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Statement No. 85

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Statement of the Shadow Financial Regulatory Committee

on

The TDPOB's Proposed Early Resolution/Assisted Merger Program

June 1, 1992

The Thrift Depositor Protection Oversight Board published for public comment in the Federal Register on February 21, 1992 an early resolution/assisted merger program for troubled thrift institutions.

In commenting previously on similar proposals, the Shadow Financial Regulatory Committee noted that, while temporary government ownership of troubled institutions may on occasion achieve the least cost resolution, in general, perverse incentives are created by such a program.[1] It can lead institutions to take additional risks because their own capital investment is minimal. It can also lead regulators to

[1] See Statement No. 7, June 9, 1986, "Proposals for Capital Forbearance Policy for Agricultural and Energy Banks;" No. 14, November 17, 1986, "Policies Toward Troubled Depository Institutions;" No. 22, November 13, 1987, "FSLIC Handling of Insolvent thrift Institutions;" No. 27, February 8, 1988, "Disposal of FDIC Equity Interests in Assisted Banks;" No. 31, May 16, 1988, "FDIC's New Policy on 'Whole Bank' Takeovers;" No. 35, September 25, 1988, "Need to Make FSLIC and FDIC Assistance Deals Accountable;" and No. 80, February 17, 1992, "FDIC's Program for 'Hospitalizing Sick Banks'."

provide continued forbearance as a way of delaying official recognition of the embedded losses and the return of the institution to the private sector.

Previous experience with government owned or managed programs has been mixed, and it has often resulted in throwing good money after bad. The Committee has criticized the FDIC for its recent nationalization of the CrossLands Savings Bank on several grounds: failing to spell out the terms of the nationalization sufficiently, producing overly pessimistic estimates of the cost of not protecting uninsured depositors fully, and offering greatly over-optimistic and unrealistic projections of its ability to "nurse" the bank back to health and to reprivatize it profitably (Statement No. 80, February 7, 1992).

The Committee is concerned that the proposed early resolution/assisted merger program will continue undesirable forbearance policies. For example, the early resolution cases provided as examples by the Oversight Board at its March 25, 1992 hearings as "weak thrifts," and potential candidates for the "program," were already clearly insolvent on either a GAAP or economic basis. Intervention, after an institution has become insolvent, is <u>late</u> rather than <u>early</u> in the supervisory process. To be effective, early intervention must be initiated before an institution becomes insolvent so as to permit resolution or recapitalization without imposing costs on the insurance fund or taxpayers.