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Statement of the Shadow Financial Regulatory Committee on

Facilitating Bank Failure Resolution

February 12, 2007

When banks fail it is important that depositors have prompt access to as much of their funds as the deposit insurance of their accounts or the assets of the failed bank would provide. In the absence of an acquisition by a healthy bank that protects all deposits, the FDIC makes at least some funds available to depositors within a very short time—usually on the Monday following a Friday bank closing. Depositors gain almost immediate access to funds up to the insurance limits on their accounts and, at times, some portion of the uninsured deposits that the FDIC expects to recover from liquidation of the failed bank's assets. The largest bank closing handled in this way had about 90,000 accounts. The largest banks have over 10 million accounts. With existing information and data processing capabilities of the banks and the FDIC, it is not certain that the FDIC could manage a least-cost resolution of a large bank failure as rapidly as it has handled smaller failures in the past.

In order to prepare the largest banks, and the FDIC itself, for the possibility of a very large bank failure, the FDIC recently released for comment a proposed rule that would require those banks to establish and maintain the capability to provide the information necessary for the FDIC to determine the insurance status of all accounts, and the ability to place provisional holds on all accounts above a minimal amount. Ideally, this will allow depositor access to most of the funds to which they are entitled almost immediately, and for additional funds to be released as soon as their insurance status can be resolved.

The Shadow Financial Regulatory Committee believes that it is very important that the FDIC has the capability to handle a large bank failure with a prompt payout to depositors or a transfer of funds to a bridge bank. When the FDIC issued a similar rule-making proposal in 2005, a number of banks acknowledged the importance of maintaining the liquidity of bank accounts at failed banks, but expressed concern that the FDIC proposal involved excessive and unnecessary costs. Following meetings with several banks and service bureaus, the FDIC issued a revised proposal.

The Committee is not able to comment on the specifics of the FDIC proposal, but believes that adherence to the prompt correction action and least cost resolution policies embodied in FDICIA requires that the FDIC have the capability that the proposal intends. In particular, the Committee is concerned that in the absence of the capability to make deposits available promptly, and in recognition of the danger to the economy if millions of depositors are denied use of their funds, the FDIC will abandon the least cost resolution and adopt a policy that would protect all depositors in full. Bailing out all depositors does not require information on deposit insurance status by account, and will look like an attractive solution as compared with long delays if data on insurance status are not readily available. In the case of a large bank failure, it would become more likely that fears of access to deposits being frozen for some time would generate concern about cascading failures and systemic risk. We would return to the world of "Too Big To Fail" that we thought had been eliminated by FDICIA.