

# Inside The Emergence Of 'Bridge Banks'

By **Michael Mancusi, Amber Hay and Christopher Allen** (March 29, 2023)

Following the significant turmoil and fears of contagion created by the two recent bank failures of Silicon Valley Bank and Signature Bank, the Federal Deposit Insurance Corporation, as receiver for the banks,[1] along with the U.S. Department of the Treasury and the Board of Governors of the Federal Reserve System, stepped into the breach.



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The FDIC announced that, as a result of the application of a systemic exemption to the nominal deposit insurance limitations, all deposits would be protected above the \$250,000 insurance limit, and that the business of the banks would resume on Monday, March 13, more or less as normal.

Following these appointments, the FDIC resorted to a seldom-used tool called a "bridge bank." [2] Added to the FDIC's receivership powers in 1987, a bridge bank allows the FDIC to continue the operations of a failed or failing bank while it seeks a buyer or buyers for the institution or its assets. Bridge banks minimize customer disruption while in theory allowing the FDIC to maximize what it can recover from a failure. [3]



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Combined with the full deposit protection, use of these bridge banks enables customers to continue their banking relationships while the FDIC seeks a more permanent solution. Because of the customer and franchise value protection offered by the bridge bank structure, we expect to see it used more frequently in the future.

## What Is a Bridge Bank and What Does It Do?

As the name implies, a bridge bank serves to "bridge" the gap between the failure of a bank and implementation of an orderly resolution and liquidation of the assets of the failed institution.



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Although the concept has a long history, it was added to the Federal Deposit Insurance Act by the Competitive Equality Banking Act of 1987. [4]

A bridge bank, in the form of a national bank, can only be chartered if the FDIC's board of directors make certain determinations regarding the economics, efficiency and other benefits of using this structure. [5] As outlined in the statute:

- Once chartered, a bridge can assume such deposits and other liabilities and purchase such assets of a failed bank that the FDIC determines to be appropriate. [6]
- A bridge bank, with some exceptions, has all the corporate powers of a national bank. [7]

- Consistent with the expressed congressional intent that, "in order to prevent unnecessary hardship or losses to the customers of any insured depository institution in default with respect to which a bridge [bank] is chartered." the FDIC should: continue to honor commitments made by the bank in default to creditworthy customers and not interrupt or terminate adequately secured loans that are being repaid by the borrower in accordance with the terms of the loan instrument.[8]
- A bridge bank can request that any judicial action to which it becomes a party as a result of assuming liabilities or acquiring assets of the defaulting bank be stayed for up to 45 days.[9]
- A bridge bank benefits from the same protection against agreements that would limit its rights in assets of the bank in default that is available to the FDIC in its capacity as receiver.[10]
- A bridge bank's obligations are backed by the FDIC and the full faith and credit of the U.S. government.[11]

A bridge bank's status terminates on the earliest of:

- The merger or consolidation of the bridge bank with a depository institution that is not a bridge bank;
- At the election of the FDIC, the sale of a majority of the capital stock of the bridge bank to an entity other than the FDIC or another bridge depository institution;
- The sale of at least 80% of the capital stock of the bridge bank to an entity other than the FDIC or another bridge depository institution;
- At the election of the FDIC, either the assumption of all or substantially all of the deposits and other liabilities of the bridge bank by a depository institution holding company or a depository institution that is not a bridge depository institution, or the acquisition of all or substantially all of the assets of the bridge bank by a depository institution holding company, a depository institution that is not a bridge depository institution, or other entity as permitted under applicable law;

- The expiration of the two-year period following the date the bridge bank was chartered, subject to up to three one-year extensions, or the earlier dissolution of the bridge bank by the FDIC at its discretion.[12]

### **What Does the Bridge Bank Process Mean for Customers?**

Based on the terms of the transfer agreements between the FDIC and bridge banks[13] and on the information provided by the FDIC, customers should generally expect bridge banks to operate in the same manner as the predecessor banks. This would include:

- **Deposits:** Customers will have full access to their deposits, including use of existing checks and ATM or debit cards. Direct deposits, bill payment and other online banking services will still work.
- **Loans:** Customers are still obligated to make loan payments in accordance with the terms of the loans. Escrow and other services previously performed with respect to loans will continue.
- **Loan advances:** The bridge banks are honoring the obligation to fund advances in accordance with existing loan documents.
- **Overdrafts and other lines of credit:** According to the FDIC, these have been transferred to the bridge banks. Consistent with the function of a bridge bank and the congressional intent described above, customers should still be able to draw on these resources. However, the FDIC advises customers to contact the bridge banks if they have further questions.
- **Sweep accounts and wire transfers:** These should continue to operate as normal with the same account numbers and wire instructions.
- **Swaps and other qualified financial contracts:** The FDIC transferred all qualified financial contracts to each of the bridge banks, which removes the ability to rely on any default provisions based upon insolvency or the appointment of a receiver.
- **Letters of credit:** According to the financial institution letter published by the FDIC on March 14, "the bridge bank is performing under all failed bank contracts and expects all counterparties to similarly fulfill their contractual obligations." [14] Holders should consider contacting the bridge banks for a definitive answer.

## **What Does the Bridge Bank Process Mean for Creditors and Other Third-Party Contractual Parties?**

The FDIC has confirmed that all contracts entered into with each bank prior to their failure were transferred into the bridge banks. Therefore, vendors and counterparties that have contracts with the bridge banks are legally obligated to continue to perform under their applicable contracts, and the bridge banks are obligated to make timely payments to vendors and counterparties and otherwise perform their obligations under the contracts.[15]

The 90-day stay period under the FDI Act prevents any party from exercising any right or power to terminate, accelerate or declare a default under any contract or to obtain possession of or exercise control over any property of the depository institution or affect any of its contractual rights without the consent of the FDIC as a receiver.[16]

### **Assets, Liabilities and Obligations Still Remaining With the Receiver**

Any assets or agreements that have not been transferred to a bridge bank, if any, and which remains to be confirmed by the FDIC, remain in FDIC receivership. As noted above, the FDIC has confirmed that all qualified financial contracts have been transferred to the bridge banks.

The FDIC has the ability to enforce contracts, notwithstanding any ipso facto provisions, and disaffirm or repudiate contracts and leases if the FDIC determines that such an agreement is burdensome and the action is needed to promote orderly administration of the failed institution affairs.[17]

### **What Comes Next?**

Even though the bridge bank process provides continuity, customers should consider what steps they may wish to take in the long run.[18] For example, refinancing credit facilities with other financial institutions that may offer more favorable terms, i.e., not requiring borrowers to deposit all of their funds with the lender or to provide an equity stake, may make sense, subject to the terms and conditions of existing agreements.

Also, although the FDIC has ceded management of assets and liabilities to the bridge banks, under the statute the agency may, in its discretion, dissolve the bridge banks and exercise the full scope of its receivership powers.[19]

In the interest of assuring that other banks have the ability to meet the needs of depositors, the Federal Reserve has created a new Bank Term Funding Program, which offers loans of up to one year to eligible U.S. federally insured depository institutions or U.S. branches or agencies of foreign banks that are eligible for primary credit to address liquidity pressures.

Advances are limited to the value of eligible collateral, like U.S. Treasuries, mortgage-backed securities, and other collateral eligible for purchase by the Federal Reserve Banks in open market operations, and all collateral pledged will be valued at par.

The FDIC is likely to provide further information and guidance as time goes on regarding the operations of the bridge banks. Not only may this shed light on issues addressed in this article, but it may also identify new issues that will need to be considered.

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[1] As receiver, by operation of law, the FDIC succeeds to "all rights, titles, powers, and privileges of the [failed] institution . . . with respect to the institution and the assets of the institution." 12 U.S.C. § 1821(d)(2)(A)(i).

[2] The most recent use of a bridge bank was in 2014, when the NYDFS created a bridge bank in connection with the resolution of Banco Espirito Santo. See here: [https://www.dfs.ny.gov/system/files/documents/2020/03/dfs\\_annualrpt\\_2014.pdf](https://www.dfs.ny.gov/system/files/documents/2020/03/dfs_annualrpt_2014.pdf).

[3] Initially on March 10, 2023, the FDIC established an interim national bank for the limited purpose of managing the disposition of insured deposits. After the uncertainty continued to spread, the FDIC, the Federal Reserve and the Treasury Department acted to protect all customer deposits, including uninsured deposits, by transferring substantially all of the assets and all deposits to the applicable bridge banks.

[4] Competitive Equality Banking Act of 1987, Public Law 100-86, § 503 (August 10, 1987). Currently "bridge depository institutions" are addressed in 12 U.S.C. § 1821(n) and include bridge federal savings associations to facilitate the resolution of failed thrifts. This change was in response to the difficulties faced in creating an institution to resolve the failure of IndyMac Bank, F.S.B. in 2008.

[5] 12 U.S.C. § 1821(n)(2)(A).

[6] 12 U.S.C. § 1821(n)(1)(B).

[7] 12 U.S.C. § 1821(n)(4).

[8] 12 U.S.C. § 1821(n)(3)(B).

[9] 12 U.S.C. § 1821(n)(4)(H).

[10] 12 U.S.C. § 1821(n)(4)(I).

[11] See, Financial Institutions are Required to Meet Contractual Obligations with Bridge Banks, FIL-10-2023 (March 14, 2023).

[12] 12 U.S.C. § 1821(n)(10).

[13] The Transfer Agreements by and between the FDIC and the bridge banks can be found here and here, respectively.

[14] FIL-10-2023.

[15] FIL-10-2023.

[16] 12 U.S.C. § 1821 (e)(13)(C).

[17] 12 U.S.C. § 1821(e)(1).

[18] On March 19, 2023, the FDIC transferred substantially all of the deposits and certain loan portfolios of Signature Bridge Bank, N.A., to Flagstar Bank, National Association. FDIC: PR-21-2023 (March 19, 2023).

[19] 12 U.S.C. § 1821(n)(12)(A)(i).