Bank, with no panic at all among the 1,000,000 depositors of the two institutions. Literally hundreds of examiners and other personnel in all three Federal agencies worked cooperatively at the time of closing to make this result possible. Third, it took a significant amount of time in all three cases to work out a satisfactory solution in advance: slightly over three months from FDIC's initial involvement in the case of Franklin National Bank, about seven weeks after FDIC's initial involvement in the case of United States National Bank, and about seven months in the less-pressing case of Bank of the Commonwealth. In the case of the two failures, the time required seems to have varied in direct proportion to the complexity and volume of the problems facing the bank in trouble, the degree of interest shown -- and

the risks faced -- by potential acquiring banks, and the extent and nature of FDIC or Federal Reserve assistance needed to make the transaction feasible from the point of view of potential acquirers. Fourth, the total FDIC outlay in these three cases to date (most of which it expects to recover in time) amounted to about \$510 million, an amount equal to roughly one-sixth of the aggregate deposits in the three banks. Each outlay was funded essentially out of the FDIC's current revenues, now running at about \$1 billion per year, rather than from the principal of the deposit insurance trust fund accumulated since 1933. The size of that trust fund, now \$6.2 billion, as well as the Corporation's statutory right to call on the Treasury for \$3 billion more if this is needed for insurance purposes, is considerable assurance that the FDIC, financially, can handle more frequent and even larger bank failures and near-failures than the three I have mentioned.

These things said, the fact remains that defensible solutions become more difficult to hammer out the larger a bank in distress is. There are several reasons for this. If a statutory merger or acquisition is contemplated, without any form of Federal Reserve or FDIC assistance, the takeover bank must be large enough to absorb the risks of the failing bank and must have, or be able to obtain, sufficient capital to support a sudden expansion of its deposit base. These risks are likely to include significant overseas exposures the larger the size of the problem bank,

and even the nation's largest banks may be quite unwilling to take on sizeable foreign exchange risks, for example, without Government support. Even if FDIC financial support or indemnities are provided, the management of the takeover bank will probably also be expected to take over a substantial portion of the assets and branch offices of the failing bank. Since there are only 107 banks with domestic assets of \$1 billion or more, only 51 with domestic assets of \$2 billion or more and only 27 banks with domestic assets of \$3 billion or more,^{*/} the number of healthy banks capable of even a Government-assisted takeover of a large bank in distress decreases rapidly the larger the failing bank is. Under existing law, of course, none of these larger banks or their parent holding companies would be eligible to acquire such a problem bank unless they operated in the same State, even assuming the terms of the transaction could be worked out to their satisfaction.

The arithmetic of diminishing numbers in seeking candidates for a deposit takeover was very much at work in the Franklin National Bank case last summer. Twenty banks and bank holding companies, each of which was believed to have significant financial and managerial resources, were contacted initially to determine the degree of their potential interest.

^{*/} As of October 15, 1974.

Antitrust clearances were obtained so that joint ventures might be considered and organized if the smaller banks or bank holding companies among the twenty felt themselves unable to proceed alone. Of those contacted, only four became seriously interested and ultimately submitted bids -- three of them under an antitrust cloud. No joint ventures got off the ground. And we were extremely fortunate, despite these handicaps, that Franklin National Bank was headquartered in New York State where there was a relatively large number of potential suitors, in-state, to be contacted.

A larger pool of potential suitors would have been very desirable last summer, and the FRB's proposal would certainly make a broader canvass possible. This is not the same as saying the final result would have been achieved in a shorter span of time. In fact, contacting potential out-of-state suitors as well as in-state suitors, and negotiating with a larger group than we did in an effort to arrive at a uniform bid package, might well have taken longer than the process actually did. On the other hand, if a significantly larger number of potential suitors had been identified, it might conceivably have been possible to arrange a deposit takeover without any form of Government assistance or it might have been possible for the FDIC and the Federal Reserve to have dictated the terms of the transaction and still have had one or two banks left which were willing to bid. In my view, only if one of these two conditions existed would the

process of finding a final solution to the Franklin affair have been "shortened considerably" as the FRB claims. Nonetheless, enlarging the pool of potential suitors regardless of the speed of resolution, is likely to improve significantly the prospects of successfully consummating a deposit assumption transaction at all, and this is the basic reason I support the concept of the FRB proposal.

Reviewing the experience of the last five years, however, I would have to inform the Congress that in my judgment FDIC, under existing law, can probably handle successfully and with reasonable dispatch the potential failure of virtually any bank with less than \$2 billion in assets and, depending on the circumstances, banks of even larger size. If the Congress wishes to narrow the coverage of the FRB bill to the area of clearest need, it can easily do so by raising the asset cutoff proposed by the FRB to at least \$2 billion. At that figure, only 51 banks in 15 of the nation's most industrialized States ^{*/} would have been potentially subject to acquisition under the bill's provisions as of October 15, 1974. This might be contrasted with the 208 banks in 38 States potentially subject to acquisition under the \$500 million cutoff proposed by the FRB.

*/ Arizona, California, Georgia, Illinois, Maryland, Massachusetts, Michigan, New York, North Carolina, Ohio, Oregon, Pennsylvania, Texas, Washington and Wisconsin.

Proponents of a lower cutoff than even the \$500 million proposed by the FRB have pointed out that in each of the remaining 12 States the largest commercial bank has less than \$500 million in assets and that such banks at least should also be covered under this proposed change in the law. I disagree with this argument, largely because it ignores two options FDIC has under present law in dealing with any such bank that finds itself in a failing condition -- either one of which I am sure the FDIC Board of Directors could and would use in preference to a statutory payoff up to the insurance limit. The first is direct FDIC financial assistance, under appropriate safeguards to insure correction of the bank's problems and ultimate repayment, designed to keep the bank operating as an independent institution. This was the option selected to prevent the failure of the \$1 billion Bank of the Commonwealth in 1972, at that time not even the largest, but the fourth largest, bank in the Detroit metropolitan area. When that assistance was granted, Michigan law did not permit the expansion of multibank holding companies, and the FDIC Board found the bank's preservation as a significant competitor in a major market to be essential for "adequate banking service in the community." By analogy, I am confident a similar finding could be made for the largest bank in a State, and possibly its nearest competitors as well, if there appeared to be no feasible possibility of a procompetitive acquisition by either an in-state or an out-of-state organization. The second option available to the FDIC under such

circumstances would be to stimulate the emergency chartering of a new bank with capable management, partially capitalized with an FDIC advance, and to permit that bank to acquire the deposits of the failing bank in exchange for the liquid assets of the problem bank and balancing FDIC cash. The equity capital which the organizers of such a new bank would have to supply under these circumstances might approximate only \$5 million or so for each \$100 million in deposits to be assumed -- a sum readily within the reach of many groups.

The Board's proposal raises in a direct way the agency restructuring issue with which it has been wrestling since last October, including specifically the FRB's own role in bank supervision and its relationship with other bank supervisors. You will have noted the power to approve an interstate acquisition of the type described has been left, in the FRB proposal, solely to the discretion of its Board of Governors under the broadest possible standards. Nothing in the language proposed would require the Board, before acting, to receive a certification from the primary supervisor of the bank in distress covering either the condition of the bank which requires emergency action or the merits of the proposed acquisition when compared to other possible solutions. Even granting that the Board would be likely to consult the Comptroller of the Currency if the bank in distress were a large national bank or the appropriate State Supervisor if a State-chartered bank were involved, nothing in the language

of the bill proposed would require such advice to be heeded. Similarly, even though the proposed acquisition may be contingent on FDIC financial assistance or indemnities, nothing in the bill requires the Board to consult with, or heed the advice of, the FDIC prior to approving the transaction.

The bill ignores the hard questions which may arise if a choice must be made between several eligible out-of-state holding companies all vying for the opportunity of purchasing the bank in distress. By its power to approve, the Board of Governors can undoubtedly predetermine the successful suitor. Will that choice be made, for example, on the basis of which lead bank, in the Board's view, is most adequately capitalized even if that judgment differs from the judgment of the lead bank's primary supervisor? Will that choice possibly depend on which lead bank is most closely adhering to the credit "guidelines" of the moment, laid down by the Board in the exercise of its monetary functions? Will the Board tend to prefer that bank holding company most of whose subsidiary banks are Federal Reserve members rather than the holding company with a greater proportion of nonmembers? How will the Board weigh a choice between two equally procompetitive proposals -- one from an in-state holding company and one from an out-of-state holding company? If the primary supervisor is attempting to work out a solution under the Bank Merger Act, will the Board defer some alternative bank holding

acquisition under the proposed bill, or will it threaten the use of its new power in an effort to speed up action by the primary supervisor? If the problem bank is a large nonmember bank, will the Board prefer the use of its new authority to the extension of a direct or conduit loan from the Federal Reserve discount window?

Questions like these are inherent in any bill which vests virtually unrestrained power in the Board of Governors to determine when, or when not, to use the new authority it has requested. I would suggest that the only way such conflicts can be completely avoided is by requiring the concurrence of the primary supervisor before the Board acts. If FDIC financial assistance or indemnities are an integral part of such an out-of-state acquisition, then the FDIC's concurrence should also be required before the Board acts.

If the Board finds this restraint on its proposed authority to be unpalatable, I will recommend that the Congress defer action on the whole proposal until it reviews the entire structure of bank regulation at the Federal level and has determined whether or not it wishes the Federal Reserve to continue to have responsibilities in matters of bank supervision in addition to its responsibilities in the monetary field. To enact the FRB proposal without amendments before that determination is made would be a clear case of prejudging the underlying issue of regulatory structure or letting it go by default.

The absence of meaningful standards for the exercise of the Board's discretion also raises the question of whether the fairness of the consideration offered to debenture holders and shareholders of the bank to be acquired should play any part in the Board's decision to approve an emergency acquisition by an out-of-state bank holding company. The FDIC, in the exercise of its responsibilities as potential receiver in the case of a bank which is thought likely to fail, has a fiduciary duty to obtain the highest price it possibly can for the going concern value of the problem bank's business. The Corporation has attempted to carry out this duty by seeking to encourage at least two prospective purchasers to bid on a uniform basis for the deposits, assets and offices of the problem bank which are to be transferred. Our experience has been that a negotiated deal with only one institution, or a bidding procedure in which there is known to be only one bidder, almost never produces a fair price for the receivership estate or for the debenture holders and shareholders of the closed bank. Will the Board of Governors, under its proposed bill, be required to follow any similar procedure? Or will it be permitted to consider the speed of resolution more important than the fairness of the consideration offered? Obviously, these two considerations may present an insoluble dilemma in a particular case, but it is no answer to suggest that the consent of the problem bank's debenture holders and shareholders will have to be obtained in any event before the

Board of Governors is called upon to act. This ignores the emergency nature of the proposed acquisition and the fact that the Comptroller of the Currency and many State Supervisors have the authority to waive shareholder or debenture holder approval in appropriate cases.

After considering all of these underlying issues, it will be my recommendation to the Congress that it pass the FRB proposal only after it is amended to increase the asset cutoff from \$500 million to \$2 billion and to require in all cases the prior concurrence of the primary supervisor of the bank to be acquired. In those cases where FDIC financial assistance or indemnities are contemplated, the bill should be amended to require the prior concurrence of the FDIC as well.

In my view, these amendments will substantially minimize the damage which might otherwise be done to the historical pattern of State primacy in matters of bank structure, to the concept of limited deposit insurance, to the regulatory structure we presently have and to the shareholders and debenture holders of the bank in distress. They will, moreover, narrow the coverage of the bill to those situations in which the need for additional regulatory flexibility in the case of large banks in distress has been most clearly demonstrated.