



**Shadow Financial
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Statement of the Shadow Financial Regulatory Committee
on
Disposal of FDIC Equity Interests in Assisted Banks
February 8, 1988

Confronted with a number of cases in which large banks have been threatened with failure, the Federal Deposit Insurance Corporation has, when providing open-bank assistance, increasingly used the technique of making an equity investment in the troubled institution. The principal motivations for using this technique are to effect a significant dilution of the interest of existing shareholders, so as to approach the impact that shareholders would feel in an insolvency proceeding, and to recoup some of its outlay if the institution regains profitability.

A significant consequence of this technique is that such institutions are effectively nationalized, although for political reasons the FDIC has been reluctant to assume day-to-day control of these institutions. Although such a procedure is desirable

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for brief periods of time during which potential private buyers for the institution can be found without confronting fire-sale prices, the Shadow Financial Regulatory Committee believes that the operation of a government-owned banking institution beyond this brief period is not a proper function for the FDIC, and undermines the efficiency and competitive equity of the banking system.

The Committee urges the FDIC to adopt an explicit policy that calls for it to dispose of any such equity interest as soon as practicable after the assistance is provided. Furthermore, the practicability of a disposition should be determined only with respect to the tasks necessary to effectuate a sale. It should not be the FDIC's policy to hold such interests for extended periods in the hope of realizing a gain on sale. Losses are equally likely.

In this respect the Committee notes that in July 1984, when the FDIC acquired an equity interest in Continental Illinois Corporation in connection with the provision of assistance to that institution, it announced its intention to dispose of that interest "as soon as practicable." More than 3-1/2 years have expired since that intention was expressed, and Continental has had a substantial period of operation under new management. There is no apparent

Shadow Financial
Regulatory Committee

- 3 -

February 8, 1988

justification for the FDIC to continue Continental as a
government-owned institution.