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**Statement of the Shadow Financial Regulatory Committee**

on

**Subsidized Federal Reserve Assistance**

February 26, 1990

Several banks in New England have been experiencing financial difficulties in recent months. Deposit rates now offered in this area are among the highest in the country. The Federal Reserve Bank of Boston has been lending more than \$1 billion to New England institutions through the discount window at less than the market rate of interest.

Because the Federal Reserve has a policy against loans to insolvent institutions, the Committee hopes that this subsidized credit is not being granted to banks that are insolvent in economic terms as well as on a book value basis. The Committee previously urged in its Policy Statement No. 41 that banks with capital of less than three percent should be required immediately to increase their capital substantially. If such institutions prove unable to raise additional equity capital, we may interpret the market to be effectively declaring them insolvent.

The Committee has previously warned about the high costs of open bank assistance to insolvent banks. In addition, if such assistance is provided because the institution is deemed "too large to fail" the Committee believes that it unfairly discriminates against smaller institutions. This doctrine was used to support lending to the Continental Illinois

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National Bank in 1984, Republic National Bank in 1988, and MCORP in 1989, among others. Nevertheless, all of these banks subsequently failed with large losses to the FDIC. The assistance primarily provided time for many uninsured depositors to withdraw their funds without loss. The loss, though, was borne first by the FDIC, and ultimately, as the bankruptcy of the FSLIC demonstrates, may be underwritten by federal taxpayers.

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It is the Committee's policy that members abstain from participation on policy statements in which they have a direct personal or professional involvement in the matter that is the subject of the statement. Accordingly, Richard Aspinwall and John D. Hawke, Jr. abstained from participation in this statement.