



Conference on Core Principles for Effective Deposit Insurance Systems

Failure Resolution: Early Detection and Timely Intervention and Resolution

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Presentation Outline

- Principle
- Explanations and Supporting Guidance
- United States Case
- Questions?

Principle 15:

Early Detection and Timely Intervention and Resolution

- **The deposit insurer should be part of a framework within the financial system safety net that provides for the early detection and timely intervention of troubled banks.**
- **The determination and recognition of when a bank is or is expected to be in serious financial difficulty should be made early and on the basis of well defined criteria by safety net participants with the operational independence and power to act.**

Principle 15:

Early Detection and Timely Intervention and Resolution *Explanations and Supporting Guidance*

- Responsibilities of deposit insurers for various aspects of supervision, prudential regulation and the resolution of troubled banks are country specific.
- Manner in which banks are supervised and regulated and how troubled banks are resolved has a major impact on the costs and other aspects of the deposit insurance system.
- Determination and recognition of when a bank is or is expected to be in serious financial difficulty should be made early.
- Intervention and resolution process should be initiated on the basis of well-defined criteria, including capital requirements, low levels of accessible liquidity, deterioration in the quality or value of assets, and the finding that the bank is operated in an unsafe and imprudent manner.

United States Case

Federal Deposit Insurance Corporation: Strategies and Solutions



Principle 15: Early Detection and Timely Intervention and Resolution FDIC Strategies and Solutions

Overview of US Financial System Safety Net

US depository institutions can choose between five different charters. The type of charter determines the Primary Federal Regulator (PFR):

FDIC	State Chartered Institutions that are NOT members of the FRS
	State Chartered Industrial Loan Companies (ILC)
Federal Reserve System (FRS)	State Chartered Institutions that are members of the FRS
	All Bank Holding Companies
OCC	All National Banks
OTS	All Institutions with (National) Federal Savings Association Charters

- As deposit insurer, the FDIC is the **ONLY** Federal Banking Supervisor with “back up” supervisory authority.
- Under certain circumstances, the FDIC can undertake an independent supervisory examination and arrive at a different conclusion than the PFR.

Principle 15: Early Detection and Timely Intervention and Resolution

FDIC Strategies and Solutions

Learning From Our History

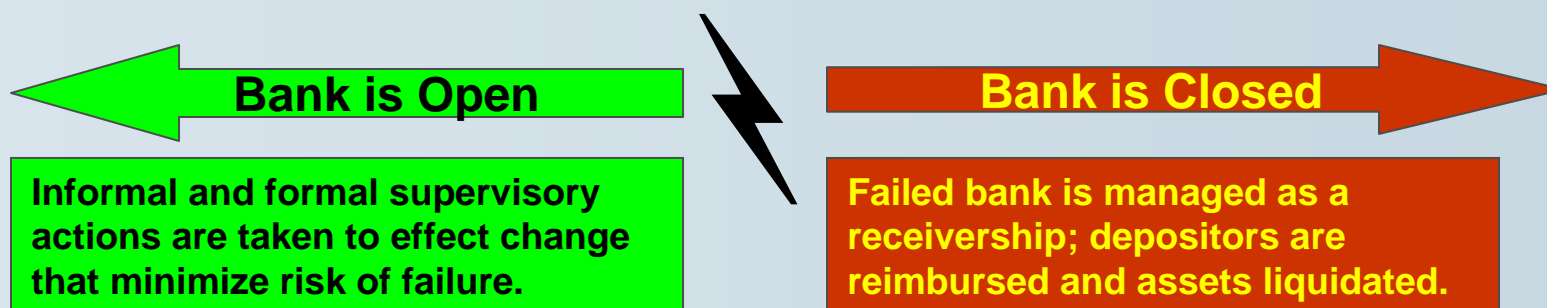
- **Problems must be identified at an early stage if serious deterioration in an institution's condition is to be prevented, and early identification requires continuous and sometimes burdensome monitoring of the institution's activities.**
- **The ability to curb excessive risk taking on the part of currently healthy institutions was (and continues to be) limited by the problem of identifying risky activities before they produce serious losses.**
- **The FDIC's approach is designed to promptly identify and address practices, conditions, or violations of law that could result in risk of loss or damage to a financial institution.**

Principle 15: Early Detection and Timely Intervention and Resolution

FDIC Strategies and Solutions

Intervention

- Literature and country practices suggests that the term intervention is sometimes used to describe supervisory action taken to address weak banks – regardless of whether the bank is “open” or “closed.”
- The FDIC does not use the term intervention to describe supervisory involvement taken while the bank is open. Instead, we generally use the term “enforcement” to describe the supervisory actions used to bring improvement in institutions while they are open.
- Once banks are closed, supervisory “intervention” efforts cease and the FDIC performs its job in its receivership capacity.



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Rigorous Enforcement

FDIC closely monitors “Troubled Institutions,” which include those that have supervisory ratings of 3, 4, or 5.

Supervisory tools used to identify and monitor troubled institutions include:

- Problem Bank Reports and Memoranda
- Risk-focused review and monitoring
- Projected Failure Reports
- Coordination with the FDIC’s Division of Resolutions and Receiverships
- Interagency Problem Bank Meetings

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FDIC Strategies and Solutions

Enforcement Tools at the FDIC's Disposal

Informal Agreements with Bank

- Commitment or Supervisory Letter
- Board Resolution
- Memorandum of Understanding

Formal – Legally Enforceable Actions

- Written Agreement
- Cease and Desist Order
- Prompt Corrective Action Directive
- Safety and Soundness Letter
- Termination of Insurance
- Civil Money Penalty
- Removal and Prohibition

Other Supervisory Tools and Options

- Investigations
- Suspicious Activity Report
- Referral to Another Agency
- Complaint to Professional Board

Supervisory Jurisdiction

These measures can be applied to bank insiders (directors, officers, controlling shareholders), but, also to *Other Institution Affiliated Parties* such as a bank's appraiser, attorney, or accountant.

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Legal Authorities

- **Federal Deposit Insurance Act of 1950 (FDIA)**
 - Authorizes the FDIC to examine national and state-member banks to determine their insurance risk.
- **Competitive Equality Banking Act of 1987 (CEBA)**
 - Grants the FDIC bridge-bank authority.
 - Becomes the first legislation to explicitly state that insured deposits are backed by the full-faith-and-credit of the US government.
- **Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA)**
 - Gives the FDIC back-up authority over S&Ls.
- **Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA)**
 - Puts significant restrictions on the designation of “too big to fail,” requiring approval of the US President.
 - Requires the FDIC to close banks in a manner that is least costly to the Bank Insurance Fund.
 - Requires that **prompt corrective action** be taken against banks based on their capital levels. Gives the FDIC Authority to close depository institutions when capital levels fall below 2%.

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Prompt Corrective Action: A Closer Look

A bank's capital position is used to determine the type and severity of supervisory action that may be required

	Total RBC	Tier 1 RBC	Leverage Ratio
Well Capitalized	≥10%	≥6%	≥5%
Adequately Capitalized	≥8%	≥4%	≥4%
Undercapitalized	<8%	<4%	<4%
Significantly Undercapitalized	<6%	<3%	<3%
Critically Undercapitalized	Tangible Equity Capital		<2%

Capital Plans are Required for All Undercapitalized Categories.

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Typical Grounds for Closing Bank and Appointment of Receiver

Critically undercapitalized under Prompt Corrective Action statute:

- **Trigger: Tangible Capital < 2% Total Assets**
- **Must recapitalize within 90 days or face closure**

Grounds for immediate bank closure:

- **Unsafe or unsound banking practices**
- **Willful violation of a Cease & Desist Order**
- **Assets insufficient to meet obligations**
- **Concealment of books, records, money laundering, etc.**
- **Need for FDIC self-appointment**

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What happens to weak banks?

Sometimes supervisory enforcement actions do not result in receivership.

- Corrective actions may be sufficient to return the institution to a safe and sound condition.
- The institution may be acquired by or merged into a stronger institution or company.
- The institution may be self-liquidated with no impact to the deposit insurance fund.

AND.....

Sometimes weak banks that are no longer viable enter into receivership.

- The regulatory entity that charters the bank has the authority to appoint the FDIC as receiver.
- The FDIC retains the statutory authority to appoint itself as receiver.
- The FDIC has authority for resolution/receivership matters for all federally insured institutions.

***Thank You.
Questions?***

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