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Statement of the Shadow Financial Regulatory Committee on the FDIC Improvement Act of 1991

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After a yearlong struggle, Congress has passed and sent to the President S.543, the Federal Deposit Insurance Corporation Improvement Act of 1991. News coverage for most of the last half-year has focused on fights among various interest groups over the extent of bank powers and activities in such areas as securities underwriting, insurance and real estate brokerage, and interstate branching. The final bill reflects a lobbying stalemate that has largely paralyzed legislative action on these subjects for several decades. That should not obscure the fact that S.543 makes major contributions to the reform of federal deposit insurance, a matter of a greater urgency and importance. The FDIC Improvement Act of 1991 is aptly named, up to a point.

I.

(1) The new banking bill would enact into law the concept of prompt regulatory actions keyed to a bank's capital ratio. The extent of supervisory attention and restriction would increase for banks with lower capital levels (§ 131). If an institution falls below a "critical" capital ratio, even though at

least nominally still solvent, the banking agency is empowered to appoint a conservator or receiver.

All of these are measures the Shadow Financial Regulatory Committee has been urging for some time (see Statements No. 38, December 5, 1988, and No. 41, February 13, 1989), and we believe they have the potential for preventing a recurrence of the deposit insurance disaster of recent years.

(2) To determine more accurately the economic condition of insured institutions, the banking agencies are to require them to include off-balance-sheet assets and liabilities in their financial statements, and to disclose estimated fair market values as well as the numbers generated by generally accepted accounting principles (§ 121). The Committee supports strengthened accounting standards and indeed has since 1986 consistently recommended the use of market value accounting standards (Policy Statements No. 3, June 9, 1986, and No. 30, February 8, 1988).

(3) S.543 also addresses the policy of "too big to fail", whereby in the past the banking agencies have in effect provided depositors and other creditors with unlimited deposit insurance despite the legal ceiling. As of 1995, the FDIC is not to pay uninsured claims in arranging a takeover of a failed institution unless the total cost would be less than that incurred in a straight liquidation (§ 141), and the Federal Reserve System is no longer to use advances to keep open and in operation "critically" undercapitalized institutions (§ 142). The Committee has previously expressed strong disapproval of the "too big to fail" policy (see Statement No. 37, December 5, 1988), and believes the action of Congress in S.543 is a major step forward.

In the area of deposit insurance reform, therefore, Congress has truly effected "FDIC improvements." But the story cannot end there. Each of the actions Congress has taken requires implementation by the banking agencies and relies on agency discretion to be effective in individual cases. The agencies must define the various capital categories and the minimum ratios on which they are based. The agencies control the sanctions imposed and the promptness of intervention and the appointment of a conservator or receiver for a critically undercapitalized institution.

It is still possible for the FDIC to read the statute to permit payment of uninsured depositors in full (by generously estimating liquidation costs) or to override the limitation itself by invoking an emergency procedure for perceived "systemic risk"; the Fed could still support an insolvent institution with advances by absorbing the interest charges. In either event, "too big to fail" reappears.

Despite the good start undertaken in S.543, therefore, the actual achievement will be determined by the implementing regulations, and even more by the discretionary actions, adopted by the federal banking agencies. Much of what the banking agencies are now expressly authorized or urged to do, they previously had implied authority to bring about; the bill can be viewed as a repudiation of the course the banking agencies followed in the 1980s. Taxpayers and the Congress will be well advised to keep a close and wary eye on the agency process in the future.

II.

The new banking bill does little to bring the scope of activities of U.S. banks into the world of the 1990s. In almost every other country, banks can offer the public a wide range of services, including insurance and securities services and underwriting. Banks in most other countries can have branches nationwide. But U.S. banks remain restricted by antiquated laws.

If and when the intent of Congress to subject banks to meaningful capital requirements is implemented by the banking agencies, banks having sufficient capital should be permitted to offer a wide range of financial products and services. In general, this change could tend to make banks less prone to failure because it would permit banks to hold more diversified assets and activities, thereby generating revenue from more diverse sources. Permitting banks to branch nationwide also would lessen the risk that a local economic downturn would result in bank failures and the absence of viable banks in the depressed area. In addition, nationwide branching would facilitate desirable consolidations.

We urge that Congress complete the job it began with the FDIC Improvement Act by repealing the restrictions on securities activities imposed by the

Glass-Steagall Act, permitting national banks to branch nationwide, and allowing banks to underwrite and sell insurance products. (See Statement No. 63, December 10, 1990, and Statement No. 56, May 7, 1990.) Consumers would benefit from these changes, the banking system would be strengthened, and taxpayers would pay less if they have to bail out commercial bank depositors.