



## CHAPTER 7

# MCorp

<b>Name of Institution:</b>	MCorp
<b>Headquarters Location:</b>	Dallas, Texas
<b>Date of Resolution:</b>	March 28, 1989
<b>Resolution Method:</b>	Bridge Bank
<b>Date of Resolution:</b>	June 28, 1989
<b>Resolution Method:</b>	Purchase and Assumption Transaction

### Introduction

MCorp is the third largest and the second most costly resolution in the Federal Deposit Insurance Corporation's (FDIC) history to date. At the time of its resolution, it was also the second largest banking entity in the state of Texas, surpassed only by the First RepublicBank Corporation (First Republic), Dallas, Texas. MCorp's situation provided a vivid illustration of the tremendous economic difficulties experienced in the southwestern United States as a result of the faltering oil, agriculture, and real estate markets in the late 1980s. The failure of the MCorp banks came only eight months after First Republic's banks were closed, and just eleven months after the FDIC provided open bank assistance to First City Bancorporation of Texas, Inc. (First City), Houston, Texas.

The MCorp resolution had a number of noteworthy features. First, the FDIC rejected MCorp's open bank assistance proposal, and 20 of its subsidiary banks with \$15.7 billion in assets were declared insolvent shortly after certain holding company creditors moved to force MCorp into bankruptcy.

Second, while all depositors were protected against any losses, affiliated banks that had made federal funds loans to the lead banks of MCorp were not paid in full but were issued receivership certificates for their pro rata shares of receivership assets. The projected losses on those interbank funds led to 14 of the MCorp subsidiary banks being declared insolvent by the Office of the Comptroller of the Currency (OCC). Then, in turn, the holding company sued the FDIC, claiming that the FDIC did not have the authority to treat like classes of creditors differently. After losing the initial lawsuit, and losing a similar suit filed by Texas American Bancshares (TAB), Fort Worth, Texas, the FDIC won the TAB case on appeal, and the ruling applied, by derivation, to MCorp.

Third, not all MCorp subsidiary banks were closed; five banks with \$3.2 billion in assets remained open.

Fourth, the Federal Reserve Bank of Dallas (Federal Reserve) and the FDIC sought, unsuccessfully, approximately \$400 million in proceeds that MCorp held after selling two of its nonbank subsidiaries. The holding company refused to downstream the money to support its insolvent banks and kept the funds in the holding company pending approval of the open bank assistance proposal. MCorp's creditors wanted the money also and forced the holding company into bankruptcy. The United States Supreme Court held that those funds could be used to satisfy holding company debt obligations.

Two court decisions, along with a lawsuit over the same issue filed by First Republic bondholders, helped the FDIC garner support for two provisions that were included in the Financial Institutions Reform, Recovery, and Enforcement Act (FIRREA) of 1989. First, the FDIC as receiver was permitted to treat like classes of creditors differently as long as every creditor received at least its pro rata share of receivership proceeds. Second, the FDIC was granted "cross guarantee" authority requiring solvent affiliated banks to support insolvent affiliated banks within a holding company.

### General Description of the Institution

In March 1989, when MCorp failed, it was the 36th largest banking entity in the United States.<sup>1</sup> As the second largest banking entity in Texas, MCorp consisted of 25 banks, 86 banking offices, and 1 trust company, all located in Texas. The company had assets of \$18 billion, and its common stock was listed on the New York Stock Exchange under the symbol M.<sup>2</sup> MCorp had a reputation as one of the most progressive banking entities, in terms of both technology and personnel.<sup>3</sup>

### Background

MCorp suffered two straight years of quarterly operating losses beginning with the fourth quarter of 1986. At the end of 1986, MCorp, which at that time had \$29.1 billion in assets, reported a net loss of \$82.1 million after adding \$534.5 million to its loan loss reserve. Losses continued the following year, starting with a first quarter loss of \$102 million. Second quarter losses accelerated to \$114.9 million, and for the 1987 fiscal year MCorp reported total losses of \$258.3 million.<sup>4</sup>

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1. Nathaniel C. Nash, "U.S. Takes Over 20 Texas Banks; High Costs Seen," *New York Times* (March 30, 1989), sec. A, p. 1.

2. David LaGesse, "MCorp to Seek Bankruptcy Protection," *The Dallas Morning News* (March 28, 1989), sec. A, p. 1.

3. L. William Seidman, *Full Faith and Credit: The Great S&L Debacle and Other Washington Sagas* (New York: Times Books, 1993), 155.

4. "MCorp's Rocky Road," *The Dallas Morning News* (March 28, 1989), sec. D, p. 24.

The losses stemmed primarily from an increasing amount of nonperforming assets and loan charge-offs.<sup>5</sup> The oil industry in Texas and the Southwest had collapsed, with declining oil prices and an excess of oil drilling equipment. The real estate and construction markets were also declining, and MCorp had concentrated lending in both energy and real estate. Still, as late as August 1987, MCorp was actively reviewing the subsidiary banks of First City in response to the FDIC's request for proposals to acquire First City.<sup>6</sup> By November 1987, it was apparent that the financial situation of MCorp had deteriorated well beyond the point where it could merge with other banks.

In April 1988, MCorp sold its MTech subsidiary to Electronic Data Systems Corporation (EDS) for \$281 million. This enabled MCorp to report a second quarter profit of \$46.2 million. Second quarter figures included an operating loss of \$169 million, the largest share of which was a \$124.6 million provision for loan losses and a \$26 million jump in noninterest expenses.<sup>7</sup> MCorp also sold MNet, its consumer lending operation. These two sales enabled the holding company to accumulate huge cash reserves of approximately \$400 million.

During 1988, MCorp submitted several informal proposals to the FDIC for open bank assistance. The FDIC viewed none of the proposals favorably, primarily because the offers proposed that MCorp retain its existing management and the FDIC provide full protection from any adverse action to the holding company, its management, and its shareholders and creditors. Also, the FDIC wanted MCorp to downstream its cash reserves of \$400 million to support its failing subsidiary banks. MCorp was reluctant to do so, and held onto the funds pending acceptance of its open bank assistance proposal.

In his book, *Full Faith and Credit: The Great S&L Debacle and Other Washington Sagas*, written five years later, then-FDIC Chairman L. William Seidman, a longtime critic of the holding company structure, wrote that the MCorp case "illustrated a basic defect in the organization of the American banking system."<sup>8</sup> The MCorp case demonstrated clearly the conflict of interest that occurred when directors of the holding company were directors of some or all the subsidiary banks, too. Bank directors were required by law to maintain the safety and soundness of the bank. If they served also as directors of the holding company, they could be sued by shareholders and bondholders of the holding company for putting money into a failing bank instead of paying holding company debt or dividends and interest. If the directors did not put money into the banks, they were liable to be sued by bank regulators for failing to support the banks. The First Republic situation provided an example of this dichotomy. The FDIC sued the directors of the First Republic banks for declaring dividends to the holding company when the banks were undercapitalized. However, the directors of the holding company,

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5. House of Representatives, *Report on FDIC Bailouts of First Republic and MCorp Banks* (1991), 38; James E. Heath, FDIC Division of Research and Statistics, *Bank Failures (Texas)*, working paper (1997), 48-49.

6. See Chapter 5, First City Bancorporation of Texas, Inc.

7. "MCorp's Rocky Road," sec. D, p. 24.

8. Seidman, *Full Faith and Credit: The Great S&L Debacle and Other Washington Sagas*, 155.

which owned the banks, had ordered that the dividends be paid. The holding company directors were not sued, because they had acted properly in carrying out their duties.<sup>9</sup>

In October 1988, the Federal Reserve, which regulates holding companies, issued a temporary cease and desist order directing MCorp to support its failing banks. MCorp did not comply. That same month, MCorp submitted a formal proposal to the FDIC for open bank assistance.<sup>10</sup> The proposal involved \$400 million in private capital (the holding company's \$400 million in cash reserves) and substantial FDIC assistance. After the OCC completed an examination, MCorp reported a loss of \$500 million for the third quarter of 1988. Later in October, MCorp announced that it would suspend interest payments on approximately \$470 million in holding company debt and indicated it might be forced to declare bankruptcy.<sup>11</sup> Almost immediately, MCorp banks began to experience a runoff of deposits, which caused them to increase their borrowings from the Federal Reserve.<sup>12</sup> However, the run on deposits was not serious enough to require immediate action.

MCorp's announcement of their suspension of interest payments on the \$470 million of holding company debt created the conditions under which the creditors could force the holding company into bankruptcy. Debt terms allowed MCorp 30 days after default before creditors could make an accelerated demand for payment of principal. Once creditors demanded and failed to receive payment, they would have a right to file a petition to place MCorp into involuntary bankruptcy. Some banking analysts viewed MCorp's suspension of interest payments on its debt as a way to prompt the FDIC into accepting the formal open bank assistance proposal quickly and avoid a bankruptcy, which would increase the FDIC's costs. Holding company creditors most likely preferred a bankruptcy because they might retain more holding company assets in that scenario. The Federal Reserve withdrew its efforts to enforce its "source of strength" policy. The policy, which states that a holding company should use available assets to support insolvent bank subsidiaries, had never been tested in court or enforced to the detriment of a bankrupt entity's creditors.<sup>13</sup>

On November 6, 1988, MCorp and the FDIC entered into a "standstill" agreement under which the FDIC would consider MCorp's request for assistance along with proposals from other interested parties.<sup>14</sup> MCorp agreed to allow potential interested buyers to review records, meet with MCorp officials, and conduct due diligence reviews. As part of the agreement, the OCC and the Federal Reserve agreed to not pursue enforce-

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9. Seidman, *Full Faith and Credit: The Great S&L Debacle and Other Washington Sagas*, 155-156.

10. Refer to Part I, Resolution and Asset Disposition Practices, Chapter 5, Open Bank Assistance.

11. "MCorp Bankruptcy Seen As Possible," *New York Times* (October 28, 1988); Joseph M. Grant, *The Great Texas Banking Crash: An Insider's Account* (Austin: University of Texas Press, 1996), 157.

12. "Emergency Fed Loans Rise Dramatically," *The Dallas Morning News* (November 15, 1988).

13. The Federal Reserve required that all assets of a bank holding company were to be used as necessary to support its banks. However, the rule had never been tested in court or backed by explicit legislation. The Federal Reserve was unwilling to have the matter decided in a bankruptcy court and withdrew its demand that MCorp recapitalize its insolvent banks.

14. *Report on FDIC Bailouts of First Republic and MCorp Banks*, 38; Heath, *Bank Failures (Texas)*, 49.

ment actions against certain MCorp banks and the holding company while the FDIC considered the proposals by MCorp and other parties. The Federal Reserve also agreed to withdraw the temporary cease and desist order. Concurrently, losses continued at MCorp as it reported a 1988 fourth quarter loss of more than \$200 million.<sup>15</sup>

MCorp's institutional creditors had decided to hold off on demands for payment pending the results of the open bank assistance request. But three small creditors, together holding only about \$2 million of debt, submitted a petition on Friday, March 24, 1989, to the U.S. Bankruptcy Court in New York for a Chapter 7 involuntary liquidation of MCorp.<sup>16</sup> S.N. Phelps & Co., a securities firm based in Greenwich, Connecticut, initiated the filing on behalf of itself and two entities that held MCorp bonds.<sup>17</sup> The creditors wanted priority claim on the assets remaining in the holding company instead of having those assets used as part of the assistance plan.

The deadline for submitting MCorp restructuring proposals was April 2, 1989. However, on Monday, March 27, 1989, MCorp announced its intent to file a petition that would convert the bondholders' petition for Chapter 7 filing into a Chapter 11 bankruptcy. MCorp's bankruptcy petition would have resulted in a suspension of all claims against MCorp and would have placed the holding company's assets under the control of the bankruptcy court.<sup>18</sup>

Depositors began major withdrawals of funds from MCorp banks; between \$50 million and \$100 million was withdrawn in the two days after MCorp announced its intention to file bankruptcy.<sup>19</sup> "If regulators perceive any kind of a deposit run, they will move quickly to declare the banks insolvent," said Richard Fitzgerald, a Washington lawyer and former chief counsel with the OCC.<sup>20</sup> FDIC Chairman Seidman said in a press conference, "The planned bankruptcy definitely accelerated the outflow of funds."<sup>21</sup>

### The Resolution—March 28, 1989

The FDIC and the OCC agreed that the holding company's bankruptcy would create a situation where it would be very difficult to resolve the insolvent subsidiary banks.

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15. "MCorp's Rocky Road," sec. D, p. 24.

16. Under Title 11, Section 303, of the United States Code, an involuntary case may be commenced under Chapter 7 or 11 of the bankruptcy code by three or more entities, each of which is either a holder of a claim against a debtor or is an indenture trustee representing such a holder, if the claim is not contingent as to liability or the subject of a bona fide dispute and if such claims aggregate at least \$10,000 more than the value of any lien on property of the debtor securing such claims held by the holders of such claims. Under Title 11, Section 109, of the United States Code, the debtor may not be an insured bank as defined in section 3(h) of the Federal Deposit Insurance Act. Therefore, although the holding company could be placed in involuntary bankruptcy, the subsidiary banks could not.

17. LaGessee, "MCorp to Seek Bankruptcy Protection," sec. A, p. 1.

18. Anatole Kaletsky, "Bondholders' Move Forces MCorp Into Chapter 11," *Financial Times* (March 28, 1989), 32.

19. Nash, "U.S. Takes Over 20 Texas Banks; High Costs Seen," sec. A, p. 1.

20. LaGessee, "MCorp to Seek Bankruptcy Protection," sec. A, p. 1.

21. Nash, "U.S. Takes Over 20 Texas Banks; High Costs Seen," sec. A, p. 1.

Because of the heavy withdrawals at MBank Dallas, the OCC determined that the Dallas bank was no longer a viable concern. The Federal Reserve decided to call the loans (demand payment in full) it had made to MBank Dallas and five other MCorp banks. The banks could not pay, and on Tuesday, March 28, 1989, about 7:00 p.m., the OCC declared those six banks insolvent and closed them immediately, one by one. After MBank Dallas was closed, the OCC determined that another 14 banks could not count on getting back funds that they had lent to MBank Dallas. Those 14 banks then became insolvent and were closed. The last bank was closed about 1:00 a.m. on March 29, 1989.<sup>22</sup> The 20 closed banks had gross assets of \$15.7 billion. Five MCorp banks, with assets of \$3.2 billion, were not considered insolvent and were left open.<sup>23</sup> The trust company also stayed open and remained with the holding company.

MCorp management opposed the closings and went to court Tuesday night to try to stop the actions. U.S. District Court Judge Barefoot Sanders declined to intervene. Judge Sanders essentially told the MCorp officials that the process had advanced too far, and that MCorp could come back and sue for damages later.<sup>24</sup> Counsel for MCorp contended that, "The FDIC purposely created a domino effect to seize control of as many assets as it could."<sup>25</sup>

Unsubordinated general creditors and depositors, including those with funds in excess of the \$100,000 insurance limit, were fully protected at 19 of the institutions. Because of the large number of judgments filed against MBank Abilene, N.A. (MBank Abilene) only insured deposits were transferred to a new bridge bank. Uninsured depositors and general creditors at MBank Abilene, along with holders of contingent or off-balance sheet claims at all the banks, were not protected. Those claimants were to share, on a pro rata basis with the FDIC, in the liquidation of the failed bank's assets. The holding company's deposits and claims and any affiliated banks' deposits and claims against any of the failed 20 banks were also to share on the same pro rata basis for each failed bank.<sup>26</sup> First Republic's affiliated banks were treated in a similar manner. Uninsured depositors and general creditors of MBank Abilene were treated differently from similarly situated creditors of the other banks. That was because MBank Abilene, as successor to the former Abilene National Bank, had approximately \$60 million in outstanding judgments filed against it, but few accounts with uninsured deposits remained at the bank.<sup>27</sup> By mid-morning Wednesday, examiners found only \$1,000 in uninsured deposits.<sup>28</sup>

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22. David LaGesse, "Deposit Run Blamed for MBank Seizures," *The Dallas Morning News* (March 30, 1989), sec. A, p. 1.

23. Nash, "U.S. Takes Over 20 Texas Banks; High Costs Seen," sec. A, p. 1.

24. LaGesse, "Deposit Run Blamed for MBank Seizures," sec. A, p. 1.

25. Nash, "U.S. Takes Over 20 Texas Banks; High Costs Seen," sec. A, p. 1.

26. FDIC and OCC Joint News Release, "New FDIC Bank to Assume Deposits of 20 Insolvent MCorp Banks," PR-71-89 (March 29, 1989).

27. LaGesse, "Deposit Run Blamed for MBank Seizures," sec. A, p. 1.

28. LaGesse, "Deposit Run Blamed for MBank Seizures," sec. A, p. 1.

To facilitate the MCorp resolution, the FDIC used its bridge bank authority (as had been done in the failure of the First Republic banks) and established the Deposit Insurance Bridge Bank, National Association (DIBB). James B. Gardner, an MCorp group chairman, was named to head the \$15.4 billion bridge bank.

The FDIC soon began the process of soliciting bids for the bridge bank. On May 30, 1989, the FDIC notified the Texas Banking Commissioner of options being considered for the resolution of the bridge bank, specifically the FDIC's intent to use the interstate emergency acquisition powers granted by the Garn–St Germain Depository Institutions Act of 1982. May 31, 1989, was set as the date for the submission of closed bank proposals.

### The Sale of the Bridge Bank—June 28, 1989

There were six bidders for the bridge bank: NCNB; Banc One Corporation (Banc One); First City; Bank of Scotland; Texas Commerce Bancshares (TCB); and Kohlberg, Kravis & Roberts & Co. (KKR). On the basis of resolution cost, the bidding was close. Two of the bidders, NCNB and First City, posed potential conflict of interest issues: the FDIC had large ownership positions in each institution from the earlier resolutions of First City and First Republic.<sup>29</sup> The FDIC was sensitive to the issue that those two banking entities should not be leveraging their federal aid to pursue more acquisitions.<sup>30</sup> The bids by those banking entities and by TCB also raised the antitrust issue of a large concentration of Texas banking assets in the hands of a small number of firms. Banc One, KKR, and Bank of Scotland were not from Texas, and their bids did not raise the same issue.

On June 28, 1989, the FDIC agreed in principle to the acquisition of the bridge bank by Banc One, Columbus, Ohio. The bridge bank's name was changed to Banc One Texas, N.A. (BOC Texas). A Banc One subsidiary managed the bridge bank under contract with the FDIC until the transaction was consummated on January 30, 1990.<sup>31</sup> "The selection of Banc One resulted from a highly competitive process in which both banking organizations and non-bank investors participated," FDIC Chairman Seidman said in a prepared statement. "We welcomed the interest from all of these qualified bidders."<sup>32</sup>

Banc One agreed to buy 100 percent of the resulting institution's voting common stock for approximately \$34 million. The FDIC agreed to purchase approximately \$416 million of BOC Texas nonvoting common stock, which was to be redeemed by Banc One within five years. The FDIC acquired 3,375,000 shares of Class B nonvoting convertible common stock for \$303.8 million and 1,250,000 shares of Class C nonvoting

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29. Refer to Chapter 5, First City Bancorporation of Texas, Inc. and Chapter 6, First Republic Bank Corporation.

30. Robert Trigaux, Jim McTague, Robert M. Garsson, Jay Rosentstein, and Steve Klinkerman, "Seidman Says 2 Bidders Were Hurt by Ties to FDIC," *American Banker* (June 30, 1989).

31. FDIC, *1989 Annual Report*, 13.

32. Michael Weiss, "Ohio Firm Will Buy Former MCorp Banks, New Institution to be Bank One Texas," *The Dallas Morning News* (June 29, 1989), sec. A, p. 1.

common stock for \$112.5 million. In exchange, Banc One gave the FDIC a note payable in the amount of \$416.3 million.

The FDIC funded the operating losses of the bridge bank during its operation (March 29, 1989, to December 31, 1989) as well as the negative equity that resulted from a mark-to-market for assets and liabilities as of the date of Banc One's acquisition, January 1, 1990. The initial financial obligations totaled \$2.6 billion and had three components. First, the FDIC assumed Federal Reserve indebtedness, including principal and interest totaling \$1.5 billion. Second, the FDIC forgave a \$300 million subordinated note advanced to the bridge bank. Third, the FDIC gave BOC Texas a nonnegotiable promissory note for \$737 million, due on or before March 1, 1995.

Unlike NCNB's acquisition of First Republic, Banc One did not receive lucrative tax breaks, because the holding company retained its tax-loss advantages. Banc One's stock, however, still rose  $4\frac{7}{8}$  that day to  $32\frac{7}{8}$ .<sup>33</sup>

### The Liquidation

The bridge bank continued to hold the title to the troubled and nonperforming assets and agreed to service the assets. A separate asset pool was set up, which started with \$2.5 billion of troubled assets and owned real estate of the insolvent MCorp banks. BOC Texas retained the right to transfer additional loans to the separate asset pool during its first two years of operations. All administrative and funding costs of the separate asset pool were borne by the FDIC during its five-year tenure, even though the assets were owned by BOC Texas.<sup>34</sup> The asset management contract was similar to the one used at First Republic, in that an oversight committee was formed to protect the interest of the FDIC. The incentive fee was tied to net, rather than gross, collections, however; this modification led to better performance.

During the life of the agreement, assets with a book value of \$4.2 billion (\$3.2 billion after mark-to-market reductions) were placed in the pool. BOC Texas collected \$3.6 billion on this pool. Total expenses were \$591 million, or 16.6 percent, of gross collections. Net collections were \$3.0 billion, or 71.3 percent, of the total book value of the pool assets, and 93.8 percent of the mark-to-market asset value.<sup>35</sup> The asset management agreement was terminated as of December 31, 1994, and, in accordance with the agreement, the FDIC purchased the remaining \$83.7 million in assets.

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33. Dennis Cauchon, "Investors Cash in on Banc One Prize," *USA Today* (June 30, 1989).

34. FDIC, *1989 Annual Report*, 90-91.

35. Refer to Part I, Resolution and Asset Disposition Practices, Chapter 14, Asset Management Contracting.



## The Stock Transactions

To effect the transaction, Banc One initially capitalized BOC Texas with \$34 million and owned 100 percent of the voting common stock. To further capitalize the new bank, the FDIC purchased 3.4 million shares of Class B nonvoting convertible common stock for \$303.8 million (\$90 per share) and 1.3 million shares of Class C nonvoting common stock for \$112.5 million (\$90 per share). In exchange for the FDIC's total investment of \$416.3 million, Banc One provided the FDIC with a note payable for the same amount. Banc One retained the right to repurchase the FDIC's stock interest for its initial investment amount of \$416.3 million plus the FDIC's cost of funds and a \$10 million premium. The stock could be repurchased in increments.

On March 1, 1991, Banc One purchased 375,000 shares of the FDIC's Class B nonvoting convertible common stock for \$37.3 million, or \$100 per share, which represented a gain for the FDIC of \$3.5 million on that stock. Banc One also purchased 577,242 shares of the FDIC's Class C nonvoting common stock for \$57.4 million, or \$100 per share, which represented a gain of \$5.5 million on that stock. Banc One reduced its note payable to the FDIC to a new balance of \$321.5 million.<sup>36</sup>

On October 28, 1991, Banc One redeemed the remaining 3 million shares of the FDIC's Class B nonvoting convertible common stock for \$316.1 million, or \$105 per share, which represented a gain of \$46.1 million on that stock. Banc One also redeemed the remaining 672,758 shares of the FDIC's Class C nonvoting common stock for \$70.9 million, or \$105 per share, which represented a gain for the FDIC of \$10.3 million on that stock. Banc One's note to the FDIC was reduced to zero. A summary of the stock transactions is shown in table II.7-1.<sup>37</sup>

## Shareholder Litigation

On March 31, 1989, MCorp (the holding company) sued the OCC and the FDIC in both its corporate and receivership capacities, alleging that the agencies did not have the authority to declare 14 MCorp banks insolvent and that the forced recognition of losses on interbank "federal funds" loans was improper. MCorp indicated in its suit that "The solvent banks then were made to appear insolvent, and their assets were unlawfully confiscated without compensation, as a result of a (government) scheme." Without adjusting for the loss of the intercompany deposits, each MCorp bank had from \$2 million to \$12 million in capital. MCorp sought to recover that capital, which it said totaled more than \$70 million; the claim was later amended to well over \$200 million.<sup>38</sup> The litigation challenged the FDIC's ability to fully protect third-party creditors of a failed bank, including the ability to treat affiliated and third-party creditors equally.

36. FDIC, *1990 Annual Report*, 58; FDIC, *Equity Investment Portfolio, Bank Insurance Fund* (December 31, 1993), 21.

37. FDIC, *Equity Investment Portfolio, Bank Insurance Fund*, 21.

38. David LaGessee, "MCorp Files Suit, Chapter 11 Motion," *The Dallas Morning News* (April 1, 1989), sec. F, p. 4.

Table II.7-1

### Summary of the FDIC's Stock Transactions in the MCorp Resolution

Date	Transaction	Beginning Number of Shares	Shares Sold, Written Down, Converted	FDIC Stock/ Equity Investment	FDIC Proceeds from Sales	FDIC Book Value of Transaction	Gain or Loss On Transaction
<b>Class B Nonvoting Convertible Common Stock</b>							
01/31/90	Original investment	3,375,000		\$303,750,000			
03/01/91	Redemption – offset against Banc One's note payable to the FDIC		(375,000)		\$37,312,518	\$33,750,000	\$3,562,518
10/28/91	Redemption of stock		(3,000,000)		316,101,177	270,000,000	46,101,177
	<b>Totals</b>	<b>3,375,000</b>	<b>(3,375,000)</b>	<b>\$303,750,000</b>	<b>\$353,413,695</b>	<b>\$303,750,000</b>	<b>\$49,663,695</b>
<b>Class C Nonvoting Common Stock</b>							
01/31/90	Original investment	1,250,000		\$112,500,000			
03/01/91	Redemption – offset against Banc One's note payable to the FDIC		(577,242)		\$57,435,607	\$51,951,780	\$5,483,827
10/28/91	Redemption of stock		(672,758)		70,886,532	60,548,220	10,338,312
	<b>Totals</b>	<b>1,250,000</b>	<b>(1,250,000)</b>	<b>\$112,500,000</b>	<b>\$128,332,139</b>	<b>\$112,500,000</b>	<b>\$15,822,139</b>
	<b>Grand Total, All Stock</b>	<b>4,625,000</b>	<b>(4,625,000)</b>	<b>\$416,250,000</b>	<b>\$481,735,834</b>	<b>\$416,250,000</b>	<b>\$65,485,834</b>

Source: FDIC, *Equity Investment Portfolio, Bank Insurance Fund*.

The purchase and assumption transaction completed with Banc One resulted in no loss to third-party creditors. However, the affiliated banks' recovery on their loans to the failed lead bank was limited to their pro rata interest in the failed bank's estate. The FDIC had estimated this interest to be about 72 percent of the amount those banks were owed at the time of the lead bank's failure.

In the MCorp case, the FDIC asked the court to reject the challenge, but the U.S. District court in Dallas held that the FDIC's treatment of affiliated creditors in MCorp was improper.<sup>39</sup> Judge Robert Porter stated that the FDIC acted illegally, because federal banking law required the FDIC to treat like classes of creditors equally when a bank failed.<sup>40</sup> In a similar suit, that of Texas American Bancshares, the FDIC received an adverse ruling on June 25, 1990, and appealed the decision. The Fifth Circuit ruled in the FDIC's favor on the TAB suit and reversed the ruling of the lower court. The court held that the FDIC is obligated to pay only the amount realized in liquidation, and that additional payments from the insurance fund can be preferred among creditors at the FDIC's discretion. Congress later enacted this limitation in FIRREA.<sup>41</sup>

### MCorp Bankruptcy

MCorp had retained about \$400 million in assets, including \$250 million in cash and marketable securities. The liquid assets came from the sale of nonbank subsidiaries such as MTech, its data-processing firm. The Federal Reserve sought that money as a source of funds to use to offset the losses of the subsidiary banks. MCorp creditors, who were to be repaid out of the holding company assets, also wanted to obtain these funds.

The bankruptcy continued a struggle between the bankrupt holding company and the Federal Reserve over MCorp assets. The Federal Reserve tried to collect on claims it had made against the holding company, which would have forced MCorp to turn over cash to the former MBank Dallas. The Federal Reserve claimed the holding company owed approximately \$65 million to the bridge bank, DIBB (because MBank Dallas was closed already), since MCorp had withheld the cash from the former MBank Dallas when it sold its subsidiaries. The Federal Reserve had filed an administrative procedure regarding its "source of strength" policy to try to get MCorp to downstream funds to support its insolvent banks. The Federal Reserve argued its administrative procedure should remain independent and outside the control of the bankruptcy court.<sup>42</sup>

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39. FDIC, *1989 Annual Report*, 29, 38.

40. David LaGesse, "Seizures May Be Illegal: Judge's Ruling Focuses on MCorp," *The Dallas Morning News* (September 8, 1989), sec. D, p. 1.

41. FDIC, *1990 Annual Report*, 28.

42. David LaGesse, "MCorp Battling in New Territory, Case Could Set Legal Precedent," *The Dallas Morning News* (May 20, 1989), sec. F, p. 1.

On June 5, 1989, U.S. District Court Judge Lynn N. Hughes issued a preliminary injunction, ruling that federal banking law does not take priority over bankruptcy law. In a strongly worded order, Judge Hughes told the Federal Reserve that it must join other creditors in the bankruptcy court to pursue its claims, and that the Federal Reserve must halt an administrative proceeding it had started against MCorp. Judge Hughes cited “the waste and confusion” that would result if he allowed the Federal Reserve to pursue independently its administrative actions against MCorp.

The judge further said the Federal Reserve was “...enjoined from using its authority ...to effect, directly or indirectly, a reorganization of the MCorp group....”<sup>43</sup> This ruling was also appealed, first to the Fifth Circuit, which affirmed Judge Hughes’ decision, then to the Supreme Court. The Supreme Court avoided the “source of strength” issue, and decided the case in favor of MCorp on procedural grounds. This allowed MCorp to sell the remaining five solvent banks along with its other assets under the protection of the bankruptcy system.

### FDIC Resolution Costs

The MCorp resolution is the second most costly resolution in FDIC’s history to date. The total cost of the transaction was approximately \$2.8 billion. This was 18 percent of the failed banks’ assets, a relatively high portion. The high cost reflects the poor condition of the bank’s assets and the ongoing weakness in the Texas economy.

Of the \$15.7 billion in total assets at failure, approximately \$4.2 billion (\$3.2 billion after mark-to-market reductions) in problem assets were assigned to a pool and managed by BOC Texas. Over the life of the agreement, gross collections totaled \$3.6 billion, which resulted in a gross recovery of approximately \$400 million on the mark-to-market adjustment. Offsetting this recovery, however, were approximately \$165 million in additional charge-offs and losses. This resulted in a settlement payment of \$235 million to the FDIC after termination of the contract. On the assets not transferred to the pool, there was an initial mark-to-market cost of more than \$1 billion.

The FDIC’s initial expenses to resolve this institution were approximately \$3 billion. This consisted of \$556 million in operating losses during the bridge bank period, approximately \$2 billion in mark-to-market losses on the bank’s assets (as described above), and \$416 million for the purchase of equity in BOC Texas. Over time, the FDIC paid approximately \$600 million in additional expenses, including more than \$500 million for administering the pool of problem assets. Against those expenses of approximately \$3.6 billion, the FDIC recovered almost \$800 million, including \$482 million in proceeds from the redemption of the BOC Texas stock, and approximately \$300 million in asset recoveries (\$72 million from a settlement immediate after failure and the \$235 million recovery after termination of the asset servicing contract).

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43. David LaGesse, “Regulators Rebuffed at MCorp,” *The Dallas Morning News* (June 6, 1989), sec. D, p. 1.

Table II.7-2

**MCorp Resolution Costs**

(\$ in Thousands)

<b>FDIC's Expenses</b>	
Purchase of preferred stock	\$416,250
Bridge bank operating losses	556,000
Mark-to-market adjustment—special asset pool assets	1,065,000
Mark-to-market adjustment—nonspecial asset pool assets	1,013,000
Separate asset pool costs	545,000
Dividends to MBank creditors	33,000
<b>Total FDIC Expense</b>	<b>\$3,628,250</b>
<b>FDIC's Recoveries</b>	
Deferred settlement	\$235,000
Post-commencement settlement	72,000
Sale of preferred stock	481,736
<b>Total FDIC Recovery</b>	<b>\$788,736</b>
<b>FDIC's Total Resolution Costs</b>	<b>\$2,839,514</b>

Sources: FDIC, *The Cost of Large Resolution Transactions*, March 12, 1996; FDIC Division of Finance; and FDIC Division of Research and Statistics.

In a present value context the loss is somewhat higher, considering the period of time over which the various stock proceeds were received. However, the effect would be relatively minor given that the total stock proceeds were a small part of the overall transaction. See table II.7-2 for a summary of resolution costs.

**Lessons Learned**

As a result of the MCorp experience, the FDIC pushed for cross guarantee legislation. Unlike the situation in First Republic, where the subsidiary banks had guaranteed the interim assistance notes, the FDIC was unable to obtain any of the value of the solvent MCorp banks to offset its losses. In 1989, FIRREA granted the FDIC cross guarantee authority. The FDIC could assess its financial costs for handling failed banks against other insured institutions controlled by the same holding company.<sup>44</sup>

FIRREA also provided the FDIC with the authority “in its discretion” to use its own funds to make additional payments to any creditor or category of creditors without having to do so for all similarly situated creditors.<sup>45</sup> The MCorp transactions provided further evidence of the usefulness of the FDIC’s bridge bank authority and its ability to allow interstate acquisitions. Between the time of the First Republic and the MCorp resolutions, the FDIC modified the incentive fee structure of its asset management contract to obtain better performance by the asset servicer.

### Effect on Future Resolutions

The MCorp resolution was the last of the major Texas bank failures. When all was said and done, only one of the nine largest banking entities in the state survived in its previous form; the other eight were taken over by out-of-state organizations or investors, generally with financial assistance from the FDIC. Altogether, 599, or 37 percent, of all the federally insured banks that failed or required assistance from 1980 through 1994, were located in Texas. Those banks held 31 percent of all failed bank assets during that 15-year period, but nevertheless still accounted for \$13.6 billion, or 38 percent, of the FDIC’s total bank failure costs. The First Republic and MCorp transactions were far and away the most costly of the resolutions. Their combined \$6.7 billion cost was half of what the FDIC spent for all 599 Texas bank failures and more than one-sixth of the FDIC’s nationwide total of \$36.3 billion in bank failure resolution costs. The MCorp difficulties led to the section of FIRREA that added provisions related to cross guarantees. The cross guarantee provision would be used most notably in the Bank of New England resolution, as described later in Chapter 8.

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44. *U.S. Code*, volume 12, section 1815(e) states in part that any insured depository institution will be liable for any loss incurred or anticipated by the FDIC in connection with the failure of or assistance provided to a commonly controlled insured depository institution that has failed. The FDIC will make a good faith estimate of the loss and advise each such commonly controlled depository institution in writing of its share of the loss and, after consultation, other regulators will either require immediate payment or establish a schedule for payment. Such liability will be superior to any obligation to shareholders and any obligation owed to any affiliate, unless the obligation to the affiliate was secured as of May 1, 1989. The liability shall be subordinate to (1) deposit liabilities in general, (2) secured obligations other than obligations to affiliates secured after May 1, 1989, (3) any other unsecured general or senior liability, and (4) any obligation subordinated to depositors or other general creditors. If the payment to the FDIC is greater than actual loss, the FDIC will refund the overpayment. If the payment to the FDIC is less than actual loss, the FDIC will require additional payment. Depository institutions are defined as “commonly controlled” for this purpose if they are controlled by the same holding company or if one depository institution is controlled by another insured depository institution.

45. *U.S. Code*, volume 12, section 1821(i) states in part that the maximum liability of the FDIC as receiver to any claimant is equal to the amount the claimant would have received if the FDIC had carried out a straight liquidation of the assets and liabilities of the failed institution. The FDIC may, in its discretion and in the interest of minimizing losses, use its own funds to make additional payments to any claimants, but will not be obligated to make additional payments to any other claimants. The FDIC may make such payments directly to the claimants or may make such payments to an open insured depository institution to induce such institution to accept liability for such claims.

Table II.7-3

## Closed MCorp Subsidiary Banks as of March 28, 1989

(\$ in Thousands)

Bank Name, City, State	Total Assets	Total Deposits	FDIC's Resolution Cost	Assets Passed to BOC Texas at Closing	FDIC Assets Retained at Closing	Resolution Cost (%)
1 MBank Abilene, N.A., Abilene, TX	\$189,363	\$195,463	\$73,229	\$156,192	\$33,171	38.67
2 MBank Brenham, N.A., Brenham, TX	143,838	135,951	5,164	131,803	12,035	3.59
3 MBank Dallas, N.A., Dallas, TX	6,973,816	3,070,111	1,610,251	6,069,568	904,248	23.09
4 MBank Houston, N.A., Houston, TX	3,098,989	2,241,548	731,303	2,749,518	349,470	23.60
5 MBank Odessa, N.A., Odessa, TX	322,582	304,357	7,056	286,263	36,319	2.19
6 MBank Round Rock, N.A., Round Rock, TX	159,912	156,272	17,891	141,401	18,511	11.19
7 MBank Austin, N.A., Austin, TX	591,009	508,900	87,126	524,991	66,018	14.74
8 MBank Ft. Worth, N.A., Fort Worth, TX	766,273	676,628	153,239	673,837	92,436	20.00
9 MBank Jefferson County, N.A., Port Arthur, TX	325,646	301,603	16,199	286,109	39,537	4.97
10 MBank Longview, N.A., Longview, TX	261,253	251,380	11,288	233,069	28,184	4.32
11 MBank Marshall, N.A., Marshall, TX	217,748	206,562	4,996	190,498	27,250	2.29
12 MBank Corsicana, N.A., Corsicana, TX	190,909	178,394	900	166,264	24,645	0.47
13 MBank Denton County, N.A., Lewisville, TX	230,149	219,689	1,286	210,828	19,321	0.56
14 MBank Greenville, N.A., Greenville, TX	166,244	155,264	4,855	143,689	22,555	2.92
15 MBank Midcities, N.A., Arlington, TX	369,280	344,874	6,652	351,584	17,696	1.80
16 MBank Orange, N.A., Orange, TX	158,888	149,198	4,167	141,281	17,606	2.62
17 MBank Sherman, N.A., Sherman, TX	274,782	260,554	3,351	244,072	30,711	1.22
18 MBank Wichita Falls, N.A., Wichita Falls, TX	455,147	418,715	15,692	397,337	57,810	3.45
19 MBank The Woodlands, N.A., Woodlands, TX	165,063	154,186	6,907	143,053	22,010	4.18
20 MBank Alamo, N.A., San Antonio, TX	687,646	648,489	82,449	621,067	66,579	11.99
<b>Totals</b>	<b>\$15,748,537</b>	<b>\$10,578,138</b>	<b>\$2,844,001</b>	<b>\$13,862,424</b>	<b>\$1,886,112</b>	<b>18.06</b>

Sources: FDIC, 1989 Annual Report, and FDIC Division of Research and Statistics.

Table II.7-4

**Remaining MCorp Subsidiary Banks as of March 31, 1989***(\$ in Thousands)*

	<b>Bank Name, City, State</b>	<b>Total Assets</b>	<b>Total Deposits</b>	<b>Total Liabilities</b>	<b>Equity</b>
1	MBank Brownsville, N.A., Brownsville, TX	\$431,326	\$403,193	\$411,320	\$20,006
2	MBank Corpus Christi, N.A., Corpus Christi, TX	717,039	622,082	712,582	4,457
3	MBank El Paso, N.A., El Paso, TX	1,194,060	1,104,454	1,152,617	41,443
4	MBank New Braunfels, N.A., New Braunfels, TX	139,784	131,792	135,079	4,705
5	MBank Waco, N.A., Waco, TX	471,755	460,845	470,707	1,048
<b>Totals</b>		<b>\$2,953,964</b>	<b>\$2,722,366</b>	<b>\$2,882,305</b>	<b>\$71,659</b>

Source: FDIC Division of Research and Statistics.





