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Statement of the Shadow Financial Regulatory Committee on

Facilitating FDIC Bank Failure Resolution

February 11, 2008

In mid January the FDIC published the third revision of its proposal to prepare for the failure of a large complex banking organization. One of the central objectives of this effort is to enable the FDIC to quickly separate insured from uninsured deposits to avoid delay in resolving the failure. In a previous statement on the 2006 version of this proposal (Statement No. 239, February 12, 2007) the Committee applauded the FDIC's efforts and pointed out that effective implementation of prompt corrective action and least cost resolution policies requires that the FDIC have the capability to identify insured deposits before or at the time of failure. Otherwise, the FDIC may be forced to protect uninsured creditors and may be inclined to return to "too-big-to-fail" policies.

In its current proposal, the FDIC focuses primarily on the handling of sweep accounts, requiring insured institutions to be able to provide standardized deposit account information to enable the FDIC to identify its insurance liability. Institutions must also have systems that have the capability of placing holds and releases upon particular accounts after a bank is taken over by the FDIC. The proposal also attempts to reduce the cost of providing this information by further simplifying information that will be required.

With respect to the treatment of sweep accounts, the FDIC proposes to honor sweep agreement contract terms, close the books of the failed bank at the end of the business day, and then determine its insurance obligations. The Shadow Committee believes this is a reasonable approach.

A related issue facing the FDIC is who should bear the loss in the case of collection accounts for mortgage and other lenders and/or account servicers which commingle payments from borrowers. As an example, should the bank fail and if a mortgage borrower had made a payment of principal of more than $100K, say $300K, the borrower may be treated as an uninsured depositor and lose part of his or her payment under present insurance coverage rules. The Committee suggests that the risk of loss in a bank's failure should reside with the party that made the decision to establish the account. Because the borrower exercised no discretion in which institution or account the payment would be deposited, the lender or servicer should bear the loss and not the borrower. This change will give the servicer or lender an incentive to carefully choose the bank in which to establish the account.

The Committee urges the FDIC to proceed with its proposal and, if necessary, raise the deposit insurance premiums to those institutions that lag or fail to demonstrate the capability to generate the required information. The FDIC, by virtue of the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA), is now the agent for insured institutions since insured institutions have to bear the costs of replenishing the insurance fund if losses result in a decline in the reserve ratio below 1.15%. The issue of compliance costs to large complex institutions should not be used to forestall providing the required information because their failure would impose costs on other insured banks.