

**Shadow Financial
Regulatory Committee**

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Statement of the Shadow Financial Regulatory Committee
on the
FDIC's New Policy on "Whole Bank" Takeovers

May 16, 1988

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On April 18, 1988, the FDIC announced that potential bidders for acquisitions of failed or failing banks will be invited to submit competitive bids on a "whole bank" basis. Under this approach the successful bidder would assume all deposit liabilities and take over all of the assets of the failed or failing bank -- not simply "clean" assets, as under past practice -- in exchange for a payment from the FDIC. Bidders would be given as much as four weeks to analyze the troubled institution before submitting bids.

The Committee believes that this new approach is a useful step in the direction of bringing market forces to bear on the valuation of insolvent banks. While the past practice of dealing with failures through "clean bank" purchase-and-assumption transactions, in which an FDIC receivership retains all problem assets, may have facilitated the submission of bids on short notice, it resulted in the FDIC assuming the costs and risks involved in liquidating such assets -- a task for which it is not necessarily well suited.

Under the new approach, bidders will have an opportunity to assess all aspects of the failing bank, and the bid process should approximate a market valuation of the institution. The successful bidder will have maximum incentive to administer problem assets efficiently, and the administration of such assets by an ongoing financial institution, as opposed to a receivership, should result in the realization of greater values.

The Committee notes that in one respect the new policy may have the potential for adding to the FDIC's costs of dealing with insolvencies. It is possible that the additional lead time allowed for the formulation of bids could increase the incidence of leaks concerning an imminent failure, and thus cause uninsured depositors to withdraw their deposits prior to the declaration of an insolvency. To the extent that this occurs, the new approach could result in an increase in the FDIC's costs when the bid process does not result in an acceptable proposal and the FDIC is forced to liquidate the bank.

On balance, however, the new policy is a desirable move toward extricating the FDIC from the task of asset salvage and increasing the role of the market in the process of insolvency resolution.

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