FedFin Client Report

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FedFin Analysis: Whom and What the FDIC and Fed Can Save How

Client Report: RESCUE79

Executive Summary

Recent editorials and other media have often said that the FRB and/or FDIC have powers or taken actions that is not the factual case as we understand it. Members of Congress also appear sometimes willing to make assertions about what agencies can do now even if it is unclear if there is statutory authority to do so. We have provided individual clients with key clarifications, but do so now more generally to support strategic and advocacy decision-making. Of particular importance is the authority the FDIC is said to have or lack related to uninsured deposits; as detailed below, the agency actually has significant authority to do so as well as even to back BHC debt, as long as certain stringent conditions are met. As detailed in FSM Report **RESCUE65**, Congress limited both the FDIC and Fed in hopes that the Dodd-Frank orderly-liquidation authority (OLA, see FSM Report **SYSTEMIC30**) would permit orderly resolution of even the largest banks and nonbanks without long-term federal support; a subsequent FedFin report will bring the assessment of OLA powers into the current crises' context given that Congress will surely seek to determine why the FDIC and its sister authorities chose to provide taxpayer support rather than deploy OLA.

Analysis

Please note that the analysis below does not provide legal advice.

FDIC

In 1991, Congress demanded significant changes to how insured depositories are supervised and resolved to address failings it believed contributed to the cost as well as national pain associated with the S&L crisis of the 1980s and the contemporaneous stress at regional banks with large CRE exposures. Among these changes were efforts to end supervisory forbearance through requirements such as those in "prompt corrective action" (PCA) provisions mandating intervention as capital thresholds decline. However, as noted in Karen Petrou's recent memo, the capital-only construct permits supervisors to defer

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action when other risks become evident as long as the banking organization is not "under-capitalized." So far, all of the failed banking organizations have been deemed well-capitalized immediately before they failed.

The 1991 Act also mandates "least-cost" resolutions so that the FDIC ceased its prior practice not only of protecting uninsured depositors, but also shareholders and in some cases even management. It has been suggested that the FDIC cannot protect uninsured depositors by virtue of provisions in 1991 and 2010 tightening its authority, but the agency in practice continued to back uninsured depositors by virtue of the purchase-and-assumption (P&A) transactions in which it sold failed banks to larger institutions. FDIC Democrats called for a re-evaluation of this policy but none has yet to be made public (see FSM Report **MERGER9**).

Using its 1991 powers, the FDIC in 2008 authorized a transaction account guarantee (TAG) program and the far more expansive backstop for all deposits and IDI-parent debt via the temporary liquidity guarantee program (TLGP, see FSM Report **DEPOSITINSURANCE54**). In 2010, Congress again sought to constrain the FDIC, but it allowed the systemic designations backing individual banks such as those issued on March 12.

The law also authorizes a variation on the TAG/TLGP backstops with significant restrictions. First, these new programs may only be provided by the FDIC at the request of Treasury and then only after majority votes of its board and that of the Fed as well as consultation with the President. Treasury and the President are to decide how much these backstop programs provide, with the program allowed to commence only after a joint Congressional approval resolution. This program is also authorized only in a "liquidity event" (tightly defined) with guarantees only to solvent IDIs and debt protections only authorized for BHCs (and perhaps S&LHCs or DIHCs). The FDIC was to set rules defining this program but we are unaware of any that have done so. Notably, the FDIC is to recoup costs for these programs from special assessments only on participants, not via the DIF.

In addition to this backstop, Dodd-Frank also reduced the FDIC's resolution options. For example, open-bank assistance is expressly prohibited for any systemic institution, but it could be used for a large regional if no other systemic designation has been deployed to protect it. This option has been discussed as possible for First Republic and some other large regionals and it would appear to be possible based on on-the-ground circumstances and how such assistance meets the aforesaid least-cost test, which continues to apply.

Federal Reserve

As also detailed in FSM **RESCUE65**, the Dodd-Frank Act expressly confined Fed authority to prohibit aid to individual companies and further restrict use of 13(3) facilities to "unusual and exigent circumstances" only through widely-available liquidity windows. The law also requires the FRB to set rules for these programs as well as define "financial stability," but the central banks only laid out 13(3) processes after Congress rejected its initial effort (see FSM Report **RESCUE70**).

Notably, the Fed is required to do valuations for all pledged collateral, a standard some may feel violates the provision in the Board's latest facility allowing valuations at par; a statutory injunction that funds through these facilities only be provided to solvent entities could also prove problematic. Treasury approval of any such program is required along with notice to Congress and a raft of subsequent disclosures.

Dodd-Frank also demanded greater discount-window and central-bank-liquidity swamp transparency, provisions with which the Board now complies through a key weekly report.

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