Purchase and Assumption

Research Paper

November 2019

Prepared by the Core Principles and Research Council Committee
International Association of Deposit Insurers
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Abbreviations

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<th>Abbreviation</th>
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<tr>
<td>BCBS</td>
<td>Basel Committee on Banking Supervision</td>
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<td>BFG</td>
<td>Bank Guarantee Fund</td>
</tr>
<tr>
<td>BIS</td>
<td>Bank for International Settlements</td>
</tr>
<tr>
<td>BRRD</td>
<td>Bank Recovery and Resolution Directive</td>
</tr>
<tr>
<td>CDIC</td>
<td>Central Deposit Insurance Corporation</td>
</tr>
<tr>
<td>CPs</td>
<td>Core Principles for Effective Deposit Insurance</td>
</tr>
<tr>
<td>DGSD</td>
<td>EU Deposit Guarantee Scheme Directive</td>
</tr>
<tr>
<td>DIA</td>
<td>Deposit Insurance Agency</td>
</tr>
<tr>
<td>DICJ</td>
<td>Deposit Insurance Corporation of Japan</td>
</tr>
<tr>
<td>DIS</td>
<td>Deposit Insurance System</td>
</tr>
<tr>
<td>EBA</td>
<td>European Banking Association</td>
</tr>
<tr>
<td>EFDI</td>
<td>European Forum of Deposit Insurers</td>
</tr>
<tr>
<td>EU</td>
<td>European Union</td>
</tr>
<tr>
<td>FDIC</td>
<td>Federal Deposit Insurance Corporation</td>
</tr>
<tr>
<td>FITD</td>
<td>Fondo Interbancario di Tutela dei Depositi</td>
</tr>
<tr>
<td>FSB</td>
<td>Financial Stability Board</td>
</tr>
<tr>
<td>IADI</td>
<td>International Association of Deposit Insurers</td>
</tr>
<tr>
<td>IMF</td>
<td>International Monetary Fund</td>
</tr>
<tr>
<td>KDIC</td>
<td>Korea Deposit Insurance Corporation</td>
</tr>
<tr>
<td>LCT</td>
<td>Least-Cost Test</td>
</tr>
<tr>
<td>LOI</td>
<td>Letter of Interest</td>
</tr>
<tr>
<td>NCUA</td>
<td>National Credit Union Administration</td>
</tr>
<tr>
<td>P&amp;A</td>
<td>Purchase and Assumption</td>
</tr>
</tbody>
</table>
Key terms

Bridge institution: An institution established to temporarily take over and maintain certain assets, liabilities and operations of a failed bank by the resolution authority. When the resolution authority cannot find an acquirer for a failed institution due to poor market conditions, the bridge institution helps provide time to arrange a permanent transaction. It also helps maintain banking services and ensure continuity of the failed institution’s critical functions. In many jurisdictions, the establishment and operation of bridge institutions are subject to less stringent requirements than those of commercial banks.

Core Principles: Provide a framework of standards that support effective deposit insurance practices. They are reflective of and adaptable to a broad range of jurisdictional circumstances, settings and structures. They have been included in the FSB’s Key Standards and are the basis for the IMF/World Bank assessments. They encourage deposit insurers to be part of an effective resolution regime that ensures prompt and accurate reimbursements and minimises resolution costs and market impact.

Due diligence: An on-site inspection of the books and records of a failing/failed bank by a potential purchaser, a supervisor, a resolution authority, a deposit insurer or their agents for a valuation/estimation of assets and liabilities. It enables the resolution authority and potential bidders to accurately identify/quantify the assets and liabilities of a failed institution. In general, a resolution authority conducts due diligence to determine a resolution strategy, while potential bidders use it to cross-check the information provided by the resolution authority prior to or after the bidding process.

Least-cost test: A test aimed at calculating/identifying the resolution method with the lowest cost to the deposit insurance fund or any other public funds. The test is conducted to select the winning bid for the P&A transaction, and it also used to determine the resolution strategy. In a number of jurisdictions, the test can be dispensed with when there are concerns about systemic risks.

Purchase and assumption: A resolution method in which a healthy bank or a group of investors assume some or all of the obligations, and purchase some or all of the assets of the failed bank. Together with the liquidation method, purchase and assumption (P&A) has become the most widely used resolution method around the world since the 1980s.

Resolution authority: A public agency responsible for the resolution of an insolvent financial institution. Deposit insurers may or may not be the resolution authority in a given jurisdiction depending on its mandates, powers and legal framework.
Executive summary

The global financial crisis brought bank failure resolution to the forefront of worldwide discussions. Due to the disorderly collapse of many financial institutions and the negative fallout on the financial system and global economy, more effective and efficient resolution regimes were sought by governments around the globe as well as international standard setters.

There has been a range of resolution methods used by resolution authorities around the world, including liquidation and deposit payout, merger and acquisition (M&A), and purchase and assumption (P&A). This paper will attempt to shed greater light on the use of the P&A method among IADI members. According to the 2016 IADI Annual Survey, which drew 124 respondents, the P&A method has been used in 29 jurisdictions and is available as a resolution tool in 89 jurisdictions. A second survey conducted by the P&A Technical Committee in 2016 received responses from 41 IADI members, and 17 deposit insurers in 15 jurisdictions said that they had resolved one or more failed institutions using the P&A structure.

The increased focus on the use of the P&A method can be attributed to its advantages, which are: reduced resolution costs; less disruption to the local economy; greater convenience over a payout for depositors; flexibility in the choice of resolution options; prompt transfer of insured deposits; and continuation of depositor services. However, completing a P&A transaction also has its challenges, such as: difficulty in pricing assets and identifying potential buyers for the assets in a constrained time frame due to weak market conditions; a lack of interested buyers; the increased costs associated with the use of a bridge bank tool; and difficulties with least-cost estimations.

The overall P&A process, from the declaration of insolvency to the development of a resolution strategy tailored to a specific institution, to the need for due diligence on assets targeted for transfer to an acquiring institution, and the marketing and sale of the institution, can be more complicated than the liquidation method. This complexity derives from the challenge of finding a third party who will acquire the failing or failed institution and aligning their terms of the purchase with the resolution authority’s incentives for avoiding unnecessary disruption and minimising resolution costs. The process of P&A seems to have slight variations among jurisdictions, according to the results of the P&A Technical Committee survey.

In order for a P&A to succeed, there are several factors that require consideration: proper due diligence to develop accurate asset value assessments; the availability of a sufficient number of qualified bidders; and the solicitation of sufficiently high bids. Failure in any of these steps may require modification of the whole process and therefore can present uncertainty for resolution authorities and deposit insurers. To minimise such uncertainties, the resolution authority must approach P&A processes with carefully designed strategies and vigorous marketing efforts. Furthermore, since a P&A is often accompanied with payments to the acquirer to make up the net asset shortfall, the resolution authority and deposit insurer should ensure that there is adequate funding available, and should have the necessary powers to efficiently recover funds from the receivership estate. Additional features needed to ensure the smooth functioning of the P&A process include a strong legal framework, a pool of outside experts, development of financial markets and advancement of IT systems, among others.
I. Introduction

The global financial crisis brought bank failure resolution to the forefront of worldwide discussions. The disorderly collapse of many financial institutions, most notably Lehman Brothers, during the crisis caused great losses to individual financial consumers, and wreaked social and economic havoc by disrupting the financial system, requiring massive injections of public funds to mitigate systemic risk.

In response, governments around the world and international standard setters, in particular the Financial Stability Board (FSB) began to address challenges in developing orderly and effective resolution regimes. In the United States, the Dodd-Frank Wall Street Reform and Consumer Protection Act introduced the Orderly Liquidation Authority, while in the United Kingdom, the Special Resolution Regime was established under the Banking Act of 2009. In addition, the FSB published the Key Attributes of Effective Resolution Regimes for Financial Institutions, setting out guidelines for effective resolution regimes. In the EU, the response to the crisis has been encapsulated in, among others, the Deposit Guarantee Schemes Directive (DGSD) and the Bank Recovery and Resolution Directive (BRRD), which were adopted in spring 2014. The DGSD and BRRD provide authorities with comprehensive and effective arrangements to deal with failing banks at national level, and cooperation arrangements to tackle cross-border banking failures.

Meanwhile, to deal with the effects of the global financial crisis, deposit insurers in many jurisdictions took action to prevent bank runs and maintain financial stability, such as increasing the scope or limit of coverage and shortening the payout period. Importantly, many deposit insurers were given larger mandates, with many moving from a simple paybox to systems encompassing greater responsibilities, including in some cases certain resolution functions. In addition, the International Association of Deposit Insurers (IADI), in cooperation with the Basel Committee on Banking Supervision (BCBS), developed the Core Principles for Effective Deposit Insurance Systems (the Core Principles) in 2009. The Core Principles were included in the FSB’s Compendium of 12 Key Standards for Sound Financial Systems in 2011 and are used by the International Monetary Fund (IMF) and the World Bank in the context of the Financial Sector Assessment Program. The Core Principles encourage deposit insurers to be part of an effective resolution regime that ensures prompt and accurate reimbursements and minimises resolution costs and market impact, in furtherance of more effective deposit insurance systems.

In considering the range of resolution options available to the authorities, there are both closed bank and open bank options. The closed bank options include: purchase and assumption (P&A); bridge bank; and liquidation. Among these, the P&A method is considered to have advantages over other alternatives because it might cost less than liquidation. It can also help to reduce the risk of the acquirer falling into insolvency because the acquirer usually assumes only good assets and liabilities from the failed financial institution, or typically acquires bad assets at considerable discounts. Furthermore, it has been shown that the P&A is an efficient option for resolving small and medium-

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1 'Bank’ is defined as any entity which accepts deposits or repayable funds from the public and is classified under the jurisdiction’s legal framework as a deposit-taking institution.
2 New resolution tools like bail-in were introduced during the global financial crisis with the emergence of systemically important financial institutions (SIFIs); traditional tools that have been widely used include P&A and liquidation.
3 The Core Principles were later revised in 2014 in light of the changes in the financial market environment and needed improvements.
4 There are also other methods indicated in the BRRD, such as the bail-in tool or the creation of an asset management vehicle (the asset separation tool) to put the bail-in into perspective, both of which can be either open or non-open.
5 Even if the bridge bank and P&A have some similarities, they are regarded as two separate resolution tools.
6 However liquidation is not classified as a resolution method in the BRRD.
sized firms, which are more vulnerable to failures and have historically failed more often than larger ones. For these reasons, there is a growing demand for research on the P&A method and technical guidelines for its use.

This paper was developed by the IADI P&A Technical Committee to study current practices, look at examples used in different jurisdictions, examine the processes and problems related to P&As, and provide technical guidelines to jurisdictions that are considering the adoption or improvement of their resolution regimes. The Annual Survey of IADI members in 2016 found that 29 out of 124 deposit insurers that responded had had experience with resolving financial institutions through P&A transactions. There are also limits to describing each step of the process in detail, due to differences in regulatory systems and financial market conditions from one jurisdiction to another. Thus, this paper seeks to outline the general P&A process and show how different jurisdictions are dealing with various steps in the process, with a view to providing the data/information necessary for the introduction or enhancement of a resolution regime.

This paper is organised as follows:

Section II provides an overview of the P&A process, discusses its advantages and disadvantages, and summarises the findings of a survey conducted by the P&A Technical Committee and the 2016 IADI Annual Survey;

Section III examines the P&A process with examples primarily drawn from four jurisdictions\(^7\) that have had significant resolution experience using P&A transactions, describes several jurisdiction-specific issues, and explains the key points for consideration when adopting the P&A method for the first time in the form of technical guidelines. Section IV presents a concluding summary.

\(^7\) Japan, Korea, Chinese Taipei and the United States.
II. Overview of P&A Transactions around the Globe

A. Overview of P&A

1. Definition of P&A

As defined in the IADI Glossary, P&A is a resolution method in which a healthy bank or a group of investors assume some or all of the obligations, and purchase some or all of the assets of the failed bank.6

2. Types of P&A Transactions

There can be variations in P&A transactions depending on the amount of time available to arrange the transaction, the location and size of the financial institution, the nature of its deposits, and the assets available for sale, as quoted in FDIC (2014). In her research paper, McGuire (2012) presented six different types of P&A.7 From the standpoint of the resolution authority, basic P&As or whole bank P&As, where the acquirer takes over the whole institution, may be most desirable, but if problems from the distressed financial institution could adversely affect the acquiring institution’s financial situation, the acquirer may need additional incentives and financial protection. In such a case, the resolution authority may enter into other types of P&A such as an optional shared loss P&A agreement, where it agrees to share any future losses on certain assets with the acquirer or reimburse the acquirer to a predetermined extent. If, despite these incentives, a P&A transaction cannot be arranged due to lack of investor interest, the resolution authority may opt to create a bridge bank and temporarily act as the acquirer, depending on the level of systemic risk, the impact of the failed institution’s insolvency on the financial industry, etc.

3. Opportunities and Challenges of P&A

In general, the goal of resolution is to protect insured depositors and maintain financial stability while keeping resolution costs to a minimum. While the resolution toolkit is broad, previous literature finds that the P&A can be a less costly method of resolving a bank (Bovenzi and Murton 1988; Brown and Epstein 1992; James 1991). Benefits of the P&A include: reduced resolution costs; less disruption to the local economy; convenience for the depositor; flexibility in the choice of resolution options; prompt transfer of assumed deposits; and continuation of depositor services. In addition, the acquirer may retain at least some of the bank locations of the failed bank, enabling customers of the failed bank

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6FDIC (2014) defined P&A as a resolution transaction in which a healthy institution purchases some or all of the assets of a failing institution and assumes some of the liabilities, including either “all deposits” or “only insured deposits,” while the BRRD defines a P&A transaction as the “sale of business”, which means the mechanism for effecting a transfer by a resolution authority of shares or other instruments of ownership issued by an institution under resolution, or assets, rights or liabilities, of an institution under resolution to a purchaser that is not a bridge institution.
to continue banking services at the same location. Depending on the type of deposit insurer (e.g. paybox or risk minimiser, the timing of financial support can be stretched out. For example, deposit insurers with narrow mandates (paybox and paybox plus) are relatively simple as they focus narrowly on financing the deposit payout. On the other hand, deposit insurers with broad mandates (loss minimiser or risk minimiser) determine the resolution strategy and take charge not only in deposit payout but also in providing financial assistance to make up the net asset shortfall. In addition, it may preserve the jobs of some of the former employees of the failed bank. P&As can also minimise market disruption, as the transfer of assets can be executed in a relatively short period.¹⁰

P&As can, however, present several challenges such as: the potential difficulty of marketing the performing assets of a failed institution due to weak market conditions, resulting in a lack of interested buyers; and difficulties in asset valuation and least-cost estimation. Private investors may not be interested in acquiring an insolvent bank or may be unable to work through regulatory requirements to qualify as prospective buyers within the short time frames involved. Accordingly, financial and regulatory support may be necessary to make the assets and liabilities package of a failed institution attractive for potential acquirers. Incentives may take the form of cash injections provided by the deposit insurer or the resolution authority, in exceptional cases and where authorised by national law, as well as loss sharing agreements, guarantees or loans. In some jurisdictions, this form of assistance must be justified as the least-cost alternative. However, in many jurisdictions, exemptions are also granted when there are concerns about systemic problems.

Moreover, the EU resolution regime requires the authorities to implement measures related to burden-sharing in resolution, as referred to in the BRRD and in the Banking Communication.¹¹

Deposit insurers that are also resolution authorities may face the task of facilitating the early valuation of assets and liabilities of the failing institution while endeavouring to maintain confidentiality.

Generally in a P&A transaction, the assuming institution or acquirer takes on only limited good assets. Bank’s fixed assets including premises can be offered on an optional basis, at a purchase price to be agreed upon by the acquirer and the resolution authority. The liabilities are then matched to the assets taken and consist of insured deposits. To the extent that the acquirer assumes more liabilities than assets, the resolution authority has to fill the gap by providing financial support to the acquirer. In any case, depositors with insured deposits are always protected by the deposit insurer.

4 Current Use of P&A

Of the 124 deposit insurers who participated in the 2016 IADI Annual Survey, 29 (23.4%) said that they had used P&A to resolve failed banks as of year-end 2015. As a bank resolution tool available to deposit insurers worldwide, P&A (89) ranked second following liquidation (107).

¹⁰ P&A transactions contribute to the achievement of the resolution objectives stipulated in the BRRD, which are: ensuring the continuity of critical functions of a financial institution, avoiding a significant adverse effect on the financial system, in particular by preventing contagion, maintaining market discipline, protection of public funds by minimising reliance on extraordinary public financial support; protection of depositors; and protection of client’s funds and assets.
¹¹ Communication from the European Commission on the application, from 1 August 2013, of State aid rules to support measures in favour of banks in the context of the financial crisis (‘Banking Communication’) (2013/C 216/01). The communication requires adequate burden sharing, which should entail, after losses are first absorbed by equity, contributions by hybrid capital holders and subordinated debt holders. Hybrid capital and subordinated debt holders must contribute to reducing the capital shortfall to the maximum extent. The power of write-down or conversion of capital applies to relevant capital instruments, i.e. Additional Tier 1 (AT1) and Tier 2 (T2), which may be written down or converted into Common Equity Tier 1 (CET 1), after CET 1 instruments are written down first.
Based on the same survey’s results, out of a total of 10,856 failed financial institutions as of year-end 2015, 4,213 (38.8%) were reported to have been resolved through P&A transactions. The preference for the P&A method is particularly strong in the United States: the Federal Deposit Insurance Corporation (FDIC) handled 1,911 of 4,089 (46.7%) failed institutions by P&A; the corresponding figure for the National Credit Union Administration (NCUA) is 1,837 (50.8%) out of a total of 3,615. When these two organisations are taken out of the survey’s results, the number of resolutions handled by the remaining 122 deposit insurance agencies is around 3,200, of which nearly 1,900 (59.4%) were resolved by depositor payout, suggesting that outside the United States deposit reimbursement has been the most widely used resolution method.

In terms of overall P&A experience, the United States is followed by Japan (Deposit Insurance Corporation of Japan, DICJ), Korea (Korea Deposit Insurance Corporation, KDIC), Chinese Taipei (Central Deposit Insurance Corporation, CDIC), and Poland (Bank Guarantee Fund, BFG). Japan (DICJ) and Chinese Taipei (CDIC) have used P&A transactions to resolve 182 and 57 failures since inception, respectively. In Korea, the KDIC resolved 88 (16.2%) out of 544 total failures through P&A transactions. More specifically, of the 45 savings banks that failed between 2003 and 2015, 18 (40.0%) were handled via P&A, 24 (53.3%) through bridge bank, and the remaining three (6.7%) through liquidation. Other jurisdictions with P&A experience include: Argentina (Seguro de Depósitos Sociedad Anónima, SEDESA); Canada (Canada Deposit Insurance Corporation, CDIC); Greece (Hellenic Deposit and Investment Guarantee Fund, TEKE); and Iceland (Icelandic Depositors’ and Investors’ Guarantee Fund, IDIGF). Table 1 shows the number of P&A and bridge bank resolutions in each jurisdiction.
Table 1. P&A Experiences since Inception

<table>
<thead>
<tr>
<th>Jurisdiction</th>
<th>Year established</th>
<th>P&amp;A (without bridge bank)</th>
<th>Bridge bank</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Argentina (SEDESA)</td>
<td>1995</td>
<td>13</td>
<td>0</td>
<td>13</td>
</tr>
<tr>
<td>Canada (CDIC)</td>
<td>1967</td>
<td>9</td>
<td>0</td>
<td>9</td>
</tr>
<tr>
<td>Greece (TEKE)</td>
<td>1995</td>
<td>12</td>
<td>2</td>
<td>14</td>
</tr>
<tr>
<td>Iceland (IDIGF)</td>
<td>1999</td>
<td>10</td>
<td>0</td>
<td>10</td>
</tr>
<tr>
<td>Italy (FITD)</td>
<td>1987</td>
<td>7</td>
<td>0</td>
<td>7</td>
</tr>
<tr>
<td>Japan (DICJ)</td>
<td>1971</td>
<td>179</td>
<td>3</td>
<td>182</td>
</tr>
<tr>
<td>Korea (KDIC)</td>
<td>1996</td>
<td>64</td>
<td>24</td>
<td>88</td>
</tr>
<tr>
<td>Poland (BFG)*</td>
<td>1995</td>
<td>32</td>
<td>0</td>
<td>32</td>
</tr>
<tr>
<td>Russia (DIA)</td>
<td>2004</td>
<td>6</td>
<td>0</td>
<td>6</td>
</tr>
<tr>
<td>Chinese Taipei (CDIC)</td>
<td>1985</td>
<td>57</td>
<td>0</td>
<td>57</td>
</tr>
<tr>
<td>United States (FDIC)</td>
<td>1933</td>
<td>1,911</td>
<td>569**</td>
<td>2,480</td>
</tr>
<tr>
<td>United States (NCUA)</td>
<td>1970</td>
<td>1,837</td>
<td>4</td>
<td>1,841</td>
</tr>
</tbody>
</table>

* The figure includes P&A transactions applied as restructuring measures towards credit unions on the basis of the former regulatory framework for the Deposit Guarantee Scheme, which was in force until 8 October 2016.

** This number includes institutions operated under government control between the date of failure and the final resolution date, either in a bridge bank operated by the FDIC, in a conservatorship operated by the Resolution Trust Corporation or the FDIC, or in a management consignment programme operated by the Federal Savings and Loan Insurance Corporation (FSLIC).

Source: IADI Annual Survey (2016)

To understand the current use of the P&A method and its procedures among IADI members, the P&A Technical Committee conducted a survey in January 2016. By the end of May of the same year, the Committee had received 41 responses; of these, 17 deposit insurers in 15 jurisdictions said that they had resolved one or more failed institutions using the P&A structure.
III. Current Practices and Technical Guidelines

A. P&A Transactions in Practice

The P&A method requires accurate asset valuation techniques. While more time-consuming than deposit payouts or liquidation under standard insolvency proceedings, this technique avoids unnecessary disruption and minimises resolution costs. In financial institution failures, the longer the resolution process continues, the more likely it is that the troubled bank’s assets will rapidly decline in value and the risk of contagion that could lead to market disturbances increases. It follows that it is in the best interests of the broader market and the authorities to ensure that the resolution procedures are carried out as quickly as possible. In addition, because failing financial institutions tend to have more liabilities than assets, there is a high possibility that the resolution authority will have to make up the gap between the value of purchased assets and the value of liabilities assumed, in an effort to induce the acquirer to enter into a P&A agreement. Thus, it is imperative for the resolution authority to develop a resolution strategy that will keep the cost of resolution to a minimum, maintain continuity of depositor and payment services, and avoid market disturbances from a bank failure.

The following section aims to outline the overall P&A process, including the declaration of insolvency, development of the resolution strategy for an institution, due diligence of assets, marketing and sale of the institution, closure of the institution, and its placement in receivership. In the Technical Committee survey, respondents were asked to arrange various activities in the P&A process in the chronological order that they are conducted in their jurisdiction. Table 2 shows the responses from five jurisdictions that have resolved at least 30 institutions through P&A transactions (see Table 1 for further details). On the basis of the survey responses, it would appear that the United States (FDIC) has often used the closed bank model. Since the United States (FDIC) has handled the largest number of P&A resolutions, it can provide something akin to guidance to other deposit insurers or resolution authorities.\(^1\) Nevertheless, each deposit insurer or resolution authority may opt to develop its own P&A method according to the structure of the resolution regime in the respective jurisdiction.

\(^1\)Likewise, the EU resolution regime provides detailed rules and regulations on the application of P&A transactions, as referred to in Articles 38–39 of the BRRD.
Table 2. Order of the P&A Process

<table>
<thead>
<tr>
<th>Stage</th>
<th>Japan (DICJ)</th>
<th>United States (FDIC)</th>
<th>Chinese Taipei (CDIC)</th>
<th>Korea (KDIC)</th>
<th>Poland (BFG)</th>
</tr>
</thead>
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<tr>
<td>Declaration by the financial supervisory authority or the chartering authority or the resolution authority that the institution is failing or is likely to fail</td>
<td>1</td>
<td>1</td>
<td>1</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>Initiation of resolution procedures</td>
<td>2</td>
<td>2</td>
<td>2</td>
<td>2</td>
<td>2</td>
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<tr>
<td>Development of resolution strategies regarding the resolution structure, etc.</td>
<td>3</td>
<td>3</td>
<td>3</td>
<td>3</td>
<td>3</td>
</tr>
<tr>
<td>Due diligence of assets for the least-cost test or development of an information package</td>
<td>4</td>
<td>4</td>
<td>5</td>
<td>4</td>
<td>4</td>
</tr>
<tr>
<td>Asset valuation</td>
<td>5</td>
<td>5</td>
<td>6</td>
<td>5</td>
<td>5</td>
</tr>
<tr>
<td>Bid announcement and marketing to prospective bidders</td>
<td>6</td>
<td>6</td>
<td>7</td>
<td>6</td>
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<tr>
<td>Due diligence by bidders</td>
<td>7</td>
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<tr>
<td>Bidding</td>
<td>8</td>
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<td>9</td>
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<tr>
<td>Performance of the least-cost test and selection of the winning bid</td>
<td>9</td>
<td>9</td>
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<td>9</td>
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</tr>
<tr>
<td>Notice to the winning bidder</td>
<td>10</td>
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<tr>
<td>Signing of a contract</td>
<td>11</td>
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<tr>
<td>Issuing a decision for P&amp;A</td>
<td>12</td>
<td>12</td>
<td>4</td>
<td>12</td>
<td>11</td>
</tr>
<tr>
<td>Placement of the institution in receivership and announcement of the P&amp;A transaction</td>
<td>13</td>
<td>13</td>
<td>12</td>
<td>13</td>
<td>12</td>
</tr>
<tr>
<td>Provision of financial assistance</td>
<td>14</td>
<td>-</td>
<td>13</td>
<td>14</td>
<td>13</td>
</tr>
</tbody>
</table>

As shown in Table 2, Japan (DICJ) and Korea (KDIC) and the United States (FDIC) differ very little in the order of their P&A processes; however, there are slight variations in the cases of Poland (BFG) and Chinese Taipei (CDIC). In Europe, under the BRRD, a determination of the resolution strategy for each entity needs to be stipulated in the resolution plans, which are developed (and updated annually) prior to the initiation of the resolution process. Subsequent to the initiation of the resolution, the resolution authority verifies the feasibility of the resolution strategy encompassed in the resolution plan. By contrast, in Chinese Taipei, an order for a P&A transaction is issued when the resolution strategy is determined and is followed by due diligence of assets.

The time frame between the declaration of insolvency or initiation of resolution procedures

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13 The resolution authority will review and revise the resolution plan at the point of failure, if necessary.
and the completion of the P&A transaction varies from jurisdiction to jurisdiction. For example, the maximum number of days allowed when resolving a failed institution through a P&A is: 45–90 days in the United States (FDIC); 112 days in Korea; and 550 days in Chinese Taipei. However, it is recommended that the P&A transaction be completed as early as circumstances allow. Table 3 provides a detailed timeline of events pertaining to the KDIC’s resolution of a failed financial institution from the determination of insolvency to the resumption of banking services by the acquiring institution.

14The number varies from 15-20 days (Russia), 30 days (Paraguay), 45-90 days (United States), 60 days (Serbia), 90 days (Québec, Canada), 112 days (Korea), and 120 days (Uruguay), up to 270-550 days (Chinese Taipei).
Table 3. Timeline of Resolution Procedures in Korea (KDIC)

<table>
<thead>
<tr>
<th>Timeline1)</th>
<th>Main Steps in the Resolution Process</th>
</tr>
</thead>
<tbody>
<tr>
<td>D-Day</td>
<td>Financial Services Commission (FSC) declares a financial institution insolvent and issues a business improvement order to stop its operation.</td>
</tr>
</tbody>
</table>
| D+1 Day    | Start of due diligence  
- Due diligence for least-cost test purposes (usually takes three weeks) |
| D+46 Days  | Announcement of bidding            |
| D+60 Days  | Receipt of letters of interest (LOIs) and selection of preliminary bidders |
| D+90 Days  | Due diligence by bidders (usually takes three weeks) and final bidding  
- Least-cost test and selection of preferred bidders |
| D+93 Days  | The KDIC informs the FSC about which resolution method is the least costly. |
| D+95 Days  | A basic agreement on the P&A transaction is signed. |
| D+100 Days | The Deposit Insurance Committee passes a resolution approving the provision of financial assistance. |
| D+109 Days | The FSC issues an administrative order calling for the closure of the institution and the execution of the P&A transaction (which usually occurs on a Friday) |
| D+112 Days | The acquiring institution starts business (on the next business day after the FSC issues an order for a P&A). |

Note:1) This time line assumes that each step in the resolution process is completed within minimum regulatory time frames, and thus may be subject to change depending on the circumstances.

Below are descriptions of some practical issues and concerns associated with each stage in the resolution of a failed financial institution through a P&A; however, there may be variations among jurisdictions.

1. **Preparatory Measures for the P&A**

In the Key Attributes of Effective Resolution Regimes for Financial Institutions, the FSB states that “resolution should be initiated when a firm is no longer viable or likely to be no longer viable, and has no reasonable prospect of becoming so. The resolution regime should provide for timely and early entry into resolution before a firm is balance-sheet insolvent and before all equity has been fully wiped out.” Therefore, it is generally a good idea to revise the resolution plan and start resolution when a financial institution starts exhibiting signs of financial difficulty. This allows the resolution authority to make the most of the existing franchise value. When the institution is placed under regulatory sanctions including prompt corrective action restrictions, it can make attempts at recapitalisation and restructuring. If the institution’s demise becomes inevitable despite these efforts, the authorities will declare it insolvent and initiate resolution proceedings.
(1) Information Package

One of the first elements that would determine the success of any resolution is the gathering of as much information as possible on the institution concerned, whether direct or indirect. Having a complete picture of the institution’s financial and operational condition is essential to accurately assessing its value, and thereby developing the optimal resolution strategy. A receiver of a failed institution has to obtain all the necessary information regarding the economic and financial situation of the bank.

- Initial Information stated in Parker (2011)

  · Bank premises and owned property, number and value of loans at each location, deposits, borrowings, contingent liabilities, ownership structure, and others

(2) Resolution Strategy

Gathering of initial information should run in parallel with the development of the resolution strategy so that the resolution can be achieved promptly in compliance with the criteria for failure resolution. In the survey, the most frequently cited considerations when selecting the appropriate resolution strategy in the survey were: minimisation of financial loss and hardship for depositors;\(^{17}\) stabilisation of financial markets and the overall financial system; and satisfaction of the least-cost resolution rule.\(^{18}\) Under these overarching goals, the resolution authority develops the most appropriate resolution strategy, with a variety of resolution options as alternatives. In developing the resolution strategy, the resolution authority should also take into account the composition of the failed institution’s assets and liabilities, the amount of liquidity available, its franchise value, time constraints, and so on.

The resolution authority may choose to use the services of third-party professionals with relevant market knowledge (such as accountants, lawyers and financial advisors). In that case, third-party professionals must be subject to strict confidentiality agreements regarding any information they receive on the failed institution and its resolution. Based on the information package prepared by the receiver and market information provided by the third-party professionals, the resolution authority must

\(^{15}\) In contrast, IADI, in its Core Principles for Effective Deposit Insurance Systems and Glossary, distinguishes early intervention from resolution, that is, if early intervention fails to restore the situation of the financial institution, then the resolution process has to be started.

\(^{16}\) FSB (2014) suggests that there should be clear standards or suitable indicators of non-viability to help guide decisions on whether a financial institution meets the conditions for entry into resolution.

\(^{17}\) The deposit insurer and/or resolution authority usually takes into account all depositors, both insured and uninsured.

\(^{18}\) Other responses in the survey included fair sharing of loss by shareholders and creditors, and imposition of market discipline.
conduct a thorough review of various factors, including the possibility of the institution achieving a turnaround on its own or its sale to a third party, the expected amount of financial assistance based on past experience, and legal issues that can arise in the resolution process.

In addition, it is important for the resolution authority to have an analysis of the impact that the resolution will have on financial markets and to maintain close consultation with other financial safety-net participants, including the government, the central bank, the supervisory authority and other governmental agencies.

(3) Least-cost Test

One of the most important requirements in the determination of the resolution strategy is the least-cost test (LCT). The costs of resolving a failed financial institution ultimately accrue to the deposit insurance fund as well as any other funds for resolution purposes, if any; therefore, the deposit insurer and/or the resolution authority will try to limit the cost. Ultimately, it is desirable to clearly and formally specify in law, regulation, or supporting documents that the selected resolution method should be the least costly to the deposit insurer. This is indeed the case in many jurisdictions, but exemptions are also granted when there are concerns about systemic problems.

Fifteen jurisdictions, including Canada (CDIC), Italy (Fondo Interbancario di Tutela dei Depositi, FITD), Japan (DICJ), Korea (KDIC), Chinese Taipei (CDIC) and the United States (FDIC), require the least-cost test from their deposit insurance agencies in a resolution. In many other jurisdictions, the responsibility for the least-cost test falls on the resolution authority or the central bank. The least-cost requirement should be taken into consideration in the selection of the winning bid for the P&A transaction, as well as in the determination of the resolution strategy. This is because the value of assets and market conditions go through considerable fluctuations during the time-consuming process from the development of the resolution strategy to the completion of the transaction; thus, the least-cost test calculations may need to be regularly revised to reflect those changes.

19 A simplified calculation of LCT is shown in FDIC (2014). Total estimated loss in receivership is calculated as follows: total gross assets + bid – (asset loss + liabilities (claims) on receivership + receivership expenses).
20 According to the legal safeguards stipulated in Article 75 of the BRRD, the creditors, and in principle, owners, are protected from incurring losses in the context of application of resolution powers greater than they would have incurred in a winding up under normal insolvency proceedings (the no-creditor-worse-off (than in liquidation), or NCWO, principle). Moreover, under Article 11 (6) of the DGSD, (EU) member states may decide that the available financial means may also be used to finance measures to preserve the access of depositors to covered deposits, including transfer of assets and liabilities and deposit book transfer, in the context of national insolvency proceedings, provided that the costs borne by the DGS do not exceed the net amount of compensating covered depositors at the credit institution concerned.
21 Of the 19 survey respondents required to use the least costly method, 13 said that they are allowed to invoke the systemic risk exception.
Due Diligence

Even though the supervisory authority has access to the balance sheet and other information on the financial status of an institution before it actually fails, there can be sudden changes in its assets and liabilities, or deteriorating market conditions can aggravate its value rapidly after the insolvency is publicly disclosed. This means that the resolution authority, which may or may not be the deposit insurer, must have an accurate recognition of the institution’s assets and liabilities in order to develop an effective resolution strategy and carry out resolution proceedings within a sufficient time frame as well as in an efficient manner.22

Due diligence by the resolution authority for determining the resolution strategy is performed within a relatively short time frame and may be done by hired professionals such as accountants.23 The resolution authority’s role is to provide guidelines for due diligence and verify the results reported by the professionals. From the findings of the due diligence, the resolution authority develops a comparison between the institution’s liquidation value and going-concern value, and calculates estimated costs for each resolution option to determine the least-cost resolution. In conducting due diligence, a reference date must be set as a basis for the valuation of assets. The United States (FDIC) estimates the cost of liquidation ahead of closure, not knowing if there will be an acquirer, and after marketing and solicitation of bids, compares the bids received to the cost of liquidation (payout). After evaluating bids, the one that is least costly determines the acquirer with which a P&A is entered into, provided the transaction is less costly than a payout. The reference date in these cases is generally 30–60 days before closing. In other jurisdictions the reference date can be different. For instance, the day on which the institution is declared insolvent can be the reference date for due diligence. If the going-concern value is higher than the liquidation value and P&A is determined to be the least-cost alternative, the resolution authority begins the process of marketing the institution to a group of bidders. Before selecting the best bid, the resolution authority conducts another least-cost analysis to take into account any intervening changes in the value of assets and liabilities and the effect they might have on the institution’s going-concern and liquidation values. This is a necessary step to further validate the findings of the earlier least-cost analysis.

In jurisdictions with significant experience with P&As, such as the United States, Korea and Chinese Taipei, the resolution authority has specific guidelines for contracted professionals to follow in their review of the failed institution’s assets.24

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22 Twelve of the respondents to the P&A Technical Committee survey perform due diligence of assets for least-cost calculations.

23 In the case of Korea (KDIC), three weeks are allocated for due diligence of assets.

24 In Europe, the BRRD sets clear rules on the valuation of the bank for the purpose of resolution: a fair, prudent and realistic valuation of assets and liabilities of the bank should be performed by an evaluator independent from any public authority before taking resolution action or exercising the power to write down or convert relevant capital instruments.
Due diligence Practices in Various Jurisdictions:

· **(EU)** The EBA has issued Draft Regulatory Technical Standards (RTS) on valuation under Directive 2014/59/EU.


· **(United States)** The asset valuation contractors are given very specific criteria, instructions and a format to follow so that there is consistency in the valuation approach and methodology followed. The FDIC uses outside contractors to value loans, foreclosed real estate, and loan servicing rights to produce an Asset Valuation Report (AVR). Typically, AVR contractors will take a team of four to five people into the bank to review a sample of the loan files, notes and collateral, and analyse the loan download (a data-tape containing current and historical loan performance data). Therefore, they have access to loan performance data, historical payment history information and substantial comparative analytical loan data to analyse, along with loan files, to arrive at current market prices for the assets. In some cases, the on-site team is smaller than stated above, and the loan file review takes less time if the loans are mostly homogeneous and there is a limited number of non-performing loans. In those instances, a limited sample of loan files may be necessary and values can be determined with data analysis coupled with a limited loan file review. Each situation is unique.

3. Marketing

To facilitate the sale of asset and liability packages of a failed institution, the resolution authority or a contracted service provider (e.g. an accounting firm or a securities firm acting as an advisor) undertakes a marketing campaign for the institution. Marketing activities for failing institutions include: exploring sales options; identifying the needs of potential bidders; and creating appropriate incentives to attract bidders.\(^{25}\) Even at this stage, leakage of the information that a certain financial

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\(^{25}\) The BRRD requires that marketing shall be carried out in accordance with the following criteria: (a) it shall be as transparent as possible and shall not materially misrepresent the assets and liabilities; (b) it shall not unduly favour or discriminate between potential purchasers; (c) it shall be free from any conflict of interest; (d) it shall not confer any unfair advantage on a potential purchaser; (e) it shall take account of the need to effect a rapid resolution action; (f) it shall aim at maximising, as far as possible, the sale price for the assets and liabilities. The resolution authority may apply the sale of business tool without complying with the requirement to market as laid down above when it determines that compliance with those requirements would be likely to undermine one or more of the resolution objectives and in particular if the following conditions are met: (a) it considers that there is a material threat to financial stability arising from or aggravated by the failure or likely failure of the
institution might be facing insolvency can lead to a depositor run and other problems, so confidentiality must be ensured. To that end, the resolution authority enters into confidentiality agreements with potential bidders to maintain confidentiality throughout the P&A process. In the Technical Committee survey, some respondents mentioned past cases where, during the P&A process, confidential information was improperly released and caused a run on the bank concerned.

(1) Potential Bidders

To acquire a failing or failed financial institution, potential bidders must have certain qualifications such as a banking charter or licence,26 a signed confidentiality agreement, and approval from their competent authorities to participate in the bid process.27 The deposit insurer or resolution authority may have only a limited ability to reach and attract bidders and, thus, may choose to commission the work to market professionals. For example, Korea (KDIC) forms a review committee, which selects a qualified accounting firm or securities firm as a sales advisor. The advisor puts together a list of prospective bidders, considering a range of factors including the current state of the pertinent industry, the competitive environment, overall market conditions, and the size and nature of the assets.

In distressed market conditions where it would be difficult to arrange a P&A transaction, or in a situation where a prompt resolution is required, Korea (KDIC) may decide to exclude P&A as a resolution option, based on the pool of potential bidders identified by the sales advisor before a formal determination of the resolution strategy is made. In the case of the United States (FDIC), the criteria used to select approved potential bidders include geographical location, minority-owned status, asset size, capital level and regulatory ratings.28 Once the bidders list has been generated, the FDIC must obtain consent from each potential bidder’s regulatory (chartering) authority in order to allow them to participate in the resolution of the failing bank. Private investors wishing to bid on a failing institution must have adequate funds and be engaged in the process of obtaining a charter and deposit insurance to create a new institution as stipulated in the FDIC Resolution Handbook (2014).

In most cases, the bidding process is only open to bidders operating in the jurisdiction, but with the resolution authority’s approval, foreign bidders who satisfy all applicable qualifications may be allowed to enter bids.

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26 In EU jurisdictions, the competent authorities must ensure that an application for relevant authorisation (of a banking licence) is considered, in conjunction with the transfer, in a timely manner, as referred to in Article 38(7) of the BRRD, should the P&A require the acquirer to obtain the authorisation.
27 Private investors such as asset management firms without a banking licence are also allowed to participate in the bidding, with restrictions in some jurisdictions.
28 See the Resolution Handbook published by the FDIC in 2014.
(2) Incentives for Bidders

Different types of P&A transactions have been devised in an effort to facilitate a P&A transaction. Bidders differ in their interests and needs. In addition, market conditions change constantly. All these necessitate continuous development of effective incentives to attract more buyers and higher bids. Examples of such incentives include: the right for the acquirer to adjust deposit rates; shared loss agreements; put options on certain transferred assets; and debt guarantees, cash incentives and loans.

The right to adjust deposit rates is granted to various stakeholders, such as the acquirer, bridge bank management, and resolution authority. In seven jurisdictions, the acquirer has the right to adjust interest rates on deposits transferred from the failed financial institution. In the United States (FDIC), when a bridge bank takes over a failed bank, the bridge bank management may decide to change the interest rates paid on the assumed deposits. In the cases of Columbia, Hungary and Turkey, the resolution authority has the power to adjust deposit rates. As a protection for the depositors of the failed bank, in eight jurisdictions including Japan (DICJ) and the United States (FDIC), depositors are allowed to withdraw their funds without penalty (e.g. early withdrawal penalty) before maturity if they do not consent to the rate change.

Several jurisdictions including Russia (DIA), Chinese Taipei (CDIC) and the United States (FDIC) offer acquirers put options on certain assets, which give them a set period to return the assets they do not want to keep. The period varies from jurisdiction to jurisdiction: up to six months in Russia (DIA); 30 months in Chinese Taipei (CDIC); and in the case of the United States (FDIC), a maximum of 365 days for assets connected to a fraud.

29 Hungary, Japan, Nicaragua, Nigeria, Paraguay, Turkey and the United States.
30 Croatia, Hungary, Japan, Nicaragua, Nigeria, Serbia, Ukraine and the United States.
4. Bidding and Issuing a Decision for a P&A Transaction

(1) Due Diligence by Potential Bidders

Either before or after the bidding process, potential bidders are offered on-site due diligence. This enables them to cross-check the information provided by the resolution authority with the actual books and records of the institution before they submit their bids. All potential bidders should be given equal access to information given the size of the institution and the urgency of the resolution process, and must sign a confidentiality agreement to ensure the protection of market sensitive information. Due diligence by prospective bidders should be limited to assets and liabilities of the target institution and should not include sensitive materials such as minutes of board meetings, supervisory ratings and personnel records.

In the United States (FDIC), all approved potential bidders are allowed to conduct due diligence before the start of the bidding process once they have signed a confidentiality agreement. To do that, the FDIC must get permission in advance from the failing institution’s board of directors for third parties to conduct due diligence.

In Korea (KDIC), the bidding process is undertaken in two stages: preliminary bidding and final bidding. In the preliminary stage, bidders submit Letters of Interest (LOIs). After receiving LOIs, the KDIC starts evaluating the bidders to select preferred bidders. This evaluation involves a review of the legal advisor’s report on whether the bidders are fit to acquire the failing institution, whether they are adequately funded, whether they have the ability to successfully contain the problems at the failing institution and not be brought down as well, and the likelihood of a successful sale. The selected bidders are given three weeks to review the assets and liabilities of the target institution, after which they submit their final bids, including the amount of premium they are willing to pay for the deposit franchise.

(2) Assets and Liabilities Transferred in a P&A

The resolution authority has incentives to induce the acquirer to purchase the maximum amount of the failed institution’s assets. However, in reality, not all assets and liabilities of a failed

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Differing Incentives for Bidders in Various Jurisdictions:

- **(Japan)** Other types of financial support such as purchase of assets, guarantee of obligations, assumption of obligations, subscription for preferred shares, and securing of damages.

- **(Poland)** As set down in the Act on the Bank Guarantee Fund, the BGF may provide financial incentives from a resolution fund or guarantee fund to an entity in resolution. The incentives include: loans or guarantees in the case of banks; and cash subsidy, loan, or guarantee, and purchase of claims in the case of credit unions.

- **(United States)** Depending on the transaction, there could potentially be a loss share agreement, money paid for liabilities assumed in excess of assets purchased, contingent liabilities retained by the receiver, indemnification, ability to adjust deposit rates, receiver powers in litigation, revocation of contracts through the receiver, and a put option on certain loans for specific reasons such as fraud.
financial institution can be transferred in a P&A transaction. Though some jurisdictions may have specific criteria for deciding which assets or liabilities can (and cannot) pass to the acquirer, most jurisdictions replied to the survey that various considerations such as achieving the least-cost resolution or creating the right set of bidder incentives should guide the decision. On the liability side, the scope of liabilities to be transferred can be expanded to include eligible deposits as well as covered deposits. On the other hand, the acquirer may not want to assume liabilities for employee welfare or tax purposes. Assets that are implicated in a fraud or other wrongdoing, or those that the acquirer refuses to take, remain with the receiver. Many jurisdictions, including Canada, Quebec (Canada), Germany, Korea and the United States, allow acquiring institutions to pick and choose which assets they will purchase, thus improving the chance of success of a P&A transaction. Some excluded assets and liabilities are listed in the following table.

<table>
<thead>
<tr>
<th>Assets Excluded from P&amp;A Transactions</th>
<th>Liabilities Excluded from P&amp;A Transactions</th>
</tr>
</thead>
<tbody>
<tr>
<td>· Illegal loans, and assets necessary for the payment of senior claims (e.g. severance pay for employees, national tax) and distribution of dividends to creditors</td>
<td>· Liabilities for employee benefits, loan loss reserves, reserve accounts for all tax liabilities, deferred gains, and any surplus or net profit reflected on the failing bank’s books at the time of closure</td>
</tr>
</tbody>
</table>

(3) Bid Submission and Selection Process

The resolution authority evaluates all qualified bids to select the best bid. If it has not already compared the costs of different resolution options in the preparatory stage, the resolution authority conducts an analysis to assess the costs associated with various resolution options such as P&As, bridge bank and liquidation/bankruptcy. The authority announces the bidding result for the P&A transaction after it completes the least-cost analysis. When an acquirer is announced, all bidders must be notified. The resolution authority then starts preparing all legal documents for the acquirer to sign and simultaneously initiates the administrative process to obtain approval for the transaction. Negotiations over detailed terms of the agreement can take from several days to weeks.

(4) Bridge Institutions

The biggest challenge to achieving a P&A happens when there is a lack of bidders due to poor market conditions, etc. In such cases, one alternative available to the resolution authority is to establish a bridge institution. This provides time to arrange a permanent transaction, 31 while maintaining banking services for the depositors and ensuring continuity of critical functions of the failed institution, thereby helping to reduce market disruption, particularly when it poses a systemic risk to the financial institutions.

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31 Twenty-two respondents to the Technical Committee survey indicated that they are allowed to establish bridge institutions. In seven of those jurisdictions, bridge institutions are subject to more relaxed requirements than private-sector institutions.
Jurisdictions such as Hungary, Korea, Poland and Chinese Taipei, among others, impose less demanding requirements on the establishment and operation of bridge institutions than those applied to commercial banks, for instance, by simplifying the licensing procedure or granting exemption from requirements for minimum capital levels or payment of deposit insurance premiums. By contrast, in some jurisdictions like the United States and Italy, bridge institutions receive no special treatment in terms of legal or regulatory requirements.

Once a bridge institution is established, it should be sold as quickly as possible. Generally, the time frame during which a bridge institution can be operated is limited by law, which makes it necessary for the resolution authority to organise a quick sale of the bridge institution as soon as market conditions allow. The maximum time frame for operating a bridge institution is usually two years, with extensions possible. Japan (DICJ), Poland (BFG) and Chinese Taipei (CDIC) allow a one-year extension; Italy (FITD) permits a two-year extension; Canada (CDIC) and the United States (FDIC) allow up to three one-year extensions; Korea (KDIC) requires a bridge institution to be resolved within five years. Croatia, Germany and Switzerland do not have any limits on how long a bridge bank can remain open.

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**Regulatory Treatment of Bridge Institutions in Various Jurisdictions:**

- **(Hungary)** A bridge institution is subject to several legal requirements (e.g. capital/liquidity requirements) but its licensing procedure is simplified and it may have three months to comply with licensing requirements. The central bank as supervisory authority exempts the bridge institutions from certain regulatory requirements for a maximum of 180 days. Furthermore, the central bank as resolution authority may grant bridge institutions rights of access to payment, clearing and settlement systems, regulated markets, and membership in the National Deposit Insurance Fund (OBA), the Investor Protection Fund (BEVA) or the Resolution Fund, while setting a maximum deadline of 24 months to obtain those rights and membership in normal procedure.

- **(Japan)** A bridge bank is exempted from the payment of deposit insurance premiums.

- **(Poland)** The Polish Financial Supervision Authority may exempt the bridge institution, at the request of the Bank Guarantee Fund, from requirements on establishing and licensing the entity if such an exemption is necessary to achieve the objectives of the resolution process. Moreover, the BFG contributes the initial share capital to a bridge institution with the resolution fund.

- **(Chinese Taipei)** A bridge bank is an insured institution with no founding capital required. If necessary, the CDIC may provide working capital. A bridge bank is also exempted from several articles of the Banking Act.

- **(United States)** The bank must comply with lending regulations, certain cash requirements and can retain some assets in the receivership as needed.

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32. The use of bridge institutions and resolution plans is part of a broader resolution strategy, often to deal with widespread failures.

33. The BRRD establishes that capital to allow the bridge bank to operate is provided by the resolution authority.

34. In July 2018, the government of Quebec passed an Act (“Bill 141”) aimed primarily at improving the regulation of the financial sector, the protection of money deposits and the operation of financial institutions (see chapter 23 of the Act). The legal provisions impacting the DI Act mostly came into force on 13 July 2018. Bill 141 gives stronger resolution powers to the AMF, notably the power to establish a bridge institution. There is no time frame for operating a bridge institution.
5. Receivership and Financial Assistance

(1) Receivership

After the transfer of assets and liabilities to the acquiring institution is complete, a receiver or liquidator is to be appointed to dispose of the remaining assets.\(^{36}\) In jurisdictions like the United States (FDIC) and Korea (KDIC), employees of the deposit insurance agency are appointed as receiver to manage the receivership estate. The responsibilities of a receiver are: to wind down the remaining assets of the failed financial institution; to handle the practical aspects of the P&A deal; and to distribute the proceeds of asset sales to creditors.

(2) Financial Assistance

Financial assistance may be available to the acquirer of a failed financial institution in a P&A transaction.\(^{36}\) Except in some jurisdictions like Hungary, where financial assistance is drawn from a resolution fund, in most jurisdictions that responded to the Technical Committee survey the deposit insurance agency is responsible for providing financial assistance to the acquirer.\(^{37}\) Burden sharing by the relevant parties of the failing financial institution should be considered when providing financial assistance. For example, in the EU the BRRD requires a minimum contribution to loss absorption and recapitalisation by shareholders and creditors before the financial incentives can be used to absorb losses and/or recapitalise the institution.\(^{38}\)

The aim of such financial assistance is to make up the shortfall in assets, thus rendering the failed institution more attractive to bidders and facilitating a speedy resolution. Financial assistance can take many forms, such as loans, equity contribution with funds raised by issuing debt instruments, debt guarantees, etc., but it is most commonly provided in the form of cash. In most jurisdictions, financial support is limited to the difference between the value of performing assets and the value of assumed liabilities; this cannot be more than the resolution cost in a liquidation. The IADI Core Principles propose safeguards on the use of deposit insurance funds.\(^{39}\)

\(^{35}\) In Russia, P&A transactions can be arranged either by the bank’s provisional administration (before the bank is declared insolvent by the court) or by the bank’s insolvency administrator or liquidator, i.e. the DIA (after the bank is declared insolvent and the DIA is appointed as insolvency administrator or liquidator).

\(^{36}\) In Switzerland, the central bank and the Federal Department of Finance are jointly responsible for providing financial support for the resolution of large institution failures.

\(^{37}\) In April 2018, the European Commission decided not to raise any objection to an Italian liquidation scheme for small banks with assets below EUR 3 billion, which allows deposit insurers to contribute by providing compensation in the form of cash to the purchaser of the assets and liabilities of the failed bank. The objective of the liquidation scheme is to grant support in the orderly liquidation of non-viable small banks under national insolvency proceedings. Italy will ensure that the costs borne by the deposit insurer do not exceed the net amount of compensation due to covered depositors of the failing institution. For the purpose of interventions under this scheme, the deposit insurer will ensure that there is a detailed calculation report with respect to the least-cost assessment and will appoint an external advisor to support that assessment. The liquidation scheme is valid for 12 months.

\(^{38}\) As indicated in Article 44(5) of the BRRD, shareholders, holders of instruments of ownership and holders of relevant capital instruments and other eligible (to bail-in) liabilities must provide a contribution to loss absorption and recapitalisation equal to at least 8% of the institution’s total liabilities, including own funds, before being able to access the financial incentives provided by the resolution authorities in support of the resolution. Moreover, the contribution of the resolution financing arrangement must not exceed 5% of the total liabilities including own funds of the institution in resolution, measured at the time of the resolution action in accordance with the valuation proceedings.

\(^{39}\) Contributions are restricted to the costs the deposit insurer would otherwise have incurred in a payout of insured depositors in a liquidation net of expected recoveries (Core Principle 9 – Sources and uses of funds).
B. Technical Implications for Practice

1. Establishing a Legal Basis for P&A Resolution

Creating a legal framework for resolving financial institutions is critical to ensuring a timely and orderly resolution. Given the nature of financial failures, the framework must address: the definition of a financial institution failure; triggers for resolution; and principles governing resolution.

It must also include a list of resolution options available to the resolution authority and the criteria for selecting the appropriate resolution method. A clear legal framework is conducive to reducing potential legal challenges, raised by various stakeholders whose interests are affected by the resolution authority’s decision, related to the selection of a resolution method or the conduct of a resolution process. The provisions concerning resolution may be scattered across different pieces of legislation, because a financial institution’s failure tends to affect numerous different types of stakeholders and because its resolution should be carried out quickly (compared to corporate bankruptcy). So it is important to have a comprehensive review of these provisions to identify any overlaps or conflicts between them. It is generally better to have one single piece of legislation that encompasses all these provisions. However, it is up to each jurisdiction to decide how to design the legal framework for resolution of financial institutions depending on its unique economic and financial circumstances.

Any resolution using the P&A method requires such a legal framework. However, of the 41 respondents to the Technical Committee survey, 11 lack a legal basis for conducting P&A transactions. Furthermore, two of the respondents stated that there is no law enabling the deposit insurer to resolve failed financial institutions and that it is the central bank’s responsibility.

There are differences between jurisdictions regarding which entity determines the resolution method and who carries out the practical work of resolving a failed institution. In the United States, Canada, Quebec (Canada) and Russia, the deposit insurance agency has the power to both authorise and undertake the practical work involved in P&A transactions. In Europe, the resolution authority decides on P&A transactions according to the resolution plan drawn up for banks. In Korea and Chinese Taipei,

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Specific Nature of Financial Assistance in Various Jurisdictions:

- (Poland) Cap constituting the difference between the value of assumed liabilities and the value of acquired property rights.
- (Japan and Chinese Taipei) The estimated cost shall be less than the estimated loss arising from the payout.
- (United States) No cap as the amount of each transaction is based on the monetary value of the failing institution and the winning bid selected by the least-cost test in a P&A. However, the winning bid must be less costly than a payout.

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If a deposit insurance agency has a paybox mandate, it is understandable that the legal framework for resolution of failed financial institutions does not provide it with a full range of resolution tools. Yet, whether the deposit insurer is the resolution authority or not, it would be good to put in place the legal basis for the use of various resolution options in advance.
it is the regulatory authority that has the power to decide how to resolve a failed institution, and the deposit insurer handles the practical implementation of resolution measures. In these latter two cases, the deposit insurance agency is responsible for developing resolution strategies, marketing the institution to prospective bidders, conducting bid sales, performing a least-cost analysis and providing financial assistance. These powers and responsibilities related to resolution are specified in the deposit insurance law or other relevant legislation.

In addition, for the sake of a speedy and orderly resolution, sometimes it is necessary to restrict the rights of stakeholders (e.g. shareholders, creditors and depositors) whose interests may potentially conflict. Such action cannot be taken without a proper legal basis. In the Technical Committee survey, 24 deposit insurance agencies indicated that they can execute P&A transactions without the prior consent of stakeholders.\(^{41}\) It is seen as a measure to ensure that the resolution authority has the power to remove unnecessary hindrances to a speedy resolution and minimise any risks that can arise when the stakeholders only pursue their own diverging interests.

Meanwhile, 30 deposit insurance agencies of those that responded to the Technical Committee survey give a failing institution additional time during which its shareholders can attempt to raise fresh capital or otherwise preserve their ownership interests. Some jurisdictions, including Korea (KDIC) and the United States (FDIC), provide a fixed period (45 days and 90 days, respectively), while others like Canada (CDIC) and Chinese Taipei (CDIC) have a more flexible schedule.\(^{42}\)

### 2 Financial Assistance Mechanism

When resolving a failed institution through a P&A transaction, the resolution authority might provide financial assistance to the acquirer. In particular, in a large institution failure, the acquirer might want financial assistance as an incentive for the purchase. As mentioned above, it is often the case that a failing institution has more liabilities than assets and, if so, the resolution authority will invariably have to make up the gap between the value of assets and the value of liabilities, depending on the limit on the contribution from the deposit insurance fund or the resolution fund. The payments, along with cash outlays for deposit payouts, are made from the deposit insurance fund, and thus could pose a threat to the fund’s stability.\(^{43}\) Sometimes, the amount needed is such that it cannot be funded by the deposit insurance fund alone, and there must therefore be a back-up funding mechanism in place to deal with such situations.

In Korea, the Depositor Protection Act states that the KDIC can make cash contributions in the amount equal to the difference between the net asset shortfall, calculated on the base date (i.e. the date the institution was declared insolvent), and the premium offered by the acquirer for the institution’s deposit franchise. The KDIC recovers the money by collecting its claims against the failed institution’s assets in receivership.

The FDIC may use P&As with optional shared loss, in which the receiver (i.e. the FDIC) agrees to absorb a significant portion of the loss experienced on certain covered assets up to a certain amount, such as 75% or 80% depending on the terms offered. This reduces the immediate funding need, spreading it out over time (8–10 years).

\(^{41}\)Colombia, Morocco, Nigeria, Palestine and the Bahamas require the consent of the failed institution’s shareholders prior to the start of the resolution process.

\(^{42}\)Fixed number of days: 30 in Libya, 45 in Korea, 60 in Kosovo, 90 in Guatemala, 90 in the United States, 3–12 months in Serbia; Flexible: Canada (CDIC), Hungary, Jamaica, Malaysia, Slovenia, Switzerland and Chinese Taipei.

\(^{43}\)IADI’s Core Principle 9 (Sources and uses of funds) provides some guidance on the use of deposit insurance funds for resolution of member institutions in Essential Criterion 8.
3. Other Issues

(1) Management of Depositor Database

To ensure a successful P&A, it is essential that the failed institution’s data, including deposit account records, should be managed carefully, which requires advanced information technology (IT) systems. Banks and non-bank savings institutions might use different formats for data entry and management. If the deposit insurer or resolution authority has to convert the data to a format compatible with its own systems in each resolution case, it may not be able to perform the resolution process within the desired time frame. An alternative is for the supervisory authority or the deposit insurer to require all insured institutions to use a standardised file format. Otherwise, moving electronic data from the failed institution’s systems to the acquirer’s system can be a time-consuming process. In ten jurisdictions, including Canada (CDIC), Quebec (Canada (AMF)), Korea (KDIC), Italy (FTTD), Poland (BFG) and Russia (DIA), the deposit insurer has developed a standardised format and requires all insured institutions to use it.

The supervisory authority or the deposit insurer should be able to verify the accuracy of depositor records and other required data maintained by financial institutions, when necessary. This is because the riskier a bank is, the more likely it is to have inaccurate data, which in turn increases the risk of failure. Of the 41 respondents to the Technical Committee survey, 27 are empowered to require member institutions to maintain depositor records, and 23 of these also have the authority to conduct examinations, at regular intervals or as needed, to check the accuracy of the data. Seventeen of them can impose penalties on the banks that show poor results in such examinations.

(2) Employment Issues

For a P&A to succeed, it is critical to secure the cooperation of the failed institution’s employees. Yet, there may be situations where the employees of failed institutions fear the loss of jobs and are unwilling to cooperate with due diligence or sales negotiations and even stage a protest. Therefore, P&As should be conducted taking into account the terms of their employment agreements or contracts.

(3) Tax Incentives

As an incentive to bidders, the resolution authority might offer tax benefits. In several jurisdictions including Korea (KDIC), Poland (BFG) and Chinese Taipei (CDIC), the acquirer is granted a waiver or reduction of acquisition taxes and/or registration taxes.

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44 Depending on the level of digitisation and standardisation of banking data, the number of days that it takes to facilitate an electronic data transfer will vary. In Korea (KDIC), data are transferred immediately after a P&A transaction is implemented. It takes two days in Chinese Taipei (CDIC), 10 days in Russia (DIA) and up to 120 days in the United States (FDIC). The reason that the period is so long in the United States is because there are situation-dependent variables that make scripts between failed bank and acquiring bank platforms complex, such as the bank size and the number of platforms.

45 In the Technical Committee survey, four jurisdictions reported that they had experienced employee protests.
IV. Conclusion

It is generally accepted that P&A can result in lower resolution costs than deposit payouts, to the extent that market conditions allow. What should come first, of course, is the effort to proactively manage risks to prevent a failure. However, sometimes failures are inevitable and, when they happen, having a diversity of resolution options at its disposal would provide the resolution authority with the necessary flexibility to effectively reduce resolution costs and minimise market disruption. In that respect, the P&A method is a good option.

The use of P&A as a resolution option is on the increase around the world. In order for a P&A to succeed, however, there are several factors that require consideration: proper due diligence to develop accurate asset value assessments; the availability of a sufficient number of qualified bidders; and the solicitation of sufficiently high bids. Failure in any of these steps may require modification of the whole process and therefore can present some uncertainty for resolution authorities and deposit insurers. To minimise such uncertainties, the resolution authority must approach P&A processes with carefully designed strategies and vigorous marketing efforts. Furthermore, since a P&A is often accompanied with payments to the acquirer to make up the net asset shortfall, the resolution authority and deposit insurer should ensure that there is adequate funding available and should have the necessary powers to efficiently recover funds from the receivership estate.

A strong legal framework should support the resolution of financial institutions, in order that members of the financial safety-net clearly understand what their roles are in resolution and successfully work together. In addition, the deposit insurer or resolution authority should have a pool of outside experts available for due diligence and marketing activities, and put in place the resources to provide effective supervision. Additional actions required to ensure the smooth functioning of the P&A process include the development of financial markets and enhancements to IT systems that would allow the authorities to promptly conduct verifications of record-keeping and the balance of assets and liabilities.

This paper was designed as a research paper to help guide the practical aspects of P&A transactions. The P&A method is a complicated process and each resolution has inherent uncertainties. Hence, this paper has limitations in that it cannot address the full range of practical and technical issues, including how to perform LCT in detail when using the P&A method. A worthwhile avenue for future research would be to complement this paper with case studies from other jurisdictions with P&A experience. This will help each jurisdiction to design and implement effective policies that are relevant to their own economic and financial circumstances.
References


Financial Stability Board, Key Attributes of Effective Resolution Regimes for Financial Institutions, 2014

International Association of Deposit Insurers, Core Principles for Effective Deposit Insurance Systems, Basel, November 2014.


## Appendix 1

### Jurisdictions that Responded to the Questionnaire

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<td>Brazil (Fundo Garantidor de Creditos, FGC)</td>
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<td>Canada (Canada Deposit Insurance Corporation, CDIC)</td>
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<td>Canada, British Columbia (Credit Union Deposit Insurance Corporation, CUDIC)</td>
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<td>Canada, Quebec (Autorité des Marchés Financiers, AMF)</td>
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<td>6</td>
<td>Chinese Taipei (Central Deposit Insurance Corporation, CDIC)</td>
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<td>Jamaica (Jamaica Deposit Insurance Corporation, JDIC)</td>
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<td>Japan (Deposit Insurance Corporation of Japan, DICJ)</td>
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<td>Malaysia (Malaysia Deposit Insurance Corporation, PIDM)</td>
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<td>Mexico (Instituto para la Protección al Ahorro Bancario, IPAB)</td>
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<td>Montenegro (Deposit Protection Fund)</td>
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<td>26</td>
<td>Nigeria (Nigeria Deposit Insurance Corporation, NDIC)</td>
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<td>27</td>
<td>Palestine (Palestine Deposit Insurance Corporation, PDIC)</td>
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41 Zimbabwe (Deposit Protection Corporation, DPC)
Appendix 2: Case Studies

Chinese Taipei - CDIC
H.L. Small and Medium Business Bank: whole bank P&A with loss sharing

1. Background: Financial status and operating problems before conservatorship

H.L. Small and Medium Business Bank had 30 branches, located mainly in eastern Chinese Taipei, and approximately 270,000 insured depositors. At the onset of conservatorship, the banks had total assets of approximately NT$14.3 billion, total liabilities of about NT$22.4 billion, a negative net worth of NT$8.1 billion, and a non-performing loan (NPL) ratio of 20.69%. Moreover, the bank had sustained monthly losses from the sale of amortised NPLs.

The failure of the bank was due mainly to poor asset quality resulting from overdue commercial loans made to related accounts. The bank sold NPLs to asset management companies on several occasions yet, rather than dropping, the NPL ratio remained high. The bank was ordered several times by the competent authority to replenish capital. Failure to meet the capital increase target led to a deteriorating financial situation at the bank.

2. The competent authority determined that the bank was mismanaged and initiated procedures for market withdrawal

In view of the bank’s negative net worth, the competent authority designated the Central Deposit Insurance Corporation (CDIC) to assume conservatorship of the bank on 5 January 2007, to protect the rights and interests of depositors and maintain financial order.

3. Principles for handling market withdrawal

After assuming conservatorship, the CDIC handled the market withdrawal according to the following principles:

(1) Uninterrupted financial services

The principle of uninterrupted financial services was followed during the conservatorship of the bank.

(2) Principles of impartiality, fairness, openness, and transparency

The assessment of assets and liabilities, the tender sale, and other matters were handled in line with the principles of impartiality, fairness, openness, transparency and consistency.

(3) Open tender

The assets and liabilities of the bank were sold by open tender. Upon completion of the tender, the transfer of assets and liabilities and payout for the asset-liability gap were rapidly handled to enable the smooth market withdrawal of the bank.

4. Planning the market withdrawal and resolution strategy

(1) The CDIC formulated a strategic plan for market withdrawal and submitted it to the competent authority for approval. The CDIC also appointed a financial consultancy through open selection to assist with the handling of P&A operations. A strategic plan calling for resolution by tender sale was proposed by the consultancy and presented to the Financial Restructuring Fund (FRF) Evaluation Team and Management Committee for deliberation and approval. It was then submitted to the competent authority for approval.
(2) Auction announcement: Upon receiving written authorisation from the competent authority, the CDIC announced the tender on its website and in newspapers. At the same time, the financial consultancy began to market the case to potential investors. The main content of the announcements was as follows.

- **Tender model**: Single tender sale of the entire bank (whole bank P&A).
- **Tender schedule**: About two months from the time of tender announcement to bid submission and award.
- **Scope of tender**: All accounted assets, liabilities and business operations were included in the scope of the tender.
- **Investor types**: The tender was open to three types of investors: domestic and foreign banks; domestic and foreign financial holding companies; and other domestic and foreign bidders with banking experience.
- **Bid submission and award mechanisms**: The reserve price was handled in two phases following assessment by the financial consultancy: a qualification tender and a price tender. Those investors who met the qualification tender requirements were allowed to participate in the price tender. The tender amount was the only consideration in the price tender. The investor submitting the best tender in comparison with the reserve price was awarded the tender.
- **Administrative incentives**: The competent authority proposed a number of administrative incentives, including permission for the winning bidder to freely move 15 of the bank’s business locations to other areas of Chinese Taipei, to attract participation by more investors in the tender and command a premium price.

5. **Assessing assets and liabilities and setting up a data room**

(1) Principles of asset and liability valuation: The principles for assessing the bank assets and liabilities were deliberated by the financial consultancy and executed following approval by the FRF Evaluation Team and Management Committee. The assessment principles called for valuation of tangible assets according to the net worth method, and valuation of the intangible operations of business units was based on the discounted cash flow method or market comparison approach. Furthermore, the integrity of the accounted liability amount and the effect of off-balance sheet assets and liabilities on net worth were verified.

(2) Data room setup: The financial consultancy communicated with the bank and the CDIC conservatorship team to confirm the content and formats of electronic files and physical files; it also reviewed the accuracy and reasonableness of the relevant information.

6. **Opening the data room for due diligence by potential investors**

After paying an information verification fee, potential investors were allowed to review the verified information provided by the financial consultancy. The bank also responded to investors’ questions to reduce problems faced by investors from information opacity and risk uncertainty.
7. Examination of investor qualification tenders

Investors participating in the bank due diligence submitted verified qualification tender documents. They were only allowed to participate in the price tender if their qualification tender passed the CDIC’s review.

8. Bid submission and opening and announcement of tender decision

(1) Investors that passed the qualification tender review were required to submit a tender bond and deliver tender documents by a certain period before the price tender opening date.

(2) Tender opening date: The tender sale was conducted on 31 May 2007. On the same day, the CDIC reported the tender sale reserve price recommended by the financial consultancy to the FRF Evaluation Team and Management Committee for review and then conducted the tender and bid opening.

(3) Tender decision and announcement: Five investors participated enthusiastically in the tender. Investor C.T. Commercial Bank submitted the best tender meeting the reserve price and was awarded the tender. The bid amount (i.e. the predetermined payment amount) was NT$4.5 billion (the net book value was NT$8.1 billion on the standard date for assessment). On 31 May 2007, the CDIC announced the tender decision and issued a press release.

9. Signing the P&A contract

The two parties to the transaction signed the P&A contract on 5 June 2007, at the CDIC. Settlement work began the same day and 8 September 2007 was set as the standard date for general assignment and assumption.

10. Handling of employee rights

(1) Severance and pension payments were calculated and issued according to stipulations in the Labor Standards Act, Labor Pension Act, and other related laws.

(2) The CDIC patiently communicated with trade unions during the tender period and required the buyer to rehire at least 50% of the original staff, enabling the tender sale to be successfully completed.

11. Signing the discharge statement on the settlement date

The settlement period was approximately three months. On the general assignment and assumption standard date (8 September 2007), the two sides signed the discharge statement and announced the general assignment. The CDIC disbursed the amount of the awarded bid on the following business day.
Japan - DICJ
Incubator Bank of Japan

1. Introduction

Since 1992, the Deposit Insurance Corporation of Japan (DICJ) has implemented 182 cases of failure resolution of financial institutions based on the provisions of the Deposit Insurance Act.

In these resolution cases, most of the operations of the failed financial institutions were directly transferred to the final assuming financial institutions through business transfer, whereas bridge banks were utilised in only three cases.

With regard to the resolution method, various resolution schemes, such as financial administrator, bridge bank, special public management and purchase of financial institutions’ assets, etc., have been established under the Financial Revitalisation Act and the Early Strengthening Act, etc. enacted in 1998, thereby creating the foundation for today’s resolution system. Subsequently, the resolution method for failed financial institutions in Japan was restructured as part of the revision of the Deposit Insurance Act in 2000, which set up the following two systems: (i) system of the financial administrator, etc. as a basic scheme and (ii) measures against financial crisis as a crisis management scheme. In 2002, the Deposit Insurance Act was revised with a view to (iii) securing the settlement of funds for failed financial institutions. Also, in 2013, (iv) the orderly resolution of financial institutions, etc. was newly established as a measure against severe disruption in Japan’s financial market and any other financial systems.

Since 2002, the scope of deposit protection had been reduced in phases from “full protection” to “limited coverage,” culminating in the current system46 in April 2005.

The following sections explain the outline and process of a resolution in Japan, citing the case of the Incubator Bank of Japan47 (hereinafter, referred to as “the Incubator bank”) in September 2010, the first resolution case under the “limited coverage.”

2. Resolution of the Incubator Bank

1) Outline: Resolution of the Incubator Bank

With regard to the resolution of the Incubator Bank, which failed on Friday, 10 September 2010, the “financial assistance method” was adopted to allow the assuming financial institution to take over the business of the failed bank and maintain financial functions such as lending. The “financial assistance method” was adopted (i) because the estimated cost of financial assistance was likely to be less than the estimated cost of an insurance payout, and (ii) in order to minimise any disorder that might accompany the failure of the Incubator Bank.

For the resolution of failed financial institutions under the limited coverage scheme, deposits beyond the scope of deposit insurance protection and other claims are reimbursed according to the

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46 General deposits, etc.: protected up to JPY 10 million in principal plus interest thereon payable until the day of failure per depositor per financial institution. Deposits for payment and settlement: fully protected.

47 Business established in April 2001. Total assets JPY 493.5 billion; deposits JPY 610.1 billion; loans JPY 447.9 billion; number of employees 829 (as at the end of August 2010).
state of assets of the failed financial institution, and bankruptcy procedures under court supervision (e.g. civil rehabilitation proceedings) are undertaken.

2) Failure Resolution Process

i. Order that the Business and Assets of the Incubator Bank be placed under the Management of a Financial Administrator, etc.

a) Administration Order

On Friday, 10 September 2010, the Incubator Bank, under the provisions of Article 74, paragraph 5 of the Deposit Insurance Act, submitted a written notification to the Commissioner of the Financial Services Agency (FSA) that its assets “are insufficient to honour its financial obligations”. In response, the Commissioner of the FSA on the same day issued an “order that the business and assets of the Incubator Bank be placed under the management of a financial administrator” under the provisions of Article 74, paragraph 1 of the Act, and appointed the DICJ as the financial administrator under the provision of Article 77, paragraph 2 of the Act. Following the above order and appointment, the DICJ was in a position to execute the business operations of the Incubator Bank and manage and dispose of its assets as the financial administrator.

b) Commencement of Civil Rehabilitation Proceedings

On Friday, 10 September 2010, the Incubator Bank filed an application with the Tokyo District Court for the commencement of civil rehabilitation proceedings, and the court ruled on the commencement of civil rehabilitation proceedings on Monday, 13 September 2010.

ii. Name-based Aggregation of Deposits, the Policy Board and the Resumption of Business

The DICJ proceeded with the following preparations from Friday (business day) and over the weekend, for the resumption of business from the beginning of the following week:

a) Operation of the Name-based Aggregation of Deposits

The DICJ aggregated and unified deposit accounts held by the same depositor at the same financial institution, and specified the amount of deposits to be protected by the deposit insurance system (“insured deposits”).

b) Holding of the Policy Board Meeting

On Sunday, 12 September 2010, the day before the resumption of business, the Policy Board of the DICJ decided to lend funds for the repayment of insured deposits, etc.

c) Resumption of Business

The Incubator Bank resumed business from 9.00 a.m. on Monday, 13 September 2010 at a total of 16 offices, including the headquarters, and started the repayment of deposits. The remaining offices reopened for business sequentially, with all of the bank’s 101 offices open for business again two weeks after the resumption of business.
iii. **Purchase of Deposits and Other Claims**

On 7 December 2010, the Policy Board of the DICJ decided to purchase deposits and claims other than insured deposits. The purchase record shows that around 90% of uninsured deposits were purchased, which covered 3,100 depositors and totalled around JPY 2.4 billion.

iv. **Transfer of Business to a Bridge Bank and Financial Assistance by the DICJ**

The DICJ publicly solicited candidates for a final assuming financial institution and conducted a document-based screening process. Since the decisions on the final assuming financial institution and the business transfer were expected to take some time, the DICJ decided to transfer the Incubator Bank to a bridge bank. The DICJ concluded the business transfer agreement on 1 April 2011, and the business transfer was carried out on 25 April 2011.

a) **Takeover of Deposits**

Insured deposits would be taken over by the bridge bank, but for the insured deposits that offered higher interest rates than those of other banks, it was decided that the deposit interest rate would be reduced from the contract interest rate, out of concern that it could adversely affect the sound and proper management of operations of the bridge bank as well as the business transfer to a final assuming financial institution.

b) **Takeover of Loan Claims, etc.**

The DICJ, as the financial administrator, selected loan assets and other assets of the Incubator Bank that were to be transferred to the bridge bank, and the Commissioner of the FSA confirmed that the selected assets were appropriate to be held by the bridge bank. The portion of the assets not to be taken over by the bridge bank was transferred to the Resolution and Collection Corporation of Japan (RCC) on the business transfer date.

c) **Financial Assistance by the DICJ**

In response to an application for financial assistance and equitable financial assistance filed in the joint names of the Incubator Bank and the bridge bank on 8 April 2011, the Policy Board of the DICJ decided to provide the financial assistance (i.e. (i) monetary grant to the bridge bank, (ii) monetary grant to the Incubator Bank, and (iii) purchase of assets from the Incubator Bank (the purchase was entrusted to the RCC)), and the financial assistance was implemented on 25 April 2011.

v. **Business Transfer to the Final Assuming Financial Institution and the End of the**

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48 The purchase of deposits and other claims represents a system for securing liquidity for depositors, etc. at an early stage prior to the payment of bankruptcy dividends or reimbursement by the failed financial institution.

49 The Incubator Bank and the bridge bank sent out documents to relevant depositors asking them whether they would consent to the takeover of their deposits by the bridge bank or cancel them before maturity.

50 The DICJ may also provide financial assistance to the failed financial institution in the form of a monetary grant in order to secure the amount of funds necessary for the repayment of the remaining debts of the failed financial institution to the creditors, so that the equal treatment of creditors (financial assistance for equal treatment) is ensured.
Business Management by the DICJ

The bridge bank worked to prevent its assets from deteriorating, and maintained the financial functions under the management of the DICJ. On 30 September 2011, AEON Bank was announced as the final assuming financial institution. On 26 December 2011, all outstanding shares of the bridge bank were transferred from the DICJ to AEON Bank, the final assuming financial institution; the business management of the bridge bank by the DICJ was thus completed.

vi. Liquidation of the Incubator Bank

With regard to the disposal of the assets of the Incubator Bank not transferred to the bridge bank (non-performing assets), they were in principle transferred to other parties, and converted into cash, taking account of the efficiency in asset recovery, by the following three methods: (i) transfer to the RCC, in which the RCC endeavoured to recover assets and eventually returned the profit from recovery to the Incubator Bank via the DICJ; (ii) sell-off to the bridge bank, which became a subsidiary of AEON Bank when the shares of the bridge bank were transferred from the DICJ to AEON Bank; and (iii) sell-off of claims through bidding.

On 27 August 2012, the Incubator Bank adopted a resolution to dissolve itself and applied for approval from the FSA, and in September 2012 the FSA approved the dissolution of the Incubator Bank, which then became the Liquidated Company of the Incubator Bank. Repayment was made in accordance with its rehabilitation plan. The Liquidated Company of the Incubator Bank began making final repayments in September 2016. On 2 May 2017, the Liquidated Company of the Incubator Bank of Japan completed all repayments and terminated liquidation operations, thereby completing the liquidation procedures on the same day.

The DICJ established the Final Assuming Financial Institution Screening Committee for the Incubator Bank as an advisory organisation for the Governor of the DICJ in March 2011. A committee was established to collect suggestions from experts from a professional perspective so that the DICJ could maintain transparency and fairness in the selection process.
Korea – KDIC

Tomato Savings Bank: basic P&A

Tomato Savings Bank, founded in 1983, had its largest shareholder changed in 2002 and since then has pursued an aggressive growth strategy. In an effort to expand its customer base for both deposits and loans, the bank added six new branches in the Seoul metropolitan area beginning in 2005. The opening of new branches coincided with a real estate boom that went on for the next several years and the easing of financial regulations, which led to a rapid growth in Tomato’s total assets: In June 2006, the bank had total assets of KRW 1.324 trillion, by December 2010 this had increased to KRW 4.456 trillion, putting Tomato in second place among savings banks in Korea in terms of asset size.

Although the bank succeeded in growing its volume, the quality of its assets began to deteriorate quickly when the domestic real estate sector contracted sharply due to the impact of the 2008 global financial crisis. As much as 50% of the bank’s loan portfolio was exposed to real estate-related businesses.

Notwithstanding the increase in problem loans, Tomato acquired a Busan-based savings bank named Yangpoong in 2009, changed Yangpoong’s name to Tomato 2 Savings Bank and formed a savings bank group with Tomato 2 as its affiliate. Tomato 2 opened new branches in Daegu and Daejeon as well as in Seoul to build a nationwide branch network and engaged in aggressive marketing campaigns.

As the slowdown in the real estate sector aggravated the distress of the savings banking sector, in 2011 the Korean financial authorities decided to conduct examinations of all savings banks to determine how safe their business conditions were. The examination teams, made up of nearly 340 people from the Financial Supervisory Service (FSS), the Korea Deposit Insurance Corporation (KDIC) and accounting firms, visited each bank’s premises for 2-4 weeks and examined their books with a particular focus on the rigoroussness of their asset classification systems and BIS capital ratios. The examination of Tomato revealed: (i) that the bank had a BIS capital ratio of –11.47% at end-June 2011, which qualified the bank to be placed under the most severe restrictions foreseen by Korea’s Prompt Corrective Action regime, under a supervisory directive called a Business Improvement Order; and (ii) it had KRW 441.9 billion more liabilities than assets.

Accordingly, on 29 August 2011 the Financial Services Commission (FSC) gave notice to Tomato Savings Bank that it would be declared insolvent and put under a Business Improvement Order. To avoid the regulatory action, on 14 September 2011, Tomato submitted a restructuring plan that included the sale of Tomato 2 and sourcing of outside investment. However, the FSC’s Management Evaluation Committee rejected the restructuring plan as unviable after reviewing its feasibility.

On 18 September 2011, the FSC, based on the results of the examination by the FSS and the KDIC and the review findings of the Management Evaluation Committee, imposed a Business Improvement Order on Tomato Savings Bank. The order not only suspended the bank from operations for six months, but also replaced its executives with government-appointed administrators. It also gave the bank 45 days to attempt a business turnaround by recapitalising itself through a rights issue, etc.

In the meantime, the KDIC began due diligence of Tomato’s assets and initiated the procedures to arrange a P&A. The bidding for Tomato was announced in October 2011 and the
KDIC received bids from two financial institutions. The preliminary bidders were given three weeks for due diligence before the opening of a competitive bid process in November.

The KDIC reviewed the final bids to compare the scope of assets and liabilities that each bidder had offered to take over and the amount of financial support that each deal would require. The review was guided by the least-cost resolution principle. On 22 November 2011, the KDIC chose Shinhan Financial Group as the preferred bidder as its bid involved a smaller net amount of financial support from the Deposit Insurance Fund, and began negotiations with Shinhan to settle details of the deal.

On 2 January 2012, the FSC issued a business licence for Shinhan Savings Bank, which is wholly owned by Shinhan Financial Group, and ordered part of Tomato’s assets and liabilities to be transferred to Shinhan Savings Bank and to a KDIC-controlled asset management company called the KR&C.

Meanwhile, the Central Investigation Division of the Supreme Prosecutors’ Office formed a joint investigation unit in collaboration with related agencies such as the FSS and the KDIC in September 2011, to investigate allegations of corruption in the savings banking sector. Their investigation included an inquiry into the causes of Tomato’s failure. It was found that Tomato had extended nearly KRW 160 billion in loans to borrowers who offered no collateral or collateral of little value, under pressure from its largest shareholder. Another KRW 70 billion of loans were made in a fraudulent scheme involving fake IDs to funnel money into the hands of the largest shareholder, who used the money to run a large golf practice range and purchase stocks.

**History of Tomato’s Resolution**

  29 Aug 2011: FSC gives prior notice of PCA to Tomato.
  14 Sep 2011: Tomato submits a restructuring plan to FSC.
- 17 Sep 2011: Management Evaluation Committee rejects Tomato’s plan.
  18 Sep 2011: FSC declares Tomato insolvent and issued a Business Improvement Order.
  21 Sep 2011: Accounting firm selected to act as an advisor.
  5 Oct 2011: An advisor for the sale of Tomato is selected.
  14 Oct 2011: An announcement of tender is made.
- 4 Nov 2011: The administrator overseeing Tomato’s operations reports that the bank is not in compliance with the Business Improvement Order.
  17 Nov 2011: Bids are received.
  22 Nov 2011: The preferred bidder (Shinhan Financial Group) is selected.
  15 Dec 2011: FSC asks KDIC to develop a resolution plan for Tomato.
  16 Dec 2011: KDIC notifies FSC of how it plans to resolve Tomato.
  23 Dec 2011: Deposit Insurance Committee passes a resolution to provide financial assistance to facilitate the P&A transaction.
26 Dec 2011: KDIC provides FSC with a detailed list of assets and liabilities that would be transferred in the P&A.

27 Dec 2011: FSC holds a hearing regarding the P&A and withdrawal of Tomato’s licence.

27 Dec 2011: KDIC signs a framework agreement with Shinhan Financial Group regarding the transfer of assets and liabilities.

28 Dec 2011: FSC decides to go ahead with the P&A transaction and the licensing of Shinhan Savings Bank.

2 Jan 2012: FSC authorises the P&A to take effect and withdraws Tomato’s business licence.

3 Jan 2012: KDIC provides financial support as per terms of the P&A agreement.
Korea - KDIC

**Tomato 2 Savings Bank: P&A with bridge bank**

An affiliate of Tomato Savings Bank which was suspended in September 2011, Tomato 2 Savings Bank was initially found to be viable in the examination conducted jointly by the FSS and the KDIC in July 2011 as part of an across-the-board effort by the authorities to test how safe and sound savings banks really were. However, the overall business environment continued to weaken as the real estate sector slowed down further. Moreover, prosecutors discovered more illegal loans that were linked to the largest shareholder, and more of Tomato 2’s assets such as syndicated loans funded by both Tomato and Tomato 2 became distressed, which put the bank’s financial and operational conditions on a downward spiral.

In August 2012, the KDIC performed an examination of Tomato 2’s business conditions and determined the value of the bank’s net assets to be KRW –196.3 billion as of July 2012. The KDIC’s Deposit Insurance Committee declared Tomato 2 insolvent on 3 September 2012 and notified the FSC of its decision.

On the same day, the FSC notified Tomato 2 that Prompt Corrective Action measures would be taken soon and asked the bank to submit a restructuring plan. But the bank failed to comply with the request for plan submission and was subsequently declared by the FSC to be insolvent on 19 September. The FSC placed Tomato 2 under a Business Improvement Order which, among other things, called for the bank to raise fresh capital so that it could achieve a BIS capital ratio of 5% or higher.

Upon the declaration of Tomato 2’s insolvency by the FSC, the KDIC began procedures to resolve the bank. Since the savings banking sector had been going through a major restructuring since 2011, there were not many interested buyers left in the market. Given the situation, the KDIC worried that if the news of another savings bank closure was leaked, a large-scale bank run would ensue. All things considered, the KDIC decided to resolve Tomato 2 through a bridge bank P&A, instead of a P&A by a third-party investor.

On Friday, 19 October 2012, the FSC made a decision to transfer part of the assets and liabilities of Tomato 2 to Yesol Savings Bank, a bridge bank established by the KDIC, and to the KR&C. These arrangements ensured that depositors covered under the KDIC’s coverage limit were able to access their funds at Yesol starting on the following Monday, 22 October.

To sell Yesol Savings Bank, the KDIC conducted an open bid process after making an announcement in March 2012, but there was no final winner due to a lack of acceptable bids. The sale of Yesol continued to be delayed until another tender was announced in March 2013.

Three companies submitted bids in April 2013. Based on a review of the bids, the KDIC selected Industrial Bank of Korea (IBK) as the preferred bidder in May 2013. After a month of negotiations, the KDIC signed an agreement to sell its Yesol shares to IBK. With the FSC’s approval of IBK’s acquisition of Yesol, resolution of Tomato 2 was completed in July 2013.
History of Tomato 2’s Resolution

- 18 Sep 2011: FSC declares Tomato 2’s parent, Tomato Savings Bank, insolvent and imposes a Business Improvement Order.

Oct–Nov 2011: KDIC tries to sell Tomato and Tomato 2 in a packaged deal to a third-party investor through a P&A.

17 Nov 2011: The sale is cancelled (no one has submitted a bid for both Tomato and Tomato 2).

2 Dec 2011: An advisor for the M&A deal is selected.

23 Dec 2011: The sale is cancelled (due to a lack of interested bids).

28 Dec 2011: FSC decides to resolve Tomato through a P&A.

- 2 Jan 2012: It is decided that Tomato’s shares in Tomato 2 will be transferred to the KR&C (KDIC-controlled asset management company) in a P&A transaction.

Feb 2012: KDIC surveys the market to gauge the level of interest for Tomato 2.

- Mar 2012: The sale process is temporarily put on hold – there are no interested buyers.

4 Aug ~ 17 Aug 2012: KDIC conducts an examination of business conditions at Tomato 2.

3 Sep 2012: Deposit Insurance Committee declares Tomato 2 insolvent.

3 Sep 2012: FSC gives notice to Tomato 2 that a Business Improvement Order is imminent.

18 Sep 2012: Tomato 2 fails to submit a restructuring plan.

19 Sep 2012: FSC imposes a Business Improvement Order on Tomato 2.

28 Sep 2012: Tomato 2 reports that it is unable to carry out the recapitalisation order.

- 2 Oct 2012: FSC seeks KDIC’s opinion on how Tomato 2 should be handled.

4 Oct 2012: KDIC presents its recommended course of action* to FSC.

* The least-cost principle required that part of Tomato 2’s assets and liabilities be transferred to Yesol and to the KR&C in a P&A.

4 Oct 2012: FSC gives notice of administrative dispositions, including the planned bridge bank P&A, to Tomato 2.

17 Oct 2012: Deposit Insurance Committee passes a resolution to provide financial assistance to facilitate the P&A transaction.

- 19 Oct 2012: FSC decides to go ahead with the P&A transaction and withdraws Tomato 2’s business licence.


15 Jul 2013: KDIC completes the sale of Yesol.
United States - FDIC

Doral Bank: basic P&A with optional loan pools and alliance opportunity

Outline

Doral Bank in Puerto Rico, holding USD 5.9 billion of assets and USD 4.1 billion of deposits, was closed on 27 February 2015. The following three P&A options were offered to the potential buyers during the resolution process.

Terms Offered

Option 1 – Whole bank
Option 2 – Basic P&A with optional loan pools
Option 3 – Basic P&A with optional loan pools and alliance opportunity

Final Terms

Banco Popular de Puerto Rico, Hato Rey, Puerto Rico (Banco Popular) assumed all the deposits and USD 3.25 billion of the assets of Doral Bank. A deposit premium of 1.59% of deposits was included in Banco Popular’s winning bid. The FDIC entered into separate agreements with two other parties, selling an additional USD 1.3 billion in assets at the time of Doral’s failure. The FDIC retained approximately USD 1.4 billion in assets to be disposed of post-closure. At the time of the bank’s closure, the FDIC estimated the resolution cost to the Deposit Insurance Fund (DIF) at USD 748.9 million. Simultaneously to it contracting with the FDIC under the P&A agreement, Banco Popular entered into separate agreements with three other banks which will operate a number of the branches it acquired under the P&A in New York City, Florida and Puerto Rico. Banco Popular retained eight of Doral’s 26 branches, with the other 18 passing to the other three acquirers.

Description of Unique Strategy and Marketing Conditions

Puerto Rico is a territory of the United States and its economy has been declining for over a decade. Its population had fallen by 9% since 2000 and unemployment in 2015 was nearly 13%. The island’s steadily declining economics led to ever growing amounts of government debt (in excess of USD 70 billion), which resulted in defaults to bond holders. In 2016, the United States Congress appointed an oversight board to oversee restructuring of the island’s debts and revenues. In 2010 the FDIC had been appointed receiver of three of the larger banks in Puerto Rico, with P&A loss share transactions being deployed.

Apart from Doral, only five banks operating in Puerto Rico were headquartered there. Due to Puerto Rico’s poor economic conditions, it was going to be difficult to interest banks outside the territory to consider an acquisition of branches in Puerto Rico. The local banks faced regulatory issues with an acquisition, including anti-trust limits on concentrations of deposits and the preference of regulators for buyers among the local banks to only acquire quality, performing loans. Doral operated branches in Florida and New York in addition to the island, and most of the Puerto Rico-based banks had no interest in operating in the continental United States. There was a significant volume of non-performing assets that the FDIC would have to retain if they could not be sold under a P&A at the time of the bank’s closure. It would not be possible for the FDIC to offer a branch breakup, or offer the branches and loans by branch to bidders as it was not operationally feasible to segregate deposits for separate buyers immediately after closure. Doing so would have allowed buyers to select locations that suited their business needs, but since this was not possible the deposits, in particular, would have to pass to a single buyer under the P&A with the FDIC.

The marketing solution that evolved was the concept of “alliance bidding”. Under the alliance concept, franchise buyers, chartered FDIC-insured institutions already operating banks, would be allowed to work together to buy Doral, working out any division of deposits and loans themselves behind the terms of the P&A. In addition, non-banks, referred to as “asset buyers”, could also be engaged to work with franchise buyers to align interests on assets that the parties could split...
them. Most performing loans could only be acquired via a bid on the franchise because the FDIC’s first priority was to find a franchise buyer taking deposits. Linking performing, better quality loans to the franchise was thought to give the FDIC the best chance of finding a buyer for the banking business, primarily the deposits. Often, operating banks are not interested in non-performing loans and, if acquiring deposits, they would likely also want quality, performing loans. Allowing asset buyers to bid on non-performing loans improved the FDIC’s chances of selling these assets at the time of closure, given that franchise buyers were less interested in them or restricted by regulators. The non-performing loans and a unique subsidiary of Doral, Doral Money, Inc., and the bank’s owned real estate (ORE) were made available to both franchise buyers and asset buyers, either through an alliance arrangement or on a stand-alone basis.

The mechanics of the alliance bidding entailed the winning franchise buyer to signing a P&A agreement with the FDIC. If there was an alliance arrangement with other parties those details were outside the P&A agreement. However, all details of alliance arrangements, terms, obligations, etc. were to be submitted to regulators for approval prior to bids being submitted. The FDIC did modify the P&A agreement to add pass-through indemnification language giving protection to alliance partners for loans it acquired that passed to the assuming institution first through the P&A. Loans sold outside the P&A agreement did not receive pass-through indemnification.

Final bidding included eleven franchise bids being received from three lead bidders. Two of the bids were whole bank bids and nine were basic P&A with optional loan pool bids. There were ten asset buyers that participated in the sale, with four of the asset buyers submitting a total of nine bids. The winning P&A bid was from Banco Popular, which included three alliance partners acquiring components of loans and deposits as detailed in the following table. Three sales were also completed with asset buyers at the time of closure. It should be noted that loss sharing was not offered in this resolution.

<table>
<thead>
<tr>
<th>Purchaser</th>
<th>Purchase form</th>
<th>Deposits (USD millions)</th>
<th>Assets</th>
</tr>
</thead>
<tbody>
<tr>
<td>Banco Popular, PR</td>
<td>P&amp;A (lead)</td>
<td>1,024</td>
<td>840</td>
</tr>
<tr>
<td>First Bank, PR</td>
<td>P&amp;A (alliance)</td>
<td>625</td>
<td>325</td>
</tr>
<tr>
<td>Centennial Bank, AR</td>
<td>P&amp;A (alliance)</td>
<td>466</td>
<td>42</td>
</tr>
<tr>
<td>Banco Popular, NY</td>
<td>P&amp;A (alliance)</td>
<td>1,277</td>
<td>931</td>
</tr>
<tr>
<td>AM PR LLC (asset buyer)</td>
<td>P&amp;A (alliance)</td>
<td></td>
<td>326</td>
</tr>
<tr>
<td>TPG (asset buyer)</td>
<td>Loan sale (asset)</td>
<td></td>
<td>1,111</td>
</tr>
<tr>
<td>Triumph Capital LLC (asset buyer)</td>
<td>Loan sale plus (Doral Money, Inc.)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>


Outline

First National Bank (FNB) of Edinburg in Texas, holding USD 3.1 billion of assets and USD 2.7 billion of deposits, was closed on 13 September 2013. The following four P&A options were offered to the potential buyers during the resolution process.

Terms Offered

Option 1 - Whole bank without loss share
Option 2 - Whole bank with commercial only loss sharing agreement
Option 3 - Whole bank with combined SFR & commercial loss sharing agreement
Option 4 - Whole bank with optional loan pools

**Final Terms**

Plains Capital Bank, Dallas, Texas assumed all of the deposits (USD 2.7 billion) of FNB Edinburg and purchased approximately USD 2.7 billion in assets. The FDIC and Plains Capital Bank entered into a loss sharing transaction on USD 1.8 billion of FNB Edinburg’s loans and owned real estate (ORE).

**Description of Unique Strategy**

The two primary detriments to the marketing effort were: (1) the large branch network spanning most of Texas; and (2) international lending (Mexico). FNB operated 51 full service branches in the largest metropolitan areas along the Texas-Mexico border (commonly referred to as the Rio Grande Valley), in addition to a number of other larger metro area markets in Texas. Lending in the Rio Grande Valley can be unique, particularly because many customers operate businesses with ties to Mexico, or the collateral or borrowers are located in Mexico. This contrast with the banking setup in the major metropolitan cities of Austin, Houston, Dallas and San Antonio made the efforts to find a buyer for this institution very challenging. The bank had a heavy concentration of real estate loans of all types, including single family residential (SFR), commercial, industrial, construction, and agricultural.

After analysing the bank data, it appeared that most of the areas in which the bank operated could be attractive to certain potential buyers, but that it might be quite difficult to find a single buyer for the entire operation. It was possible that a buyer could be found with an interest in a large portion of the bank’s branches but not all of them, and if the failing bank was only offered as a whole, this could result in no bids. The secure web-based data room was launched on 20 May 2013. On-site due diligence was offered from 3 June 2013 to 23 August 2013. Each group was allowed one week on-site in Edinburg, Texas at the bank’s main office and an additional week at the FDIC’s office in Dallas, Texas to review imaged loan files. The bid list criteria used by the FDIC to identify institutions large enough, with sufficient financial strength, and with operations rated satisfactory, resulted in 113 banks being contacted to consider this acquisition, including five banks that were located in Texas. During the first week, the FDIC received little response from the electronic invitations it sent to potential bidders; therefore, a calling campaign was started in the second week.

With hopes of generating more interest in the acquisition, a “regional offering” was developed and released on 11 July 2013. The basic concept of the regional offering was to allow a potential bidder to maintain full banking services in regions of its choosing (“selected” regions) and to pay out deposits in regions not chosen (“non-selected” regions). A minimum of one branch was required to remain open for at least 12 months in selected regions and 90 days in non-selected regions. Regardless of which branches the buyer designated as “selected” or “non-selected”, it would have to initially take all deposits in order to allow those depositors in non-selected branches time to move their accounts. The FDIC gave bidders the option of bidding to include all deposits or only insured deposits. Uninsured deposits were estimated at approximately USD 95 million. Also, the whole bank (all loans and deposits) could be taken, and loss share was available if buyers opted for it. Loss sharing was deemed appropriate because the Rio Grande Valley is a unique area of the State of Texas with which some buyers may not have been familiar, and also to protect them against uncertain asset quality or losses. Loss sharing could give them sufficient downside protection to proceed in analysing an acquisition. The regional offering separated the branches into the following areas of Texas:
<table>
<thead>
<tr>
<th>Region</th>
<th>Number of branches</th>
<th>Total deposits (USD millions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>McAllen, TX</td>
<td>9</td>
<td>336</td>
</tr>
<tr>
<td>Brownsville, TX</td>
<td>8</td>
<td>227</td>
</tr>
<tr>
<td>Corpus Christi, TX</td>
<td>4</td>
<td>117</td>
</tr>
<tr>
<td>Houston, TX</td>
<td>7</td>
<td>343</td>
</tr>
<tr>
<td>Dallas, TX</td>
<td>1</td>
<td>559</td>
</tr>
<tr>
<td>Edinburg, TX</td>
<td>10</td>
<td>378</td>
</tr>
<tr>
<td>San Antonio, TX</td>
<td>4</td>
<td>100</td>
</tr>
<tr>
<td>Laredo, TX</td>
<td>4</td>
<td>154</td>
</tr>
<tr>
<td>Austin, TX</td>
<td>3</td>
<td>117</td>
</tr>
<tr>
<td>El Paso, TX</td>
<td>2</td>
<td>69</td>
</tr>
<tr>
<td>Totals</td>
<td>52</td>
<td>2,400</td>
</tr>
</tbody>
</table>

There was a total of nine bids received from three bidders. The winning bidder was Plains Capital Bank, a Dallas, Texas based bank with total assets of approximately USD 6.8 billion. The transaction was a ‘whole bank with optional loss sharing’ transaction. The buyer elected to acquire 40 of the bank’s 53 branches along with 4 other buildings owned by the failed bank. The FDIC as receiver retained 210 loans for USD 267.3 million and 16 ORE with a book value of USD 11.3 million. The buyer took the majority of the loans (USD 1.8 million) and ORE (USD 219.0 million). Deposits passed to the buyer totalled approximately USD 24.4 billion. The loans and ORE retained by the FDIC were mostly loans collateralised by assets in Mexico or ORE in Mexico; the buyers had indicated that they lacked the expertise to deal with working assets in that jurisdiction.
## Appendix 3: Members of the Technical Committee

<table>
<thead>
<tr>
<th>Name</th>
<th>Organisation</th>
<th>Jurisdiction</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yangig Cho (Chair)</td>
<td>Korea Deposit Insurance Corporation (KDIC)</td>
<td>Korea</td>
</tr>
<tr>
<td>Joanna Smolarek</td>
<td>Bank Guarantee Fund (BFG; Poland)</td>
<td>Poland</td>
</tr>
<tr>
<td>Margaret Chuang</td>
<td>Central Deposit Insurance Corporation (CDIC)</td>
<td>Chinese Taipei</td>
</tr>
<tr>
<td>Noel Nunes</td>
<td>Deposit Insurance Corporation (DICTT)</td>
<td>Trinidad and Tobago</td>
</tr>
<tr>
<td>Yuichi Fujimura</td>
<td>Deposit Insurance Corporation of Japan (DICJ)</td>
<td>Japan</td>
</tr>
<tr>
<td>John Chikura</td>
<td>Deposit Protection Corporation (DPC)</td>
<td>Zimbabwe</td>
</tr>
<tr>
<td>David Hoelscher</td>
<td>Federal Deposit Insurance Corporation (FDIC)</td>
<td>United States of America</td>
</tr>
<tr>
<td>Fernan Ulate</td>
<td>Fondo de Garantías de Instituciones Financieras (FOGAFIN)</td>
<td>Colombia</td>
</tr>
<tr>
<td>Juan Carlos Quintero</td>
<td>Fondo de Garantías de Instituciones Financieras (FOGAFIN)</td>
<td>Colombia</td>
</tr>
<tr>
<td>Kumudini Hajra</td>
<td>IADI Secretariat</td>
<td>-</td>
</tr>
<tr>
<td>Sanjeeve Sharma</td>
<td>IADI Secretariat</td>
<td>-</td>
</tr>
<tr>
<td>Bakyt Kogulov</td>
<td>Kazakhstan Deposit Insurance Fund (KDIF)</td>
<td>Kazakhstan</td>
</tr>
<tr>
<td>Kuanyshbek Abzhanov</td>
<td>Kazakhstan Deposit Insurance Fund (KDIF)</td>
<td>Kazakhstan</td>
</tr>
<tr>
<td>Mohammed Mohamud</td>
<td>Kenya Deposit Insurance Corporation (KDIC)</td>
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<td>Seungkon Oh</td>
<td>Korea Deposit Insurance Corporation (KDIC)</td>
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<td>Youngwoon Kim</td>
<td>Korea Deposit Insurance Corporation (KDIC)</td>
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<tr>
<td>Josefina J. Velilla</td>
<td>Philippines Deposit Insurance Corporation (PDIC)</td>
<td>Philippines</td>
</tr>
<tr>
<td>Nilo Aldrin M. Lucinario</td>
<td>Philippines Deposit Insurance Corporation (PDIC)</td>
<td>Philippines</td>
</tr>
<tr>
<td>Güçlü Şirin</td>
<td>Savings Deposit Insurance Fund (SDIF)</td>
<td>Turkey</td>
</tr>
</tbody>
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