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NORTH CAROLINA
BANKING INSTITUTE

Volume 6 | Issue 1

Article 15

2002

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Recommended Citation

Nancy J. Coppola, *Increased Federal Deposit Insurance Coverage: At What Cost*, 6 N.C. BANKING INST. 429 (2002).

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Increased Federal Deposit Insurance Coverage: At What Cost?

I. INTRODUCTION

Modern debate on Federal Deposit Insurance Corporation (FDIC) deposit insurance reform was initially precipitated by dissatisfaction with the effectiveness of bank regulation and the wave of bank failures in the 1980s.¹ In the late 1990s, however, the booming economy and favorable banking conditions put discussion of deposit insurance reform on the back burner. Then, in late summer 2001, Superior Bank of Hinsdale, Illinois collapsed, reviving Capitol Hill interest in overhauling the FDIC deposit insurance system.² “Superior’s failure was a warning that even when the insurance funds are healthy, trouble lurks just around the corner.”³ The failure of Superior Bank was not an isolated event; since 1998 the FDIC has lost over one billion dollars due to bank failures that share similarities with Superior.⁴ These similarities include poor bank management and internal controls, faulty accounting opinions, and a high percentage of sub-prime loans in the banks’ asset portfolios.⁵ Although Superior focused attention on this issue, the FDIC has been arguing for years that troubled

1. George Hanc, *Deposit Insurance Reform: State of the Debate*, 12 FDIC BANKING REV. 1, 1 (1999), available at http://www.fdic.gov/bank/analytical/banking/1999dec/1_v12n3.pdf (last visited Feb. 15, 2002). At the time the article was published, George Hanc was Associate Director for the Div. of Research and Statistics at the FDIC. *Id.*

2. Mike McNamee, *One Bank Down. Time to Bolster the FDIC?*, BUS. WK., Sept. 3, 2001, at 45.

3. *Id.*

4. John Reich, FED. DEPOSIT INS CORP., THE LESSONS OF SUPERIOR, (Aug. 21, 2001), at 1, at <http://www.fdic.gov/news/news/speeches/chairman/sp28aug01.html> (last updated Aug. 28, 2001). Between January 1 and February 7, 2002, four FDIC-insured banks failed. Richard Cowden, *Bank Failures: OCC Closes Internet-Only Nextbank, Marking 4th Failure in 2002*, Banking Daily (BNA), Feb. 8, 2002. The second 2002 bank failure will result in a \$1.4 million charge to the BIF. R. Christian Bruce, *Financial Institutions: FDIC Takes Over Failed Texas Bank; Shutdown Marls Second Failure in 2002*, Banking Daily (BNA), Jan. 23, 2002.

5. *Id.*

institutions with several volatile factors were increasing the risk to the deposit insurance funds.⁶

This Note examines identified problems with the current FDIC system, focusing specifically on deposit insurance coverage limits, and reviews and evaluates various proposed solutions. It begins with a brief history of deposit insurance and an overview of the statutory basis for the current system.⁷ The Note then discusses some of the perceived system flaws, considers whether the system needs reform, and debates whether the timing for reform is now appropriate.⁸ Next, the Note reviews several reform proposals: the five-part 2001 reform proposal package published under the former FDIC leadership of Donna Tanoue;⁹ current Chairman Donald Powell's comments on the 2001 proposal, along with his additional recommendations regarding increasing deposit insurance;¹⁰ and current legislative activity on this topic.¹¹ The Note follows with an analysis of diverging viewpoints on one provision of the proposal—increasing and/or indexing the deposit insurance coverage level.¹² Finally, the Note concludes with a summary review of the balancing issues legislators must consider when evaluating the various proposals.¹³

II. BACKGROUND

A. *Brief History*

For over sixty years, the United States' deposit insurance system has been the cornerstone on which American consumer confidence in its banking and financial systems rests,¹⁴ and a world-

6. *Id.*

7. *See infra* notes 14-42 and accompanying text.

8. *See infra* notes 43-85 and accompanying text.

9. *See infra* notes 86-98 and accompanying text.

10. *See infra* notes 99-1110 and accompanying text.

11. *See infra* notes 111-124 and accompanying text.

12. *See infra* notes 125-187 and accompanying text.

13. *See infra* notes 188-206 and accompanying text.

14. *See* FED. DEPOSIT INS. CORP., KEEPING THE PROMISE: RECOMMENDATIONS FOR DEPOSIT INSURANCE REFORM, at i (Apr. 5, 2001) [hereinafter KEEPING THE PROMISE], available at <http://www.fdic.gov/deposit/insurance/initiative/direcommendations.PDF> (last visited Feb. 2, 2002).

wide model.¹⁵ The insurance system arose to address a series of actual and threatened bank runs and ensuing bank failures across the nation, as well as the public's distrust of the U.S. banking system.¹⁶ In response, the U.S. Congress passed the Banking Act of 1933, which provided for a temporary plan of federal deposit insurance and established the Federal Deposit Insurance Corporation (FDIC).¹⁷ The program's primary purpose was to ensure the continued stability of the monetary system, but related purposes included protecting the small depositor¹⁸ and supporting a predominantly unit banking system.¹⁹ The initial insurance coverage level, set temporarily at \$2,500, was adopted in January of 1934²⁰ but was subsequently increased to \$5,000 a year later and maintained at that level when the program became permanent in 1935.²¹

15. FED. DEPOSIT INS. CORP., DEPOSIT INSURANCE OPTIONS PAPER § I (Aug. 2000) [hereinafter DEPOSIT INSURANCE OPTIONS PAPER], available at <http://www2.fdic.gov/EPC/DII/DIL.asp> (last visited Feb. 15, 2002). The Deposit Insurance Options Paper documents the FDIC's comprehensive review of the U.S. deposit insurance system, and was produced in collaboration with the risk-management consulting firm of Oliver, Wyman & Co. *Id.*

16. Christine M. Bradley, *A Historical Perspective on Deposit Insurance Coverage*, 13 FDIC BANKING REV. 1, 1-4 (Dec. 2000), available at http://www.fdic.gov/bank/analytical/banking/2000dec/brv13n2_1.pdf (last visited Feb. 2, 2002).

17. *Id.* at 4-5; see Banking Act of 1933 (The Glass Steagall Act), Pub. L. No. 66, § 12B(a), 48 Stat. 162, 168 (1933) (codified in 12 U.S.C. §§ 1811-1835(a) (2000)); see also Hanc, *supra* note 1, at 2-3; LISSA L. BROOME & JERRY W. MARKHAM, REGULATION OF BANK FINANCIAL SERVICE ACTIVITIES 44 (2001).

18. Bradley, *supra* note 16, at 5. *Contra*, Alan S. Blinder & Robert F. Westcott, *Reform of Deposit Insurance—A Report to the FDIC* (Mar. 20, 2001), at <http://www.fdic.gov/deposit/insurance/initiative/reform.html> (last updated Apr. 30, 2001). Blinder and Westcott argue that protecting the small depositor is only an "incidental benefit," and not the main purpose, of deposit insurance, stating that the U.S. government should maintain deposit insurance most importantly to enhance macroeconomic and financial stability. *Id.* The small depositor is protected through the government's guarantee that the depositor will receive back the amount of his deposit (up to the insured amount) in the event of bank failure. BROOME & MARKHAM, *supra* note 17, at 463.

19. Hanc, *supra* note 1, at 2.

20. Bradley, *supra* note 16, at 6; see Banking Act of 1933 (The Glass Steagall Act), Pub. L. No. 66, § 12B(y), 48 Stat. 162, 179 (1933).

21. Bradley, *supra* note 16, at 10; see also Pub. L. No. 305, § 12B(e)(13), 49 Stat. 684, 686 (1935); Hanc, *supra* note 1, at 2. The Banking Act of 1935 converted the FDIC from a temporary to a permanent agency. BROOME & MARKHAM, *supra* note 17, at 44.

The newly elected president, Franklin Roosevelt, opposed government guarantees of bank deposits and nearly vetoed the legislation, claiming that “insurance covering all banks would protect improvident operators from the consequences of their own folly.”²² The American Bankers Association concurred, maintaining that such insurance would reward ineptness in banking practices.²³ However, public opinion regarding the dire condition of the nation’s banking system forced Congressional action.²⁴

Since 1935, Congress has approved several non-systematic increases to deposit insurance’s coverage limit, with the last increase in 1980 bringing the maximum coverage from \$40,000 to \$100,000 per institution per ownership type.²⁵ Increasing the coverage limit again is currently among several FDIC reform proposals that the legislature, government entities such as the Treasury and the Federal Reserve Board, and various banking trade associations are debating.

B. Current System—Statutory Basis and Recent Legislation

Legislative acts passed within the past twenty-five years provide the statutory basis for how the federal deposit insurance system operates today. A series of external forces, including the dramatic increase in world oil prices, drove inflation rates to record levels, peaking at a prime rate of above twenty percent in

22. Notes: *FDIC’s Lifesaver*, THE BANKER, Nov. 1, 1990; see also Bradley, *supra* note 16, at 5.

23. Bradley, *supra* note 16, at 5.

24. *Id.*

25. Hanc, *supra* note 1, at 3. The FDIC calculates deposit insurance coverage based on the types of ownership in which the funds are held. FED. DEPOSIT INS. CORP., EDIE (ELECTRONIC DEPOSIT INS. ESTIMATOR)—ARE MY FUNDS ADEQUATELY INSURED?, at <http://www2.fdic.gov/edie/cHelpLinks/L03asp> (last updated Nov. 8, 2000). Funds held in different types of ownership, such as individual, joint, retirement, etc. are separately insured. *Id.* Thus, it is possible for an individual to have funds exceeding \$100,000 in the same institution and be fully insured. *Id.*; see also 12 C.F.R. § 330.3 (2001). Deposit insurance coverage is based on ownership rights and capacities (i.e., for the benefits of a particular depositor or depositors) in which the deposit accounts are maintained at insured depository institutions. *Id.* All deposits in a particular institution, maintained in the same right and capacity, are added together and insured in accordance with the regulations determining the coverage limit. *Id.*

the early 1980s.²⁶ Interest rate ceilings and restrictions then imposed on banks prevented them from competing for new or existing deposits with savings vehicles such as money market mutual funds, which were not so restricted.²⁷ These factors, coupled with prior unprecedented economic expansion, high interest-rate volatility, low personal savings rates and unstable deposit flows,²⁸ resulted in "disintermediation," driving the banking industry into crisis.²⁹ Savings institutions, stuck with portfolios of long-term mortgages at low interest rates, were thus additionally challenged to fund these mortgages.³⁰

Against this economic background, Congress passed legislation that implemented wide-ranging changes to the nation's monetary system by deregulating interest rates, authorizing interest payment on negotiable order of withdrawal (NOW) accounts, and requiring all depository institutions to comply with certain Federal Reserve requirements.³¹ It was also at this time that Congress instituted the most recent increase in deposit insurance coverage, from \$40,000 to the current level of \$100,000.³²

The savings and loan crisis in the 1980s precipitated Congress's legislative enactment of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA) to increase the FDIC's supervisory authority to reform the deposit insurance system.³³ This act, among other things, abolished the

26. JONATHAN R. MACEY & GEOFFREY P. MILLER, *BANKING LAW AND REGULATION*, at 30 (2d ed. 1997).

27. *Id.* The Banking Act of 1933 prohibited banks from paying interest on checking accounts, and the Federal Reserve Board's Regulation Q limited the interest rates that banks and thrifts could pay on time and savings accounts. *Id.* Regulation Q capped interest rates for banks at 5¼% and for thrifts at 5½% (in order to assist thrifts in attracting deposits for home mortgage lending); conversely, money market mutual funds were paying the fourteen to fifteen percent Treasury bill rates. BROOME & MARKHAM, *supra* note 17, at 102.

28. *See* Bradley, *supra* note 16, at 17.

29. MACEY & MILLER, *supra* note 26, at 30-31. "Disintermediation" refers to the phenomenon whereby customers withdraw their funds from banks and invest them elsewhere. *Id.* at 31.

30. *See* Bradley, *supra* note 16, at 17-18.

31. *Id.* at 18; *see also* Depository Institutions Deregulation and Monetary Control Act of 1980 (DIDMCA or Monetary Control Act), Pub. L. No. 96-221, 94 Stat. 132-141 (1980).

32. Bradley, *supra* note 16, at 17.

33. The Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA), Pub. L. No. 101-73, § 101, 103 Stat. 183, 187 (1989) (codified as amended

Federal Savings and Loan Insurance Corporation (FSLIC), which provided insurance for most of the nation's savings banks and savings and loans,³⁴ and subsequently created two new federal deposit insurance systems: the Savings Association Insurance Fund (SAIF) and the Bank Insurance Fund (BIF).³⁵

The Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA) directed the FDIC to implement a risk-based system of deposit insurance premiums, and required that each fund maintain its ratio of reserves to insured deposits at a designated reserve ratio (DRR) of 1.25%.³⁶ If the actual ratio of either of the funds falls below the DRR, by statute, the FDIC must charge or raise premiums to the institutions insured by that fund by enough to bring the ratio back to the DRR within one year,³⁷ or it must charge premiums of at least twenty-three basis points until the DRR is met.³⁸

in scattered sections of 12 U.S.C. § 1811 (2000)).

34. MACEY & MILLER, *supra* note 26, at 67-68.

35. FIRREA, Pub. L. No. 101-73, § 211, (5), (6), 103 Stat. 183, 219 (1989) (codified as amended in 12 U.S.C. § 1811 (2000)). All national banks, most state-chartered commercial banks, and a small number of thrifts are insured through the BIF; savings banks and savings and loans are primarily insured through the SAIF. MACEY & MILLER, *supra* note 26, at 67. The BIF and SAIF funds were "originally intended to insure bank and savings association deposits separately," however, today both funds insure deposits at both banks and savings associations, and banks and savings associations often hold both types of deposits (those insured by BIF and SAIF). KEEPING THE PROMISE, *supra* note 14, at 2. Although both funds provide the same insurance coverage and operate under the same statutory assessment system, the assessment rates for the two funds are set separately, raising the possibility of institutions with similar risk characteristics paying different premiums. *Id.* at 2 & 4.

36. The Federal Deposit Insurance Corporation Improvement Act (FDICIA), Pub. L. No. 102-242, § 302 (b)(1), 105 Stat. 2345 (1991) (codified as amended in 12 U.S.C. § 1817(b)(1)(A), (b)(2)(A)(iv) (2000)) as cited in KEEPING THE PROMISE, *supra* note 14, at 2. The FDIC places insured institutions into risk categories by utilizing a nine-cell, two-dimensional matrix based on capital levels (1, 2, 3) and supervisory ratings (A, B, C). *Id.* at 2. The capital ratios are based on leverage ratios and risk-based capital ratios; the supervisory ratings are based on each bank's composite CAMELS rating (an acronym for Capital, Asset quality, Management, Earnings, Liquidity, and Sensitivity to market risk) which is assigned by bank examiners. *Id.* at 2 and n.4. 1A is the highest composite rating. *Id.* at 2. Although FDICIA directed the FDIC to adopt risk-based pricing, the law prohibits it from distinguishing among institutions that pose significant variations in risk exposure if they fall within the same risk category. *Id.* at 4.

37. The Federal Deposit Insurance Corporation Improvement Act (FDICIA), Pub. L. No. 102-242, § 104 (a)(C)(ii), 105 Stat. 2238-2239 (1991) (codified as amended in 12 U.S.C. § 1817(b) (2000)).

38. KEEPING THE PROMISE, *supra* note 14, at 2 n.3.

The Deposit Insurance Funds Act of 1996 (DIFA), a more recent act, prohibits the FDIC from charging any premiums to well-capitalized institutions as long as the funds' reserve ratio exceeds the DRR.³⁹ Because both the BIF and SAIF ratios have remained well above the DRR, most BIF institutions have not paid any premiums since 1995, the year in which the BIF insurance funds were recapitalized; members of SAIF that are rated 1A have paid no premiums since 1997.⁴⁰ Thus, de novo institutions - 844 new banks and thrifts - have never paid any premiums and are often perceived as free-loaders.⁴¹

Illustrating a relatively recent phenomenon, brokerage institutions, such as Merrill Lynch and Salomon Smith Barney, are shifting billions of dollars from uninsured accounts into FDIC insured accounts at affiliated banks that have never paid any deposit insurance premiums, further diluting the DRR and directing additional attention to the free-rider problem.⁴²

39. *Id.* at 3. The Deposit Insurance Funds Act of 1996 (DIFA), Pub. L. No. 204-208, § 2708, 110 Stat. 3009-497 (codified as amended in 12 U.S.C. § 1817(b)(2)(A)(i) (2000)). Nearly ninety-two percent of banks are considered well-capitalized by virtue of falling within one of the two top categories and thus currently pay no premiums. *Hearing to Examine Key Issues Related to the FDIC Before the Subcomm. on Financial Institutions and Consumer Credit of the House Financial Services Comm.*, 107th Cong. App. A (May 16, 2001) (testimony of James E. Smith on behalf of the Am. Bankers Assoc.) [hereinafter Testimony of James E. Smith, May 16, 2001], at http://www.aba.com/NR/rdonlyres/00003db9wmktdubwcauevcud/DI_Testimony_Jim_Smith_051609.pdf (last visited Feb. 15, 2002). The FDIC may raise the DRR for any year in which it can document "circumstances raising a significant risk of substantial future losses to the fund." *Id.*

40. DEPOSIT INSURANCE OPTIONS PAPER, *supra* note 15, § I, at 3.

41. Steve Cocheo, *Deposit Insurance Reform: The Next Big Issue?*, A.B.A. BANKING J., Oct. 1, 2000, at 6 [hereinafter Cocheo, *Deposit Insurance Reform*].

42. Rob Blackwell, *In Focus: Solly's Sweeps Show FDIC Fund Worries Still Apply*, AM. BANKER, Oct. 29, 2001, at 1-2 [hereinafter Blackwell, *In Focus*]. Salomon has moved \$32 billion from securities accounts to insured bank accounts at Citigroup, Inc.; Merrill Lynch has shifted \$47.3 billion. *Id.* at 3. See also comments by Federal Reserve Board Governor, Laurence Meyer, referring to free-rider problem caused by the movement of billions of dollars by two brokerage houses into insured accounts without paying new premiums. Rob Blackwell, *Treasury Joins Fed to Back FDIC Reform*, AM. BANKER, July 27, 2001, at 1, 3 [hereinafter Blackwell, *Treasury Joins Fed*].

III. NEED FOR REFORM

The federal deposit insurance system is currently healthy and well-funded;⁴³ BIF and SAIF ratios are at similar DRR levels,⁴⁴ and the banking industry is well-capitalized.⁴⁵ However, as a result of the recent period of weak economic performance, traditional indicators suggest that bank asset (loan) quality is deteriorating.⁴⁶ Community banks, in particular, saw a thirty-six basis point drop in net interest margins in 2001 over the previous year.⁴⁷

Democrat Donna Tanoue who stepped down as chairman of the FDIC during the summer of 2001, as well as many lawmakers and bankers, believe the time is right to examine perceived flaws, debate various reform proposals and enact changes so that the system can continue serving as an “anchor for public confidence.”⁴⁸ On October 17, 2001, in his first official appearance, FDIC Chairman Donald Powell, also voiced his

43. Testimony of James E. Smith, May 16, 2001, *supra* note 39, at 1. At year-end 2000, the BIF was at \$32 billion and the SAIF was at nearly \$11 billion dollars—a total of over \$41 billion dollars in financial resources. *Id.*

44. See DEPOSIT INSURANCE OPTIONS PAPER, *supra* note 15, § V. “As of March 31, 2000, the reserve ratio of the BIF was 1.35% and SAIF was 1.44%,” which at those levels would produce a combined fund ratio of approximately 1.38%. *Id.*

45. *Condition of the U.S. Banking System, Presentation Before the Senate Comm. on Banking, Housing and Urban Affairs, 107th Cong. app.* (June 20, 2001) (testimony of Alan Greenspan, Chairman, Federal Reserve Board) [hereinafter Greenspan, *Condition of the U.S. Banking System*], <http://www.federalreserve.gov/boarddocs/testimony/2001/20010620/appendix.htm> (last updated June 20, 2001). “The U.S. banking industry is well capitalized and highly profitable by historical standards and is in reasonably good shape . . .” *Id.*

46. See Donald Powell, Chairman, Fed. Deposit Ins. Corp., Opening Remarks at a Press Conference Announcing the Release of the FDIC’s Preliminary Bank Earnings Report (Nov. 29, 2001) [hereinafter Powell, Remarks, Nov. 29, 2001], available at <http://www.fdic.gov/news/speeches/archives/2001/sp29nov01.html> (last updated Nov. 29, 2001). In November 2001, troubled commercial and industrial loans were reported to have risen dramatically in the past several years, and net charge-offs attributed to these loans were up almost eighty-four percent from the previous year. *Id.*

47. Richard Cowden, *Quarterly Bank Earnings Remain Strong; Powell Concerned About Small Institutions*, 77 BANKING REP. (BNA) 355 (Sept. 10, 2001), at 355-56 [hereinafter Cowden, *Quarterly Bank Earnings Remain Strong*] (citing Chairman Powell’s address at his first public meeting as FDIC chairman on September 5, 2001). Community banks, as used here, are signified as those with less than \$100 million in assets. *Id.*

48. KEEPING THE PROMISE, *supra* note 14, Letter from the FDIC Chairman.

strong support for reforming the deposit insurance system before the House Financial Services Committee.⁴⁹

Tanoue believes that some provisions of the current system, rather than protecting investors from loss of funds due to bank failures, actually increase the likelihood of bank failure by encouraging risk on the part of both depositors and bankers.⁵⁰ Additionally, external factors such as changing demographics, the faltering economy,⁵¹ and the September 11, 2001, terrorist attacks on the Pentagon and World Trade Center, may give rise to changing consumer savings behaviors that could alter DRR ratios, renew the charging of bank premiums, and most likely fuel the demand for reform.

One of the primary purposes of deposit insurance is to give "small" depositors, which can include individuals, families, and small businesses, a safe place to keep their savings/funds without having to worry about the condition of the institution in which they deposit them.⁵² In order to retain the real level of the available coverage, Congress has increased the maximum coverage level six times since 1934, and generally the increases have kept pace with, or exceeded, the level of inflation.⁵³

As mentioned previously, in 1980 the last increase occurred within the context of a tumultuous period in banking history.⁵⁴ With little debate, and occurring along with other banking reform legislation, Congress increased deposit insurance coverage from the 1974-set level of \$40,000 to \$100,000, reasoning that this substantial coverage increase would help banks attract new

49. Adam Wasch, *Powell Advises Higher Coverage for Retirement Savings Accounts*, 77 BANKING REP. (BNA) 627 (Oct. 22, 2001).

50. See KEEPING THE PROMISE, *supra* note 14, Letter from the FDIC Chairman.

51. Six in ten respondents to an FDIC survey conducted by Gallup reported that "a stock market crash or recession would prompt them to move their money to insured deposits." Press Release, Fed. Dep. Ins. Corp., FDIC Insurance Big Factor in Investment Decisions, Gallup Survey Shows (May 3, 2001) [hereinafter FDIC Insurance Big Factor], available at <http://www.fdic.gov/news/news/press/2001/pr3101.html> (last updated May 3, 2001).

52. KEEPING THE PROMISE, *supra* note 14, at 17.

53. *Id.* at 17-18. The 1980 increase to \$100,000 far exceeded the necessities of inflation and was instituted in part to help banks and thrifts retain outstanding certificates of deposit and attract new deposits to offset outflows due to interest rate ceilings. DEPOSIT INSURANCE OPTIONS PAPER, *supra* note 15, § IV.

54. See *supra* notes 26-30 and accompanying text.

deposits.⁵⁵ In hindsight, this disproportionate increase has been cited as one reason for the 1980s savings and loan crisis; it facilitated an influx of deposits into thrifts⁵⁶ creating moral hazard—the incentive for insured banks to engage in riskier behavior than they would have had they been uninsured.⁵⁷ The FDIC is authorized, as an ultimate enforcement measure against this risky behavior, to bring an action to terminate an institution's insurance if unsafe or unsound practices are discovered, however the penalty is so severe that it is rarely used.⁵⁸

Deposit insurance, additionally, creates moral hazard of a different sort. Deposit insurance shifts the bank insolvency risk away from depositors, who are the principal bank-debt holders, thus removing the incentive for them to monitor their banks' risky behaviors.⁵⁹

55. Bradley, *supra* note 16, at 18, (citing from STEPHEN PIZZO, MARY FRICKER & PAUL MUOLO, *INSIDE JOB: THE LOOTING OF AMERICA'S SAVINGS AND LOANS* (1989)).

56. KEEPING THE PROMISE, *supra* note 14, at 20; *see also* DEPOSIT INSURANCE OPTIONS PAPER, *supra* note 15, § IV; Blinder & Wescott, *supra* note 18 (stating that there existed a widely-held view that the increase in 1980 was unjustified at the time and contributed to the savings and loan crisis); John R. Engen, *The Family Feud over Deposit Insurance*, U.S. BANKER, Nov. 1997 at 69, 70 (citing Richard Kovacevic, Chairman and CEO at Norwest Corp.) (claiming deposit insurance caused the S&L crisis because it provided incentive for thrift management to take foolish risks, knowing they would be bailed out).

57. *Hanc*, *supra* note 1, at 3. Moral hazard is mitigated when losses are passed on to the insurer but profits accrue to owners. *See* MACEY & MILLER, *supra* note 26, at 280-81. Thus, nearly insolvent insured banks are especially attracted to risky investments with high potential gain, because with insurance there is only an upside to their action. *Hanc*, *supra* note 1, at 3-4. A strong capital position will shift losses from the insurer to the bank, which is why strong capital regulation tends to curb moral hazard. *Id.* at 4. U.S. taxpayers, as the ultimate insurers, paid over \$130 billion to clean up this crisis, which followed the demise of the Federal Savings and Loan Insurance Corporation (FSLIC), the predecessor to the BIF and SAIF. DEPOSIT INSURANCE OPTIONS PAPER, *supra* note 15, § I. *See also Fed Offers Broad Support for Deposit Insurance Reform*, BANK BAILOUT LITIGATION NEWS, Sept. 17, 2001 [hereinafter *Fed Offers Broad Support*] (citing Federal Reserve Board of Governor, Laurence Meyer defining "moral hazard" as the inducement to take risks at the expense of the insurer).

58. MACEY & MILLER, *supra* note 26, at 597. An order to immediately terminate a bank's deposit insurance would trigger a run on the bank; thus, termination of insurance is usually phased-in for current deposits, and additional deposits made after the order are not insured. *Id.*

59. *Id.*, Ch. 3 at 281. Depositors' lax attitudes about monitoring their bank's loans have been especially prevalent in recent years due to the widespread perception that certain banks are too big to fail, thus making deposits of any size, in

Based on the Consumer Price Index (CPI), the real value today of the \$100,000 coverage has fallen to half of its 1980 value, and is actually less than it was in 1974 when the level was increased to \$40,000.⁶⁰ However, it is important to keep in mind that at the time it was instituted, there was no clear rationale for the \$100,000 figure.⁶¹ Some economists, espousing the free-market view, believe the government should not provide any deposit insurance because, as stated above, it discourages depositors from monitoring their banks for soundness.⁶² However, one can argue that average individual or small business depositors can hardly be expected to have the time, inclination, or skill to evaluate the safety of their banks.⁶³ In a March 2001 report to the FDIC on reform of deposit insurance, the authors maintain that depositor monitoring would be unrealistic and inefficient, except possibly for extremely large or sophisticated depositors.⁶⁴ Thus a key policy question arises as to what constitutes a small deposit and, accordingly, at what level should each deposit be insured.⁶⁵ Additionally, the authors argue that because the current limit is based, not on the individual, but on the right and capacity⁶⁶ in which an individual holds an account, investors can easily exceed the \$100,000 limit and still retain insurance on their funds.⁶⁷ Thus the authors urge modifying the formula for determining how

such a bank, totally guaranteed by the government. *Id.*

60. KEEPING THE PROMISE, *supra* note 14, at 18. In 1980 dollars, the initial coverage level, six increases, and current level are valued as follows: 1934 (January), \$15,373; 1934 (June), \$30,746; 1950, \$34,191; 1966, \$38,148; 1969, \$44,905; 1974, \$66,856; 1980, \$100,000; 2000 (still at 1980 level), \$43,728. *Id.* at 18.

61. See Blinder & Wescott, *supra* note 18. "The current limit was pulled out of thin air in 1980, and thus has no particular claim to optimality. . . ." *Id.*

62. *Id.*

63. See *id.*

64. *Id.*

65. *Id.*

66. The FDIC defines "right and capacity" as the manner in which funds are owned or held; for instance in individual, joint, trust, or retirement accounts. FED. DEPOSIT INS. CORP., EDIE (ELECTRONIC DEPOSIT INS. ESTIMATOR): DEPOSIT INS. DEFINITIONS, at <http://www2.fdic.gov/edie/cHelpLinks/L07.asp> (last updated Nov. 8, 2000).

67. Blinder & Wescott, *supra* note 18. To illustrate this principle, recent revisions to FDIC regulations concerning insurance coverage for joint accounts allow coverage up to \$200,000 on joint accounts in the names of both spouses that are comprised of community property funds *separate* from any funds deposited in their individual accounts. 12 C.F.R. § 330.9 (2001).

deposit limits apply, so limits are imposed on the individual versus the account type.⁶⁸

The Independent Community Bankers of America (ICBA), which promotes itself as the “primary voice for community banks in the United States,”⁶⁹ points out its members’ unique challenges to competing in the marketplace for deposits and loans. On one side, they argue they are disadvantaged in competing with tax-exempt credit unions and the Farm Credit System, both of which can attract funds more easily and charge lower interest rates on loans.⁷⁰ On the other side, large banks, considered too-big-to-fail have an advantage in attracting large deposits because depositors tend not to worry about uninsured savings in excess of the \$100,000 limit.⁷¹ In addition, the ICBA argues the current deflated value of deposit insurance essentially erodes the advantage and value of safe retirement planning and conservative saving in bank deposit accounts by destroying the

68. Blinder & Wescott, *supra* note 18.

69. INDEPENDENT COMMUNITY BANKERS OF AMERICA, MISSION STATEMENT, at http://www.ibaa.org/about_icba/mission.html (last visited March 3, 2002).

70. INDEPENDENT COMM. BANKERS OF AMERICA, FED. DEPOSIT INS.—TIME FOR REFORM AND INCREASED COVERAGE, ICBA SPECIAL REP. 4-5 (Fall 2000) [hereinafter ICBA SPECIAL REP.], available at http://www.icba.org/deposit_insurance/depinsbrochure.pdf (last visited Feb. 3, 2002). The Farm Credit System is a government-sponsored enterprise (GSE) that offers deposit-like instruments to farmers. *Id.* As a GSE, it enjoys tax exemptions and can raise funds more favorably in the capital markets. *Id.* at 5. Credit unions also enjoy tax exempt status. *Id.* at 4.

71. *Id.* at 5. The “too big to fail” doctrine refers to the systemic risk exception which advances funds (upon a joint determination by the Secretary of the Treasury, the President, the FDIC and the Fed) to institutions deemed “too big to fail.” Testimony of James E. Smith, May 16, 2001, *supra* note 39, at 14 & n.4. The result is that technically uninsured deposits are in reality “implicitly insured,” providing these banks with an unfair competitive advantage in raising funds. Blinder & Wescott, *supra* note 18. During the 1980s, bank regulators feared the possibility that imposing losses on uninsured depositors and other creditors of large failed banks would trigger runs on other large banks that depended on uninsured funding. Hanc, *supra* note 1, at 9. “The FDICIA codified the notion that some banks are so important to the nation’s economic health that the government cannot allow them to collapse.” Engen, *supra* note 56, at 69, 72. The FDICIA allows the government to cover uninsured depositors and creditors to prevent a failure that would endanger the existing global payment systems. *Id.* Chairman Greenspan claims uninsured creditors will have little reason to conduct a risk analysis on larger banking institutions if it is understood that they will always be made whole under a de facto “too big to fail” policy. Chairman Greenspan, *Condition of the U.S. Banking System*, *supra* note 45. However, under the 1991 FDICIA, there are no requirements that uninsured creditors be made whole. *Id.*

trade-off between security and return, which inadvertently forces consumers into higher risk investments.⁷²

All of these arguments highlight community banks' current difficulty in sustaining their deposit base, which has historically been their prime funding source for local lending.⁷³ Loan-to-deposit ratio norms have shifted from the mid-seventy percent range in the early to mid 1990s to the mid-ninety percent range currently, with some banks now exceeding one hundred percent.⁷⁴

Congress addressed these funding concerns when it passed the Federal Home Loan Bank (FHLB) provisions of the Gramm-Leach-Bliley Act of 1999, creating access to advances from home loan banks for qualifying community financial institutions.⁷⁵ Unfortunately, the costs to qualifying institutions to obtain such advances are higher than traditional sources of funding, and advances often contain other undesirable provisions such as increased collateral requirements and callability.⁷⁶ Thus, the three federal banking regulators and some policy makers have misgivings about banks becoming too dependent on FHLB, warning that banks need to maintain their regulatory ratings in order to retain eligibility.⁷⁷

Banks can alternatively obtain funds through selling mortgages on the secondary market.⁷⁸ This is, however, a limited option for community banks serving primarily rural markets since the majority of their mortgages do not meet secondary market underwriting requirements.⁷⁹

72. ICBA SPECIAL REP., *supra* note 70, at 12. Investments in bank time deposits only become more attractive if they are totally secure because in such a situation they offer the elimination of risk at the sacrifice of greater potential yield. *Id.* Once investors exceed the \$100,000 limit, this security diminishes, shifting the balance. *Id.*

73. *Id.* at 15.

74. Steve Cocheo, *The Search for Funding*, A.B.A. BANKING J., Jan. 2001, at 6.

75. ICBA SPECIAL REP., *supra* note 70, at 15. Qualifying banks are community financial institutions with \$500 million or less in assets. *Id.* See generally Gramm-Leach-Bliley Act, Pub. L. No. 106-102, 113 Stat. 1338-1481 (1999) (codified as amended in scattered sections of 12, 15, 16, 18 U.S.C.). Since 1980, FHLB advances to thrifts have grown from 8.2% to 19.1% of liabilities. DEPOSIT INSURANCE OPTIONS PAPER, *supra* note 15, § IV.

76. See Cocheo, *The Search for Funding*, *supra* note 74, at 6.

77. ICBA SPECIAL REP., *supra* note 70, at 15-17; see also Cocheo, *The Search for Funding*, *supra* note 74, at 6.

78. ICBA SPECIAL REP., *supra* note 70, at 16-17.

79. *Id.* at 16-17.

In its August 2000 Options Paper, the FDIC reported that proponents of extending deposit insurance coverage for municipal and other public deposits “argue that it would allow smaller banks to compete more effectively for public deposits and it would reduce administrative burdens for all insured institutions.”⁸⁰ The current requirement that financial institutions pledge bank assets for these deposits limits the amount of public funds that insured institutions can attract.⁸¹ Full FDIC coverage would eliminate these requirements since formerly secured deposits would now be insured; thus this option could increase the possibility of moral hazard and lead to a large rise in insured deposits, substantially reducing the BIF and SAIF funds.⁸² Full coverage would also enhance the entire banking industry’s ability to attract more funds, consequently eliminating the purported advantage to community banks.⁸³ A better reform option might be to continue to provide higher coverage only for in-market municipal deposits.⁸⁴

Thus, deposit insurance raises a number of related issues and requires a careful balancing of interwoven public policy concerns.⁸⁵

IV. FDIC PROPOSALS AND PROPOSED LEGISLATION

A. *FDIC Proposal under Chairman Tanoue’s Tenure*

The FDIC, under Tanoue’s leadership, issued an Options Paper in August 2000, discussing some of the current system’s weaknesses, and proposing a number of solutions.⁸⁶ In April 2001,

80. DEPOSIT INSURANCE OPTIONS PAPER, *supra* note 15, § IV. Currently state law requires that most banks collateralize these deposits, which creates reporting requirements and requires collateral asset management, and associated administrative expenses. *Id.*

81. *Id.*

82. *Id.* Based upon March 31, 2000 data, it is estimated in the Options Paper that if public deposits became fully insured, insured deposits would increase \$113.7 billion, bringing the combined BIF and SAIF reserve ratios from 1.38% to 1.32%. *Id.*

83. *Id.*

84. DEPOSIT INSURANCE OPTIONS PAPER, *supra* note 15, § IV. Currently the in-state public deposit coverage limit is \$200,000; the out-of-state limit is \$100,000. *Id.* Historically, the difference between the coverage for public and private deposits has been even larger. *Id.*

85. *Id.* § I.

86. *See id.* §§ I–VII (as cited in KEEPING THE PROMISE, *supra* note 14, at i).

the FDIC released an agency report entitled, *Keeping the Promise: Recommendations for Deposit Insurance Reform*, announcing its proposed package of five general reforms and offering multiple suggestions for how some of these revisions could be implemented.⁸⁷ The proposed reforms, all of which would require statutory changes, included: (1) merging the BIF and SAIF funds; (2) amending the statutory restrictions against charging regular risk-based premiums to all institutions (rather than just to those that are undercapitalized) regardless of the level of the fund; (3) changing the way premiums are assessed when the fund(s) fall below the mandated DRR, thereby eliminating the potential for sharp premium swings; (4) using rebates to avoid excessive growth to the insurance fund; and (5) indexing deposit insurance coverage to maintain its value in real terms.⁸⁸

While this report has garnered support among many industry watchers, various parties (legislators, interested government officials and representatives of banking groups) disagree with some or all of these recommendations, or that these recommendations must be implemented as a package deal. Perhaps one of the most contentious recommendations, particularly in terms of how it affects consumers, is the issue of raising the insurance coverage level. Even before the FDIC released its paper, Tanoue warned [regarding the proposed increase to the coverage limit] that “we must be mindful of incentives and the potential for unintended consequences”⁸⁹

Assuming that some level of deposit insurance is a good thing,⁹⁰ the FDIC purported that a better way to maintain the real value of deposit insurance coverage, as opposed to the current unpredictable, unevenly-timed system of ad hoc Congressional increases, is through an indexing system.⁹¹

87. See Press Release, Donald E. Powell, Chairman, Fed. Dep. Ins. Corp., Opening Statement Announcing the FDIC Preliminary Bank Earnings Rep., Second Quarter, 2001 (Sept. 5, 2001) [hereinafter Powell, Opening Statement, Sept. 5, 2001], available at <http://www.fdic.gov/news/news/speeches/archives/2001/sp05sep01.html> (last visited Feb. 28, 2002).

88. See KEEPING THE PROMISE, *supra* note 14, at 6.

89. *FDIC Considers Increase in Deposit Insurance Limit*, COM. LENDING LITIGATION NEWS, Mar. 31, 2000.

90. See *supra* note 52 and accompanying text.

91. KEEPING THE PROMISE, *supra* note 14, at 18.

Several questions emerge when considering an index system, including what index to use and the timing of the initial and subsequent adjustments.⁹² In *Keeping the Promise*, the FDIC proposed using the Consumer Price Index (CPI) as a practical index choice because it is widely understood and accepted, quickly available, and tracks well with the rate of inflation.⁹³ The FDIC further pointed out that other important government programs such as Social Security, Medicare, and taxes are indexed, and argued that consumers would easily understand this indexing concept.⁹⁴

Because changing the level creates burdens for banks and thrifts, the FDIC recommended soliciting industry input before deciding on the timing determinants: i.e., the particular percentage decline required to trigger an increase and a minimum time interval between each increase.⁹⁵ The FDIC also maintained that coverage levels should occur in round numbers and should not be allowed to decrease, so as to avoid creating uncertainties or burdening the public with the necessity of monitoring the level to avoid being underinsured.⁹⁶ Stating that it views Congress as the appropriate body to determine the ultimate level of coverage, the FDIC nevertheless suggested several factors for Congress to consider as it debates this issue.⁹⁷ These include: the adequacy of the current level; the moral hazard variable; qualifying municipal deposits and IRAs for higher coverage; and offering the option of additional coverage to banks, for an increased fee, in order to enable them to retain and/or attract large deposits.⁹⁸

B. *FDIC Chairman Donald Powell's Recommendations*

Deposit insurance reform advocates initially feared that a George Bush-appointed FDIC chairman might hinder the reform efforts initiated by outgoing Chairman Tanoue.⁹⁹ In his first

92. *Id.*

93. *Id.*

94. *Id.*

95. *Id.* at 19.

96. *KEEPING THE PROMISE*, *supra* note 14, at 19.

97. *Id.* at 20.

98. *Id.* at 20-21.

99. The Bush administration, in its 2003 budget proposal to Congress, announced it is not considering any proposals to raise the current deposit insurance coverage

appearance before Congress in his position as FDIC Chairman, the former Texas community banker,¹⁰⁰ Donald Powell, endorsed predecessor Chairman Tanoue's proposals¹⁰¹ and relayed his own thoughts on how he thinks Congress can create a better system.¹⁰²

As he addressed the issue of deposit insurance coverage, Chairman Powell stated that any reforms should attempt to address and balance: (1) the public's need for protection; (2) small bank funding needs; (3) the effect of any increase on the deposit insurance fund; and (4) the moral hazard problem.¹⁰³ While he did not support an immediate across-the-board increase in insurance coverage, he did recommend maintaining the future value of the coverage through indexing.¹⁰⁴ Chairman Powell suggested indexing the current \$100,000 limit to the CPI beginning January 1, 2005, with subsequent round-number adjustments occurring every five years.¹⁰⁵ He was willing, however, to support any reasonable, easy-to-understand indexing system.¹⁰⁵

Citing several reasons, Chairman Powell expressed stronger and more specific recommendations regarding raising insurance limits for IRA and Keogh (retirement) accounts.¹⁰⁷ He argued that protecting such accounts was consistent with existing government policies encouraging long-term saving; that the current \$100,000 limit was inadequate for middle-class family retirement savings; and that encouraging savings in such long-term vehicles would funnel funds back into the economy facilitating solid,

limit above \$100,000. Adam Wasch, *Financial Institutions: Bush Rejects Increasing Deposit Insurance Coverage; Budget Pushes for Less Regulation*, *Banking Daily* (BNA), Feb. 5, 2002.

100. Donald Powell had been Chairman of the FDIC for almost a week when he gave his opening statement at a press conference on September 5, 2001. See Powell, *Opening Statement*, Sept. 5, 2001, *supra* note 87, at 1.

101. Rob Blackwell, *Near-Dead FDIC Reform Looking Like High Priority*, *AM. BANKER*, Dec. 27, 2001, at 1.

102. *Deposit Insurance Reform: Hearings Before the Subcomm. on Financial Institutions and Consumer Credit, House Comm. on Financial Services, 107th Cong.* (Oct. 17, 2001) (statement of Donald E. Powell, Chairman of the Fed. Deposit Ins. Corp.) [hereinafter Powell, Statement, Oct. 17, 2001], available at <http://www.fdic.gov/news/news/speeches/archives/2001/sp17oct01.html> (last updated Feb. 28, 2001).

103. *Id.* at 2.

104. *Id.*

105. *Id.*

106. *Id.*

107. *Id.* at 3.

sustainable growth.¹⁰⁸ Chairman Powell suggested dramatically increasing the coverage level for these accounts to \$250,000,¹⁰⁹ but conceded that the FDIC must first research the implications of such a change and furnish its findings to Congress and the public before a final decision is made.¹¹⁰

C. *Proposed Legislation*

Whereas industry representatives have presented a somewhat united front concerning the need for FDIC reform, members of Congress have appeared more divided.¹¹¹ However, the recent Superior Bank failure, which is expected to impact the SAIF fund severely, raised a warning about the potential exposure to the deposit insurance system if a banking crisis develops and has prompted concerns in Congress.¹¹²

Currently, “two legislative champions—Senator Tim Johnson (D-SD) and Representative Spencer Bachus (R-AL)—are poised to introduce comprehensive legislation” early in 2002.¹¹³ After Chairman Powell’s testimony on his recommendations for FDIC reform at the House Financial Services Financial Institutions Subcommittee meeting, Chairman Bachus indicated to Chairman Powell that he generally agreed with his views and was particularly pleased to hear about Chairman Powell’s stance on

108. Powell, Statement, Oct. 17, 2001, *supra* note 102, at 3.

109. Blackwell, *Near-Dead FDIC Reform*, *supra* note 101, at 1.

110. Powell, Statement, Oct. 17, 2001, *supra* note 102, at 3.

111. Rob Blackwell, *Sarbanes: Is Warning System Working?*, AM. BANKER, Aug. 3, 2001, at 1, 4.

112. *Id.*; see also McNamee, *supra* note 2, at 45. Senate Banking Committee Chairman, Paul Sarbanes (D-MD) warns that “Superior is ‘a timely reminder of the potential exposure’” to the FDIC funds. *Id.* As of September 30, 2001, the SAIF had fallen from 1.44% to 1.39% in three quarters, and during the same period the BIF dropped from 1.35% to 1.32%. Blackwell, *Near-Dead FDIC Reform*, *supra* note 101, at 1. After September 11, federal banking regulatory policy-making activity has focused primarily on regulatory proposals to combat terrorism through controlling access to international banking services. Richard Cowden, *Outlook 2002: Federal Banking Regulatory Agendas Dominated by USA Patriot Act Rulemaking*, BANKING DAILY (BNA), Jan. 23, 2002. Though the FDIC deposit insurance reform proposal is supported by key subcommittee chairs on the House and Senate banking committees, it must compete with other pressing issues for time on the congressional schedule. *Id.* See generally Robert S. Pasley, *Privacy Rights vs. Anti-Money Laundering Enforcement*, 6 N.C. BANKING INST. 147 (2002).

113. Blackwell, *Near-Dead FDIC Reform*, *supra* note 101, at 1.

increasing coverage for retirement accounts.¹¹⁴ In February 2002, Chairman Bachus, in conjunction with Representative Michael Oxley (R-OH), House Financial Services Committee Chair, introduced long-anticipated, and comprehensive, reform legislation which they plan to move through committee and have ready for presidential signature before the end of the year.¹¹⁵ The bill would, among other things, increase the coverage limit from \$100,000 to \$130,000, provide for inflation indexing every ten years, raise retirement account coverage to \$260,000, and “insure in-state municipal deposits up to the total equity capital of the insured institution.”¹¹⁶

In the Senate, the June 2001 defection of Vermont Senator James Jefford from the Republican party set in motion a change in leadership, both in the Senate and in its Banking Committee, which should favor continued discussion on the topic of deposit insurance reform and increasing insurance coverage.¹¹⁷ Senator Johnson, who is the third-ranking Democrat on the Senate Banking Committee and new chairman of the Subcommittee on Financial Institutions, introduced in January 2001 an amending bill to the Federal Deposit Insurance Act to require periodic (every three years) cost of living adjustments to the maximum amount of deposit insurance coverage.¹¹⁸ This bill tracked the ICBA’s recommendations on indexing deposit insurance.¹¹⁹ Senator

114. Rob Blackwell, *FDIC Chief's IRA, Premium Ideas Find House Support*, AM. BANKER, Oct. 18, 2001, at 1 [hereinafter Blackwell, *FDIC Chief's IRA, Premium Ideas*].

115. Adam Wasch, *Financial Institutions: Rep. Bachus Introduces Deposit Insurance Reform Bill*, Banking Daily (BNA), Feb. 13, 2002. See also Adam Wasch, *Deposit Insurance: Oxley, Bachus Push for Higher Deposit Insurance Coverage Limits*, Banking Daily (BNA), Feb. 8, 2002.

116. *Id.*

117. See Steve Cocheo, *Quick: Take on the Senate Turnover*. A.B.A. BANKING J., July 2001, at 6. Senator Paul Sarbanes (D-MD) replaced Senator Phil Gramm (R-TX) as Chair of the Senate Banking Committee. *Id.* Senator Gramm was extremely opposed to deposit insurance reform and did not plan to address it in committee, thus hearings on this topic, which would likely not have occurred soon or at all under Senator Gramm’s leadership, may now take place. *Id.*

118. See S. 128, 107th Cong. (1st Sess. 2001) (cited as Meeting America’s Investment Needs in Small Towns Act of 2001).

119. Richard Cowden, *Powell Backs Deposit Insurance Reform as Proposed in April by Predecessor Tanoue*, 77 BANKING REP. (BNA) 355, Sept. 10, 2001 [hereinafter Cowden, *Powell Backs Deposit Insurance Reform*].

Johnson plans to draft a 2002 bill, similar to the Bachus bill, so that the Senate legislature tracks with the House efforts.¹²⁰

A number of earlier bills that addressed some of the deposit insurance coverage issues raised by the FDIC had also been introduced in both the House and Senate in 2001.¹²¹ Representative Joel Hefley (R-CO) introduced a bill similar to the Johnson bill in June 2001 that provided for cost of living adjustments every three years beginning January 1, 2002.¹²²

Senator Robert Toricelli (D-NJ), in January 2001, introduced a bill (similar to a provision in the Bachus bill) increasing deposit insurance coverage for in-state municipal depositors up to the total amount of the deposit.¹²³ In May 2001, Representative Paul Gillmor (R-OH) sponsored a similar House bill.¹²⁴

V. EVALUATION OF THE DEPOSIT INSURANCE COVERAGE PROPOSALS

A. *Positions of Regulators and Other Government Entities*

Federal government representatives have conflicting views regarding increasing and/or indexing deposit insurance coverage at this time. Donald Powell, Chairman of FDIC, and Ellen Seidman, former Director of the Office of Thrift Supervision (OTS)/Treasury, endorse indexation; Alan Greenspan, Chairman of the Federal Reserve Board (the Fed) and Sheila Bair, the Assistant Secretary for Financial Institutions at the Treasury Department, oppose any indexing.¹²⁵ John Hawke, Comptroller of the Currency, recently stated he had “no objection” to indexing,¹²⁶

120. Adam Wasch, *Deposit Insurance: Rep. Bachus, Sen. Johnson Prepare Broad Deposit Insurance Reform Proposals*, Banking Daily (BNA), Jan. 25, 2002.

121. Representative Oxley reported holding three hearings on deposit insurance reform in 2001. *Id.*

122. See H.R. 746, 107th Cong. (1st Sess. 2001) (cited as the Federal Deposit Insurance Corporation Adjustment Act).

123. See S. 227, 107th Cong. (1st Sess. 2001) (cited as the Municipal Deposit Insurance Protection Act of 2001).

124. See H.R. 1899, 107th Cong. (1st Sess. 2001) (cited as the Municipal Deposit Insurance Protection Act of 2001).

125. Rob Blackwell, *In Brief: Comptroller Endorses Insurance Indexing*, AM. BANKER, Dec. 26, 2001, at 5.

126. *Id.*

leading some to believe there is growing support among federal regulators for FDIC reform.¹²⁷

Representatives of the Fed and some representatives from the Treasury Department disagree with both the aim and method of insurance coverage reform and oppose raising the coverage level because they believe it would weaken market discipline and encourage more risk-taking by banking institutions.¹²⁸ They are also among those who believe in maintaining the coverage ceiling at this time, testifying that depositors, especially large wealthy ones, should be held accountable for scrutinizing their financial institutions for soundness¹²⁹ rather than depending solely on deposit insurance to keep their savings safe. Refuting this view, Kenneth Guenther, President and Chief Executive Officer of the ICBA, questioned how an ordinary depositor could be expected to effectively monitor banks when the OTS was unable to predict the recent failure of \$2.3 billion asset Superior Bank.¹³⁰

The Fed and various Treasury representatives are likely, as well, to continue their opposition to an index system to maintain the real value of the coverage limit because of their belief that raising coverage would dramatically increase the federal safety net and undermine market discipline.¹³¹ In addition, it is anticipated that they will oppose Chairman Powell's proposal to increase the coverage level for retirement accounts to \$250,000.¹³²

Speaking before a subcommittee of the House Financial Services Committee, Fed Governor Laurence Meyer supported all the FDIC reform proposals except for the increase to deposit insurance coverage.¹³³ Although small banks argued that the increase would enable them to compete with larger institutions offering multiple insured accounts through affiliated entities, Governor Meyer countered this argument, claiming that "raising

127. *Id.* (citing Senator Tim Johnson (D-SD)).

128. Rob Blackwell, *What Price Is Too High for Reform?*, AM. BANKER, Aug. 6, 2001, at 1, 4.

129. Rob Blackwell, *Superior's Uninsured \$66M: Fuel for Reform*, AM. BANKER, Aug. 14, 2001, at 1, 5 [hereinafter Blackwell, *Superior's Uninsured \$66M*]. See also Blackwell, *What Price Is Too High*, *supra* note 128, at 1, 4.

130. Blackwell, *Superior's Uninsured \$66M*, *supra* note 129, at 1, 5.

131. Blackwell, *Near-Dead FDIC Reform*, *supra* note 101, at 1. Some large banks join the Fed and Treasury Dept. in this view. *Id.*

132. Blackwell, *Near-Dead FDIC Reform*, *supra* note 101, at 1.

133. *Fed Offers Broad Support*, *supra* note 57.

the coverage limit of each account would also increase the amount large multibank organizations would be able to offer, preserving the competitive disparity.”¹³⁴ Governor Meyer also reiterated that deposit insurance creates a moral hazard issue—inducing banks to take excessive risks at the expense of the insurer (the FDIC) because insured depositors are no longer concerned about banks’ risky conduct.¹³⁵ Governor Meyer further warned that when contemplating deposit insurance reforms, it is necessary to consider the inherent tradeoffs between the benefit of providing market stability and protection to the small investor, and the cost of the reduction of market discipline.¹³⁶

Chairman Greenspan, has also stated his opposition to increasing the deposit insurance coverage limit because it would undermine depositor discipline.¹³⁷ FDIC Chairman Powell, however, disputed the arguments made by Chairman Greenspan and other critics that indexing the insurance coverage limit would undermine depositor discipline by increasing the federal safety net.¹³⁸ Instead, Chairman Powell claimed the FDIC was not recommending an *increase* to the safety net, but simply recommending that it not be *decreased* due to inflation.¹³⁹

Industry observers and participants had not seen FDIC reform as a high priority for the current administration as there has been only moderate pressure from the industry to push through changes.¹⁴⁰ The administration’s current propensity may become even more pronounced due to its recent focus on national

134. *Id.*

135. *Id.*

136. *Id.*

137. See AM. BANKERS ASSOC., ABA TALKING POINTS ON DEPOSIT INSURANCE REFORM (Mar. 8, 2001) (citing Chairman Greenspan’s stated opposition to enacting a \$200,000 limit), available at <http://www.aba.com/Industry+Issues/DITalkingPoints.html> (last visited Feb 28, 2002); see also Blackwell, *FDIC Chief’s IRA, Premium Ideas*, *supra* note 114, at 1 (citing Chairman Powell’s reference to Chairman Greenspan’s objection to indexing the deposit insurance limit). Chairman Greenspan refers to deposit insurance and other federal programs intended to keep banks safe as the “safety net.” *Greenspan Cautions on F.D.I.C.*, N.Y. TIMES, May 11, 2001, at C14. He cautions that any changes to this safety net must be balanced against potential costs. *Id.*

138. Blackwell, *FDIC Chief’s IRA, Premium Ideas*, *supra* note 114, at 1.

139. Powell, Statement, Oct. 17, 2001, *supra* note 102, at 3.

140. Michele Heller, *A Read (Finally) on Treasury’s Policy Plan*, AM. BANKER, Aug. 22, 2001, at 1, 4 (citing Edward L. Yingling, chief lobbyist for the ABA) [hereinafter Heller, *A Read (Finally)*].

security and combating international terrorism. Additionally, both the Fed and Treasury argue that depositors are not asking for an increase and do not believe that lost deposits due to coverage limits are the cause of the funding shortage in community banks.¹⁴¹ Regarding the issue of depositor demands, the government's position on increasing deposit insurance is interesting, especially in view of the results of a recent Gallup survey poll indicating deposit insurance was important to the majority of respondents when making decisions on where to invest.¹⁴² With the aging of baby boomers, and in our present national climate, touched by fear of war and terrorism as well as uncertainty about the economy, one can surmise from the results of this survey that consumers will increasingly favor financial safety and increased insurance coverage for their deposits. Kenneth Guenther (ICBA President) has also indicated that the "AARP generation" has become much more interested in increased depositor coverage since the decline of the stock market.¹⁴³

In an appendix to recent testimony before the Senate Committee on Banking, Housing, and Urban Affairs, Chairman Greenspan reported that community banks have successfully maintained their core deposit bases, although the percentage of their assets funded by core deposits has dropped moderately in the

141. Blackwell, *Treasury Joins Fed*, *supra* note 42, at 1, 3. *Contra* ICBA SPECIAL REP., *supra* note 70, at 15. In its fall 2000 special report on Federal Deposit Insurance, the ICBA (Independent Community Bankers of America) cited small banks' difficulty attracting and maintaining their deposit base—historically their primary funding source—which is needed to keep pace with strong loan demand against the backdrop of a strong economy and more attractive alternative investment vehicles. *Id.*

142. The poll, questioning individual consumers who make household financial decisions, showed that while more respondents cited risk and return as factors in deciding where to invest family money, fifty-seven percent of them considered deposit insurance "very important" when determining where to invest. *See FDIC Insurance Big Factor*, *supra* note 51. The majority of respondents also would reportedly move some deposits into bank insured accounts if levels were raised, and predicted they would be more likely to move their money to insured deposits as they neared retirement, or in response to a stock market crash or recession. *Id.*

143. Blackwell, *Near-Dead FDIC Reform*, *supra* note 101, at 1. AARP, formerly known as the American Association of Retired Persons, is a non-partisan organization for individuals fifty years of age and older with over thirty-four million members. AARP, WHAT IS AARP?, at http://aarp.org/what_is.html (last visited Jan. 18, 2002). It focuses on enhancing the lives of its members in four areas (health and wellness; economic security and work; long term care and independent living; and personal enrichment) through, among other things, advocacy and education. *Id.*

past ten years from eighty percent to seventy-three percent for banks with less than fifty million dollars in assets.¹⁴⁴ Rapid loan growth, however, combined with this moderate drop in the percentage of assets funded by core deposits, has put pressures on community banks to seek funding elsewhere.¹⁴⁵ The Fed expressed concern that the variety, complexity, volatility and volume of these non-traditional funding sources create new issues, prompting it to provide guidance highlighting the importance of adequate bank management techniques for ensuring stable and consistent funding.¹⁴⁶

In August 2001, Sheila Bair, the Assistant Secretary for Financial Institutions at the Treasury Department, and the first Bush administration official to speak at length about deposit insurance, testified on behalf of the Treasury Department before the House Financial Services Subcommittee. She strongly endorsed many of the FDIC recommendations but opposed deposit insurance coverage increases and indexing,¹⁴⁷ claiming the Treasury did not find the current limit on deposit insurance burdensome to consumers.¹⁴⁸

Former OTS Director Ellen Seidman, in an address to the House Financial Institutions Subcommittee, encouraged Congress to build on the FDIC reform proposal.¹⁴⁹ She stated that before raising or indexing the deposit insurance coverage limit, the implementation of a real risk-based pricing system was necessary because the negative effects of inappropriate insurance pricing are magnified as the ceiling increases.¹⁵⁰ She also pointed out that

144. Greenspan, *Condition of the Banking Industry*, *supra* note 45, at 5.

145. *Id.* Community banks are responding to this challenge by turning to jumbo deposits and Federal Home Loan Bank advances, and by liquidating securities holdings and raising their loan-to-deposit ratios to peak levels. *Id.*

146. *Id.* at 5-6.

147. Heller, *A Read (Finally)*, *supra* note 140, at 1, 5. See also Cowden, *Quarterly Bank Earnings Remain Strong*, *supra* note 47, at 355.

148. Cowden, *Powell Backs Deposit Insurance Reform*, *supra* note 119, at 355 (citing 77 BBR 173, July 30, 2001).

149. *OTS Stakes Out Position on Deposit Insurance Reform*, BANK BAILOUT LITIGATION NEWS, Sept. 17, 2001 [hereinafter *OTS Stakes Out Position*]. Seidman also supported reforming the misallocation of insurance fund resources concerning bank and thrift regulatory supervision. *Id.*

150. *Federal Deposit Insurance Reform: Hearings Before the Subcomm. on Financial Institutions and Consumer Credit, House Comm. on Financial Services*, 107th Cong. 9 (July 26, 2001) (testimony by Ellen Seidman, Dir. of the Off. of Thrift Supervision) [hereinafter *Seidman, Testimony*, July 26, 2001], <http://www.ots.treas.gov>.

choosing the right level is especially important with indexing, as opposed to ad hoc increases, because it would lock in the level over time.¹⁵¹ While Seidman endorses indexation,¹⁵² she nevertheless cautions that the FDIC reform components are highly interrelated and supports changing coverage levels only in “the context of comprehensive reform.”¹⁵³

B. Banks' Positions—Funding Concerns

Efforts to revise deposit insurance may ultimately depend on whether bankers with different perspectives and objectives can come to agreement on a number of technical issues.¹⁵⁴ Most banks generally oppose any unilateral increase in premiums, and thus fear that an increase in deposit coverage will necessarily entail some type of funding mechanism to maintain the DRR level.¹⁵⁵ Other banks, especially small community banks, are more willing to assume some small increase if it will mean increased deposits.¹⁵⁶

The American Bankers Association (ABA) is the largest banking trade organization in the country, representing banks of all sizes and categories from community and regional to money center banks and holding companies.¹⁵⁷ In 2000 it commissioned an independent study to measure the impact of raising the deposit insurance level to \$200,000.¹⁵⁸ Professor Mark Flannery, the

gov/docs/87088.pdf (last visited Jan. 19, 2002).

151. *Id.* at 9-10.

152. See Blackwell, *In Brief*, *supra* note 125, at 5.

153. *OTS Stakes Out Position*, *supra* note 149.

154. McNamee, *supra* note 2, at 45.

155. See Press Release, *Deposit Insurance Reform, Hearings Before the Subcomm. on Financial Institutions of the Senate Comm. on Banking, Housing and Urban Affairs* (Aug. 2, 2001) (testimony of Jeff L. Plagge on behalf of the ABA) [hereinafter Plagge, Testimony Aug. 2, 2001] at <http://www.aba.com/Press+Room/testimony080201.html> (last visited Feb. 14, 2002).

156. Press Release, Don Mengedoth, *Deposit Insurance Reform, Memo to All Banking Inst. from ABA President* (Mar. 9, 2001) at <http://www.aba.com/Press+Room/DepositInsuranceMemoFollowup.html> (last visited Feb. 14, 2002). See generally Plagge, Testimony, Aug. 2, 2001. The ICBA argues that an increase in coverage may not increase the FDIC's or the taxpayer's exposure, which will be dependent on depositor behavior. ICBA SPECIAL REP., *supra* note 70, at 5.

157. Plagge, Testimony, Aug. 2, 2001, *supra* note 155.

158. Press Release, Don Mengedoth, *Study on Benefits and Costs of \$200K Deposit Ins. Coverage, Memo to Member Banks and Savings Inst. CEOs from ABA President* (Jan. 3, 2001), at <http://www.aba.com/Press+Room/>

Banking Chair at the University of Florida, conducted this study, and his research and modeling enabled him to predict both the expected benefits and costs to the industry.¹⁵⁹ His projections included a combined rise in insured deposit balances of \$128 to \$422 billion, driving the insurance fund's reserve ratio to between 1.11% to 1.21%, which would necessitate renewed premium assessments for all covered institutions.¹⁶⁰

The ABA had previously urged an upward adjustment to the insurance limit to take into account inflationary devaluation, and also recommended permanently indexing the fund to ease depositors' fears about protection erosion.¹⁶¹ However, after reviewing responses to ABA President Don Mengedoth's letter to its members soliciting feedback on the proposed coverage increase, the organization recognizes splits in member opinions on this issue.¹⁶² Some members, primarily community bank executives, feel \$200,000 coverage is essential to attracting deposits and are willing to absorb additional cost, while other community bankers disagree that increased coverage would result in a transfer of funds from higher-yield, uninsured accounts from other

DepositInsurancememo.htm (last visited Feb. 14, 2002).

159. Mark J. Flannery, Ph.D., *Increasing Deposit Insurance Coverage: Implications for the Federal Insurance Funds and for Bank Deposit Balances*, prepared for the American Bankers Association, Dec. 2000, at <http://www.aba.com/NR/rdonlyres/00002ea2panhegmuokjcjrym/mjfrepp9999996.pdf> (last visited Feb. 14, 2002). The study hypothesized that raising the insurance limit would raise insured deposit balances in two ways: (1) by raising the insurable portion of balances already in place; and (2) by helping bankers attract new funds into the industry. *Id.* at ii. Doubling the insurance coverage on *existing* bank balances (as of June 30, 2000) would have increased the total insured balances approximately 8.33% (\$246 billion) higher than they were under the \$100,000 limit, without even experiencing an increase in the actual deposits and would subsequently reduce the combined BIF and SAIF reserve ratio from 1.36% to 1.26%. *Id.* Flannery stated that projecting the amount of *additional* bank deposits resulting from the increased coverage level was more difficult because it necessarily involves estimations. *Id.* at 18. He based his estimates on customer attitudes towards deposit insurance, gathered through ABA-sponsored telephone surveys to high net worth individual and small business owner customers, and roughly predicted a four to thirteen percent increase over current domestic deposits. *Id.* at ii-iii.

160. *Id.* at iii-iv.

161. See *ABA Urges Insurance Deposit Reform*, BANK BAILOUT LITIGATION NEWS, July 17, 2000 (citing comments by James E. Smith, First Vice President of ABA); see also *FDIC Releases 'Options Paper' on Deposit Insurance Reform*, BANK BAILOUT LITIGATION NEWS, Sept. 12, 2000 (citing comments by Edward Yingling, Executive Director of ABA Government Relations).

162. Mengedoth, *Deposit Insurance Reform*, *supra* note 156.

institutions.¹⁶³ Still others suggest more research is needed, including a more detailed look at the effects of the 1980 increase.¹⁶⁴

The ABA, as an organization, has strong reservations about increasing insurance premium costs to its member banks, and generally opposes any deposit insurance legislation that imposes significant new insurance costs.¹⁶⁵ It has consistently opposed legislative reforms that would result in an increase in premiums when the insurance funds are above the statutory 1.25% DRR.¹⁶⁶ It argues strongly for continuance of the zero-premium system¹⁶⁷ for top-rated banks, except those which are growing faster than the norm, claiming that the current forty-two billion dollars in FDIC funds are a result of significant previous sacrifice on the part of banks and savings institutions.¹⁶⁸ The ABA also argues that the zero-premium system provides incentives for banks to be in the top category, and that new premiums, translating into additional expenses for the banks, would result in lost lending opportunities.¹⁶⁹

With its diverse constituency, the ABA also admits, that the current \$100,000 limit has lost over half of its real value since 1980, making it especially difficult for smaller community banks to attract sufficient deposits to fund local mortgage loan demand.¹⁷⁰ After Professor Flannery's study pointed out the potential cost associated with the proposed increase to \$200,000, some bankers expressed concerns over raising the coverage limit, especially regarding the loss of the current insurance fund buffer and the potential for premium increases.¹⁷¹ The ABA, accordingly, has somewhat vacillated from its official position, stating that the

163. *Id.*

164. *Id.*

165. Testimony of James E. Smith, May 16, 2001, *supra* note 39, at 3.

166. Blackwell, *What Price Is Too High*, *supra* note 128, at 1, 4.

167. Press Release, Don Mengedoth, Letter from ABA President to Members of the House Financial Services Comm. Regarding Deposit Ins. Reform (Aug. 17, 2001) [hereinafter Mengedoth, Aug. 17, 2001 Letter] at http://www.aba.com/Press+Room/housefinsvcltr_081701.html (last visited Feb. 14, 2002). The present funding level in the deposit insurance funds (over forty-two billion dollars) is so large that the funds are currently self-insured, requiring no premium payments from top-rated institutions. *Id.*

168. *In Brief: ABA: Banks Get No Free Ride*, AM. BANKER, Aug. 23, 2001, at 5.

169. Mengedoth, Aug. 17, 2001 Letter, *supra* note 167.

170. Testimony of James E. Smith, May 16, 2001, *supra* note 39, at 4.

171. *Id.* at 6.

current limit should be increased “to the maximum possible without incurring significant costs that would outweigh the value of the increase.”¹⁷²

The ICBA appears to view the proposed increase in deposit insurance coverage levels as one of the key items in the FDIC’s five-part reform proposal. In a thirty-page special report on federal deposit insurance, the ICBA unequivocally argues that an adequate deposit insurance level is critical to the viability of the community bank system because of its link to attracting core deposits to support community lending—typically mortgages and small business loans.¹⁷³ The ICBA minimizes the potential exposure to the FDIC or the taxpayer resulting from an increase in coverage levels, citing former FDIC Chairman Tanoue’s words at the March 2000 ICBA convention.¹⁷⁴ At that time she expressed the FDIC’s belief that ““raising the coverage limit to \$200,000 may not substantially elevate the risk exposure because depositors already have the ability to structure their accounts to achieve far greater coverage”” over \$100,000.¹⁷⁵ The ICBA favors indexing from the current \$100,000 level, which would raise coverage to approximately \$200,000 for each insured account.¹⁷⁶

A third trade organization, America’s Community Bankers (ACB), which represents the nation’s community banks of all charter types and sizes, has also been a leading advocate of deposit insurance reform. However, in contrast to the ICBA, its prime emphasis on reform appears to be focused more on resolving the free-rider problem than on insurance coverage limits.¹⁷⁷ The ACB

172. *Id.*

173. ICBA SPECIAL REP., *supra* note 70, at 4.

174. *Id.* at 5.

175. *Id.*

176. Cowden, *Quarterly Bank Earnings Remain Strong*, *supra* note 47, at 355-56.

177. In an August, 2001 press release, the organization prompted Congress to resolve deposit insurance issues, “especially the free-rider problem,” and urged passage of H.R. 1293 (the proposed Deposit Insurance Stabilization Act) which would allow the FDIC to impose a fee on insured depository institutions experiencing a to-be-determined net increase in new insured deposits, merge the BIF and SAIIF, and give the FDIC flexibility to recapitalize the funds without charging the mandatory 23 basis-point premium. *See generally* Press Release, ACB Calls for Passage of Legislation to Strengthen Deposit Insurance Funds (Aug. 2, 2001) [hereinafter ACB Calls for Passage], at http://www.acbankers.org/newsbank/scripts/press_view.asp?prID=326 (last visited Feb. 14, 2002). *See also* H.R. 1293, 107th Cong. (1st Sess. 2001).

supports modestly indexing insurance coverage from 1974, which would currently bring the limit to approximately \$135,000.¹⁷³ Diane Casey, ACB's President, relayed that member banks have extremely serious objections to paying premiums, and expressed the fear that new insurance costs could be a "deal killer."¹⁷⁹

C. *Banks' Positions—Retirement Accounts*

The ABA suggests that long-term savings vehicles such as IRAs, Keoghs, and potentially, private social security accounts should perhaps be treated differently than other deposits in terms of insurance coverage limits for several reasons.¹⁸⁰ These investment deposits tend to: be long-term; grow considerably over time; and represent an important source of stable funding for banks.¹⁸¹ In addition, since these deposits are designated as retirement funds, consumers may seek safety and security in these vehicles, thus making deposit insurance especially appealing.¹⁸² There is also precedence for higher insurance coverage for retirement accounts; the 1978 Financial Institutions Regulatory and Interest Rate Control Act provided coverage of \$100,000—two and one half times the standard \$40,000 limit in place at that time.¹⁸³

In contrast to its modest support of indexing for insurance coverage in general, ACB strongly promotes increased insurance protection on retirement accounts, claiming that \$100,000 is no longer adequate.¹⁸⁴ FDIC statistics indicate that retirement deposits in insured institutions rose from \$216 billion in 1999 to \$221 billion in 2000, while retirement savings in mutual funds

178. ACB Calls for Passage, *supra* note 177.

179. Blackwell, *What Price Is Too High*, *supra* note 128, at 1, 4.

180. Testimony of James E. Smith, May 16, 2001, *supra* note 39, at 6-7.

181. *Id.* at 6.

182. *Id.*

183. *Id.* at 7. See Financial Institutions Regulatory and Interest Rate Control Act of 1978, Pub. L. No. 95-630, § 1401(3), 92 Stat. 3721 (1978).

184. Press Release, U.S. Banking Executive Calls for Increase in Deposit Ins. Coverage of Retirement Accounts (Sept. 13, 2001) at http://www.acbankers.org/newsbank/scripts/press_view.asp?prID=330 (last visited Feb. 14, 2002). In a September 2001 address to the 12th Special Seminar on International Finance, Mr. Bochnowski remarked that "\$100,000 coverage for retirement accounts was insufficient, and that "our government must increase deposit insurance coverage for retirement savings accounts, and it needs to do so now." *Id.*

declined.¹⁸⁵ Accordingly, David Bochnowski, ACB's Chair, maintains that banks are the first choice safe haven for retirement savings and argues that government policy must reflect that choice.¹⁸⁶ He also points out that retirement savings accounts historically were insured at twice the coverage of non-retirement accounts and argues that we need to reclaim that insurance differential.¹⁸⁷

VI. CONCLUSION

At first blush, increased deposit insurance coverage appears to be advantageous for everyone. Depositors favor an increase because it will add insurance protection to a greater share of their savings, thus relieving them from worrying about bank stability and the safety of their money.¹⁸⁸ Banks, especially community banks, like it because it helps them compete for deposit dollars, which they can then use as an inexpensive source to fund income-producing loans.¹⁸⁹ Legislators support deposit insurance because it bolsters the public's confidence in the banking system and stabilizes the economy, an especially relevant factor if the nation begins to experience a large number of bank failures and subsequent panic by the saving public.¹⁹⁰ Depositors of funds in covered institutions within the insurable limit have never lost a penny as the result of a bank or thrift failure since Congress instituted deposit insurance and the FDIC.¹⁹¹

However, these benefits do not come without a cost. Deposit insurance requires a balancing of public policy objectives such as safety for savers and a stable banking system against concomitant risks and expenses.¹⁹² "Proposals for reforming deposit insurance are generally based on the view that the present balance between the terms of the trade-off is inappropriate."¹⁹³

185. *Id.* (citing Bochnowski).

186. *Id.*

187. *Id.*

188. *See* Bradley, *supra* note 16 and accompanying text.

189. *See* ICBA SPECIAL REP., *supra* note 173 and accompanying text.

190. *See supra* notes 14-16 and note 52, and accompanying text.

191. DEPOSIT INSURANCE OPTIONS PAPER, *supra* note 15, § IV.

192. Hanc, *supra* note 1, at 20.

193. *Id.* at 21.

Hence, to get more insurance coverage, someone has to pay something for it.

Most covered banks have already paid dearly to build up the BIF and SAIF insurance funds to their present level and understandably do not want to be charged premiums while the pool is fully funded,¹⁹⁴ especially if they are managing their asset risks responsibly. Instead, banks experiencing normal growth strongly advocate charging premiums to fast growing institutions to address inherent unfairness in the current system, rather than across the board increases for all institutions.¹⁹⁵ Required premiums paid to, and held by, the government are dollars that banks cannot lend out in the community. This decrease in available funds to lend could impact the economy's rate of recovery. Deposit insurance creates moral hazard, and a strong argument also exists for the premise that the more their deposits are insured, the more banks will have incentives to take risks, which usually come in the form of lower quality loans.¹⁹⁶

It appears that in order to determine the correct insurance coverage level, the American public needs to decide its prime objectives in maintaining or increasing it. In addition to the previously mentioned benefits, deposit insurance helps to preserve the unit banking system, a system made up of a large number of independently owned banks and thrifts, as opposed to a branch banking system with consolidated ownership.¹⁹⁷ Small banks have difficulties gaining access to inexpensive funding for loans; thus, deposit insurance, which helps them attract core deposits, allows them to stay in business within the small communities they serve.¹⁹⁸ Their presence in these often rural communities assists in maintaining the viability of the town by providing affordable loans for mortgages, farms and small businesses.

In an era where employees are less dependent on social security and company-funded pension plans to fund their

194. See Mengedoth, Letter, Aug. 17, *supra* note 167, at 1.

195. Testimony of James E. Smith, May 16, 2001 *supra* note 39, at 8; see also Plagge, Testimony, Aug. 2, 2001, *supra* note 155 (stating that addressing the "inherent unfairness in the current system that allows fast growing institutions to pay no premiums, even though their growth materially dilutes the coverage reserve ratio of the insurance funds" is the top reform priority for some bankers).

196. See *Fed Offers Broad Support*, *supra* note 135 and accompanying text.

197. See Hanc, *supra* note 1; *supra* note 19 and accompanying text.

198. See generally ICBA SPECIAL REP., *supra* note 70, at 18-19.

retirement,¹⁹⁹ deposit insurance provides security and encouragement for individual, risk-free saving for retirement. Many legislators, who are subject to political accountability, appear to use this public policy rationale when arguing for increased deposit insurance limits. As the earliest baby-boomers are approaching retirement age, voters may demand higher insurance coverage despite the tradeoffs. Reform supporters have also courted the AARP to back the idea of increased coverage for individual retirement accounts, and if this were to occur it would add extensive political clout to the position.²⁰⁰ Young adult investors who, due to the current economic downturn, are experiencing for the first time a serious drop in the value of their investment portfolios, may also increasingly turn to safer investments, thus exerting additional political pressure for increased levels of deposit insurance.

Although not covered extensively in this Note, many of the moral hazard issues associated with increasing deposit insurance coverage levels will be tackled more fully and effectively in other FDIC reform provisions that directly address risk-based premium issues and methods for premium assessments and rebates.²⁰¹ This intertwining of issues regarding deposit insurance reform strongly supports the “package approach” to reforms promoted by the FDIC. Although the 1980 increase is cited as a contributing factor in the ensuing savings and loan crisis, the system then did not have the current risk-based pricing or prompt-corrective action capital rules.²⁰² However, the unintended consequences²⁰³ of the last increase should serve as a warning about the hazards of implementing a piecemeal, versus package, reform.

Modifying the deposit insurance system requires statutory revisions.²⁰⁴ Thus, if and how the system will change in the near future depends on whether legislators and their constituents see this as an important topic. Domestic issues will most probably take a back seat to national security and foreign policy issues over

199. *Id.* at 18-19.

200. Blackwell, *Near-Dead FDIC Reform*, *supra* note 101, at 1.

201. See KEEPING THE PROMISE, *supra* note 14, at i-ii.

202. Seidman, Testimony, July 26, 2001, *supra* note 150, at 4.

203. *Id.*

204. See *supra* note 88 and accompanying text.

the following year,²⁰⁵ and legislators may decide to follow the old maxim, “if it ain’t broke, don’t fix it.” However, the state of the economy may ultimately determine whether reforming legislation is enacted. As Senator Johnson stated at the end of 2001, “[t]he time to reform the system is now, before we dip further into recession.”²⁰⁶

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205. “[Deposit] reform legislation seemed doomed after September 11, like other issues unrelated to national security.” Blackwell, *Near-Dead FDIC Reform*, *supra* note 101, at 1.

206. *Id.*

