

## 11. Deposit Insurance Reform in the United States: Post-FDICIA

*Entries in this section were published after passage of the FDICIA reform legislation in December 1991. They include overviews of the law; periodic assessments of its application and effectiveness, weaknesses and shortcomings, and effect on bank operations and incentive structures; discussions of continuing problems with bank regulation and deposit insurance; and recommendations for additional reforms.*

American Bankers Association (ABA). 1991. *Summary Overview of the Federal Deposit Insurance Corporation Improvement Act of 1991*. Gibson, Dunn and Crutcher.

This overview of FDICIA outlines the principal provisions that are likely to interest members of the American Bankers Association and that the ABA supported, including recapitalization of the Bank Insurance Fund, limits on the too-big-to-fail doctrine, and improvements in FIRREA's requirements for using licensed and certified appraisers.

American Conference Institute. 1993. *From FDICIA to Now: The Winds of Regulatory Change*. Proceedings of the October 21 and 22 conference. American Conference Institute.

The papers presented at the conference include "Mortgage Loan Discrimination," by Paul Hancock; "Pending FDICIA Proposal on Safety and Soundness to Take Flexible Approach," by Paul Allan Schott; "Notice of Proposed Rulemaking for Safety and Soundness Standards," by Patrick S. Antrim; "Annual Reporting, Audit Committee, and Independent Audit Requirements of Section 112 of FDICIA," by Harris Weinstein and Susan A. Maxson; "Antitrust Analysis of Bank Mergers: Recent Developments," by Terry Calvani and W. Todd Miller; "Bank Holding Company Mergers and Acquisitions," by Stuart C. Stock; "OTS Enforcement Powers," by Carolyn B. Lieberman; "Criminal And Civil Enforcement after FDICIA," by Robert B. Serino; "Recent Enforcement Actions and Related Issues," by Herbert A. Biern; "Interstate Activities of Federal Thrifts," by John H. Huffstutler; "Proposed Revisions to Offering Regulations," by Ellen Broadman and Elizabeth Malone; "Bank and Mutual Funds: Legal Considerations," by Robert M. Kurucz, Robert G. Ballen, and Natalie H. Diana; and "Implementation of the Foreign Bank Supervision Enhancement Act of 1991," by James S. Keller.

Ballen, Robert G., and Joseph P. Savage. 1992. The Impact of the Federal Deposit Insurance Corporation Improvement Act of 1991 on the United States Payments System. *Loyola Consumer Law Reporter* 4, no. 4:112-16.

This article reviews the provisions of FDICIA that affect the payments system, especially the provisions amending the Expedited Funds Availability Act (EFAA)—the federal statute that requires a bank to allow consumers access to their deposited funds. The article first gives an overview of EFAA and what it requires of depository institutions. The article next reviews the amendments to EFAA under FDICIA. Last, the article discusses certain other provisions of

FDICIA—those concerning payments netting arrangements and interbank exposure—as well as certain payments provisions that were proposed but not included in the bill passed by Congress.

Bankers Roundtable. 1997a. *Deposit Insurance Reform in the Public Interest: Partnering for Financial Services Modernization*. Report of the Subcommittee and Working Group on Deposit Insurance Reform, Retail Issues and Deposit Insurance Committee. Bankers Roundtable.

This report outlines why it is time for reform and why the marketplace should increasingly serve as the regulator, with government regulation playing a less-intrusive and less-burdensome role. The suggestion is made that reform will prevent the Bank Insurance Fund and the Savings Association Insurance Fund from experiencing unnecessary losses when depository institutions fail. Reform is also needed for other reasons: (1) to protect taxpayers fully against any such losses; (2) to prevent deposit insurance from being used as a rationalization for costly and burdensome banking regulations, or as an excuse to deny banks the competitive opportunity to offer new products and services to their customers; and (3) to encourage bank management to establish proper policies and practices for managing and controlling risk, rather than relying on the federal guarantee of deposits. This report makes recommendations for achieving these reforms.

Benston, George J., and George G. Kaufman. 1993. Deposit Insurance Reform: A Functional Approach: A Comment [on Merton and Bodie in same issue]. *Carnegie-Rochester Conference Series on Public Policy* 38: 41–49.

The authors discuss the flaws associated with the Merton and Bodie approach to deposit insurance reform. Benston and Kaufman cite the costs of the Merton and Bodie approach as being too high and give their own suggestions for a less-costly and less-disruptive solution. The Benston–Kaufman proposal would allow banks to offer whatever services they wished, as long as they maintained sufficient capital to absorb most of the losses they might incur.

Benston, George J., and George G. Kaufman. 1997. FDICIA after Five Years. *Journal of Economic Perspectives* 11, no. 3:139–58.

At year-end 1991, Congress enacted fundamental deposit insurance reform for banks and thrifts--the FDIC Improvement Act. This reform followed the failure of more than 2,000 depository institutions in the 1980s. Many failed because the incentive incompatibility of the structure of federal government-provided deposit insurance encouraged moral hazard behavior by banks and poor agent behavior by regulators. Insurance was put on a more incentive compatible basis, providing for a graduated series of sanctions mimicking market discipline that first may and then must be applied by the regulators on floundering banks. This article reviews these changes and evaluates early results. (©1999 EconLit)

Benston, George J., and George G. Kaufman. 1998. Deposit Insurance Reform in the FDIC Improvement Act: The Experience to Date. *Federal Reserve Bank of Chicago Economic Perspectives* 22, no. 2:2-20.

In 1991, in the FDIC Improvement Act, the United States adopted fundamental deposit insurance reform. This article reveals why the severe banking crisis of the 1980s made such reform necessary, and analyzes FDICIA's success to date.

Berger, George S. 1994. Reforming Deposit Insurance and the Regulatory System: The Failure of the Middle Way. *Cato Journal* 14, no. 2:221-41.

This article presents a brief analysis of federal deposit insurance, followed by a detailed critique of a number of reform proposals. The most important reform proposals can be classified into one of two main categories: (1) the reform of deposit insurance, and (2) the reform of regulation.

Carnell, Richard Scott. 1993. A Partial Antidote to Perverse Incentives: The FDIC Improvement Act of 1991. *Annual Review of Banking Law* 12:317-71.

The author explains why the pre-FDICIA system of federal deposit insurance and depository institution regulation encouraged owners, managers, and regulators of insured depository institutions to act in ways inimical to the interests of the deposit insurance funds. These perverse incentives, resulting in excessive risk-taking by depository institutions and forbearance by their regulators, ultimately helped make the Federal Savings and Loan Insurance Corporation insolvent.

Carnell, Richard Scott. 1996. The FDIC Improvement Act of 1991: What Has Worked and What Has Not. *Treasury News*, no. RR-1417.

The author focuses on the criticisms of FDICIA and explains that the act has indeed been successful; bank profitability increased and failures and problem cases decreased. He warns of squandering the beneficial incentive-effects of FDICIA's key reforms by succumbing to complacency and thereby leaving depository institutions needlessly vulnerable to future stress.

Carns, Frederick. 1995. A "Two-Window" System for Banking Reform. *FDIC Banking Review* 8, no. 2:1-9.

The author maintains that despite the strong performance of the banking industry in the early 1990s, banking reform should be a priority for at least two reasons: insured deposits have increasingly been used to fund activities for which safety-net protection is unnecessary; and banking organizations operate under legal restrictions that inhibit competition for financial services. An alternative two-window system would restrict the uses of insured deposits to traditional banking activities, but it would permit banking organizations to use uninsured funds for nonbank activities of their choice as long as the activities were conducted in separately capitalized and legally distinct affiliates. The author concludes that the two-window system offers important advantages over both the current structure and any structure based on narrow banks.

Carow, Kenneth A., and Glen A. Larsen Jr. 1997. The Effect of FDICIA Regulation on Bank Holding Companies. *Journal of Financial Research* 20, no. 2:159–174.

The authors examine market reactions to legislative announcements surrounding the passage of the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA). Research shows that bank regulation adversely affects shareholder wealth on the one hand, yet often provides government subsidies on the other. The removal of Federal regulators' discretionary authority and the imposition of mandatory regulations in the FDICIA have an overall negative effect on the author's sample of bank holding companies. The results are consistent with either the costly regulation hypothesis or the decreased subsidies hypothesis. (©1999 EconLit)

Cebula, R. J. 1997. An Exploratory Empirical Analysis of the Impact of the Federal Deposit Insurance Corporation Improvement Act of 1991 on Bank Failures in the United States. *Applied Financial Economics* 7, no. 6:695–701.

This article examines the effect of the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA) on bank failures in the United States. After summarizing a number of the most important provisions in this legislation and presenting certain relevant data, the article provides an exploratory empirical analysis that allows for variables such as the cost of deposits and other interest rates, capital/asset ratios, federal deposit insurance coverage, real GDP growth, and increased competition within the industry. The reduced-form estimates find that FDICIA appears to have reduced the failure rate of commercial banks in the United States.

Chapman, Cornelius. 1994. Regulation: Banking on Markets. *Reason* 26, no. 1.

The author claims that the U.S. deposit insurance system presents moral-hazard problems. To correct this situation, the author proposes a cross-guarantee system in which other banks, insurance companies, pension funds, and anyone else who could satisfy certain tests of financial strength would back bank deposits. A privatized, market-driven insurance system would protect taxpayers and allow banks to be more responsive to local economies and their needs.

Conference of State Bank Supervisors (CSBS). 1990. *Comments on Federal Deposit Insurance Reform*. CSBS.

In this document, the Conference of State Bank Supervisors (CSBS) strongly urges the Treasury Department to include in its review of options for reform an analysis of the effect that reform would have on the dual banking system. The CSBS reviews those issues that are of particular interest to the state banking system and makes recommendations when appropriate. The recommendations in this paper include the following: the “too-big-to-fail” doctrine should be abandoned; the \$100,000 limit for deposit insurance should be maintained; private deposit insurance will not work; states should retain the authority to close state-chartered institutions; market value accounting of bank loan portfolios does not offer a significant improvement over GAAP; and failed-bank resolution should be

reformed in a manner that treats all institutions equally and reinstates depositor discipline.

Dale, Richard S. 1998. Deposit Insurance: Policy Clash over EC and US Reforms. In *The Emerging Framework of Financial Regulation*, edited by C. A. E. Goodhart, 559–80. Central Banking Publications.

Both the United States and the European Community have introduced new policy initiatives on deposit insurance. However, these two schemes move in diametrically opposite directions. On the one hand, U.S. authorities have sought to curtail the scope of deposit protection in the hope that exposing depositors to greater risk will cause greater financial discipline to be imposed. On the other hand, the European Commission, as part of its program for a single European financial market, has issued a directive that will extend the scope of deposit protection within the European Community without imposing any limit on the coverage offered by individual member states.

D’Arista, Jane W. 1993. No More Bank Bailouts: A Proposal for Deposit Insurance Reform. In *Transforming the U.S. Financial System: Equity and Efficiency for the 21st Century*, edited by Gary A. Dymski, Gerald Epstein, and Robert Pollin. Economic Policy Institute Series. Sharpe.

This chapter proposes a system for providing financial guarantees—a system that both insures individual savers and protects the capacity of financial institutions to support the transactions essential for economic stability and growth. To make the case for this new approach to federal financial guarantee programs, the author first outlines the history and purposes of financial guarantees and describes the structural changes that have undermined a system that worked so well in the past. She then presents detailed proposals for reforming federal insurance of savings and transactions deposits.

Downes, Patrick T., David Marston, and İnci Ötker. 1999. Mapping Financial Sector Vulnerability in a Non-Crisis Country. Policy Discussion Paper no. PDP/99/4. International Monetary Fund.

The forward-looking framework expounded in this paper links a qualitative evaluation of system-wide vulnerability (covering macro, sectional, institutional, and systemic liquidity issues) with a quantitative assessment of the financial condition of significant financial institutions. Using vulnerability criteria and judgmental stress tests, the authors develop 12 indicators of soundness that measure risk exposure, solvency, liquidity, profitability, and supervisory assessment. This holistic methodology can be used not only as an early-warning/crisis-avoidance system to identify potential systemic problems—and problem institutions—requiring immediate attention, but also as a way to pinpoint needed reforms in the legal, regulatory, and institutional infrastructure, to lessen the likelihood of a future crisis.

Ely, Bert. 1994. Financial Innovation and Deposit Insurance: The 100 Percent Cross-Guarantee Concept. *Cato Journal* 13, no. 3:413–36.

The author argues that in past decades, dramatic changes in the economics of the financial-services industry—due largely to the computer revolution—have destroyed the efficacy of traditional financial-services regulation. Despite these developments, the federal government has merely tinkered with the regulatory system. Such tinkering is counterproductive because the current rigid, central-planning style of financial-services regulation is inherently flawed. The author contends that the United States must create a market-driven regulatory model that gives individual banks and thrifts the flexibility to pursue unique business strategies. The author’s 100 percent cross-guarantee concept is a reform proposal that would meet this test. Embodied in legislation introduced in September 1992 by Rep. Tom Petri (R-Wis.), it would lead to better-priced bank lending while eliminating the risk that federal deposit insurance poses to taxpayers. Cross-guarantees would also end “regulatory arbitrage,” that is, the flight of lower-risk assets from banks and thrifts to less-taxed and less-regulated channels of financial intermediation.

Evanhoff, Douglas D. 1992. Preferred Sources of Market Discipline: Depositors vs. Subordinated Debt Holders. Issues in Financial Regulation Working Paper Series, no. 1992-21. Federal Reserve Bank of Chicago.

This paper discusses market discipline in the financial-services industry and offers an alternative to market discipline that has all of the favorable characteristics of either dollar-based or maturity-based deposit insurance coverage, relatively few of the problems, and a number of additional attributes. The author presents the case for having subordinated debtholders protect the insurance fund. He shows that there are numerous advantages to restructuring banks’ capital requirements to have subordinated debtholders serve as a major source of market discipline.

Federal Deposit Insurance Corporation (FDIC). 1992. Report to the Congress on the Findings and Recommendations concerning the “Two-Window” Deposit System Proposal. Report. FDIC.

This FDIC study, mandated by FDICIA, reports on the “two-window” structure that would allow banking organizations to compete in nonbank markets without exposing the deposit insurance fund to undue risk.

Flannery, Mark J. 1993. Deposit Insurance Reform: A Functional Approach: A Comment [on Merton and Bodie in same issue]. *Carnegie–Rochester Conference Series on Public Policy* 38:35–39.

This article discusses Merton and Bodie’s proposal for deposit insurance reform. The author agrees that their proposal brings a novel perspective to the analysis, but he highlights flaws in their proposal—topics they did not discuss.

Flood, Mark D. 1996. The Great Deposit Insurance Debate. In *Stability in the Financial System*, edited by Dimitri B. Papadimitriou, 34–83. Jerome Levy Economics Institute

Series. St. Martin's Press. Also 1992. *The Great Deposit Insurance Debate*. Federal Reserve Bank of St. Louis *Review* 74, no. 4:51-77.

Federal deposit insurance is a defining feature of our nation's financial landscape. For many years, deposit insurance was regarded as a tremendous success. By protecting individual depositors, it discouraged banking panics, thus contributing greatly to monetary stability. The painful experiences of the 1980s have soured this cheery assessment. Recent legislation has made significant changes in deposit insurance, and many are calling for further reforms. The authors assess the various options for reform, and recall that federal deposit insurance was extremely controversial at its inception in the Banking Act of 1933. In this article the author reexamines the debate that surrounded the adoption of federal deposit insurance, first to see what the issues and arguments were at the time and, second, to see how those issues were treated in the legislation. He finds that the legislators of 1933 both understood the difficulties with deposit insurance and incorporated in the legislation numerous provisions designed to mitigate those problems. (©1999 EconLit)

Golembe, Carter H. 1992. *Shadow and Substance—Further Thoughts on 1991's Deposit Insurance Legislation*. *The Golembe Reports* 1992-6.

The author examines the Federal Deposit Insurance Corporation Improvement Act of 1991 and its effect on the banking industry after a year. In the first section he asks what happened to deposit insurance reform, and in the second he examines the status of plans for capital regulation.

Golembe, Carter H. 1995. *Deposit Insurance: Is Privatization an Option?* *The Golembe Reports* 1995-8.

The author alerts readers to a dialogue on deposit insurance reform that he believes will emerge, and suggests policy matters for consideration. In Section I he deals briefly with the system of government deposit insurance that is the subject of privatization proposals. In Section II he summarizes ideas on the privatization of deposit insurance, and identifies a few policy questions likely to arise. In Section III he offers concluding observations.

Golembe, Carter H. 1996. *Reforming Deposit Insurance: Don't Build on the Past*. *Banking Policy Report* 15:4-6.

The author examines deposit insurance issues. He begins with the reduction of deposit insurance assessments almost to zero and asks, (1) How did this happen? (2) Why did this happen? and (3) What might it portend for the future? He returns to the matter of privatization of the federal deposit insurance system as discussed in a previous paper [*The Golembe Reports* 1995-8], and includes some history.

Gordon, Sheldon. 1994. Deposit Insurance: It's Safe, But Is It Sound? *Canadian Banker* 101, no. 6:32–36.

After the Canada Deposit Insurance Corporation (CDIC) experienced financial difficulties in the early 1990s, and especially after the failures of the bank Confederation Life and its subsidiary, Confederation Trust, the debate about the Canadian federal deposit insurance system intensified. The author, a freelance economics writer, discusses the need for reforms with Grant Reuber, chairman of the CDIC, and Anne Riley, director of financial institutions for the Canadian Bankers Association.

Gorton, Gary. 1994. Privatizing Deposit Insurance: The Ely Proposal. *Cato Journal* 13, no. 3:437–45.

The author believes that privatizing deposit insurance in the manner that Bert Ely has proposed (his 100 percent cross-guarantee concept) would eliminate the moral-hazard problem associated with flat-rate deposit insurance. In theory this problem is due to the fact that bank equityholders have an incentive to add risk to the bank's assets when this risk is not priced and when the value of the bank's charter (an intangible asset), is low enough. The proposal shifts the role of monitoring banks from the government, which currently examines and disciplines banks, to private guarantors.

Hanc, George. 1999. Deposit Insurance Reform: State of the Debate. *FDIC Banking Review* 12, no. 3:1–26.

This article examines various deposit insurance issues under the following main headings: (1) the role and functions of deposit insurance; (2) the nature of the moral-hazard and principal-agent problems inherent in deposit insurance; and (3) a review of specific deposit insurance reform proposals. A concluding section attributes differences in views on reform issues mainly to differences in views on public-policy priorities, the economic role of bank intermediation, the cost of bank risk monitoring, and the relative efficacy of government supervisory authorities and private-sector agents in identifying and restraining risky bank behavior.

Herendeen, James B., and Janet Hendrickson-Smith. 1993. The Banking Crisis and Regulatory and Deposit Insurance Reform: The Issues in Historic Perspective. In *Proceedings of the Seventh Annual Meeting of the Pennsylvania Economic Association*, edited by James C. Luizer, 323–34.

The authors hold that regulatory reform must be accompanied by reform of the deposit insurance system. The 1989 thrift rescue bill failed to come to grips with reform of the deposit insurance system and thus left the thrift industry vulnerable to a repeat experience of the 1980s. The authors explain why proposals before Congress to deal with the banking crisis fail to propose serious reform of deposit insurance. Deregulation of the banking industry, as has been proposed, will probably make things worse rather than better.



Huber, Stephen K. 1992. The Federal Deposit Insurance Corporation Improvement Act of 1991. *Banking Law Journal* 109, no. 4:300–336.

In 1991, the proponents of banking reform introduced sweeping legislation in a heroic attempt to fundamentally change the current banking and financial system of the United States and expand the powers of financial institutions. The author claims that, instead, Congress enacted a bill with a narrower focus—the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA)—the purposes of which are to recapitalize and protect the bank insurance funds, reform the deposit insurance system, and improve supervision of federally insured depository institutions, including foreign banks. The author provides an overview and analysis of the many changes made by FDICIA that will be of interest to bank and thrift officials as well as to the lawyers and accountants who work for those banks and thrifts.

Hughes, Sarah Jane. 1993. Banking and Deposit Insurance: An Unfinished Agenda for the 1990s. *Indiana Law Journal* 68, no. 3:835ff.

The author explains that instead of the broad reforms sought by the Treasury Department and the banking industry, the focus of the Federal Deposit Insurance Corporation Improvement Act (FDICIA) was protecting the deposit insurance funds. To the extent that Congress failed to include structural banking reform in FDICIA, it merely postponed action necessary for the future health of the banking industry and, ultimately, for the integrity of the deposit insurance funds. The author analyzes three provisions of FDICIA that demonstrate continuing problems in the federal deposit insurance system: (1) the “least-possible-cost” resolution requirement, including restrictions on payments to uninsured and foreign depositors; (2) the “prompt corrective action” standards; and (3) the call for an enhanced insurance assessment. The author concludes that FDICIA will fail to achieve recapitalization of the Bank Insurance Fund and that, accordingly, further funding for the deposit insurance system will be required in the near term.

Jones, David S., and Kathleen Kuester King. 1992. An Analysis of the Implementation of Prompt Corrective Action. Finance and Economics Discussion Series, no. 204. Board of Governors of the Federal Reserve System.

Among the major provisions of the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA) is the requirement that the federal banking agencies implement, by year-end 1992, a capital-based policy of prompt corrective action (PCA). Under this framework each depository institution (DI) must be placed in one of five regulatory zones based on its capital position: (1) well-capitalized, (2) adequately capitalized, (3) undercapitalized, (4) significantly undercapitalized, or (5) critically undercapitalized. For each of the three categories of undercapitalized DIs, FDICIA specifies corrective actions that must be undertaken and a menu of discretionary actions. This paper evaluates alternative capital-driven assignment rules based on their ability to target for corrective actions commercial banks that the authors have identified as exhibiting a high risk of becoming insolvent between January 1984 and June 1989. (©1999 EconLit)

Kane, Edward. 1994. The Federal Deposit Insurance Fund That Didn't Bark in the Night. Working Paper no. 4648. National Bureau of Economic Research.

Unlike the Federal Savings and Loan Insurance Corporation and the Bank Insurance Fund, the National Credit Union Share Insurance Fund (NCUSIF) entered the 1990s in a state of accounting solvency. This paper develops evidence to show that NCUSIF remained solvent in a market-value sense as well. Differences in institutional product lines and risk-taking opportunities between credit unions and banks and thrifts are not consequential enough to explain the differences in their funds' health. This paper explains how differences in decisionmaking environments caused a substantial divergence between managerial and regulatory risk-taking incentives in the credit-union industry and those in the banking and thrift industries. The differences in incentive structure support the hypothesis that private co-insurance could lessen taxpayer loss exposure elsewhere in the federal deposit insurance system.

Kaufman, George G. 1994. FDICIA: The Early Evidence. *Challenge* 37, no. 4:53–57.

The author discusses how, despite the efforts of the regulators, the deposit insurance reform provisions of FDICIA have reduced the banks' and regulators' problems previously associated with deposit insurance and have financially strengthened the industry. The act provides a loophole for regulators to leave uninsured deposits at large banks unprotected. However, it is less likely that either the large number of bank and thrift failures or the large dollar losses from failures that were experienced in the 1980s will occur again. The author agrees that FDICIA is the most important prudential banking legislation since the Banking Act of 1933.

Kaufman, George G. 1995. FDICIA and Bank Capital. *Journal of Banking and Finance* 19, no. 3–4:721–22.

The FDIC Improvement Act of 1991 (FDICIA) attempts to correct the two major problems with deposit insurance that contributed greatly to the banking debacle of the 1980s—moral hazard, which occurred for banks primarily in the form of insufficient capital, and agency, which occurred for bank regulators primarily in the form of forbearance with respect to both timely sanctions and closure. The author concludes that FDICIA has successfully addressed these problems and has helped to make the banking industry financially healthier, while changing the behavior of regulators.

Kaufman, George G. 1997. Lessons for Transitional and Developing Economies from U.S. Deposit Insurance Reform. In *Standards and Politics: Banking and Finance Regulations in the NAFTA Countries*, edited by George von Furstenberg, 17-35. Kluwer Academic Publishers. Also 1997. Lessons for Transitional and Developing Economies from U.S. Deposit Insurance Reform. In *Regulation and Supervision of Financial Institutions in the NAFTA Countries and Beyond*, edited by George von Furstenberg. Kluwer Academic Publishers.

This article seeks to discover whether banking is more fragile than other industries and, if so, what the causes and implications are. The article concludes that banks are more fragile, but that this would not have translated into greater breakage (failure) without the help of well-intentioned but counterproductive government policies. The author finds that within the United States, state-owned banks are particularly troublesome because they are used to allocate credit by the government and are frequently insolvent and able to continue to operate only because of implicit government deposit insurance. These insolvencies need to be resolved before lasting deposit insurance reform can be successfully introduced.

Kaufman, George G., ed. 1994a. *Assessing Bank Performance: FDICIA Two Years Later*. Proceedings of the December 10, 1993, Symposium. Loyola University of Chicago.

This is a collection of papers presented at the second annual conference examining the effect of FDICIA. Authors and papers on the subject of deposit insurance include "FDICIA Two Years Later," by Philip Bartholomew; "Changing Structure of Commercial Banking in the 1990s," by Richard S. Peterson; "Assessing Bank Performance: FDICIA Two Years Later," by Douglas J. Kasl; and "Never on a Sunday," by Linda L. Stromberg.

Kaufman, George G., ed. 1994b. *Reforming Financial Institutions and Markets in the United States: Towards Rebuilding a Safe and More Efficient System*. Kluwer Academic Publishers.

This book contains a variety of essays, including "The Intellectual History of the Federal Deposit Insurance Corporation Improvement Act of 1991," by George J. Benston and George G. Kaufman; "Banking Reform: Economic Propellants, Political Impediments," by Kenneth E. Scott and Barry R. Weingast; "Taxpayer Loss Exposure in the Bank Insurance Fund," by Edward J. Kane; "The Role of Forbearance and Its Costs in Handling Troubled and Failed Depository Institutions," by Robert A. Eisenbeis and Paul M. Horvitz; "Long-Run Benefits in Financial Regulation from Increased Accountability and Privatization," by Edward J. Kane; and "The Application of Private Insurance to Banking Oversight," by Richard C. Aspinwall.

Kaufman, George G., ed. 1997. *FDICIA: Bank Reform Five Years Later and Five Years Ahead*. Research in Financial Services: Private and Public Policy, vol. 9. JAI Press.

Most of the papers in this collection were presented at a conference celebrating the fifth anniversary of the signing of the Federal Deposit Insurance Corporation

Improvement Act of 1991 (FDICIA). The conference was held in December 1996 at the Brookings Institution in Washington, D.C. The papers look back over banking and financial services in the five years since FDICIA and try to anticipate what may happen over the next five years. Papers include “The OCC and FDICIA,” by Eugene A. Ludwig; “The FDIC Improvement Act of 1991: What Has Worked and What Has Not?” by Richard Scott Carnell; “Evaluating FDICIA,” by Frederic S. Mishkin; “FDICIA after Five Years: What Has Worked and What Has Not?” by George Kaufman; “Evaluating the Prompt Corrective Action and Least Cost Resolution Provisions of the FDIC Improvement Act: The Watchdog’s Perspective,” by James Bothwell; “Contacting for Improved Supervisory Performance from Federal Banking Regulations,” by Edward Kane; “Safe and Sound Banking in Developing Countries: We’re Not in Kansas Anymore,” by Gerald Caprio Jr.; “An International Banking Standard: The Time Is Ripe,” by Morris Goldstein; “Main Features of Banking Problems and Solutions in Japan,” by Masaru Yoshitomi; “Optimal Supervision and Regulation of Banks,” by Alice Rivlin; “Central Banks’ Approach to Dealing with Settlement Risk in Foreign Exchange Transactions,” by Christopher J. McCurdy; “What’s New after FDICIA?” by Robert E. Litan; “The FIRREA Next Time: Consumer Debt and Congressional Action,” by Karen Shaw Petrou; “The Next Five Years in Banking: A Proposed Agenda for the New Administration and Congress,” by David Vitale; “FDICIA: The Unfinished Business,” by William Haraf; “The FDIC and FDICIA,” by Ricki Helfer; and “A Partial Antidote to Perverse Incentives: The FDICIA Improvement Act of 1991,” by Richard Scott Carnell.

Kaufman, George G., and Robert E. Litan, eds. 1993. *Assessing Bank Reform: FDICIA One Year Later*. Brookings Institution.

FDICIA was passed by Congress in November 1991 and signed into law a month later. The act promises to be the most important banking legislation since the Banking Act of 1933, yet it is also one of the most misunderstood and controversial laws enacted in years. This collection of papers examines the history and implementation of FDICIA, the responses to it, and its future.

Kennickell, Arthur B., Myron L. Kwast, and Martha Starr-McCluer. 1996. Households’ Deposit Insurance Coverage: Evidence and Analysis of Potential Reforms. *Journal of Money, Credit, and Banking* 28, no. 3 (part 1): 311–22.

It is often suggested that reducing deposit insurance would reduce problems of moral hazard in the banking industry. However, little is known about likely effects of proposed reforms on household depositors. This study uses data from the Survey of Consumer Finances to examine the characteristics of household depositors, particularly those with uninsured funds. The authors find that large depositors tend to have substantial shares of their assets in insured depositories, yet often fail to keep their holdings within insurance limits. Various explanations for these factors are considered. The authors also simulate the effects of proposed reforms on the pool of uninsured depositors. (©1999 EconLit)

Konstas, Panos. 1992. How to DIG Ourselves out of the Insurance Mess. *Journal of Retail Banking* 14, no. 1:16–24.

The Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA), the legislation that bailed out the savings and loan industry, did not address how deposit insurance should be reformed in order to avoid similar disasters in the future. Instead, the law directed the U.S. General Accounting Office and the Treasury Department to conduct (and submit to Congress) independent studies of the issue before any legislation on deposit insurance reform would be undertaken. Among the specific points to be investigated were the combining of federal and private insurance and restricting the liability of the FDIC to deposits explicitly covered by insurance. This article offers a plan to achieve both objectives. Because the system of de facto full insurance coverage of deposits encourages banks to take on highly risky assets, an intermediate private depositor is needed—dubbed a DIG for deposit intermediary and guarantor—with a vested interest in increased market discipline over banks. The author believes his plan to transfer regulation and insurance from the government to private parties would greatly improve bank safety, while reducing risks to the federal insurance fund and to the taxpayer.

Lai, Van Son, and Stephan Warywoda. 1997. Coinsurance and Private–Public Partnership in Deposit Insurance. In *Research in Finance*, vol. 15, edited by Andrew H. Chen, 275–303. JAI Press.

The authors derive closed forms formulas, using contingent claims analysis, to value co-insurance contracts and a private-public partnership in an attempt to shed light on various proposals for deposit insurance reform. They then compare the merits of these deposit insurance arrangements with one another and with the benchmark deposit coverage. They draw policy implications from the schemes that best mitigate moral-hazard problems. They find that some forms of co-insurance and private-federal partnership in deposit insurance reduce moral-hazard problems and constitute a means of containing government contingent liabilities.

Mantripragada, Krishna G., and H. Banarjee Rau. 1995. Private Deposit Insurance: An Assessment. *Journal of Insurance Regulation* 14, no. 1:90–114.

Although changes in the federal deposit insurance system have been made under the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA), some view private deposit insurance as preferable even to a reformed federal deposit insurance. The author feels FDICIA does not reflect this preference but it does allow the FDIC to conduct limited experiments with private reinsurance. This article seeks to bring together the major ideas relating to privatization of deposit insurance, examining its appeal and feasibility as well as critically evaluating alternative plans that would implement it. Although in certain respects private deposit insurance may be preferable to federal insurance, many problems would have to be resolved before it could develop into a major force.

Merton, Robert C., and Zvi Bodie. 1993a. Deposit Insurance Reform: A Functional Approach. *Carnegie–Rochester Conference Series on Public Policy* 38:1–34.

The deposit insurance system has a basic structural problem: a mismatch between the deposits insured by the FDIC and the “opaque” and illiquid bank loans used to collateralize those insured deposits. At one time, synergy might have been created by the use of insured deposits as the primary source to finance the commercial lending activities of banks, but the authors see no evidence that such benefits, if any, exist in the financial system. There are, however, significant costs for maintaining the institutional structure. The authors conclude that an efficient solution to the mismatch is for commercial lending to be financed by standard instruments such as debt, preferred stock, and equity, and for deposit insurance to be limited to institutions or accounts that collateralize deposits with U.S. Treasury bills or their equivalent.

Merton, Robert C., and Zvi Bodie. 1993b. Deposit Insurance Reform: A Functional Approach: Reply [to Benston and Kaufman in same issue]. *Carnegie–Rochester Conference Series on Public Policy* 38:51–55.

Benston and Kaufman use a narrow-bank structure as a straw-man foil for making the case for their proposal, but Merton and Bodie claim the Benston–Kaufman article does little to address the merits and flaws of the Merton–Bodie article in either absolute or relative terms. Benston and Kaufman exaggerated the costs of implementing the Merton–Bodie proposal and understated the potential costs associated with the monitoring system in their own proposal. The Benston–Kaufman proposal would create moral hazard arising from asymmetric information between the insured banks and FDIC.

National Commission on Financial Institution Reform, Recovery and Enforcement. 1993. *Origins and Causes of the S&L Debacle: A Blueprint for Reform: A Report to the President and Congress of the United States*. Government Printing Office.

The national commission’s report was based on months of study, public hearings, recorded interviews, and original research on the causes of the savings and loan crisis of the 1980s and early 1990s. The report focuses on the major forces that led to the crisis and/or contributed to its magnitude. The report recommends the following policy changes that would reduce the chances for a similar, future crisis: (1) give agencies that administer guarantee programs automatic borrowing authority; (2) allow institutions to offer federally insured deposit accounts solely through separately capitalized, federally insured, money-market funds; (3) require that the OMB and GAO make a joint annual report on the loss exposure of all financial insurance programs; (4) require each agency that provides financial insurance to assess possible adverse incentives built into its programs; and (5) grant all such agencies the authority to determine regulatory and examination standards.

Nelson, Richard W. 1996. Can the Federal Government Do a Better Job of Providing Deposit Insurance? In *Research in Financial Services: Private and Public Policy*, vol. 8, edited by George G. Kaufman, 259-65. JAI Press.

This article reviews the desirability of narrowing federal deposit insurance as proposed by the National Commission on Financial Institution Reform, Recovery and Enforcement. The article approaches the issue primarily from the post-debacle perspective of cost to taxpayers, but also considers the pre-debacle question of economic stability. Before turning to the public-policy issue, the author briefly discusses the nature of the deposit insurance business.

Parry, Robert T. 1992. A Central Banker's Perspective on Bank Reform. *Business Economics* 27, no. 3:13-18.

The Federal Deposit Insurance Corporation Improvement Act of 1991 made some progress toward reform in banking. In particular, the act establishes a more objective framework for prompt corrective action that limits regulatory discretion and mandates risk-based deposit insurance premiums. However, the U.S. still is a long way from shedding the antiquated regulatory structure adopted in the 1930s. For the sake of economic efficiency, banking regulation should move toward greater integration of commercial and investment banking, broader insurance powers for banks, and a system of nationwide branching. To protect the deposit insurance system better, it is important to have regulatory standards based on market-value criteria and to establish a more credible position against the too-big-to-fail policy. (©1999 EconLit)

Peek, Joe, and Eric S. Rosengren. 1997. Will Legislated Early Intervention Prevent the Next Banking Crisis? *Southern Economic Journal* 64, no. 1:268-80.

A key provision of the Federal Deposit Insurance Corporation Improvement Act of 1991 was prompt corrective action (PCA). PCA emphasized early intervention by bank supervisors and was intended to limit forbearance by making supervisory intervention more timely and less discretionary. However, PCA, as implemented, appears to have been oversold. Had PCA been in place during the recent banking crisis in New England, it would have had little, if any, effect. Since it imposes an essentially nonbinding constraint on bank supervisors, PCA is not likely to play a major role in preventing the next banking crisis. (©1999 EconLit)

Roper, Don E. 1993. Depository Institutions: Reforms along the Lines of Islamic Banking Principles. Ph.D. diss., University of Colorado at Boulder.

Depository institutions play an important role in the world's economic activities, and debt contracts are the most commonly used tools of those institutions. This dissertation affirms that debt contracts are risky for economic stability, especially when the overall indebtedness that countries, banks, and individuals have reached is taken into account. The author suggests a fundamental reform in depository institutions' daily practices. Limiting depository institution reform to supervisory and regulatory measures, albeit necessary, is not enough and might be dangerous. This dissertation investigates the possibility of including the main idea of Islamic

banking in the needed reform for the U.S. depository institutions. This idea would base the liability side of depository institutions on the principle of sharing (equity instead of debt contract) and would, this dissertation claims, eliminate any need for deposit insurance.

Silverberg, Stanley. 1993. A Case for Broadening the Deposit Insurance Assessment Base. Report. Independent Bankers Association of America.

The FDIC Improvement Act (FDICIA) gave the FDIC the authority to redefine the deposit insurance assessment base. Since the enactment of FDICIA in December 1991, assessment issues have focused on the recapitalization of the Bank Insurance Fund (BIF), the level of assessments, and the implementation of risk-based assessments. The FDIC has deferred serious consideration of modifying the assessment base—perhaps waiting for the general level of assessments to come down. This report is intended to provide an early contribution to determining the appropriate assessment base.

Smale, P. H. 1993. Bank Failures and the Deposit Insurance Fund. Congressional Research Service *Issue Brief* 92, no. 5:1–9.

Many factors contributed to the problems experienced by the U.S. deposit insurance system in the 1980s, including deregulation, technology, individual bank management, and economic conditions. Congressional concern grew as the pace of the failures accelerated. Interest in banks' financial problems increased as a result of the severe problems of the thrift industry, which required enormous infusions of government funds. This article responds to Congress's concern that its recapitalization of the BIF may not be sufficient to ensure the stability of the banking industry as a whole.

Stern, Gary H. 1997. A Modest Proposal for Meaningful Deposit Insurance Reform. Federal Reserve Bank of Minneapolis *Region* 11, no. 3:2–3.

The president of the Federal Reserve Bank of Minneapolis discusses the need to reinvestigate the issue of deposit insurance reform. He recommends that uninsured depositors—those with more than \$100,000 in a bank account—should face some risk; if they did, they would put pressure on banks to operate in a more safe and sound manner. In particular, the author's proposal addresses the issue of moral hazard, the term that refers to the costly side effect of a de facto full insurance program: depositors and banks have an incentive to take on more risk than they otherwise would. If depositors were subject to a limited but meaningful loss, the market for information about the financial condition of banks would certainly broaden and deepen over time, and so would banks' commitment to safe and sound banking practices.

Stern, Gary H. 1998. Market Discipline as Bank Regulator. Federal Reserve Bank of Minneapolis *Region* 12, no. 2:2–3.

The president of the Federal Reserve Bank of Minneapolis briefly outlines his bank's proposal for deposit insurance reform, and comments on the role of market



discipline in helping to constrain excessive risk-taking by banks, especially large banks. The proposal would address the too-big-to-fail issue through legislation—specifically, an amendment to FDICIA (1991)—to provide that uninsured depositors suffer some loss even when FDICIA’s too-big-to-fail provisions are invoked. The idea is that these creditors would know in advance that they would have to bear the consequences of their decisions, and therefore before-the-fact market discipline from uninsured depositors would increase. This reform would be coupled with market-based pricing of deposit insurance premiums and increased disclosure of information about the financial condition of banks.

Timmer, Barbara. 1993. Deposit Insurance: Back to the Future. In *Assessing Bank Reform: FDICIA One Year Later*, edited by George G. Kaufman and Robert E. Litan, 135–40. Brookings Institution.

The author reflects upon the Brookings Institution conference entitled *Assessing Bank Reform: FDICIA One Year Later*—the papers presented, ideas discussed, comparison with past conferences, and presenters’ biographies.

Todd, Walker F. 1993a. Discount Window Provisions of the Federal Deposit Insurance Corporation Improvement Act of 1991. *Banking Policy Report* 12, no. 5.

The author discusses how and why Congress was prompted to redraw the limits of the Federal Reserve’s statutory authority regarding the discount window. After Congress was aroused by what it apparently deemed evidence of use of the discount window to rescue uninsured claimants on failing depository institutions, it decided to provide explicit guidance and limitations on use of Federal Reserve Bank advances so as to minimize losses to the FDIC and taxpayers.

Todd, Walker F. 1993b. FDICIA’s Emergency Liquidity Provisions. Federal Reserve Bank of Cleveland *Economic Review* 29, no. 3:16–23

The Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA) made a potentially significant change in the standards for Federal Reserve discount window access by nonbanks. In exploring the background of this issue, the author contends that although most provisions decreased the federal financial safety net for undercapitalized insured depository institutions, FDICIA enlarged the moral-hazard problem by altering the Reserve Banks’ collateral or purpose of borrowing standards to accommodate nonbanks’ asset portfolios.

Todd, Walker F., and Gerald P. O’Driscoll Jr. 1993. Deposit Insurance Reform Is Not Enough. In *The Crisis in American Banking*, edited by Lawrence H. White, 119–38. New York University Press.

The authors argue that deposit insurance reform alone cannot eliminate the structural instabilities of the U.S. banking system. Deposit insurance is only one part of the federal financial safety net that undergirds the banking industry. Other elements of the safety net reinforce and enhance the perverse incentives generated by deposit insurance. The authors cite the reasons any form of deposit insurance

will prevent the United States from achieving a stable and equitable banking system.

Wall, Larry D. 1997. Taking Note of the Deposit Insurance Fund: A Plan for the FDIC to Issue Capital Notes. Federal Reserve Bank of Atlanta *Economic Review* 82, no. 1:14–30.

In the United States the risk that a financial breakdown could lead to a taxpayer bailout of the deposit insurance fund has been cited to justify current regulatory controls on the activities that banks may engage in. Despite some regulatory changes in the 1990s to protect taxpayers from future debacles, however, widespread failures could still expose taxpayers to losses. This article proposes a new way to monitor the deposit insurance fund: have the FDIC issue capital notes. Because the interest paid on the notes would be suspended if the fund required a loan from the Treasury or would be eliminated if taxpayer funds were contributed to offset deposit insurance losses, noteholders would have an incentive to clearly signal the condition of the insurance fund. This signal would help regulators, taxpayers, and members of Congress monitor the health of the fund and would change the incentive structure facing FDIC directors.

Wenninger, John. 1993. Implications of Narrow Banking for Monetary Policy. Research Paper no. 9327. Federal Reserve Bank of New York.

Narrow banking (or a variation on this theme, 100 percent reserve requirements) has been frequently proposed as an alternative to the current deposit insurance arrangements. However, the monetary policy implications of these proposals have not always been fully appreciated. In this article, the author reviews the potential advantages claimed for narrow banking in terms of deposit insurance reform and also explores in considerable detail the major disadvantages which come largely in the area of monetary policy. The main conclusion of this paper is that the problems that could be created for monetary policy are potentially so great that narrow banking probably would not be a viable approach to insurance reform, even though certain aspects of this approach do have some intuitive appeal. (©1999 EconLit)

Williamson, R. Mark. 1994. Regulatory Theory and Deposit Insurance Reform. *Cleveland State Law Review* 42, no. 1:105–31.

This article briefly examines what the role of banks would be in an economy where informational and other market conditions were perfect and where there was no regulation of any kind, and attempts to articulate an information failure theory to justify government regulation of banking. Next, the article focuses on the regulatory costs of deposit insurance—specifically, the adverse effects on the behavior of banks and depositors. The article contains a two-part conclusion: (1) it offers a reform proposal that calls for a political choice between retaining the overall architecture of the existing deposit insurance system or abandoning that architecture in favor of segregating or nationalizing banks that insure deposits; and (2) using a theoretical framework, it makes suggestions for tailoring reform to the political choices just described.