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Banking and Deposit Insurance: An Unfinished Agenda for the 1990s[†]

SARAH JANE HUGHES*

"In the first 100 days of the new administration, banks and S&Ls will fail at the rate of more than one a day"¹

The United States banking industry is at a turning point. On December 20, 1991, Congress enacted the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA or Act).² One year later, beginning on December 19, 1992, bank regulators and the Federal Deposit Insurance Corporation (FDIC or Corporation) were forced either to close large numbers of critically undercapitalized banks and thrifts or to justify why they should not close these institutions. A new round of closures would place considerable new burdens on the already stressed federal deposit insurance system.

Enactment of the FDICIA followed an extensive debate about the future scope of banking activities and the likely insolvency in 1992 of the Bank Insurance Fund, as more banks and thrifts experienced losses in loan portfolios and eventually exhausted their capital. Instead of the broad reforms sought by the Treasury Department and banking industry, the FDICIA focused on protection of deposit insurance funds. Its provisions, which become effective over the next several years,³ are likely to yield a very different

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* Adjunct Associate Professor, Indiana University School of Law-Bloomington; A.B., Mount Holyoke College, 1971; J.D., University of Washington, 1974. I wish to thank my colleague, Aviva Orenstein, for her comments, and my research assistants, Michael L. Fuelling, Class of 1992, and Jamey L. Kurtzer, Class of 1994, for their diligence and support. Due to the space limitations of this Sesquicentennial Issue, this Essay does not discuss all of the important issues of the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA) nor all of the policy issues, such as overbreadth, that relate to the federal deposit insurance system.

1. Jerry Knight & Susan Schmidt, *The Unmentioned Monster: Bush, Clinton Reluctant to Discuss Coming Wave of Bank, Thrift Failures*, WASH. POST, Oct. 4, 1992, at H1.

2. The FDICIA was enacted as part of the Comprehensive Deposit Insurance Reform and Taxpayer Protection Act of 1991, Pub. L. No. 102-242, 105 Stat. 2236. The complete text of the bill is reprinted at Comprehensive Deposit Insurance Reform and Taxpayer Protection Act of 1991, Fed. Banking L. Rep. (CCH) No. 1413, Part II, at 255-530 (October 24, 1991). The FDICIA amends the Federal Deposit Insurance Act (FDIA), 12 U.S.C. §§ 1811-1834(b) (1988).

3. See, e.g., FDICIA § 302(g), 12 U.S.C. § 1817(b) (Supp. III 1991) (regarding date for risk-based assessments: earlier of 180 days after final regulations become effective or January 1, 1994); FDICIA § 111(b), 12 U.S.C. § 1820(d) (Supp. III 1991) (regarding deadline for annual on-site examinations of insured depository institutions: December 19, 1992); FDICIA § 133(g), 12 U.S.C. § 1821(c)(5) (Supp. III 1991) (concerning conservatorship and receivership amendments to facilitate prompt corrective action: December 19, 1992).

banking industry than the United States has today. For example, in addition to its potential for increasing the number of bank failures, the Act will result in additional consolidation of banking resources across the country. The FDICIA also will change the focus of investments in and by banks because it increases the strategic advantages of major banks over their smaller competitors.

The FDICIA not only reflects the dominance of deposit insurance in federal banking regulation, but also Congress's inability to enact structural banking reforms that would increase opportunities for banks to compete profitably with other financial service providers.⁴ To the extent Congress failed to include structural banking reforms in the FDICIA, it merely postponed action necessary for the future health of the banking industry and, ultimately, for the integrity of the deposit insurance funds.

For the purposes of this Essay, I initially assess the principal aims of the FDICIA. Next, I analyze three provisions of the FDICIA that demonstrate continuing problems in the federal deposit insurance system: (1) the "least possible cost" resolution requirements, including restrictions on payments to uninsured and foreign depositors; (2) the "prompt corrective action" standards; and (3) the call for enhanced insurance assessments. Finally, I conclude that the FDICIA will fail to achieve recapitalization of the Bank Insurance Fund and, accordingly, that further funding for the deposit insurance system will be required in the near term. In addition, the Act's shortcomings highlight the need for a new round of banking reforms.⁵

I. THE FDICIA

Deposit insurance has been among the most powerful factors in our bank regulatory system since the Depression-era banking reforms.⁶ Policy makers have cited risks to the deposit insurance system to justify enhancing the enforcement powers of federal regulators as well as the increasing frequency and scope of bank examinations, with the exception of bank and thrift

4. See Jonathan Rauch, *Demosclerosis*, 24 NAT'L J. 1998, 2000 (1992). These reforms include the much-debated nationwide branching, insurance, and underwriting activities for insured banks.

5. See 27 House Banking Members Urge Gonzalez to Bring Bank Relief Bills Up This Year, BNA BANKING DAILY, Sept. 25, 1992, at 13-15 (describing Sept. 22, 1992, letter to Committee Chair, Henry B. Gonzalez, requesting hearings on additional banking reforms, including reduction of the FDICIA's compliance burdens).

6. See generally HELEN A. GARTEN, WHY BANK REGULATION FAILED xvi-xvii, 148-50 (1991); Michael Klausner, *An Economic Analysis of Bank Regulatory Reform: The Financial Institutions Safety and Consumer Choice Act of 1991*, 69 WASH. U. L.Q. 695, 705-09 (1991) (noting that deposit insurance is third pillar of regulatory scheme; others are restrictions on entry and geographic expansion); IRVINE H. SPRAGUE, BAILOUT: AN INSIDER'S ACCOUNT OF BANK FAILURES AND RESCUES (1986).

deregulation in the early 1980s.⁷ Commentators generally agree that deregulation in conjunction with severe regional recessions, questionable internal management practices, and flawed supervision by federal regulatory agencies⁸ led both to the massive thrift and bank failures of the late 1980s⁹ and to the current profitability problems of and capital burdens on the banking system.¹⁰ To reduce the stresses on the deposit insurance system following the thrift crisis, Congress enacted the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA).¹¹ Its major foci were recapitalization of the thrift insurance fund and enhanced supervisory powers for federal regulators and the FDIC.¹²

A. Principal Aims of the FDICIA

The FDICIA's principal aims were to recapitalize the Bank Insurance Fund,¹³ to protect the integrity of the deposit insurance funds,¹⁴ and to

7. See Depository Institutions Deregulation and Monetary Control Act of 1980 (DIDMCA), Pub. L. No. 96-221, 94 Stat. 132; Garn-St. Germain Depository Institutions Act of 1982 (Garn-St. Germain), Pub. L. No. 97-320, 96 Stat. 1469. Through these two deregulatory measures, Congress expanded deposit insurance coverage to \$100,000 per account, granted considerable "new" powers to thrifts and banks, and deregulated the interest rates offered by insured institutions.

8. See generally PAUL Z. PILZER, OTHER PEOPLE'S MONEY (1989). See also SPRAGUE, *supra* note 6, at 233 (citing severe economic conditions and poor management as factors in bank failures).

9. The FDIC reported more than 1,000 failures during the 1980s. See Paul H. Irving & T. Hale Boggs, *Financial Institution Directors: Mitigating Risks of Liability in Shareholder Actions*, 109 BANKING L.J. 336, 336 n.1 (1992).

10. E.g., Alfred J.T. Byrne & Martha L. Coulter, *Safety and Soundness in Banking Reform: Implications for the Federal Deposit Insurer*, 69 WASH. U. L.Q. 679, 680 n.3 (1991) ("[DIDMCA and Garn-St. Germain] did not provide adequate safeguards, such as increased supervisory powers, to protect against excessive safety-and-soundness risk. On balance, the new powers adversely affected the financial health of the savings and loan industry, as well as the federal deposit insurance fund that covered savings and loans at the time."). The current stresses are evident, for example, in the fact that the Bank Insurance Fund would have become insolvent if Congress had not raised its borrowing authority in the FDICIA. Stephen K. Huber, *The Federal Deposit Insurance Corporation Improvement Act of 1991*, 109 BANKING L.J. 300, 301 (1992); see also John L. Douglas, *Deposit Insurance Reform*, 27 WAKE FOREST L. REV. 11 (1992); David Greising & Geoffrey Smith, *Banks Get Real About Real Estate Losses*, BUS. WK., Oct. 5, 1992, at 116.

11. Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA), Pub. L. No. 101-73, 103 Stat. 183 (codified in scattered sections of 12 U.S.C.). For a thorough analysis of FIRREA's provisions, see BLOCH & WILLIAMS, A PRACTICAL GUIDE TO FIRREA (1990).

12. FIRREA §§ 511, 512, 12 U.S.C. §§ 1441, 1441(b) (Supp. II 1990).

13. See FDICIA § 101, 12 U.S.C. § 1824(a) (Supp. III 1991) (extending from \$5 billion to \$30 billion the FDIC's borrowing authority to finance deposit insurance payments); see also FDICIA § 302(a), 12 U.S.C. § 1817(b)(1)(A) (Supp. III 1991) (encouraging FDIC to impose higher and risk-based deposit insurance assessments).

14. *FDIC Improvement Act of 1991, RTC Refinancing, Restructuring, and Improvement Act of 1991*, Fed. Banking L. Rep. (CCH) No. 1420 (Dec. 6, 1991) (Conference Report on S. 543 [FDICIA]).

protect the taxpayer from further bailouts of those funds.¹⁵ Consistent with these goals, the FDICIA directs the FDIC to close critically undercapitalized banks whose capital fails the Act's two percent tangible equity test¹⁶ and to liquidate failed banks unless another resolution method is "less costly"¹⁷ In addition, the Act enhanced the FDIC's supervisory powers, including authority to conduct additional examinations and impose stricter accounting standards.¹⁸

The FDICIA also includes provisions to implement its three central policies. For example, it limits the FDIC's ability to pay certain classes of creditors of failed institutions, including holders of uninsured domestic¹⁹ and foreign²⁰ deposits, and creditors (for example, debtholders and shareholders) other than depositors.²¹

The FDICIA, however, does not include any of the structural reforms of the banking industry that Congress had considered.²² These reforms include the

15. For more discussion of the provisions of the FDICIA and its companion, the RTC Refinancing, Restructuring, and Improvement Act of 1991, see Huber, *supra* note 10; *Federal Banking Insurance Reform: FDIC and RTC Improvement Acts of 1991*, Fed. Banking L. Rep. (CCH) No. 1425 (Jan. 10, 1992) [hereinafter *Federal Banking Insurance Reform*]; FDIC IMPROVEMENT ACT OF 1991 AND RTC REFINANCING, RESTRUCTURING, AND IMPROVEMENT ACT OF 1991 (1992).

16. FDICIA § 141, 12 U.S.C. § 1823(c)(4)(B) (Supp. III 1991). The goal of this provision is to reduce deposit insurance losses by closing a failing bank before it has a zero-capital position, on the ground that these banks' assets deteriorate after FDIC action. See Jonathan R. Macey, *Needless Nationalization at the FDIC*, WALL ST. J., Feb. 14, 1992, at A10 (criticizing delays in declaring bank insolvencies, particularly in 1992 case of failed New York thrift, CrossLand FSB).

17. 12 U.S.C. § 1823(c)(4).

18. FDICIA §§ 111(a), 112(a), 121(a), 12 U.S.C. §§ 1820(d), 1831(m), 1831(n) (Supp. III 1991); see also Douglas, *supra* note 10, at 28; Dean Foust, *The Bank Police Get a Bigger Stick*, BUS. WK., Aug. 31, 1992, at 59.

19. 12 U.S.C. § 1823(c)(4)(E) (provision effective after December 31, 1994, or sooner as the corporation may determine); see also *Federal Banking Insurance Reform*, *supra* note 15, ¶ 118.

20. FDICIA § 312, FDIA § 41, 12 U.S.C. § 1831(r) (Supp. III 1991); see *infra* text accompanying notes 63, 73.

21. 12 U.S.C. § 1823(c)(4)(E). Payments to shareholders and creditors other than depositors was one of the most controversial features in the bailout of Continental Bank of Illinois in 1984. See SPRAGUE, *supra* note 6, at 189, 191; see also Douglas, *supra* note 10, at 21-22.

22. U.S. DEP'T OF TREASURY, MODERNIZING THE FINANCIAL SYSTEM: RECOMMENDATIONS FOR SAFER, MORE COMPETITIVE BANKS (1991) [hereinafter MODERNIZING THE FINANCIAL SYSTEM]. The Administration's proposal—the Financial Institutions Safety and Consumer Choice Act of 1991 (FISCCA)—called for nationwide banking, new or expanded financial activities for banks (particularly in securities underwriting and insurance), and commercial ownership of banking organizations. In addition, it recommended reducing deposit insurance coverage, both to reduce risks that banks may take and to channel deposits to sounder banks. S. 713, 102d Cong., 1st Sess. (1991); H.R. 1505, 102d Cong., 1st Sess. (1991). These are reproduced at Fed. Banking L. Rep. (CCH) No. 1383, Part II (1991). For analysis of the FISCCA proposals, see Klausner, *supra* note 6. See generally Robert M. Garsson, *Rescue of Insurance Fund Approved by House Panel*, AM. BANKER, Nov. 20, 1991, at 1; George Graham, *Thwarted Ambitions*, FIN. TIMES, Nov. 6, 1991, at 20; George Graham, *Congress Near Decision on Bank Reform*, FIN. TIMES, Oct. 31, 1991, at 6; George Graham, *Compromise Angers Bank Reform Lobby*, FIN. TIMES, Oct. 25, 1991, at 6.

creation of a nationwide banking system and the repeal of statutes, such as the Banking Act of 1933,²³ the McFadden Act,²⁴ and the Douglas Amendment,²⁵ that limit the ability of banks and bank holding companies to compete with nationwide, non-bank financial service providers.

B. The "Least Possible Cost" Resolution Requirements

Although prior law required the FDIC to select the least costly resolution method, it permitted the FDIC to employ *any method* of resolution requiring fewer Corporation funds than liquidation would require, even if alternative measures less costly than the *chosen method* may have been available.²⁶ The FDIC, however, could avoid the "least costly" requirement if the Corporation deemed, as it often did,²⁷ the failed institution either "essential to the community"²⁸ or "essential to the financial system."²⁹ Also, regardless of its mandate to fashion the least costly resolution, for many years the FDIC structured the majority of resolutions so that it protected uninsured as well as insured deposits.³⁰ In many of these resolutions, this practice increased the cost to deposit insurance funds above the amount that would have been expended if the FDIC had employed the least expensive method.³¹ Commentators agreed that meaningful reform of the deposit insurance system required ending the FDIC's former pattern of protecting uninsured deposits³² and instead imposing market discipline on banks and depositors.³³

23. Banking Act of 1933, ch. 89, 48 Stat. 162 (1933) (codified as amended in scattered sections of 12 U.S.C.) The provisions separating "banking" from "commerce" commonly referred to as the Glass-Steagall Act.

24. 12 U.S.C. § 36 (1988).

25. 12 U.S.C. § 1842(d) (1988). In 1982, Garn-St. German amended the Douglas Amendment to permit emergency acquisitions involving failed or failing banks. Garn-St. German § 188(c) (codified as amended at 12 U.S.C. § 1823(f) (1988)) (concerning FDIC's emergency acquisitions procedures).

26. 12 U.S.C. § 1823(c)(4)(A) (1988).

27. See *infra* notes 43-44 and accompanying text.

28. 12 U.S.C. § 1823(c)(4)(A).

29. See 12 U.S.C. § 1823(c)(1)(C) (Supp. I 1989).

30. Jonathan R. Macey & Geoffrey P. Miller, *America's Banking System: The Origins and Future of the Current Crisis*, 69 WASH. U. L.Q. 769, 783-84 (1991); Klausner, *supra* note 6, at 706-08, 731; see also Henry B. Gonzalez, *Toward Deposit Insurance Reform*, 69 WASH. U. L.Q. 665, 668 (1991).

31. E.g., Macey & Miller, *supra* note 30, at 788; Knight & Schmidt, *supra* note 1, at H4 (estimating costs of guaranteeing all deposits at \$40 billion). By arranging for coverage of uninsured deposits, the FDIC diluted the proportion of the failed institution's assets to insured deposits and, correspondingly, decreased its likely share of the proceeds of those assets and increased the size of its contribution to the resolution costs. Coverage of uninsured deposits exaggerated immediate losses to the insurance funds because the failed institutions had not paid for coverage.

32. E.g., Macey & Miller, *supra* note 30, at 783-90.

33. E.g., *id.* at 786; Klausner, *supra* note 6, at 709-16.

The FDICIA contains a number of provisions designed to restrict the FDIC's discretion in choosing the least costly method. These include (1) a requirement that the FDIC select the resolution method that is the "least costly" of all possible methods,³⁴ (2) a new, restrictive definition of "liquidation costs,"³⁵ (3) specification of the time at which the FDIC must determine the "least possible cost" method of resolution,³⁶ (4) a prohibition on using deposit insurance funds to pay uninsured domestic or foreign deposits³⁷ or claims of nondeposit creditors,³⁸ and (5) a narrower "systemic risk" exception to the least cost requirement than prior law provided.

1. Systemic Risk

In order to encourage more liquidations of failed institutions, the FDICIA provides a narrower "systemic risk" exception to the least cost requirement. It only permits the FDIC to provide extraordinary assistance to financial institutions whose liquidation the Secretary of the Treasury (in consultation with the President), together with the Board of Directors of the FDIC and the Board of Governors of the Federal Reserve System, determines would have "serious adverse effects on economic conditions or financial stability" that more comprehensive FDIC coverage would avert or mitigate.³⁹ In addition, Congress required the FDIC to recapture the excess costs of these bailouts by a special assessment on other members of the affected insurance fund (for example, the Bank Insurance Fund or the Savings Association Insurance Fund).⁴⁰ The FDICIA also directs the General Accounting Office to audit the FDIC's decision and its plan to recapture the funds.⁴¹ Thus, the FDICIA did not end the FDIC's authority to rescue a major institution from failure if its failure would have especially significant implications for the health of the

34. FDICIA § 141(a)(4)(A)(ii), 12 U.S.C. § 1823(c)(4)(A)(ii) (Supp. III 1991).

35. *Id.* § 1823(c)(4)(D).

36. *Id.* § 1823(c)(4)(C).

37. *Id.* § 1823(c)(4)(E)(i)(I).

38. *Id.* § 1823(c)(4)(E)(i)(II) (prohibiting payments to "creditors other than depositors"); FDICIA § 311(a)(8), 12 U.S.C. § 1821(a)(8) (Supp. III 1991) (excluding certain investment contracts and brokered deposits from definition of "insured deposits").

39. 12 U.S.C. § 1823(c)(4)(G); *see id.* § 1823(c)(4)(G)(i) (regarding approval requirements). *See generally* PAUL EINZIG, *THE EURO-DOLLAR SYSTEM* 66 (4th ed. 1970) (relating origins of systemic risk principle to Creditanstalt crisis in 1931).

40. 12 U.S.C. § 1823(c)(4)(G)(ii). The special assessment, assuming that the FDIC levies one, will complicate planning by banks or thrifts participating in the insurance funds because these banks and thrifts can neither predict the timing nor control the size of assessments.

41. *Id.* § 1823(c)(4)(G)(iv) (regarding annual GAO compliance audit).

banking system.⁴² Rather, it imposed political and financial constraints on its exercise of this exception.

Banking experts disagree about the likely effect of these new requirements on resolutions. They cite four factors that complicate the ability of Congress or the industry to evaluate the basis for the FDIC's "least costly" determination. First, regulators historically have preferred "almost any bid" to the process of closing and liquidating banks.⁴³ Second, the FDIC does not publicize the nature of the bids it receives for failed institutions or the cost comparisons on which it makes its determinations.⁴⁴ Third, the FDIC often assumes portfolios of nonperforming loans from failed institutions or otherwise guarantees a fixed yield on the purchaser's investment; these actions present difficult-to-measure contingent liabilities to deposit insurance funds.⁴⁵ Fourth, the FDIC has granted tax concessions to purchasers of failed institutions, which increase the overall government cost of the resolution without observable effects on deposit insurance expenditures.⁴⁶ Because the FDICIA does not require the FDIC to change any of these practices, it is unclear how the Act will result in lower expenditures for the resolution of failed institutions.

Banking experts disagree about the strictness of the "systemic risk" provision. At least one commentator believes that the systemic risk standards are so strict that the FDIC will use this authority only in rare cases.⁴⁷ However, the FDIC has used its authority in the past to rescue institutions that

42. See GARTEN, *supra* note 6, at 16-20 (outlining factors favoring the rescue of some banks from liquidation); see also SPRAGUE, *supra* note 6, at 248-52 (noting that the FDIC considered Continental Illinois' role as a correspondent bank for hundreds of other financial institutions and as a major commercial lender in deciding to rescue and recapitalize that bank with federal funds).

43. See Neil Barsky & Kenneth H. Bacon, *FDIC Rejects Two Bids for CrossLand, Puts Up \$1.2 Billion of Its Own Capital*, WALL ST. J., Jan. 27, 1992, at A5 (citing former FDIC Chairman William Issac's view).

44. See Kenneth H. Bacon & Steven Lipin, *Under New Bank Law, More Large Depositors Face Losses in Failures*, WALL ST. J., Oct. 22, 1992, at A1; see also Macey, *supra* note 16. For a report critical of the FDIC's post-FDICIA procedures for making the "least possible cost" determination, see GENERAL ACCOUNTING OFFICE, *FAILED BANK—FDIC DOCUMENTATION OF CROSSLAND SAVINGS, FSB, DECISION WAS INADEQUATE*, REPORT GAO/GGD-92-92 (July 7, 1992).

45. *E.g.*, Macey, *supra* note 16; Barbara A. Rehm, *FDIC Plans to Guarantee New Loans in Northeast*, AM. BANKER, Feb. 6, 1992, at 1, 10 (stating that Fleet/Norstar purchase of failed Bank of New England left \$6 billion in bad assets with FDIC; value of assets declines as collection proceeds).

46. *E.g.*, Macey & Miller, *supra* note 30, at 790 (noting that the FDIC substantially discounts assets to induce purchases and grants purchasers yield-maintenance guarantees and buy-back options); Christopher Georges, *Egads! The S&L Scandal Lives!*, WASH. MONTHLY, Jan. 1992, at 18, 20 (describing \$600 million tax benefit as part of a \$5 billion federal guarantee to Revlon Chairman, Ron Perleman, in acquisition of First Gibraltar Savings under so-called "Southwest Plan").

47. Huber, *supra* note 10, at 303. Indeed, the FDIC characterized the CrossLand conservatorship as, if anything, a "least possible cost" resolution. See GENERAL ACCOUNTING OFFICE, *supra* note 44.

few would have considered "essential" to the community or the financial system.⁴⁸ Some experts point to this past use as evidence that the FDIC will use its own discretion to overlook or manipulate statutory constraints.⁴⁹

Some commentators believe the "systemic risk" provision leaves too much discretion with bank regulators to favor larger banks over smaller banks.⁵⁰ They argue that the prospect of full coverage of uninsured deposits will cause many depositors to shift to larger banks because of the added "safety net" larger banks can provide. Also, the "systemic risk" exception encourages bigger banks to follow business plans that increase their access to nationwide markets, but also increase the risks that their activities may pose to the deposit insurance funds. For example, banks legally may increase their nationwide activities in a variety of ways, including (1) acquisitions through regional banking compacts, (2) various nonbranch expansion devices, such as loan production offices and credit cards, and (3) takeovers of failed institutions in other regions.⁵¹ Bank analysts predict that, by increasing their respective size and by engaging in nationwide operations, banks may reduce the price they pay for deposits, particularly for uninsured deposits,⁵² because depositors will factor into the yields they otherwise would receive the deposit insurance subsidy they are likely to receive under the systemic risk provision.⁵³

In addition to the obvious strategic advantages held by larger banks, experts recognize that regulators routinely face political pressures not to declare bank

48. See FDICIA § 141, 12 U.S.C. § 1823(c)(4)(A), 1823(c)(1)(C) (Supp. III 1991); SPRAGUE, *supra* note 6, at 35-38.

49. Gonzalez, *supra* note 30, at 668 (arguing that FDIC misused essentiality authority and citing insistence of former FDIC Director William Seidman that FDIC acted properly); see also Macey & Miller, *supra* note 30, at 788; SPRAGUE, *supra* note 6, at 272.

50. Michael Quint, *U.S. Shift on Deposit Insurance*, N.Y. TIMES, Mar. 26, 1992, at D1; see also Macey & Miller, *supra* note 30, at 788 (concluding that provisions of FISCCA comparable to FDICIA left too much discretion to the FDIC and predicting "a massive disparity in regulatory treatment between big banks and smaller banks, with uninsured depositors in small and medium-sized banks facing a realistic prospect of losing money in the event of a bank failure, and depositors in larger banks enjoying complete protection").

51. These developments were well underway at the time of the FDIC's 1984 bailout of Continental Illinois National Bank. Former director Sprague warns that they would create additional banking networks that would be considered too big to fail. SPRAGUE, *supra* note 6, at 240-41.

52. See Norbert McCrady, *End FDIC Tilt Against Community Banks*, AM. BANKER, Mar. 19, 1992, at 4; see also Joseph P. Hughes & Loretta J. Mester, *A Quality and Risk-Adjusted Cost Function for Banks: Evidence on the "Too-Big-To-Fail" Doctrine*, Working Paper No. 91-21, Federal Reserve Bank of Philadelphia, Nov. 1991; Macey, *supra* note 16; Macey & Miller, *supra* note 30, at 787; see *supra* text accompanying note 30.

53. See Hughes & Mester, *supra* note 52, at 16; cf. Christi Harlan, *U.S. Takes over at Texas First City Bancorp.*, WALL ST. J., Nov. 2, 1992, at A3, A8 (noting that the FDIC guaranteed only 80% of deposits exceeding the \$100,000 insured limit in the four largest banks of First City Bancorporation).

insolvencies and not to liquidate financial institutions.⁵⁴ These pressures mount during election years,⁵⁵ increasing the likelihood that the FDIC will use the systemic risk exception to bailout major institutions⁵⁶ and perhaps some that are not so major.⁵⁷

For these reasons, commentators believe that the FDIC, by sustaining larger institutions, will experience losses not contemplated by the FDICIA.⁵⁸ These large bank resolutions also will increase the potential shortfalls in insurance funds in the near future.⁵⁹

2. Exclusions of Certain Deposits from Coverage

a. Uninsured Domestic Deposits and Non-Deposit Creditors

One of the chief criticisms of recent bank resolutions has been the FDIC's tendency to cover all deposits of failed institutions, including those portions over the \$100,000 limit for insured deposits. The FDICIA prohibits the FDIC from continuing to pay uninsured depositors after December 31, 1994, or earlier if the FDIC considers it appropriate.⁶⁰

54. See Macey, *supra* note 16; Klausner, *supra* note 6, at 739.

55. Macey, *supra* note 16.

56. See Klausner, *supra* note 6, at 739 (giving a prime example of the magnitude of forces employed when a major employer is faced with extinction—the government's bailout of Chrysler Corporation).

57. For example, the FDIC took over CrossLand FSB in late January, 1992, its first resolution following enactment of the FDICIA and its first "bailout." CrossLand, located in Brooklyn, New York, was the second largest thrift in the Northeast. The FDIC rejected bids from two bank holding companies and created a new bank under its management that it expects to sell when economic conditions in the metropolitan New York City area rebound. In addition, by reorganizing the thrift under its management, the FDIC protected a substantial number of uninsured blue-collar depositors in the New York metropolitan area as well as a sizeable volume of underperforming real estate loans. The FDIC justified its overall strategy on the ground that operating CrossLand was the "least possible cost" method available to the FDIC, although commentators question whether it will prove to be so. For criticism of the CrossLand rescue, see Macey, *supra* note 16; see also GENERAL ACCOUNTING OFFICE, *supra* note 44; *CrossLand Deal Spillover: FDIC's Credibility Affected; Impact on Future Bidding Feared*, THE FDIC WATCH, Feb. 24, 1992, at 1 [hereinafter *CrossLand Deal Spillover*]; *Former FDIC Officials Join the Chorus of Criticism of Agency's CrossLand Takeover*, THE FDIC WATCH, Mar. 23, 1992, at 3 [hereinafter *CrossLand Takeover*]; Barbara A. Rehm, *Crossland Sets Tone for Future FDIC Takeovers*, AM. BANKER, Jan. 29, 1992, at 1; Tim Smart et al., *Perfect Timing for Sick Banks*, BUS. WK., Mar. 23, 1992, at 29. CrossLand remains under federal management more than one year after its takeover by the FDIC, although the FDIC has begun to market it. *CrossLand Sale Effort Set*, N.Y. TIMES, Jan. 7, 1993, at D4; Phil Roosevelt, *Crossland Has Big Plans for Servicing Portfolio*, AM. BANKER, Feb. 5, 1993, at 10 (reporting sale of CrossLand Mortgage Corp. to private investors).

58. E.g., Macey, *supra* note 16; Rehm, *supra* note 57, at 1; *CrossLand Deal Spillover*, *supra* note 57, at 1; Smart et al., *supra* note 57, at 29; *CrossLand Takeover*, *supra* note 57, at 3.

59. See *infra* text accompanying notes 92-118.

60. FDICIA § 141, 12 U.S.C. § 1823(c)(4)(E) (Supp. III 1991).

The FDIC has begun to implement this provision, with some uninsured depositors "taking haircuts"—as the industry describes full or partial losses on uninsured deposits—when their banks failed.⁶¹ Based on the FDIC's actions since the FDICIA, it appears that the size of the failed institution determines whether uninsured depositors will suffer losses, so that depositors of larger institutions are less likely to suffer losses even where the FDIC does not claim to invoke the "systemic risk" provision.⁶²

b. Foreign Deposits

In addition to prohibiting the FDIC from paying uninsured depositors, the FDICIA expressly excludes "foreign deposits" from deposit insurance coverage.⁶³ Foreign deposits,⁶⁴ generally handled by major banks,⁶⁵ earn above-market interest rates in part because they are not subject to deposit insurance assessments.⁶⁶ The conventional wisdom was that depositors of these large sums were less interested in deposit insurance coverage than in the higher yields generally paid on these deposits.⁶⁷ In fact, because the FDIC

61. Quint, *supra* note 50 (discussing the FDIC's projection, by Harrison Young, that 50% of the anticipated failures in 1992 would result in losses to uninsured depositors, and noting that in 9 of the 21 actual bank closures in early 1992, depositors had suffered losses as opposed to losses in 21 cases in all of 1991).

62. Compare Macey, *supra* note 16 (criticizing the FDIC's protection of all depositors in the January, 1992, bailout of giant CrossLand FSB on the "least possible cost" basis) with Quint, *supra* note 50 (noting that depositors of Broadway Bank and Trust Company of Patterson, New Jersey, lost \$6.3 million in uninsured deposits). But see John Rather, *Bank Failures Catch Depositors Off Guard*, N.Y. TIMES, June 28, 1992, § 13 (Long Island), at 1 (discussing the FDIC's covering of 75% of uninsured deposits at American Savings Bank in the New York City metropolitan area (\$3.2 billion bank) while not covering all uninsured deposits in the 1990 closing of Freedom National Bank in Harlem (\$120.5 million bank) or the 1991 closing of Commerce National Bank of Staten Island (\$404.6 million bank).

63. FDICIA § 312, 12 U.S.C. § 1831(r) (Supp. III 1991). For the full text, see *Federal Banking Insurance Reform*, *supra* note 15, at ¶ 2212.

64. Widespread use of foreign deposits, which are deposits denominated in a currency other than that of the country in which they are deposited, is one of the bigger structural changes in international banking of the last 35 years. See EINZIG, *supra* note 39, at xiv, 1. Accordingly, "Eurodollars" are dollar-denominated deposits held by banks outside the United States.

65. Huber, *supra* note 10, at 309.

66. 12 U.S.C. § 1813(l)(5) (1988). See generally Henry S. Terrell & Rodney H. Mills, Jr., *International Banking Facilities and the Eurodollar Market*, in EURODOLLARS AND INTERNATIONAL BANKING 183, 199 (Paolo Savona & George Sutija eds., 1985).

67. Huber, *supra* note 10, at 309.

frequently has protected these depositors,⁶⁸ they could expect to have both higher yields and de facto deposit insurance coverage.⁶⁹

Bank regulators and experts have argued for the imposition of deposit insurance premiums on foreign deposits as one means of reducing the risks they represent to the health of the system.⁷⁰ However, large banks with foreign deposits and foreign depositors prefer the present, no-assessment arrangement, perhaps counting on the FDIC's history of paying their deposits in the event of bank failure—the perfect free-rider arrangement. Because major U.S. banks have had foreign deposits as large as their domestic deposit bases,⁷¹ bank experts consider these foreign deposits as representing substantial off-balance-sheet risks for the deposit insurance fund.⁷²

Despite the FDICIA's express exclusion of foreign deposits from FDIC coverage, the FDIC's past behavior vis-à-vis foreign deposits and the systemic risk provision in the FDICIA still may tempt the FDIC to cover foreign deposits in the future. To the extent that banks' deposit insurance assessments do not include the foreign-deposit bases that major banks maintain, these deposits represent potential future drains on deposit insurance funds.⁷³

68. *E.g., id.*, SPRAGUE, *supra* note 6, at 249-51 (recognizing that the FDIC's bailout of Continental covered \$30 billion in foreign deposits); *see also Anacostia's Banking Reprieve*, WASH. POST, Apr. 16, 1991, at A18 (protecting \$37 million in uninsured foreign deposits through 1990 sale of National Bank of Washington to Riggs Bank, which bought balance of deposits from the FDIC).

69. *Anacostia's Banking Reprieve*, *supra* note 68. Others have criticized this policy. *E.g.*, Macey & Miller, *supra* note 30, at 787 (criticizing de facto insurance for all deposits).

70. SPRAGUE, *supra* note 6, at 249; *see also Core Banks Proposal: Hearing before the Committee on Banking, Finance and Urban Affairs House of Representatives*, 102d Cong., 1st Sess. 190 (1991) [hereinafter *Core Banks*] (comment of Wells Fargo Bank representative).

71. *See* SPRAGUE, *supra* note 6, at 250. Continental paid \$6.5 million in insurance premiums in 1983. That sum purchased FDIC coverage for \$69 billion of Continental's liabilities, including \$30 billion in foreign deposits as well as \$36 billion in uninsured foreign loans. *Id.* Criticisms of the free ride that the FDIC has granted to foreign deposits were common prior to the enactment of the FDICIA. *E.g.*, *Core Banks*, *supra* note 70, at 190.

72. *See* SPRAGUE, *supra* note 6, at 251 (table 14.1) (showing that in 1984, the 10 leading banks in foreign deposits held \$222 billion in foreign deposits and \$226 billion in domestic deposits).

73. A separate question is whether foreign depositors will be willing to rely on coverage in the event of bank failure. Greater risks perceived by depositors may dampen the interest of those depositors to place their funds with U.S. banks. This prospect may be exacerbated whenever interest rates in the U.S. are lower than those offered by our principal trading partners, such as Germany. *E.g.*, Peter Truell, *European System Braces for French Vote; Major Nations to Urge German Rate Cut: Most G-7 Finance Chiefs See Growth Tied to Easing Credit, Calming Market*, WALL ST. J., Sept. 18, 1992, at A2 (noting that high German interest rates, coupled with rapid integration of the EC's currencies and economies caused turmoil in currency markets); Floyd Norris, *Currency Wars: Central Banks May Yet Prevail*, N.Y. TIMES, Sept. 27, 1992, § 3, at 1.

*C. Prompt Corrective Action for
Critically Undercapitalized Institutions*

Perhaps the most significant changes made by the FDICIA are in section 131. Prior law authorized appointment of a receiver or conservator under a variety of circumstances, such as when an institution became insolvent⁷⁴ or violated a final cease-and-desist order of its supervisory agency.⁷⁵ Critics of past resolutions argued that delays in closing failing institutions added significantly to resolution costs.⁷⁶

The goal of section 131 is to restrict the losses that undercapitalized depository institutions may impose on deposit insurance funds by requiring prompt corrective action on the part of the supervisory agency and the FDIC.⁷⁷ To reduce the expenditures for resolutions, section 131 mandates closer monitoring of the capital health of insured institutions.⁷⁸ It requires supervisory agencies to take specific actions earlier than in the past, when institutions first qualify as "significantly undercapitalized"⁷⁹ or "critically undercapitalized."⁸⁰ For example, for critically undercapitalized institutions, the FDICIA requires supervisory agencies either to appoint a receiver or conservator within ninety days or to document why other action is more appropriate.⁸¹ In addition, the FDICIA requires supervisory agencies and the FDIC to restrict the activities of insured institutions during any period in which they are critically undercapitalized, so that they cannot engage in activities that historically have increased deposit insurance losses.⁸²

Under section 131, which became effective on December 19, 1992, many more institutions will be eligible for receivership or conservatorship than

74. FDIA § 11(c)(5), 12 U.S.C. § 1821(c)(5)(A) (Supp. II 1990).

75. *Id.* § 1821(c)(5)(D).

76. *E.g.*, Klausner, *supra* note 6, at 115; Macey & Miller, *supra* note 30, at 790 (explaining that assets decline in value and costs of maintaining assets are high); GARTEN, *supra* note 6, at 9; Macey, *supra* note 16.

77. *E.g.*, Macey, *supra* note 16 (noting that delays disguise the health of banking industry); Klausner, *supra* note 6, at 760-61 (noting that delays make ultimate resolution more costly).

78. FDICIA § 131(e), 12 U.S.C. § 1831(e) (Supp. III 1991).

79. *Id.* § 1831(b)(1)(D). A significantly undercapitalized depository institution is "significantly below the required minimum level for any relevant capital measure" as specified by the primary supervisory agency. *Id.*

80. *Id.* §§ 1831(b)(1)(E), 1831(c)(3). A "critically undercapitalized" depository institution fails to meet any capital measure required by a primary supervisory agency, and does not possess two percent or more tangible equity to total assets. *Id.* For a definition of "tangible equity," see Bacon & Lipin, *supra* note 44, at A8.

81. 12 U.S.C. § 1831(h)(3)(A).

82. *Id.* § 1831(i) (prohibiting, without FDIC's prior approval, investment, expansion, acquisition, sale of assets, extension of credit in highly leveraged transactions, material change in accounting methods, payment of excessive compensation or bonuses, payment of above-market interest rates).

would have been eligible previously. Some commentators and regulators have predicted that this provision will increase the number of institutions requiring receivership or conservatorship in 1993 and 1994 far beyond recent projections.⁸³

Although the FDIC earmarked the cash available in the Bank Insurance Fund to cover resolutions of banks it expected to fail in 1992, the FDIC estimated that it would have a deficit of approximately \$5.5 billion when those resolutions become final.⁸⁴ In addition, of the 111 banks and thrifts that were critically undercapitalized in late 1992, 80 held assets of roughly \$30 billion.⁸⁵ As the round of resolutions prompted by section 131 begins, the FDIC will continue to draw on and eventually may exhaust the \$30 billion line of credit that the Treasury may provide to the FDIC directly.⁸⁶ After that, the FDIC will have to turn to its other sources for additional funding⁸⁷—working capital loans from the Federal Financing Bank⁸⁸ or loans from members of the Bank Insurance Fund.⁸⁹ Accordingly, regardless of the number of additional insured institutions that may come under receivership or conservatorship in the near term, it seems likely that the FDIC will require additional funding during the resolution of the banks now targeted for closure because they qualify as critically undercapitalized.

II. INSURANCE ASSESSMENTS

Commentators long have criticized the federal deposit insurance programs as being underfunded and overly broad.⁹⁰ Banking experts projected that the

83. See Foust, *supra* note 18, at 59 (“[The] FDIC estimates that Congress’s 2% solution could force regulators to shutter banks with upwards of \$76 billion in assets, double what they initially expected for 1993.”); see also Knight & Schmidt, *supra* note 1, at H1 (stating that 80 banks and 31 thrifts face certain seizure under FDICIA test; more than 1,000 institutions are on FDIC’s “problem bank list”). Estimates of the number of institutions that may fail to meet capital standards have varied significantly over the past year; more recent projections predict a smaller number of critically undercapitalized institutions due to general improvements in banks’ profits in 1992. See Barbara A. Rehm & Claudia Cummins, *Budget Office Cuts Estimate of Price Tag for Failures*, AM. BANKER, Jan. 27, 1993, at 1, 6; Barbara A. Rehm, *Bank Profits Shattered Record in '92*, AM. BANKER, Mar. 10, 1993, at 1 (reporting that 787 banks remain on “problem list” after 229 removed).

84. Knight & Schmidt, *supra* note 1, at H4.

85. *Id.*

86. FDICIA § 101, 12 U.S.C. § 1824(a) (Supp. III 1991).

87. Huber, *supra* note 10, at 302 (estimating \$40 billion limit based on collateral held by Bank Insurance Fund as of enactment of the FDICIA).

88. 12 U.S.C. § 1824(b). Of course, these funds represent a taxpayer bailout of the Bank Insurance Fund because the Federal Financing Bank must borrow operating funds while it disposes of assets from failed institutions. See Huber, *supra* note 10, at 302.

89. 12 U.S.C. § 1824(d).

90. E.g., Klausner, *supra* note 6, at 735 n.135 (regarding improper pricing of deposit insurance); Macey & Miller, *supra* note 30, at 782 (concerning overbreadth); GARTEN, *supra* note 6, at 18-19, 148-50, 170.

Bank Insurance Fund, for example, would become insolvent in 1992, falling from a surplus of more than \$18 billion in 1988 to a probable deficit of \$5.5 billion by the close of 1992.⁹¹ Regardless of the Fund's precise financial circumstances, the FDICIA authorized additional funding for the FDIC with the stated goal of recapitalizing the Bank Insurance Fund. The FDICIA has two provisions specifically designed to increase funding.

A. Increased Assessments

First, the FDICIA encourages increased assessments for deposit insurance to make more funds available to the FDIC without requiring additional borrowing authority or other nonassessment funding. The FDICIA directed the FDIC to set deposit insurance assessments to recapitalize the Bank Insurance Fund within fifteen years.⁹² Once the aggregate premiums reach the specified level, the Act directs the FDIC to maintain that level.⁹³ In addition, the Act authorizes the FDIC to collect emergency assessments to cover amounts borrowed from the Treasury, the Federal Financing Board, or members of the affected insurance fund.⁹⁴

Despite Congress's desire to raise more funds through deposit insurance assessments, the FDIC has not made dramatic changes in assessments. In its most recent assessments in September, 1992 (effective January 1, 1993), the FDIC did not increase assessments for three-quarters of the industry and

91. Huber, *supra* note 10, at 301. There appears to be some dispute about the Fund's precise financial circumstances. Compare *A Stop to Go-Go Banking*, WASH. POST, July 6, 1992, at A18 (discussing how the Bank Insurance Fund lost \$25 billion in four years, from an \$18.3 billion balance) and Alex Pham, *White House Faulted on Bank Reform Law; GAO Chief Says Administration, Industry Seek to Weaken Measure*, WASH. POST, July 1, 1992, at F1 (reporting Bank Insurance Fund deficit of about \$7 billion in 1991 following \$18.3 billion balance four years earlier; the FDIC estimates that Bank Insurance Fund will need \$25.8 to \$35.3 billion over next two years) and Rep. Gonzalez Accuses Bank Regulators of Forbearance as Two Large Banks Close, BNA BANKING DAILY, Oct. 6, 1992, at 30 (noting that Bank Insurance Fund faced \$5.5 billion deficit at end of June, 1992, and is "essentially bankrupt," and reporting that Savings Association Insurance Fund is "nearly penniless with \$187 million as of August [1992]") and Stephen Labaton, *U.S. Regulators Scale Back Rise in Banking Fees*, N.Y. TIMES, Sept. 16, 1992, at A1 (reporting that in 1991, the FDIC estimated that failures in 1992 and 1993 would cost only \$15 billion) and John M. Berry, *Bank Savings Hit Record High; 1st-Quarter Profits up 36%; Interest Rate Break Offsets Loan Losses*, WASH. POST, June 11, 1992, at 10 (expecting insurance fund with deficit of \$5.5 billion to not show positive balance until well after year 2000) with Bert Ely, *There's No Need to Hike Premiums in '93*, AM. BANKER, Aug. 31, 1992, at 4 (stating that fund solvent in mid-1992).

92. FDICIA § 104(a), 12 U.S.C. § 1817(b)(1)(C) (Supp. III 1991) (setting assessment so that the aggregate premiums paid reach 1.25% of total deposits at insured institutions within 15 years). The FDICIA also authorized the FDIC to set assessments at any level necessary to reach solvency. *Id.* § 1817(b)(1)(A).

93. *Id.* § 1817(b)(1)(C); see Huber, *supra* note 10, at 302.

94. 12 U.S.C. § 1817(b)(7).

applied a smaller-than-expected increase to the remaining one-quarter.⁹⁵ The FDIC cited improved bank profits as the primary reason for the decision.⁹⁶ As a result of this action, as of January 1, 1993, the majority of banks will pay the same 23¢ for every \$100 in deposits—roughly one-quarter of one percent⁹⁷—and the weakest banks will pay as much as 31¢ per \$100.⁹⁸

Critics assailed the FDIC's actions. Foremost among their objections was that by not adopting higher fees, the FDIC had succumbed to political pressures.⁹⁹ In addition, commentators pointed out that the industry was not as healthy as it might have appeared based on its then-current profitability,¹⁰⁰ because fleeting conditions, such as lower interest rates and income from mortgage refinancings and government securities, accounted for some of the profits.¹⁰¹ More cynical commentators charged that the FDIC may have postponed action against weaker banks to make the industry appear healthier—a well-recognized election-year phenomenon.¹⁰²

While the assessment *increases* were projected to raise \$600 million from banks and \$180 million from savings institutions,¹⁰³ these are not substantial sums when viewed in context.¹⁰⁴ For example, the FDIC estimated that more

95. Labaton, *supra* note 91, at A1 (finding risk-based assessment only 50% of original proposal).

96. *Id.*, see also Dean Foust, *Banking Pulls Back from the Brink*, BUS. WK., Nov. 2, 1992, at 142 (attributing profits and higher stock prices to low interest rates).

97. Jerry Knight, *Bank Deposit Insurance Rate Hike Reviewed; FDIC May Shift Load to Weaker Institutions*, WASH. POST, Sept. 15, 1992, at D1.

98. See Labaton, *supra* note 91, at A1.

99. *E.g.*, *id.* (noting that congressional members suspect administration of postponing bad news until after presidential election); see also Stephen Labaton, *Banks Aim to Block Fee Rise*, N.Y. TIMES, May 12, 1992, at D1 (reporting that Congress and General Accounting Office urged increases; banks and administration urged no increases).

100. *E.g.*, Greising & Smith, *supra* note 10, at 117; Michael Quint, *Why Haven't More Banks Failed*, N.Y. TIMES, Aug. 19, 1992, at D1 (noting that the FDIC projected closing 200 banks with \$80 billion in assets, but it has only closed 70 banks with \$20.9 billion in assets); Labaton, *supra* note 91, at A1 (suggesting that surge in earnings is only temporary).

101. Quint, *supra* note 100.

102. Macey, *supra* note 16; Labaton, *supra* note 91, at A1 (noting Congressman Henry B. Gonzalez's argument that regulators who are putting off industry's troubles until after election need to shore up insurance fund).

103. Labaton, *supra* note 91.

104. According to Jerome Powell, former Undersecretary for Finance in the U.S. Department of Treasury, the FDIC had receipts of approximately \$6 billion. *The MacNeil/Lehrer NewsHour* (PBS television broadcast, Oct. 22, 1992), available in LEXIS, Nexis Library, Transcript File. In the past, however, big bank failures have required federal assistance as high as \$2.9 billion. *MCorp's Regulators Faulted*, N.Y. TIMES, Mar. 17, 1992, at D8 (estimating cost to FDIC of 1988 failure of First Republic Bank Corporation of Dallas to be \$2.9 billion and FDIC's cost in MCorp failure to be \$2.7 billion). Even small bank failures can require relatively high FDIC assistance. See James Grant, *The Bank Failure that Nobody Noticed*, AM. BANKER, Feb. 20, 1992, at 4 (reporting that FDIC advanced \$53.5 million in assistance to purchaser of failed \$82.3 million Lautharach Bank of Fort Worth, Texas). Although the number of troubled banks has declined steadily, the value of the assets they

than 1,000 banks on the FDIC's "problem list" had assets of \$610 billion at the end of 1991.¹⁰⁵ The late FDIC Chairman William Taylor had argued that increases in interest rates (whenever they might occur) would enlarge the number of "problem list" banks so that larger assessments than those actually assessed would be necessary to provide funds for that contingency.¹⁰⁶ Other experts have pointed to banks' continuing problems with their real estate portfolios that depress earnings and capital, and raise the chances of future bank failures.¹⁰⁷ Indeed, the FDIC has estimated that the 1,000 weakest commercial banks could cost the Bank Insurance Fund between \$25 and \$36 billion in the next two years.¹⁰⁸ The General Accounting Office, however, projected in mid-1992 that the Bank Insurance Fund will use as much as \$72 billion over the next four years.¹⁰⁹

B. Risk-Based Assessments

The second FDICIA provision aimed at funding encourages risk-based assessments. Such assessments will reduce the flat-rate character of deposit insurance premiums that less risky banks otherwise pay and also will apportion more fairly among risk-taking institutions, their shareholders, and depositors the risk that the FDIC will have to pay off deposits in their institutions.¹¹⁰ Congress intended risk-based assessments to cause bank shareholders and depositors to monitor the risks that their respective depository institutions present to the deposit insurance fund.¹¹¹ Despite the FDICIA's mandate for higher, risk-based premiums, the FDIC adopted an assessment one-half as large as originally proposed.¹¹²

hold—estimated at more than \$600 billion—is at a record level. See Labaton, *supra* note 91, at C2. Thus, the FDIC's receipts may be insufficient for the assets held by failing institutions.

105. Quint, *supra* note 100, at D1 (citing experts who believe that \$610 billion figure—up from \$487 billion three months earlier—must include assets of one or more major banks).

106. *Id.*

107. *E.g.*, Greising & Smith, *supra* note 10, at 116; Foust, *supra* note 96, at 143 (noting that experts cite slower economy, higher interest rates, and deeper discounts in real estate as threats to banks, and want 18 additional months of low rates to restore health).

108. *A Stop to Go-Go Banking*, *supra* note 91.

109. *Id.* Large bank bailouts can use huge sums; for example, at one point during the early phase of the Continental bailout, Continental used \$13.7 billion of capital provided or arranged by the FDIC. SPRAGUE, *supra* note 6, at 9.

110. See Klausner, *supra* note 6, at 710.

111. *Id.* at 711-13 (describing "moral hazard" present in all insurance schemes with flat-rate fees); see also Stephen Labaton, *FDIC Postpones Increase for Deposit Insurance Fees*, N.Y. TIMES, Apr. 8, 1992, at D1 (noting that current flat-rate system disadvantages well-managed institutions).

112. See *supra* note 95 and accompanying text.

Commentators argue that the FDICIA's basis for setting risk-based assessments—capital adequacy—is flawed because the capital ratios that serve as the criterion are crude measures of the risks actually presented by institutions.¹¹³ Instead, banking experts favor market-based measures of risks,¹¹⁴ including reinsurance¹¹⁵ or coinsurance.¹¹⁶ Congress has directed the FDIC to conduct two studies that pertain to the future shape of deposit insurance; one study concerns the feasibility of reinsurance and the other the feasibility of offering both insured and uninsured deposit accounts.¹¹⁷

Whether one views the experts' predictions of bank failure rates as unduly rosy or gloomy, and the method of determining the need for increases as useful or flawed, the FDIC's actions demonstrate familiar problems with the deposit insurance system—underfunding and intense political pressures. If the FDIC has estimated incorrectly the near-term incidence of failures or the potential costs of those failures, it will be faced with the need to draw upon the lines of credit authorized by the FDICIA (for example, loans from the Treasury, Federal Financing Bank, or Bank Insurance Fund members) or to ask Congress for additional funding in the event of a sizeable shortfall. Regrettably, it appears that the FDICIA will be only a stopgap financing measure and further adjustments in the deposit insurance system are likely¹¹⁸

III. THE FDICIA'S UNFINISHED BUSINESS: PARAMETERS FOR FUTURE ACTION

It is hard to predict what the next few years will bring for the banking industry. Certain factors—many of which have been apparent for some years—will shape the future debate about the banking industry and its

113. Macey & Miller, *supra* note 30, at 801.

114. 137 CONG. REC. S1160-70 (daily ed. Jan. 24, 1991) (statement of Sen. Dixon) (discussing the Deposit Insurance Reform Act of 1991, S. 261, 102d Cong., 1st Sess., which did not become law).

115. See Macey & Miller, *supra* note 30, at 801-02.

116. *Id.* at 801-02 n.65 (citing Kenneth E. Scott, *Deposit Insurance—The Appropriate Roles for State and Federal Governments*, 53 BROOK. L. REV. 27, 35 (1987)); see also S. 261, 102d Cong., 1st Sess. (1991).

117. FDICIA §§ 321-322, 12 U.S.C. § 1811 (Supp. III 1991). For the full texts of these provisions, see *Federal Banking Insurance Reform*, *supra* note 15, at ¶¶ 2221-2222. The Board of Governors of the Federal Reserve System released its report on December 19, 1992. 50 Fed. Reg. 3019 (Jan. 7, 1993).

118. In light of the banking industry's current efforts to repeal some of the FDICIA's provisions, it is likely that Congress will consider further banking reforms. See *A Stop to Go-Go Banking*, *supra* note 91, at A18 (citing administration efforts to repeal the FDICIA's tighter accounting, auditing, and examination rules).

regulation. These factors include the structural reforms not adopted in the FDICIA.¹¹⁹

There are at least four distinct factors that will shape the debate. First, the market for traditional commercial banking services has been shrinking over the last decade.¹²⁰ This shrinkage is attributable in part to the limits on the products and services that FDIC-insured banks and thrifts are legally allowed to offer their customers.¹²¹ These limits enable non-bank financial services providers to encroach upon service lines formerly offered by financial institutions, thus limiting the banks' profit-making opportunities. Shrinking opportunities also have roots in technological advances that make financial services as available as the closest automated teller machine or telephone.

Second, foreign competition for banking business has intensified. This competition includes offshore netting of dollar-denominated transactions¹²² and the influence of Japanese and European banks that offer customers a wider range of services than their U.S. counterparts.¹²³

Third, major financial institutions are consolidating rapidly. Recent acquisitions by many of the largest U.S. bank holding companies and by regional bank holding companies, such as BancOne,¹²⁴ First Union

119. See *supra* notes 22-25 and accompanying text. This discussion does not reach the current state barriers to nationwide banking and diversification, which many commentators agree should be relaxed, repealed, or preempted. *E.g.*, Byrne & Coulter, *supra* note 10, at 681-94; Macey & Miller, *supra* note 30, at 769.

120. See GARTEN, *supra* note 6, at 154-56. Professor Garten argues that shrinkage is inevitable, and she expresses concern that the FDICIA will interfere with appropriate shrinkage to the extent that the FDIC and other bank regulators pursue a goal of profitability for financial institutions—a goal that in her view is obtainable only in a highly protected environment such as our current bank regulatory scheme. *Id.*, see also Macey & Miller, *supra* note 30, at 781; *cf.* Klausner, *supra* note 6, at 728-29.

121. See MODERNIZING THE FINANCIAL SYSTEM, *supra* note 22, at 54-55; *cf.* Klausner, *supra* note 6, at 728-29.

122. See Federal Reserve Board Interim Policy Statement on Offshore Netting and Clearing Arrangements, 54 Fed. Reg. 26,092 (June 21, 1989). In addition, foreign banks have developed alternatives to the major funds transfer systems operated by the Federal Reserve System (Fedwire) and the Clearinghouse of New York Banks (C.H.I.P.S.). Sarah Jane Hughes, *Policing Money Laundering Through Funds Transfers: A Critique of Regulation Under the Bank Secrecy Act*, 67 IND. L.J. 283, 313 nn. 179-81 (1992).

123. The U.S. banking system more strictly separates banking and commerce than other leading banking systems. Consequently, U.S. banks—as opposed to non-bank subsidiaries of bank holding companies—may not participate in investment banking. Banking Act of 1933, ch. 89, 48 Stat. 162 (codified as amended in scattered sections of 12 U.S.C.); *J.P. Morgan & Co. Inc., The Chase Manhattan Corp., Bankers Trust New York Corp., Citicorp, and Security Pacific Corp.*, 75 FED. RESERVE BULL. 192 (1989) [hereinafter *J.P. Morgan & Co.*] (authorizing non-bank subsidiaries of bank holding companies to offer corporate equity and debt underwriting services).

124. BancOne was the twelfth largest holding company in the United States as of December 31, 1991. *Top 100 U.S. Bank Holding Companies*, AM. BANKER, Apr. 16, 1992, at 10. On April 13, 1992, it agreed to acquire Valley National Corp., a Phoenix, Arizona, bank holding company that was ranked 52nd largest as of December 31, 1991. *Id.* at 11.

Corp.,¹²⁵ and KeyCorp.,¹²⁶ provide ample evidence of consolidation. Consolidation signals the emergence of giant, more diversified financial institution networks.¹²⁷ It also evidences a pattern of the 1960s through the 1980s when federal and state bank regulatory agencies, as opposed to Congress, made most of the industry's structural reforms. For example, federal regulators approved expanded bank products,¹²⁸ and states removed or reduced barriers to acquisitions by out-of-state banks.¹²⁹

On the other side of the geographic and product diversification issue, communities have expressed their concerns that consolidations would decrease local services, particularly services necessary to fund entrepreneurship and job creation.¹³⁰ Some experts predict that banking will split into two camps—one that competes with investment bankers and international banks to serve major commercial clients but does not have deposit insurance for most of its activities, and the other that serves local clients and that has deposit insurance for most deposits.¹³¹

The fourth factor relates to the spillover from the thrift crisis, particularly the backlog of assets of thrifts and banks that failed in the 1980s and 1990s. Banking experts generally agree that these assets, including banking facilities, loan portfolios, and property that served as collateral, not only drag down the

125. First Union ranked 13th among holding companies. *Id.* at 10. In 1992, it agreed to acquire Dominion Bankshares Corp., Roanoke, Virginia. See *Dominion Bankshares Earnings Declined 48% in Third Quarter*; *Loyola Capital, Ameribanc Report Higher Profits*, WASH. POST, Oct. 21, 1992, at G3.

126. KeyCorp. was ranked 28th largest prior to its agreements to acquire Puget Sound Bancorp., a Tacoma, Washington, company ranked 94th, and 48 branches of the former Security Pacific Bank located in Washington State from BankAmerica Corp. *Top 100 U.S. Bank Holding Companies*, *supra* note 124.

127. See GARTEN, *supra* note 6, at 155; Jerry Knight, *Mega-Merger Creates 11-State NationsBank; Chemical, Manufacturers Also Combine*, WASH. POST, Jan. 1, 1992, at D9.

128. See GARTEN, *supra* note 6, at 134-36.

129. *E.g.*, CONN. GEN. STAT. ANN. §§ 36-552 to 36-563 (West 1987); DEL. CODE ANN., tit. 5, §§ 801-807 (Supp. 1992); IOWA CODE § 524.1805 (1983); MASS. LAWS ANN., ch. 167(A), § 2 (Law. Cop. 1987); WASH. REV. CODE § 30.04.230 (1983).

130. *E.g.*, *Capital Crunch Holds Small Business Lending at Bay*, HOUSTON BUS. J., Mar. 16, 1992, § 1, at 29; Knight, *supra* note 127, at D9 (citing bank owner Joseph L. Allbritton's statement that banks based out of town are "bad for community").

131. Paul S. Nadler, *Fast Forward to the Year 2000*, AM. BANKER, July 27, 1992, at 4. The FDICIA may assist in this separation in two ways. First, it offers financial institutions credits against deposit insurance assessments for the provision of community services. FDICIA §§ 232-234, 12 U.S.C. §§ 1834a, 1834b (Supp. III 1991); *Federal Banking Insurance Reform*, *supra* note 15, at ¶¶ 2131-2134. During his election campaign, President Clinton proposed a more extensive plan for community-oriented banks that would increase the assistance available from the banking industry and the federal government. *Campaign '92—Clinton Pledges Rewrite of CRA, Network of Community Banks*, BNA BANKING DAILY, Sept. 21, 1992.

In addition, Congress directed the FDIC to study a "two-window" deposit system—with one window for insured deposits and another for non-insured deposits. FDICIA §§ 321-322, 12 U.S.C. § 1811 (Supp. III 1991); *Federal Banking Insurance Reform*, *supra* note 15, at ¶¶ 2221-2222.

value of other bank properties and assets,¹³² but also erode other profits as banks establish huge reserves for losses.¹³³ The availability of these assets and the FDICIA's potentially stricter "least possible cost" test depress the current values of bank and thrift franchises¹³⁴ and, accordingly, decrease the amounts that potential purchasers of failed banks will be ready to invest to purchase them.¹³⁵

The FDICIA reflects a caretaker's staid mentality rather than a reformer's zeal: it preserves the fundamental character of the deposit insurance system while augmenting the regulatory structure designed to limit risks to the system.¹³⁶ Despite its attempted reforms of FDIC policies that have been criticized in recent years, the FDICIA and the FDIC's actions since its enactment offer fresh evidence of how difficult it is to restructure the banking industry through legislative action.¹³⁷ We have little reason to expect that Congress will adopt real reforms when it next recapitalizes the deposit insurance funds—an event the FDIC's current approaches to institutions' failures makes very likely.

In adopting the FDICIA, Congress did not enact structural reforms for the banking industry, such as the repeal of the Banking Act of 1933, the McFadden Act, and the Douglas Amendment. It also left deposit insurance coverage substantially unchanged. Congress must correct these deficiencies in the near term or be prepared to provide additional funding for resolutions of failed institutions. It also must expect that these resolutions will be very costly.

As Congress increases oversight and regulatory supervision of insured depository institutions and as institutions feel the pressures of increasing deposit insurance assessments, experts expect that some major financial institutions with more diversified business¹³⁸ may relinquish their federal

132. See Greising & Smith, *supra* note 10, at 116.

133. *Id.* at 116-17.

134. *E.g.*, Rehm, *supra* note 57, at 1.

135. *E.g.*, *id.*, Phil Roosevelt & Barbara A. Rehm, *CrossLand Seized as Regulations Reject Bids*, AM. BANKER, Jan. 27, 1992, at 1.

136. See FDICIA §§ 112, 132, 12 U.S.C. § 1820(b) (Supp. III 1991). These provisions call for annual examinations by bank regulatory agencies and audits of the financial condition of the financial institution.

137. See GARTEN, *supra* note 6, at 64-66 (noting that legislative restructuring is rare in banking industry). Indeed, banking, like other matters regulated at the federal level, appears to be affected by "demosclerosis," a phenomenon by which interest groups preserve the status quo by making it too difficult to make major changes. See Rauch, *supra* note 4, at 1998, 2000 (describing the difficulty of changing regulation of banking and deposit insurance).

138. This category could include banks, such as Bankers Trust, that now pursue less traditional, less deposit-oriented strategies, such as corporate equity and debt underwriting through affiliates in the holding company. See *J.P. Morgan & Co.*, *supra* note 123.

banking charters¹³⁹ so that they may compete for the more profitable commercial and international banking business and to avoid the burden of deposit insurance assessments. Their departure from the body of banks paying deposit insurance assessments will place more pressures on the funding of deposit insurance and finally may prompt Congress to undertake a more thorough reform of the banking and deposit insurance systems.

AUTHOR'S EPILOGUE

This Essay was based primarily on research covering the period from January through October, 1992. Since I completed this Essay in October, 1992, the general banking environment in the United States has improved,¹⁴⁰ but not sufficiently to conclude that the banking system has conquered the problems of the 1980s and early 1990s.¹⁴¹ For example, on October 30, 1992, the FDIC declared insolvent a number of banks, including twenty owned by First City Bancorporation of Texas.¹⁴²

For all of 1992, the FDIC closed 120 insured banks.¹⁴³ The December 19, 1992, effective date of section 141 of the FDICIA, which requires prompt action against undercapitalized banks, was not the "December surprise" predicted by banking experts.¹⁴⁴ Favorable interest rates allowed many banks to report improved profits for 1992.¹⁴⁵

139. See Nadler, *supra* note 131, at 4; *Core Banks*, *supra* note 70, at 190-92.

140. See Rehm & Cummins, *supra* note 83, at 1; *FDIC Office Reiterates that There Will Be No December Surprise of Bank Failures*, BNA BANKING DAILY, Dec. 3, 1992, at 1.

141. See *OTS May Close 81 More Thrifts by August 1993*, BNA BANKING DAILY, Oct. 14, 1992; *FDIC Has 35 U.S. Banks with \$7 BLN Assets in Danger*, REUTER MONEY REP., Dec. 2, 1992, available in LEXIS, Banking Library, Monrpt File; cf. Rehm, *supra* note 83, at 1 (quoting acting FDIC Chairman Andrew C. Hove's prediction that the industry was "off the critical list").

142. Steven Greenhouse, *U.S. Closes First City Bancorp.*, N.Y. TIMES, Oct. 31, 1992, at 37. The FDIC operated the group until their sale in late January, 1993, to Chemical Banking Corporation's Texas Commerce Bankshares and to 15 other banks or bank holding corporations. Kenneth H. Bacon & Michael Allan, *FDIC Selling Assets of First City Bancorp.*, WALL ST. J., Jan. 28, 1993, at A3. The FDIC had rescued the First City banks in 1988 with a \$970 million capital infusion. Harlan, *supra* note 53, at A3. The premiums paid for the individual banks in late 1992 surprised the FDIC and banking experts in part because of the FDIC's projections at the time of the October, 1992, insolvency declarations that it would lose an additional \$500 million on the First City banks. *Id.*

143. Bill Atkinson, *Bitter Requiem for a Small-Town Bank*, AM. BANKER, Feb. 2, 1993, at 1, 1.

144. Barbara A. Rehm, *Just 20 Banks Seen Failing Under Dec. 19 Rule Change*, AM. BANKER, Dec. 3, 1992, at 1.

145. See Rehm & Cummins, *supra* note 83, at 6; Steve Klinkerman, *Banking Recovery Strong but Erratic*, AM. BANKER, Sept. 16, 1992, at 1.

Other banks, particularly those in California and the Atlantic and New England states, continued to suffer from nonperforming real estate loan assets.¹⁴⁶ One out of five savings banks remained on the FDIC's "problem list" at year's end.¹⁴⁷ Banks in areas other than those named above remain susceptible to regional recession and to reduced profitability, particularly if the Federal Reserve System were to relax its low-interest-rate policy.¹⁴⁸

Regardless of their insolvency just three months earlier, in late January, 1993, the FDIC sold the First City banks for a substantial premium—in marked contrast to both initial expectations and prices prevailing over the past two years.¹⁴⁹ In addition, it began to market CrossLand Federal Savings Bank, a New York institution¹⁵⁰ that it placed in conservatorship in late January, 1992, with the announced intention of waiting as many as three years before offering it for sale.¹⁵¹

Despite the more favorable aspects of these developments (no "December surprise," higher profits, and the premium paid for First City's banks), I stand by my assessments of the FDICIA of 1991 and, in particular, of the state of our deposit insurance system.

146. Calvin Sims, *Bad Tidings for California Banks*, N.Y. TIMES, Dec. 15, 1992, at D1 (reporting that regulators predict 30 fewer banks in California may fail in 1993); Determination of Economically Depressed Regions, 57 Fed. Reg. 60,140 (Dec. 18, 1992) (discussing proposed rule to revise the designation of economically depressed areas in which Savings Association Insurance Fund members may receive direct FDIC assistance; revised rule would drop Alaska, Arkansas, Colorado, Louisiana, New Mexico, Oklahoma, and Texas, and add California, Connecticut, District of Columbia, Maine, Massachusetts, New Hampshire, New Jersey, New York, Rhode Island, and Vermont).

147. *FDIC Tallies up a Record Quarter*, AM. BANKER, Dec. 24, 1992, at 7, 10 (reporting one in five savings banks are on "problem list").

148. Susan Schmidt, *Thrift Supervision Chief to Depart Next Month*, WASH. POST, Nov. 9, 1992, at A19; Steve Klinkerman, *Some Banks Seen Vulnerable to Rate Spikes*, AM. BANKER, Dec. 22, 1992, at 1.

149. Bacon & Allan, *supra* note 142, at A3.

150. *See supra* note 57.

151. *See supra* notes 43-44.