Minutes of the Meeting between FDIC and CDIC Taiwan,

Nov. 16, 2005

1. Due to the concerns of competitive equity among smaller banks and thrifts, the U.S. banking regulators have proposed a revised timeline of Basel II implementation, which includes a minimum three-year transition period from 2008. What is the reason that the U.S. intends to adopt the parallel run (Basel I and Basel II Advanced Internal Ratings Based approach (AIRB)) rather than Basel II standard approach? As the average asset size of the banks in Taiwan is around USD 16,383 million which is relatively smaller than that of the U.S., do you think Taiwan should implement Basel II at the end of 2006?

DSC – One of the important objectives of Basel I and Basel II is the promotion of competitive consistency of capital requirements for banks that compete directly in global markets. The focus on global markets is one of the reasons the US banking Agencies did not believe it was necessary to impose Basel II on most US banks, because those banks operate almost entirely in domestic markets. The Agencies have a different view, however, with respect to large, complex banking organizations, especially those with significant operations abroad.

One important supervisory objective is to encourage the largest banking organizations to continue to incorporate into their operations the most sophisticated risk measurement and management techniques. The Agencies have decided that the Advanced Internal Ratings Based approaches for measuring credit risk and the Advanced Measurement Approaches for measuring operational risk are best suited to address the evolving complexity of our largest banks and ensure that modern techniques are being used to manage the risks taken.

As suggested above, most US banks do not yet need the full panoply of sophisticated risk measurement techniques that would be required under the advanced Basel II approaches. In addition, most small US banks now hold considerable capital exceeding regulatory minimums established under Basel I.

The US banking agencies decided not to adopt the Standardized Approach for non-Basel II banks due to the additional regulatory burden this would place on small banks relative to the benefits.

The US banking system has a very large number of small banks and a small number of very large banks. The Agencies believe the advanced approaches will be adopted by a small set of core banks and by a small set of opt-in banks. The remaining banks are expected to remain under the current Basel I system, which is being revised and updated.

2. The U. S. is maintaining a segregated (but interconnected) structure of functional regulation. How does each financial regulator exchange and cooperate with each other? And how to share information of the call reports submitted by the financial institutions as well as the on-site examination reports?

DSC – The FDIC, along with other bank supervisory authorities, places high priority on working together to identify and reduce regulatory burden and on coordinating supervisory activities, not only with each other and state bank and thrift supervisors, but also with United States securities and insurance regulators and foreign financial institution supervisors.

The Federal Financial Institutions Examination Council (FFIEC), which includes the agencies and the National Credit Union Administration, is a formal body responsible for promoting uniform supervisory policies and establishing uniform principles, standards, and report forms for examinations of depository institutions. Through its advisory State Liaison Committee, the FFIEC also serves as an important forum for dialogue between Federal and state supervisory agencies.

To foster interagency cooperation more effectively, the FFIEC has established interagency task forces on consumer compliance, examiner education, information sharing, regulatory reports, surveillance systems, and supervision. These task forces serve as a means to share information and coordinate activities on a wide range of supervisory issues. The Task Force on Supervision, for example, has subcommittees for capital, information systems initiatives, and Bank Secrecy Act/anti-money laundering issues.

The agencies routinely collaborate on and adopt common reporting forms, with a goal of streamlining and reducing burden where possible. For example, all banking regulatory agencies use interagency forms with respect to filings under the Bank Merger Act and the Change in Bank Control Act. In addition, the FDIC, OCC and the OTS have adopted a common form for federal charters and federal deposit insurance applications.

To the extent possible, the agencies build upon each other's supervisory reviews and databases to minimize regulatory burden. The agencies routinely share reports of examination, inspection reports, and other agency-institution communications. The agencies also provide each other with access to their organizations' structure, financial, and supervisory information. Meetings and discussions take place among the regulatory agencies throughout the year, and when appropriate, the agencies hold joint meetings with institutions involving matters of mutual interest. This approach extends to periodic coordinated reviews or examinations where a business activity is conducted across legal entities.

The FFIEC's Task Force on Information Sharing serves as a vehicle to enhance and improve the exchange of electronic information among the agencies. This group is responsible for establishing principles that protect the privacy, security,

and integrity of shared information. It also oversees the development of data management standards to improve consistency and encourages the development of compatible technical architectures among the agencies to ensure that information can be shared efficiently. In addition to overseeing the timely and accurate exchange of financial, examination, and structure data, the task force has most recently focused on the electronic exchange of holding company information and data used to assign risk-based deposit insurance premiums.

Where applicable, the agencies coordinate their supervisory activities related to insurance, securities, and banking businesses by meeting frequently with functional regulators, such as the SEC and state insurance regulators, with the National Association of Insurance Commissioners (NAIC), and with foreign supervisors and state bank supervisors.

The passage of the Gramm-Leach-Bliley (GLB) Act heightened the emphasis on sharing appropriate supervisory information among the financial sector supervisors to foster effective supervision of the financial services industry. The GLB Act also emphasized the need for the agencies to rely on the functional insurance and securities supervisors for the supervision of functionally regulated affiliates and subsidiaries. The agencies implemented information-sharing agreements with insurance regulators for sharing confidential supervisory information to facilitate the coordinated supervision of diversified financial services firms. Information-sharing agreements are in place between each of the agencies and almost all of the state insurance departments for sharing of appropriate supervisory information. The Federal Reserve also has information-sharing arrangements in place with the SEC to facilitate the Federal Reserve's role as supervisor for financial holding companies as well as to exchange confidential supervisory information where supervisory responsibilities of the agencies overlap.

The agencies continue to work with state insurance regulators through NAIC to foster a sound foundation for effective information sharing. The agencies also continued to follow developments regarding the insurance industry's regulatory capital regimes; to develop and apply tools to help examiners translate the insurance risks identified by the functional regulator into their risk assessments of the insured depository institution and consolidated holding company; and to understand the insurance regulators' approaches for identifying and supervising institutions in weakened financial condition.

3. It is important for RTC or FDIC as receiver, to collect any losses from the failed banks or their directors, officers and others who provided professional service to the failed banks. In addition, RTC or FDIC can receive the compensation from the director and officer liability insurance policy. However, CDIC (Taiwan) only can collect losses resulting from dishonest or fraudulent acts by these directors, officers and employees, and the outcome is not effective due to the inefficient litigations and few properties for enforcement. Therefore, we wish to know (1) how does FDIC purse these losses and (2) the recent development of liability claims and

enforcement operations at FDIC. Moreover, please share FDIC's above achievements with us.

Legal – Director and officer insurance contracts purchased by institutions before failure have been the principal source of recovery for losses resulting from misconduct of culpable directors and officers before their institutions failed. Depository institutions purchase D&O insurance to protect their directors and officers against liability, posed by negligence, gross negligence, and breach of fiduciary duty claims. In almost all cases, D&O insurance generally excludes claims resulting from dishonesty, fraud, and intentional misconduct. However, losses from dishonesty and fraud are potentially covered by fidelity bond insurance that all insured financial institutions are required to purchase by the various regulatory agencies.

In this connection, during the period 1990 through 1995, the FDIC and RTC collected $1.3 billion on director and officer claims and $300 million from fidelity bond claims.[1]

In general, the FDIC has brought claims against directors and officers in less than one fourth of bank failures. The FDIC has and continues to use a two-part test in determining whether to institute a potential professional liability case: 1) is the case meritorious? and 2) is the case cost effective? During the height of the banking crisis in the early 1990's, there were far more investigations where we did not sue because the case was not meritorious. However, there were a number of cases where a suit was not instituted because, even though there was a meritorious claim, the case would not be cost effective to pursue.

The FDIC has sued attorneys, accountants, and other professionals far less frequently than we have sued directors and officers. In such cases, the reason for not brining a case is primarily for lack of merit because most outside professionals have professional liability insurance. The FDIC believes that suing directors and officers and other professionals serves two primary purposes: 1) lawsuits produce positive net recoveries for the affected receiverships, and 2) lawsuits serve as a deterrent to remind directors and officers and other professionals that they will be held accountable if they do not fulfill their professional duties and responsibilities. This deterrent effect is probably more important in protecting the viability of the deposit insurance fund than are the net recoveries from lawsuits.

In the past 15 years, the law upon which the receiver can recover against directors and officers has become more restrictive in the United States. This has not prevented the FDIC from instituting litigation when the underlying case is meritorious and cost effective. For example, during 2005, the FDIC has received two significant recoveries on cases instituted against directors and officer. In NextBank, the FDIC recovered approximately $13 million and in Hamilton Bank the FDIC recovered approximately $9.4 million.

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[1] Managing the Crisis at 285.

4. Recently, our Legislative Yuan revised and passed the Executive Yuan Financial Restructuring Fund Establishment and Management Statute (FRF), whose function is similar to RTC. Pursuant to Article 4 of FRF, the Financial Restructuring Fund Commission only can pay off the loss of the depositors of the failed bank, excluding other losses from the failed bank. Compared with the U.S. RTC, we wish to know how RTC dealt with these situations and any difficulties such as dealing with other creditors of the failed bank who could not be compensated by RTC, termination of employment contract with the failed bank employees, and more.

DRR – Under our system of creditor preference the depositor class is a higher category than the unsecured creditors. In a receivership the FDIC/RTC steps into the shoes of the insured depositors and makes them whole. The FDIC becomes a creditor of the receivership along with the uninsured depositors. The unsecured creditors are a lower order of preference creditor of the receivership. As the assets of the receivership are liquidated the depositor class receives dividends. The unsecured creditors do not receive any payment unless the depositor class is paid in full. In most cases the unsecured creditors suffered a 100% loss.

Employment contracts are generally repudiated at the time of the appointment of the receiver. If certain officers are needed to help in running the receivership than the receiver negotiates new contracts with the individuals. This was done at Superior

5. Under the amended U.S. Bank Holding Company Act, a bank holding company shall serve as a source of financial and managerial strength to its subsidiary banks. Besides, the 1987 Federal Reserve Board policy statement asserted that the bank holding companies were required to provide capital and other financial resources to assist their subsidiary banks. Similarly, our Legislative Yuan passed the Financial Holding Company Act (FHCA) in 2001, and according to Article 56I of the FHCA, the financial holding company shall assist its subsidiaries if the circumstances may threaten the interests of depositor. From 2001 to 2005, there are 14 financial holding companies existing. We are concerned that if there is any loss from a failing banking subsidiary, could FDIC require the financial holding company to assist its failing bank at first? Could you provide some recent cases about these situations?

DSC / Legal – The FDIC has supervisory and enforcement jurisdiction over insured state nonmember banks and their institution-affiliated parties (IAPs). The Federal Deposit Insurance Act defines IAP to include "any controlling stockholder (other than a bank holding company) of an insured bank…" Thus, it would be the Board of Governors of the Federal Reserve System that would have the jurisdiction to attempt to require the holding company to assist its failing bank at first.[2] The Federal Reserve's actions in this respect are intended to protect or

[2] The Office of Thrift Supervision (OTS) supervises thrift holding companies.

strengthen the bank. However, in *MCorp Financial v. Board of Governors*, the Firth Circuit Court of Appeals in 1990 held that the Board did not have authority under the Bank Holding Company Act to require a bank holding company to transfer its funds to troubled subsidiary banks. The Court held that such a transfer of funds "would require MCorp to disregard its own corporation's separate status; it would amount to a wasting of the holding company's assets in violation of its duty to its shareholders." Essentially, the Court indicated that neither the Federal Reserve nor any other regulator could compel a shareholder to make a capital injection.

Nevertheless, the FDIC has a number of mechanisms available that have been used effectively to get bank holding companies to obligate themselves to support subsidiary bank operations. First, the prompt corrective action provisions enacted by Congress in 1991 require that any involved holding company guarantee the capital restoration plan submitted by its troubled subsidiary bank before the FDIC can approve such a plan. These guarantees may be enforceable in court as contracts. In addition, the FDIC has had success in imposing requirements on holding companies in connection with applications for deposit insurance and in entering into written agreements with holding companies to address capital and/or funding concerns.

For instance, the FDIC entered into a capital maintenance agreement with the holding company of Medallion Bank by way of a written agreement; this agreement was established as a condition for the approval of deposit insurance. Perhaps of more significance are several instances in which parent companies have performed under Capital and Liquidity Maintenance Agreements (CALMAs) entered into as part of supervisory actions against problem financial institutions. In these cases, the holding companies agreed to and did provide significant financial and managerial assistance in resolving the problems faced by the subsidiary banks. In the case of First Consumers National Bank, the FDIC, Office of the Comptroller of the Currency, the bank, and the bank's parent organization entered into an agreement providing for capital and liquidity protection while the bank was in the process of terminating operations.

Thus, the FDIC has been successful in using CALMAs and similar agreements to ensure that holding companies maintain the capital and liquidity of troubled subsidiary banks.

6. When any bank failure arises, one of resolutions for FDIC to choose is bridge bank. Since a bridge bank is a temporary banking structure controlled by the FDIC to take over the operations of a failed bank and maintain banking services for the customers, are there any difficulties that such temporary bank may face when assuming assets and liabilities? We are concerned with any issue on operating this bridge bank and wish to learn some experience from FDIC.

DRR – The bridge bank question is too broad to answer here in brief form. Mr. Don Inscoe will send you a CD of our Bridge Bank Manual which addresses a wide range of issues upon his return to the United States.

7. We do sympathize with the Southern States in the U.S. hit by hurricanes, and know that some of banks, creditors and lenders in these states were severely affected. In this situation, is there any bank's operation involved in difficulties or even worse became a problem bank? If yes, how would FDIC resolve the problem bank and what is the difference between that and normal situation?

DSC / DRR –The FDIC's existing policy provides for due consideration of circumstances beyond bank management's control when rating the bank and considering a supervisory response to problems (for example, asset quality) identified. Our written Policy on assessing bank management states: "Appropriate recognition should also be given to the extent to which weaknesses are caused by external problems (such as a severely depressed local economy). A distinction should be made between problems caused by bank management and those largely due to outside influences. Management of a bank whose problems are related to the economy would warrant a higher rating than management believed substantially responsible for a bank's problems, provided that prudent planning and policies are in place and management is pursuing realistic resolution of the problems."

In addition, the US Federal Banking Agencies have agreed to publish examiner guidance that would remind examiners to be reasonable and use common sense when evaluating the condition of affected banks and developing supervisory responses to problems identified.

8. How does FDIC deal with the labor disputes while resolving problem or failed institutions?

DRR – The FDIC does not have to deal with labor issues as many other countries do. The FDIC as Receiver has special receivership powers granted to it by federal law. These special powers were granted when the FDIC was chartered so as to protect the deposit insurance fund by reducing losses. For example, the FDIC could use its power to repudiate any employment contracts that would be deemed burdensome (costly) to the Receiver.

Also, bank employees are not unionized nor do they enjoy federal or state guarantees of employment or severance packages. Oftentimes, many of the failed bank's employees are eager to be quickly hired by the acquiring bank(s) and other employees may be offered temporary positions to assist the FDIC receivership. The U.S. banking and financial services industry is very large and healthy and it is not difficult for the failed bank employees to find suitable employment with another financial institution.

9. What is the most difficult situation that FDIC faced in the past during the resolution process? What kind of litigation may FDIC face with during resolution process?

Legal - One of the more difficult situations the FDIC faces in the resolution process arises when the failed bank is owned by a holding company that actively opposes the FDIC's efforts to resolve and liquidate the institution. This may include challenge litigation brought by a bank holding company in an attempt to either prevent a subsidiary bank from being placed in receivership or in the alternative to prevent the FDIC as receiver from maximizing the receivership estate. While the FDIC has been successful in almost all cases in defeating these challenges, during the 1980's several large bank holding companies in New England and Texas forced the FDIC to expend considerable resources in litigation to ultimately resolve the challenge litigation. Moreover, the holding companies' failure to cooperate with the receiver's subsequent liquidation plans often caused delays and increased liquidation costs.

During the resolution process, the FDIC encounters a myriad of defensive litigation. For example, certain claimants bring claims that they are entitled to be treated as depositors rather than creditors of the receivership estate. In addition, other claimants may bring lawsuits maintaining that the FDIC has failed to allow their claims as creditors of the receivership, or has done so in an insufficient amount. Moreover, FDIC has faced numerous lawsuits by claimants maintaining that the receiver has improperly breached or rescinded contracts. The FDIC has also encountered a number of lawsuits when the receiver is attempting to collect on the assets in the receivership, and the other party brings counterclaims again the FDIC in its attempt to reduce the FDIC's recoveries.

10. As we know, FDIC could exempt from resolution cost restriction (least cost method) while handling systemic banking crisis. In this situation, does FDIC compensate for non-deposit credits?

DRR – In the past, before the least-cost test and systemic risk exception were enacted, assisted acquisitions typically did protect general creditors (also see response to question 11).

11. What criteria are used for the competent authority to determine that a bank would have systemic consequences if closed? Are there quantitative/qualitative benchmarks or indicators for assessments?

Legal – Under Section 13(c)(4)(G) of the Federal Deposit Insurance Act, 12 USC 1823(c)(4)(G), a failure resolution that does not meet the least-costly standard is permitted only if the least-costly resolution structure "would have serious adverse effects on economic conditions or financial stability" and an alternative resolution "would avoid or mitigate such adverse effects." The determination that the least-costly resolution would have such consequences must be made by the Secretary of the Treasury, in consultation with the President, upon the written recommendation of the FDIC Board of Directors (pursuant to a two-thirds vote of its members) and the Board of Governors of the Federal Reserve System (pursuant to a two-thirds vote of its members). This is

commonly referred to as a systemic risk determination. Since the enactment of this provision in 1991, no failure of an insured depository institution has been found to raise systemic risk implications. No federal agency has published any official comment regarding the criteria for a systemic risk determination, nor has any federal agency promulgated any rules, regulations, or procedures implementing the systemic risk provisions of the FDIA.

12. Will the FDIC or FRB supply financial assistance for the problem financial institution that is under receivership? If so, is there any restriction?

DRR – The FRB does not supply assistance to receiverships. The FDIC will provide liquidity to receiverships when need to fund the receiverships operation. This would only be done to the extent that the FDIC was confident that it would be repaid. This loan would be repaid prior to any dividends being paid to the depositor class.

13. Pursuant to the Federal Deposit Insurance Act Section 6, some factors are required to be considered before the Board of Directors of FDIC approves that any institution becomes insured by FDIC. We would like to know what is the operating procedure when FDIC determines whether to approve the application for insurance by a financial institution? Could you please provide with us the concrete materials, such as standard operating procedure (SOF)?

DSC – The question seeks clarification on the FDIC's deposit insurance review and approval program and requests that we furnish materials (written) explaining these procedures.

The Applications section of the FDIC's Risk Management Manual of Examination Policies is available at the FDIC's public website (http://www.fdic.gov/regulations/safety/manual/section12-1.html#part1) and provides information that may be useful in understanding how deposit insurance applications are processed.

The FDIC Statement of Policy on Applications for Deposit Insurance also provides useful information on the policies and procedures employed when addressing deposit insurance applications (http://www.fdic.gov/regulations/laws/rules/5000-3000.html).

14. According to the Federal Deposit Insurance Reform Act of 2005, the FDIC proposes to raise the insurance coverage limit from US$100,000 to US$130,000. Why does the FDIC plan to do so and how to determine the coverage limit US$130,000?

DIR – The FDIC did not propose raising the insurance coverage limit to $130,000. Rather, the FDIC proposed indexing whatever limit Congress set for inflation to insure that the value of deposit insurance does not wither away over time.

15. The FDIC introduced the risk-based premium system in 1993 and the rates were set from 0.23% to 0.31%. In 1995 the FDIC adjusted premium rates to the range from 0.04% to 0.31% and then in 1996 lowered them to the range from 0% to 0.27%. How did the FDIC set the above premium rates? And how did the FDIC decide the timing and range when planning to adjust the premium rates?

DIR – Changes to risk-based assessment rates generally have been dictated by law. When the risk-based premium system was implemented in 1993, the BIF reserve ratio was below the Designated Reserve Ratio (DRR) of 1.25%. Law required that the FDIC set assessment rates sufficient to provide revenue at least equivalent to that generated by an annual 23 basis point rate. In setting the upper end of the assessment range at 31 basis points, the FDIC intended to balance its need for increased revenue to recapitalize the funds with the desire to avoid imposing premium rates that could, in themselves, threaten the viability of insured institutions. (Analysis by FDIC staff indicated that 31 basis points would be the highest feasible rate.) After the BIF was recapitalized in 1995, the FDIC was free to expand the range of rates to better reflect the range of risk among institutions. Legislation passed in 1996 restricted the FDIC from charging premiums to most banks that are well-capitalized and highly rated by supervisors as long as the insurance fund is above the DRR. At the same time, the rate charged banks in the weakest insurance category was lowered to 27 basis points, reflecting the FDIC's reduced funding needs and the improving health of the banking industry

16. As stipulated by the Federal Deposit Insurance Act, the target ratio of the deposit insurance funds is 1.25% of insured deposits. How was the target ratio being set? Did the FDIC conduct any analysis or research? And according to the Federal Deposit Insurance Reform Act of 2005, the reserve ratio will be replaced with the reserve range. The range is to be set from 1.15% to 1.4%. How does the FDIC set this range?

DIR – 1.25% was the approximate historical average of the reserve ratio during several decades of the FDIC's early existence. While the FDIC recommended to Congress that the FDIC be allowed to manage the fund within a range, the FDIC did not propose the specific range of 1.15 to 1.40 percent contained in the Federal Deposit Insurance Reform Act of 2005. The FDIC suggested that the range be broader, e.g. 1.0 to 1.5 percent.

1 7. When the risk-based premium system was initially implemented, premium rates applied to the insured banks were different from those of the SAIF-member institutions. Was it because of the considerations of different types and insured risks of the financial institutions? And according to the Federal Deposit Insurance Reform Act of 2005, FDIC proposes to consolidate two funds—the bank insurance fund (BIF) and the savings association insurance fund (SAIF)—into one. In addition to the concerns of the decrease in the management cost, what are other reasons?

DIR – Premium rates during the first years after the risk-based system was implemented differed between the BIF and SAIF because the SAIF was more significantly undercapitalized. Moreover, a large part of SAIF revenue was used to pay interest on Financing Corporation bonds, which slowed the rate of recapitalization. Today, the FDIC favors a combined fund because such a fund would be stronger and would avoid the destabilizing effects that would result if one fund required premiums while the other did not and the unfairness of charging different rates for essentially the same product. Additionally, many banks and thrifts have commingled BIF- and SAIF-insured deposits. A merger of the funds also would greatly simplify reporting and accounting responsibilities for both the institutions and the FDIC.