



## FDIC Unit To Explore Megafailure Scenario

*New team not geared toward 'it's going to happen' but 'if it did'*

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*By Joe Adler*

WASHINGTON - Though it has been more than two years since the last bank failure, the Federal Deposit Insurance Corp. is spending much of its time preparing for an event that may never come: a megabank collapse.

As part of a series of changes to its supervision department, the agency formed a unit devoted solely to watching "complex financial institutions" and selected John Lane, a top agency veteran, to oversee it.

The 16-employee unit, unveiled in October, analyzes data from the roughly 120 banks that have more than \$10 billion of assets. It also examines the 24 state nonmember banks that are a part of this group.

Before taking over the unit, Mr. Lane had been the FDIC's deputy director for risk management. He joined the agency in 1977 and has broad experience there, including dealing with enforcement proceedings, fraud investigations, charter-application processing, and problem banks.

The FDIC said Mr. Lane was unavailable for an interview, but his boss, Sandra L. Thompson, the supervision division's director, described his new duties as "coordinating information-sharing activities" for large institutions with the other regulators.

"He has discussions with his regulatory counterparts on a regular basis," Ms. Thompson said. "To the extent that we need information, John Lane would be the point-person to get that information and also share it" with the FDIC's division of resolutions and receiverships.

The unit is the product of years of internal debate over the potential impact of a colossal failure, and its creation was spurred by industry consolidation that has put a quarter of domestic deposits in the hands of just four companies.

Back in 1998 the agency formed a task force to look at the effect of megamergers, and in a 2002 agreement with fellow regulators, it put a dedicated examiner at the eight largest banks (since reduced to six as a result of mergers).

Ever since the \$40-billion asset Continental Illinois National Bank and Trust Co., then the country's seventh-largest bank, collapsed in 1984, "there's been a focus at the FDIC -- how do we deal with a megafailure?" said Nicholas Ketcha Jr., a former head of the agency's supervision division. "What resources do we need? What are the systemic implications of it? It's not saying, 'It's going to happen,' but, 'Hey, if it did happen, there could be major consequences here, so how do we deal with it?' "

Current and former agency officials said changes in the industry have made the new unit necessary. Though most failures involve small institutions, the FDIC increasingly worries about larger banks. As of Sept. 30, four companies -- Bank of America Corp., JPMorgan Chase & Co., Wells Fargo & Co., and

Wachovia Corp. -- held \$1.63 trillion of the industry's \$6.47 trillion of domestic deposits.

"The consolidation of the industry and growing size" of those institutions "presents insurance issues to the FDIC," said John Bovenzi, its chief operating officer. "It's important for us to have groups that are focused on understanding the risk in those institutions."

The moves to enhance the FDIC's oversight of the largest banks raise a question: Is the agency angling to argue it has the expertise needed to supervise the huge companies chartering industrial loan companies?

That question is one of many being debated as the FDIC weighs a July 2005 application by Wal-Mart Stores Inc. to charter an ILC in Utah. Critics of the Wal-Mart application have claimed the FDIC does not have the resources or the authority to oversee large commercial companies that own banks.

To buy some breathing room, the FDIC announced in July that it would not make any decisions on ILC applications until Jan. 31, and the agency is widely expected to extend that deadline.

Mr. Bovenzi and Ms. Thompson said the decision to create the large-bank unit was unrelated to the Wal-Mart debate. They said the unit would not oversee retailer-owned ILCs such as the \$13 million-asset Target Bank or a Wal-Mart one -- projected to have \$135.5 million of assets in its first year -- because neither meets the \$10 billion minimum for large institutions.

An exception would be Merrill Lynch Bank USA, the nation's largest ILC, with \$60 billion of assets.

"The ownership was not a factor," Ms. Thompson said. "It's really size-driven, not ownership-driven."

The focus is a reversal of sorts for the FDIC, which, as the supervisor of state banks that are not members of the Federal Reserve System, historically has focused its oversight on thousands of small banks.

"FDIC had kind of grown up as a small-bank supervisor, because that's where our regulatory load was," said Jim Sexton, the agency's supervision director in 1999 and 2000. "The question was frequently brought up ... whether there needed to be some kind of esoteric organization and process for banks that we were not used to supervising directly. ... This is the culmination of those discussions."

Agency officials are also worried the FDIC's resolution skills may be a little rusty. More than 920 days have passed since the June 2004 failure of the \$46.4 million-asset Bank of Ephraim in Utah -- the longest streak in the agency's history without a bank failure.

In an August interview, FDIC Chairman Sheila Bair said the no-failure streak poses a challenge to her agency's preparedness for a future collapse.

"It's hard -- it's like playing outfield and waiting for that pop fly," she said. "In two years it hasn't come out there yet. To stay acute and aware and ready is difficult."

The unit also will handle any appeals filed by large banks challenging their deposit insurance premium assessment. The FDIC recently enacted a bifurcated assessment system for large and small banks. Under the plan, the FDIC uses a large bank's credit rating and other market data not available for small banks in determining an institution's assessment.

The new unit is part of a reorganization in the supervision division. In October the agency promoted Ms. Thompson to division director (she had been acting director) and named Christopher Spoth, the head of the New York office, as the head of the small-bank examination program, a new position.

Some consumer groups criticized the FDIC's 2002 decision to combine its supervision and consumer affairs divisions. Soon after taking office, Ms. Bair said that she did not want to split the divisions again, but that she would emphasize the agency's consumer protection role.

"There has been a sense in the past that the compliance role is a secondary function," she said. "It's very much compatible with the overall safe and sound profile of an institution. I think FDIC stands for safety, but safety of insured deposits. But for our regulated institutions, I'd like it to stand for safety for how that institution is going to deal with customers."

FDIC officials said the reorganization was an effort to realize that goal.

"We're trying to take a more collaborative approach to emerging issues," Ms. Thompson said. "For example, with nontraditional mortgages, there are both risk management and safety-and-soundness issues associated with some of these products, and also consumer protection issues."

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