

10. Deposit Insurance Reform in the United States: Pre-FDICIA

The Federal Deposit Insurance Corporation Improvement Act was passed in December 1991. Entries in this section were published before or soon after its passage and describe the problems and weaknesses of the pre-FDICIA deposit insurance system. Highlighting the need for reform, these entries contain numerous recommendations for reforming, if not abolishing or privatizing, deposit insurance.

American Bankers Association (ABA). 1990. Federal Deposit Insurance: A Program for Reform. Report. Deposit Insurance Reform Committee, ABA.

This report presents an approach to handling insolvent depository institutions that eliminates the troublesome “too-big-to-fail” doctrine and treats all banks equally while at the same time preserving essential liquidity. If the approach were implemented, the ABA believes it would result in a stronger and more stable banking industry and a sound deposit insurance system.

Arshadi, Nasser. 1989. Exclusion of Foreign Deposits from the Deposit Insurance Assessments: Consequences and Solutions. *Issues in Bank Regulation* 13, no. 1:29–32.

The exclusion of foreign deposits from the assessment for current insurance premiums has become highly controversial. Because of the exclusion, larger institutions are exempt from assessments on a substantial portion of their deposit base, whereas smaller banks must pay premiums on their total deposits and are therefore taking a heavier burden of the deposit insurance cost. The author explains why a risk-based insurance system would eliminate this disparity in premiums.

Avery, Robert B., and Allen N. Berger. 1991. Risk-Based Capital and Deposit Insurance Reform. *Journal of Banking and Finance* 15, no. 4–5:847–74.

This paper analyzes the risk-based capital (RBC) standards using data on U.S. banks from 1982 to 1989. The associations between bank performance (including bankruptcy) and the RBC relative risk weights and compliance with the RBC standards are assessed. These associations suggest that RBC constitutes a significant improvement over the old capital standards, although both standards incorporate useful independent information. The data also indicate that relative to the old standards, the new standards are much more strict on large banks and are more stringent overall. As a result, banks representing more than one-fourth of all bank assets would have failed the new standards as of 1989. (©1999 EconLit)

Baer, Herbert L. 1990. What We Know about the Deposit Insurance Problem. *Chicago Fed Letter* 35:1–3.

Deposit insurance is very different from other forms of insurance. For example, with life and automobile insurance, the insurer has limited control of risk once the decision to insure and the terms of the contract are set. With deposit insurance, the insurer can control risks. The author argues that the failure of regulatory

bodies to use their preventive tools to avert deposit insurance losses represents, in effect, a subsidy to insolvent and poorly capitalized financial institutions. The availability of this subsidized deposit insurance gives beneficiaries an incentive to increase their expected profits by taking additional risks. Deposit insurance also creates a climate that fosters forbearance, which allows insolvent financial institutions to remain open. The heavy losses suffered by insolvent banks and thrifts during the 1980s make clear the important role the closure decision plays in controlling the cost of deposit insurance. If legislators and regulators wish to avoid the failure of a future deposit insurance system, they must reintroduce creditor discipline.

Bank Administration Institute and the Institute for Strategy Development. 1991. *Deposit Insurance Reform: A Blueprint for Change*. Center for Banking Issues and Strategies, Bank Administration Institute.

This document examines (1) FIRREA's changes to the deposit insurance system; (2) the health of the bank and thrift insurance funds; (3) the effect of deposit insurance reform on profitability; and (4) deposit insurance reform and industry restructuring. The document presents the proposed legislation as well as regulatory proposals to reform and modernize deposit insurance and protect taxpayers.

Bartel, Richard D. 1991. Insure All Savings—Not Just Bank Deposits. *Challenge* 34, no. 5:20–25.

The author interviewed Jane D'Arista, Associate Director of the Morin Center for Banking Law Studies at the Boston University School of Law. She discussed the expansion of insurance to all forms of savings. Proposed reforms would restructure deposit insurance for banks and other depository institutions and would examine the functioning of the entire financial system. In an attempt to protect international capital, the administration has proposed more powers and products for banks, infusions of capital from nontraditional sources, and regulatory relaxations. However, D'Arista feels, community banks, their customers, and the average taxpayer would suffer if such banking proposals were implemented.

Barth, James R., Philip F. Bartholomew, and Michael G. Bradley. 1989. Reforming Federal Deposit Insurance: What Can Be Learned from Private Insurance Practices? *Consumer Finance Quarterly Report* 45:140–47. Also 1989. Reforming Federal Deposit Insurance: What Can Be Learned from Private Insurance Practices? Research Paper no. 161. Federal Home Loan Bank Board.

The authors feel that the thrift crisis of the 1980s has been a catalyst for proposals to reform federal deposit insurance. All of the reform proposals reflect a common theme: the deposit insurer should adopt private insurance practices. Federal deposit insurance, however, is not insurance in the normal sense of the word. It is a guarantee that insured deposits will be protected against all loss. Such a guarantee could not be provided by a private insurer, given the possibility of a catastrophic loss. Furthermore, deposit insurance generates beneficial

externalities such that government intervention may be necessary to ensure that the socially optimal amount of insurance is provided. Problems with federal deposit insurance, however, remain to be resolved, and much can be learned from private insurance practices. But the government should not blindly adopt those practices. Rather, it should analyze them to determine how they affect the behavior of the insured.

Barth, James R., and R. Dan Brumbaugh Jr. 1990. The Rough Road from FIRREA to Deposit Insurance Reform. *Stanford Law and Policy Review* 2, no. 1:58-67.

The Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA) represents Congress's attempt to grapple with banking sector problems. The authors feel the legislation provides too little reform, misguided enforcement, insufficient funds, and too many adverse incentives for full recovery of the banking sector. They believe FIRREA will come to be seen as one more mutation of the problem. This article addresses the question of where FIRREA went awry and how its shortcomings can be remedied.

Barth, James R., and R. Dan Brumbaugh Jr., eds. 1992. *The Reform of Federal Deposit Insurance: Disciplining the Government and Protecting Taxpayers*. Harper Business.

This collection of papers on the topic of deposit insurance includes the following: "Getting the Incentives Right in the Current Deposit-Insurance System: Successes from the Pre-FDIC Era," by Charles W. Calomiris; "The Thrift Industry Crisis: Revealed Weaknesses in the Federal Deposit Insurance System," by James R. Barth and Philip F. Bartholomew; "A Critique of the Financial Institutions Reform, Recovery, and Enforcement Act (FIRREA) of 1989 and the Financial Strength of the Commercial Banks," by R. Dan Brumbaugh Jr. and Robert E. Litan; "The Incentive Incompatibility of Government-Sponsored Deposit-Insurance Funds," by Edward J. Kane; "Aggregate Shocks, Loan Losses, and Portfolio Concentrations: Lessons for Assessing Depository Institution Risk," by Robert S. Chirinko and Gene D. Guill; "Lender of Last Resort, Too Large to Fail, and Deposit-Insurance Reform," by George G. Kaufman; "The Role of Market Value Accounting in the Regulation of Insured Depository Institutions," by William H. Beaver, Srikant Datar, and Mark A. Wolfson.

Barth, James R., Carl D. Hudson, and Daniel E. Page. 1991. The Need to Reform the Federal Deposit Insurance System. *Contemporary Policy Issues* 9, no. 1:24-35.

The biggest financial disaster in modern history struck the savings and loan industry during the 1980s. This paper argues that the unifying cause of this debacle was the way in which the federal deposit insurance system is structured. The fundamental cause was not fraud and deregulation, as is commonly argued. The government not only permitted reportedly insolvent institutions to continue to operate, it permitted many such institutions to grow by offering relatively high rates on their deposits. Unfortunately, the Financial Institutions Reform, Recovery, and Enforcement Act (FIRREA) of 1989 may not prevent a similar situation from ever recurring. Therefore, one must understand exactly what happened, what the FIRREA does and does not do, and the proposals for

reforming the entire structure of the federal deposit insurance system. (©1999 EconLit)

Berlin, Mitchell, Anthony Saunders, and Gregory F. Udell. 1991. Deposit Insurance Reform: What Are the Issues and What Needs to Be Fixed? *Journal of Banking and Finance* 15:735–52.

Problems in the commercial banking industry have led to widespread calls for reform of the deposit insurance contract on the grounds that it promotes moral hazard. This article reviews the empirical evidence for the importance of moral hazard in contributing to crises. The article then evaluates various reform proposals, grouping them into two broad classes: proposals that seek to impose greater discipline on bank stockholders, and proposals to increase the disciplinary role of bank debtholders. Finally, the article identifies some issues that have received inadequate attention in the literature on bank regulation, including (1) the effects of actual changes in regulators' monitoring policies on bank behavior; (2) the advantages and disadvantages of public and private production of bank accounting information; (3) the optimal mix of public and private monitoring; and (4) the implications of externalities, contagion effects, and information asymmetries for the design of optimal insurance premiums.

Black, Robert P. 1991. Reflections on Deposit Insurance. Federal Reserve Bank of Richmond *Economic Review* 77, no. 1:3–6.

A crucial public-policy issue is the need for reform of the nation's deposit insurance system. This article discusses the role of deposit insurance and outlines some proposals for reform. (©1999 EconLit)

Blad, Leiv H. Jr. 1990. Searching for the Ideological Foundations of Federal Deposit Insurance. *Annual Review of Banking Law* 9: 533–57.

This document analyzes the problems inherent in federal deposit insurance and the proposals to remedy the situation. It investigates the legislative history of deposit insurance and concludes that many of the problems of insurance can be traced to unresolved contradictions in the original legislation. The article then analyzes the three most plausible reform proposals, before concluding that Congress can resolve the central dilemma of federal deposit insurance by adopting a modified version of these proposals.

Boss, Maria, and Gary Watson. 1991. The FDIC's Special Defenses: Before and after FIRREA. *American Business Law Journal* 29, no. 2:309–34.

The article explains how the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 might affect the special defenses that protect the government from debtor defenses, as well as the affirmative lender liability claims. The special defenses, called "superpowers," are as follows: (1) the D'Oench doctrine, which stipulates that if a debtor lends itself to an arrangement that tends to deceive bank examiners or a bank's creditors, the debtor is barred from raising a defense based on that scheme; (2) 12 Code section 1823 (3), which

extends the D'Oench doctrine to any agreement, whether or not it was secret and regardless of the participants in the scheme; and (3) the federal holder in due course argument, according to which the FDIC is not subject to personal defenses that a borrower could otherwise assert against a failed institution.

Bradley, Michael G. 1991. Empirical Analysis of the Thrift Crisis and Deposit Insurance Reform. In *Proceedings of the American Statistical Association (AMSTAT) Annual Meetings: Business and Economics Statistics*, 19-28. AMSTAT.

The author provides a theoretical foundation involving empirical analysis of the thrift crisis. His opinion is that policymakers and economists have overlooked an empirical analysis of the banking crisis, which has led to the adoption of inappropriate deposit insurance reform. The author discusses selected empirical studies and presents a general empirical model of the thrift crisis. He concludes with examples of how economists might transmit poor results, and describes the role economics plays in the political process.

Brookings Institution. 1989. *Blueprint for Restructuring America's Financial Institutions: Report of a Task Force*. Brookings Institution.

The task force members are George Benston, R. Dan Brumbaugh Jr., Jack M. Guttentag, Richard J. Herring, George G. Kaufman, Robert E. Litan, and Kenneth E. Scott. They identify four flaws in the banking system: (1) deposit insurance encourages risk-taking; (2) regulators have been unable to detect excessive risk exposure; (3) authorities have not intervened in weak institutions early enough; (4) and interventions have protected all depositors, not just the insured. Any structural reform proposals should attempt to (1) maintain the safety of insured deposits; (2) strengthen market discipline of risk exposure; (3) enhance market efficiency by eliminating some restrictions on bank powers and by minimizing costs of necessary restrictions; (4) dispose of insolvent institutions promptly; and (5) minimize transaction costs by allowing institutions to choose which regulatory system they operate under. The authors stress the need to adopt a new deposit insurance system quickly.

Brumbaugh, R. Dan Jr., Andrew S. Carron, and Robert E. Litan. 1989. Cleaning up the Depository Institutions Mess. *Brookings Papers on Economic Activity* 1:243-83.

This paper estimates that the present value cost of merging or liquidating the hundreds of insolvent thrift institutions still operating as of the end of 1988 will range between \$100-150 billion. Given federal deposit insurance, the failure to implement and enforce sound capital standards is identified as the principal reason for the thrift crisis. Significantly, thirteen of the nation's fifteen largest banks, holding \$700 billion in assets, are also weakly capitalized and thus susceptible to similar "moral hazard" incentives to take risks. Long-term reform of the depository industry requires sound capital regulation and market value accounting. (©1999 EconLit)

Burnham, James B. 1990. *A Financial System for the Year 2000: The Case for Narrow Banking*. Formal Publication no. 97. Center for the Study of American Business, Washington University of St. Louis.

This study focuses on the portion of the financial sector that is covered by deposit insurance. The author proposes limiting deposit insurance to only “narrow banks,” those whose investment opportunities are severely limited. He further suggests that only narrow banks should have access to the Federal Reserve’s payments system. He reviews and comments on other reform proposals.

Burnham, James B. 1991. *Deposit Insurance: The Case for the Narrow Bank*. *Cato Institute Regulation* 14, no. 2:35–43.

The reform proposal discussed in this article is a proposal to limit federal insurance to “narrow banking,” that is, to deposits invested solely in low-risk assets. The article details key features of a financial system with narrow banks and advances extensive arguments in favor of such reform. The author argues that the central issue is not the capacity of private financial institutions and their customers to make the necessary adjustments, but the ability of regulators and lawmakers to adjust their mind sets and policies. The author suggests what he believes is a practical and sensitive way to accomplish the twin goals of reducing taxpayer exposure and fostering a sounder, more competitive financial system.

Byrne, Alfred J. T. 1991. *Safety and Soundness in Banking Reform: Implications for the Federal Deposit Insurer*. *Washington University Law Quarterly* 69, no. 3:679–768.

Despite restrictions, banking organizations have been able to expand into new product and geographic areas to a limited extent. Even in the absence of statutory reform, such expansion can be expected to continue. In an effort to compete more effectively, banks will try to keep pace with developments in the marketplace. A carefully considered, cohesive reform policy is needed to provide a rational framework within which banks can expand more freely, subject to the safeguards necessary to ensure the continued stability of the banking system and to avoid unnecessary losses to the deposit insurance fund.

Cargill, Thomas F., and Thomas Mayer. 1992. *U.S. Deposit Insurance Reform*. *Contemporary Policy Issues* 10, no. 3:95–103.

In late 1991, Congress enacted a banking reform measure that (1) authorizes \$70 billion of additional FDIC funding, (2) enhances bank regulation and supervision, and (3) adopts a “trip wire” system for increasingly severe regulation based on a bank’s capital. In doing so, Congress rejected a number of key elements of a U.S. Treasury proposal submitted early in 1991, such as interstate banking and expanded bank powers. The author contends that the Treasury proposal failed to recognize that in the current financial environment, regulatory oversight is a poor substitute for market discipline. The authors review problems with the financial reform process and discuss the failure of the Treasury proposal to recognize these problems. They also review alternative approaches to deposit insurance reform.

Carns, Frederick S. 1989. Should the \$100,000 Deposit Insurance Limit Be Changed? *FDIC Banking Review* 2, no. 1:11-19.

In considering how to harness market forces to better control bank risk-taking, one often finds recommendations to alter the \$100,000 statutory limit on deposit insurance coverage. The most common suggestion is to reduce the scope of coverage—and thus promote “depositor discipline”—either by lowering the dollar amount of coverage per deposit by or restricting coverage to particular classes of deposits. This article considers the merits of proposals to enhance market discipline by changing the statutory limit on deposit insurance coverage.

Carns, Frederick S., Arthur J. Murton, and Lynn A. Nejezchleb. 1989. No Free Lunch in Deposit Insurance Reform. In *The Financial Safety Net for Consumer Savings: Policy Options for the 1990s*, 51-59. Conference proceedings, Pace University.

The authors briefly discuss two often overlooked considerations that bear on the potential cost and effectiveness of market-oriented reforms of deposit insurance. The first consideration is that banks provide a special intermediary function that may be impaired—at a cost to the economy—if reforms expose depositors to increased risk; and the second is that political and institutional forces can be important to the effectiveness of any deposit insurance scheme. If these forces are neglected in the design of deposit insurance reform, the new system may be considerably less effective and/or more costly to operate than the present system.

Dotsey, Michael, and Anatoli Kuprianov. 1990. Reforming Deposit Insurance: Lessons from the Savings and Loan Crisis. Federal Reserve Bank of Richmond *Economic Review* (March): 3-28.

This article provides a detailed analysis of the savings and loan crisis. It concludes that deregulation was not the root cause of the savings and loan industry's financial difficulties; instead, the overly stringent limitations on the investment powers of thrifts can be blamed for the crisis. In other words, deregulation combined with lax supervision ultimately produced the crisis in the thrift industry. Moreover, without deposit insurance and the accompanying regulatory structure, the crisis could never have attained the dimensions it did. A meaningful reform of the regulatory system will require providing for the automatic and prompt closure of failing institutions. But just the opposite happened. Once the Federal Savings and Loan Insurance Corporation became insolvent, regulators faced competing incentives that interfered with an efficient resolution of thrift insolvencies. The suggestions for reform arise from an analysis of bankruptcy law as it applies to unregulated nonfinancial firms, which do not have access to the kinds of government guarantees provided by deposit insurance. Recommended changes include incentives to discourage depositors from funding insolvent institutions, together with a system of judicial oversight of bank and thrift failure-resolution proceedings similar to the oversight of legal bankruptcy proceedings established to deal with financially troubled firms.

Douglas, John L. 1992. Deposit Insurance Reform. *Wake Forest Law Review* 27, no. 1:11ff.

The cost of deposit insurance and the dissatisfaction with the administration of the deposit insurance system have prompted a widespread push for reform. Unfortunately, no uniformity or agreement exists as to the steps necessary to reform the deposit insurance system. This article briefly reviews the history of deposit insurance, its role within the U.S. financial system, and the prospects and proposals for reform. Finally, it suggests a framework within which to move forward.

Eisenbeis, Robert A. 1990. Restructuring Federal Deposit Insurance and the Federal Safety Net. Unpublished manuscript. Board of Governors of the Federal Reserve System.

This paper explores the premises of previous proposals for financial reform. It first discusses developments in financial markets and changes in transactions accounts and the role of banks. It then looks at the implications of these changes with regard to the manner in which the federal safety net protects the payments system. The last sections look at the deposit insurance component of the federal safety net; discuss flaws in the existing system that were revealed in the thrift crisis; and propose remedial reforms. Although the author does not fully discuss the functioning and operation of the discount window, he does raise issues concerning its operation.

Ely, Bert. 1990. *Making Deposit Insurance Safe through 100% Cross-Guarantees*. Ely and Company.

The author maintains that deposit insurance should be reformed. He believes that federal deposit insurance cannot be fixed, because it is inherently flawed. Deposit insurance can be reformed only by completely replacing federal deposit insurance with a sound private-sector insurance mechanism. According to the author, the 100 percent cross-guarantee concept is that mechanism; further, it is the only comprehensive and feasible reform proposal that has been offered in the growing debate over the future of deposit insurance.

Ely, Bert. 1991. The Narrow Bank: A Flawed Response to the Failings of Federal Deposit Insurance. *Cato Institute Regulation* 14, no. 2:44–52.

Narrow-banking proposals are a response to the increasing burden some feel federal deposit insurance is placing on taxpayers. This article focuses on the flaws of the narrow-bank concept and the ways in which the real problems facing taxpayers might be solved with marketplace incentives. In addition, the article examines three more-specific implications of narrow banking: the fragmentation that will arise from the small-bank exemption, a substantial reduction in banking offices, and an inefficient severing of the credit-granting and deposit-taking functions now performed by banks.

Ely, Bert, and Vicki A. Vanderhoff. 1991. *Lessons Learned from the S&L Debacle: The Price of Failed Public Policy*. Policy Report no. 108. Institute for Policy Innovation.

Bert Ely was one of the early predictors of the FSLIC bankruptcy, and in this report he and a colleague point to deposit insurance as the root of the S&L debacle. The authors examine the federal and state policies related to deposit insurance that contributed to the failures.

Ely, David P., and Richard R. Weaver. 1991. *The Shifting Value of Federal Deposit Insurance: Implications for Reform*. *Journal of Financial Services Research* 5, no. 2:111-30.

This article examines the relationship between the value of federal deposit insurance and bank size. The authors conclude that since 1981, the value of deposit insurance has often been greater for the largest bank holding companies. This differential is consistent with the notion that the largest banks have greater ability to circumvent regulatory and/or market discipline. The source of this differential appears to lie with less capital rather than greater asset risk. These results suggest that recent proposals to improve the deposit insurance system should be evaluated on the basis of their ability to effect even-handed discipline throughout the banking industry, eliminating and forestalling expansion of the large-institution bias.

England, Catherine. 1990. *Federal Deposit Insurance: Should It Be Privatized?* Honor Society of Phi Kappa Phi *National Forum* 10 no. 2:2-24.

The author believes that at the root of the S&L crisis is the federal deposit insurance system. She feels federal deposit insurance encourages risk-taking among depositors, bank managers, stockholders, and politicians. And though the problems created by federal guarantees have been most apparent in the unfolding savings and loan debacle, the same flaws also affect banks. Ultimately, correcting current problems and returning the financial industry to a more stable course will require turning from federal guarantees to the private sector.

Federal Deposit Insurance Corporation (FDIC). 1989. *Deposit Insurance for the Nineties: Meeting the Challenge: A Staff Study*. FDIC.

This report, issued just before passage of FIRREA, presents (1) the FDIC's view of the problems associated with the then-existing deposit insurance regime, and (2) the Corporation's recommendations for reform. Topics include (1) the feasibility of implementing a system of risk-based insurance premiums; (2) the need for strong and effective supervision, including enforcement of capital standards and appropriate closure rules; (3) supervisory forbearance and the questions of when and how much forbearance is appropriate; (4) issues related to alternative techniques for handling bank failures; and (5) the question of whether banks should be treated differently in failure situations depending on their size.

Field, William. 1989. Reforming Deposit Insurance: The Subordinated Debt Option. *American Business Review* 7, no. 1:57–62.

The author argues that the FDIC actually contributes to the rise in the bank failure rate. He considers possible reforms in deposit insurance to deal with increased risk-taking and a rising failure rate, including (1) a switch to private insurance; (2) the use by the FDIC of risk-based premiums; and (3) a requirement that banks issue subordinated debt. The author advocates the third proposal.

Golembe, Carter. 1989. Assessing Foreign Deposits, and Deposit Insurance Reform. *The Golembe Reports* 1989-4.

This report examines the question of whether U.S. banks with deposits outside of the country should pay insurance assessments on those foreign deposits. The first section examines why the foreign deposits of U.S. banks are not assessed and what magnitudes are involved. The second section discusses the pros and cons of assessing foreign deposits in terms of both actual deposit insurance programs and deposit insurance reform proposals.

Gonzalez, Henry B. 1991. Toward Deposit Insurance Reform. *Washington University Law Quarterly* 69, no. 3:665–78.

This article outlines proposals for deposit insurance reform. The author thinks reform is necessary, since deposit insurance coverage has been extended—primarily through regulatory actions or decisions—to almost every deposit for almost any amount. Multimillion-dollar accounts are protected as if the insurance coverage “passes through” to recipients. Amounts over \$100,000 are regularly protected when insolvent institutions are resolved, despite the clear language of the law passed in 1980 that limits coverage to \$100,000. In fact, studies by the House Banking Committee have shown that more than 99 percent of all deposits in failed banks, including those over \$100,000, have been covered by the FDIC. The sole exception provided for by statute, when a particular institution’s deposit services are “essential to its community,” has been turned on its head.

Independent Bankers Association of America. 1989. *Study of Consumer Reaction to Changes in Federal Deposit Insurance*. Market Facts.

As part of a larger study of possible regulatory changes, the Independent Bankers Association of America retained the services of Market Facts, Inc., to conduct a telephone survey of consumers who have accounts with depository institutions to determine how consumers view deposit insurance, what their reactions are to the proposal for reducing the ceiling for insured deposits, and what their reactions are to sharing the loss if an institution fails. The survey was conducted among a nationally representative sample of adults 18 and over who have a savings, checking, or money-market account, or an IRA or CD, with a bank, savings and loan, or credit union. To provide a large enough sample of respondents with large deposits (\$50,000+), the national probability interviews were supplemented with a sample of higher-income respondents (household income of \$50,000+).

John, Kose, Teresa A. John, and Lemma W. Senbet. 1991. Risk-Shifting Incentives of Depository Institutions: A New Perspective on Federal Deposit Insurance Reform. *Journal of Banking and Finance* 15, no. 4-5:895-915.

The authors characterize the risk-shifting incentives of a depository institution as arising fundamentally from the existence of limited liability and the associated convex payoff to equity-holders. This risk incentive feature is unchanged by deposits being insured, and hence excessive risk-taking by depository institutions is not solely attributable to the flat rate insurance premium. Consequently, the incentive problem cannot be resolved through a risk-based insurance premium, contrary to the prevailing view. The authors propose a solution that eliminates risk-shifting through an optimal tax structure and specify a corresponding insurance premium that is revenue neutral from the social planner's (regulator's) standpoint. The solution is derived in the context of a social objective function that trades off the benefits of liquidity services by banks and the unique informational role of bank loans with the costs of investment distortions engendered by risk-shifting. (©1999 EconLit)

Jones, DuPre. 1990. Debate over Deposit Insurance Reform Heats Up. *Office of Thrift Supervision Journal* 20, no. 2:21-25.

The thrift crisis in the 1980s prompted one of the most significant banking and thrift regulatory reform packages since the Great Depression. The Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA) set new accounting, investment, and solvency standards for thrifts and increased the supervisory enforcement powers of the regulators, but did not attempt to address the question of deposit insurance. A central catalyst of the thrift crisis, many believe, was the entrepreneurial subversion of deposit insurance from safety net to all-purpose guarantee. Congress and the administration are studying the question of deposit insurance and the extent of federal coverage of deposit accounts. This article contains comments on deposit insurance reform by industry leaders and lobbyists, legislators, regulators, citizens' groups, and economic theorists.

Kareken, John H. 1990. Deposit Insurance Reform: Or, Deregulation Is the Cart, Not the Horse. Federal Reserve Bank of Minneapolis *Quarterly Review* (winter): 3-11.

With the intention of ensuring fair competition, Congress has managed, directly and indirectly, a significant deregulation of U.S. commercial banks and savings and loan associations. Historically U.S. banks have been limited in what they could pay depositors. However, with the advent of money-market accounts and Super-NOW accounts, they have much more freedom. But despite significant deregulation, Congress has yet to make a start at changing the U.S. deposit insurance scheme. If the objective of government-provided insurance for bank depositors is to prevent bank runs, then a radical alternative to the scheme is essential for deregulation to be effective. Suggested alternatives include (1) assessing an insurance premium that depends on the risk of default; (2) doing without government-provided insurance for bank depositors; (3) making banks hold 100 percent reserves in the absence of government-provided insurance; and (4) requiring banks to value their assets continuously at market prices.

Kaufman, George G. 1990. Make FDIC Insurance Redundant. *Challenge* 33, no. 1:13–17.

The commercial banking system is far healthier than the thrift industry system, but it is not healthy enough to withstand shocks comparable to those that shook the thrift industry in the 1980s. The Shadow Financial Regulatory Committee favors more timely mandatory recapitalization of insufficiently capitalized banks before they have exhausted their capital and have become so economically insolvent that they cannot repay depositors in full and on time. In addition, the Committee explains that since the most fundamental problem in the banking industry is the structure of federal deposit insurance, any effort to strengthen the banking industry should be pointed in that direction. The way to improve the deposit insurance system is to require banks to hold higher capital ratios and to progressively reduce banks' capital-asset ratio. When the bank's capital ratio declines to some low but positive number, mandatory recapitalization by present or new owners should be required.

Kaufman, George G., ed. 1990. *Restructuring the American Financial System*. Kluwer Academic Publishers.

In this collection of articles, the topics and authors are as follows: "Purpose and Operation of the Shadow Financial Regulatory Committee," by George G. Kaufman; "Guaranty of Deposits under the Banking Act of 1933," by Guy Emerson; "Restructuring Banking: The Shadow Financial Regulatory Committee's Program for Banking Reform," by Robert A. Eisenbeis; "Market-Value Accounting by Banks: Benefits, Costs, and Incentives," by George J. Benston; "The Savings and Loan Rescue of 1989: Causes and Perspectives," by George G. Kaufman; "Never Again: The S&L Bailout Bill," by Kenneth E. Scott; "The Collapse of the Texas Thrift Industry: Causes of the Problem and Implications for Reform," by Paul M. Horvitz; "Defective Regulatory Incentives and the Bush Initiative," by Edward J. Kane; "The Need for Timely and Accurate Measures of Federal Deposit Insurers' Net Reserves Position," by Edward J. Kane; and "Regulatory Reform of Securities and Futures Markets: Two Years after the Crash," by Franklin R. Edwards.

Keeley, Michael C. 1989. Reforming Deposit Insurance. Federal Reserve Bank of San Francisco *Weekly Letter* (April 21).

This *Letter* evaluates ways to reform the deposit insurance and regulatory systems to eliminate moral hazard. Such reform is vital to ensure that problems similar to those in the 1980s do not recur.

Keeton, William R. 1991. The Treasury Plan for Banking Reform. Federal Reserve Bank of Kansas City *Economic Review* 76, no. 3:5–24.

Problems in the banking industry prompted Congress to order the Treasury Department to undertake a comprehensive study of banking reform. The Treasury study, completed in February 1991, has become the focus of an intense debate.

The Treasury plan has two parts. One part would reform deposit insurance by varying deposit insurance premiums with risk, by reducing coverage, and by enforcing capital requirements more strictly. The second part would restructure the financial system by indirectly allowing full interstate banking. According to Treasury, both sets of reforms are needed—the deposit insurance reforms to protect the taxpayer and allocate credit more efficiently, and the restructuring proposal to protect the taxpayer and restore the long-run health of the banking industry. The author argues that the Treasury plan contains a number of useful proposals but is too cautious in some respects and too bold in others. He reviews the Treasury's justification for reform and examines the department's proposals.

Klebaner, Benjamin J. 1991. Banking Reform in the New Deal Era. *Banca Nazionale del Lavoro Quarterly Review* no. 178 (September): 319–41.

Despite the collapse of American banking in the early 1930s and Roosevelt's dislike of bankers, the New Deal did not overhaul the system. Deposit insurance and capital infusions from federal funds revived small local banks' prospects. Yet another agency to supervise commercial banks was added while state bank membership in the Federal Reserve remained optional; branching policy continued to be left to the states. Banking Acts of 1933 and 1935 bequeathed a significant agenda for the 1990s: to undo Glass-Steagall's ban on bank underwriting of securities, authorize nationwide banking, reform deposit insurance, and decrease federal loans and loan guarantees. (©1999 EconLit)

Kuprianov, Anatoli, and David L. Mengle. 1989. The Future of Deposit Insurance: An Analysis of the Alternatives. Federal Reserve Bank of Richmond *Economic Review* 75, no. 3:3–15.

Deposit insurance, while reducing the threat of bank runs, also lessens bankers' incentives to control risks. Reforms of the deposit insurance system are necessary to discourage excessive risk-taking such as characterized the recent S&L crisis. The adoption of market value accounting, early closing of failed banks, and exposing uninsured depositors and creditors to losses--all would give bankers less incentives to take excessive risks with insured deposits. (©1999 EconLit)

Kwast, Myron L. 1991. The Role of Empirical Research in Deposit Insurance Reform: Views of One Caught in the Middle. In *Proceedings of the American Statistical Association (AMSTAT) Annual Meetings: Business and Economic Statistics*, 29–38. AMSTAT. [Followed by comments by Gregory F. Udell.]

This paper is concerned with the process by which empirical results are communicated to economic policymakers, and it uses the debate over deposit insurance reform as a case study. The author proposes ten rules, or guidelines, to improve the way empirical results are communicated to policymakers.

LeRoy, Stephen F. 1990. Mutual Deposit Insurance. Federal Reserve Bank of San Francisco *Weekly Letter* (June 8).

To contribute to the debate about the best way to reform the deposit insurance system, this *Letter* briefly describes a variety of proposals and then offers one that has not received much attention, namely, replacing government-sponsored insurance with a mutual insurance program in which banks and thrifts monitor one another's loans and incentives and guarantee one another's deposits.

Levonian, Mark E. 1991. Deposit Insurance: Recapitalize or Reform. Federal Reserve Bank of San Francisco *Weekly Letter*, no. 91-36.

In 1991, Congress considered two deposit insurance reform proposals: First, pump more money into the Bank Insurance Fund (BIF) in the short run to "recapitalize" the fund, and second, undertake a more fundamental overhaul or "reform" of the U.S. deposit insurance system. The author argues that both recapitalization and reform are appropriate solutions, but to two different types of financial problems. Determining the relative merits of the solutions therefore requires a thorough understanding of the BIF's current difficulties.

Levonian, Mark E., and Paul P. Cheng. 1991. Changing the \$100,000 Deposit Insurance Limit. Federal Reserve Bank of San Francisco *Weekly Letter*, no. 91-19.

This *Letter* argues that FDIC treatment of failed banks would make changes in the coverage limit more symbolic than effective. Such changes would introduce little additional discipline, and small banks and their depositors would bear a disproportionate burden. Moreover, even if depositor discipline could be introduced through a reduction in coverage, it probably is undesirable. Hence, although market discipline in banking is a worthy goal, deposit markets may be the wrong place to seek that discipline.

Macey, Jonathan R., and Geoffrey P. Miller. 1991. Toward Enhanced Consumer Choice in Banking: Uninsured Deposit Facilities as Financial Intermediaries for the 1990s. In *Annual Survey of American Law* 1991, no. 3:865-99. School of Law, New York University.

The authors argue that the banking industry cannot easily sustain the costs of backward-looking regulations, especially given the existence of powerful nonbank competitors not subject to similar regulatory burdens. The burdens of the regulatory system, moreover, fall disproportionately on consumers who have the least flexibility in structuring their financial affairs so as to avoid the increasingly uneconomic banking system. The authors propose a simple reform designed to remedy some, but not all, of these problems: the establishment of uninsured depository facilities—or, to use a more convenient if less exact terminology, consumer-choice banks.

Meigs, A. James, and John C. Goodman. 1990. Federal Deposit Insurance: The Case for Radical Reform. Policy Report no. 155. National Center for Policy Analysis.

The authors use historical examples of deposit insurance failure to support their point that “no deposit insurance scheme has ever been successful over a long period of time.” The paper includes a list of the steps necessary to eliminate deposit insurance.

Mester, Loretta J. 1992. Curing Our Ailing Deposit-Insurance System. In *Bank Management and Regulation: A Book of Readings*, edited by Anthony Saunders, Gregory F. Udell, and Lawrence J. White. Mayfield. Also 1990. Curing Our Ailing Deposit-Insurance System. Federal Reserve Bank of Philadelphia *Business Review* (September/October): 13–24.

The savings and loan debacle brought to light the problems with the U.S. system of federal deposit insurance. The Treasury Department is studying these problems, and regulators, trade groups, and private economists have offered their own proposals for reforming the system. The more radical proposals suggest taking deposit insurance out of the federal government and putting it in the hands of private insurers. The other proposals, however, focus on the fundamental flaws of the system and on what can be done to repair it. The author describes (1) the goals of deposit insurance; (2) the history of deposit insurance; (3) problems with the current system; and (4) proposals from seven banking organizations concerning deposit insurance reform.

Nadler, Paul S. 1991. Where Is Banking Headed? *Journal of Cash Management* 11, no. 6:17–22.

The author describes the changes he thinks the banking industry will undergo in the 1990s. He explains why legislative and regulatory changes will affect the too-big-to-fail doctrine, the McFadden Act, and the Glass–Steagall Act. He predicts that the banking industry will probably be broader in scope than the industry that experienced crises in the late 1980s and early 1990s, with a few large national banks, a large number of independent community banks, and a few strong regional banks, all with broad powers.

Nakamura, Leonard I. 1990. Reforming Deposit Insurance When Banks Conduct Loan Workouts and Runs Are Possible. Working Paper no. 90-30. Federal Reserve Bank of Philadelphia.

The author addresses the problem of how to regulate banks when bank runs may occur, given that banks are “special” because they conduct loan workouts. In the paper, banks partially solve one information-based problem: improving the incentives of borrowers. However, banks in turn create an information-based problem: runs become possible. Moreover, stopping runs through deposit insurance fails to take into consideration the incentive problems faced by the bank. In conclusion, deposit insurance does not create an incentive problem but fails to cure it.

Neuberger, Jonathan A. 1989. FIRREA and Deposit Insurance Reform. Federal Reserve Bank of San Francisco *Weekly Letter* (December 1).

The author analyzes key provisions of FIRREA and finds that although the law takes a number of positive steps to deal with the thrift crisis, it contains elements of forbearance that invite further growth in the number of claims on the deposit insurance funds. Perhaps more important, FIRREA does not address the flawed incentive structure of the deposit insurance system. Additional reforms, therefore, will be necessary if future problems are to be avoided.

O'Driscoll, Gerald P. Jr. 1990. Banking Reform. Research Paper no. 9004. Federal Reserve Bank of Dallas.

The author examines the thrift crisis and banking-system problems. He also examines proposed remedies and explains deposit insurance and its role in the debacle, noting that deposit insurance "is one American idea that should be discarded, not imitated." A significant portion of the paper is devoted to the topic of deposit insurance reform.

Petri, Thomas E., and Bert Ely. 1992. Real Taxpayer Protection: Sound Deposit Insurance through Cross-Guarantees. Heritage Foundation *Policy Review* 60:25–29.

The authors propose replacing federal deposit insurance with a new form of protection because the FDIC will never be able to charge accurate risk-based premiums. The authors suggest that a 100 percent cross-guarantee system would (1) end all taxpayer risk in deposit insurance while fully guaranteeing all bank and thrift deposits; (2) lead to wiser credit allocation that would ensure effective use of U.S. savings; and (3) promote a more efficient banking system.

Sczudlo, Raymond S. 1990. FIRREA: A First Step on the Road to Reform. *Bankers Magazine* 173, no. 6:12–16.

FIRREA was designed to overhaul the regulatory structure of the U.S. savings and loan industry and to provide funding to close hundreds of insolvent thrifts. Two of FIRREA's stated purposes were to promote a safe and stable system of affordable housing finance and to improve the supervision of S&L associations by strengthening capital, accounting, and other supervisory standards. Yet despite progress with the S&L situation, there have been setbacks, including the ever-increasing cost of the cleanup. And as radical as some of FIRREA's measures were, lawmakers recognized that the need to stem the S&L crisis took priority and that consideration of many long-standing proposals for financial services reform would have to be deferred—proposals that dealt with deposit insurance reform, the concept of the narrow bank, proposals for functional regulation, expanded powers, the Corrigan Proposal, and so forth.

The Secura Group. 1989. Deposit Insurance Reform: A Framework for Analysis. Paper prepared for the Association of Reserve City Bankers.

This paper offers a framework for analyzing proposals to reform the deposit insurance system and addresses four questions: (1) What are, or were, the public-

policy objectives of deposit insurance? (2) How have the insurance agencies approached their task; what kind of system has evolved; and how, if at all, has it fallen short of serving its objectives? (3) What proposals have been made to reform or significantly alter the present deposit insurance system? (4) How do the various proposals address problems that have been identified, and what is their relevance to broader banking issues?

Shaffer, Sherrill. 1991. Aggregate Deposit Insurance Funding and Taxpayer Bailouts. *Journal of Banking and Finance* 15, no. 4-5:1019-1037.

Past events have focused attention on the fragility of the federal deposit insurance funds and have led many policymakers to pursue actively the goal of redesigning the insurance systems. This article explores the implications of different rate structures for the long-term solvency of the funds, using two simulation techniques based on historical loss distributions. Three findings stand out: (1) under the former 8.33 bp premium rate as well as under the 15 bp premium rate mandated as the new long-run target or default premium rate, the probability that the funds could become insolvent over a given 55-year period is higher than previously recognized; (2) raising the effective cap on the funds to as low as 2.5 percent of deposits can substantially reduce the probability of insolvency without further increasing the premium rate; and (3) the anticipated temporary 1991 premium rate of 19.5 bp implies a quite low probability of insolvency.

Short, Genie D., and Kenneth J. Robinson. 1990. Deposit Insurance Reform in the Post-FIRREA Environment: Lessons from the Texas Deposit Market. Financial Industry Working Paper no. 90-7. Federal Reserve Bank of Dallas.

This paper offers evidence from the experience of the Texas financial industry during the 1980s to underscore the need for more fundamental financial reform. The high concentration of asset-quality problems at the Texas institutions, together with the unique characteristics that emerged in the Texas deposit markets, indicated that broad-based reform of the current system of federal safety nets was needed. The proposed reforms address the problems of excessive risk-taking that contributed to the deterioration of U.S. banks and thrifts during the 1980s.

Stern School of Business. 1991. [Papers presented at] Conference on Deposit Insurance Reform, May 17. Salomon Center, New York University.

Conference papers and presenters include the following: "Deposit Insurance Reform: What Are the Issues and What Needs to Be Fixed?" by Mitchell Berlin, Anthony Saunders, and Gregory F. Udell; "The Limitations of Market Value Accounting and a More Realistic Alternative," by Allen N. Berger, Kathleen Kuester King, and James M. O'Brien; "A Framework for Assessing Credit Risk in Depository Institutions: Toward Regulatory Reform," by Robert S. Chirinko and Gene D. Guill; "Capital Controls and Bank Risk," by Gerard Genotte and David Pyle; "Aggregate Deposit Insurance Funding and Taxpayer Bailouts," by Sherrill Shaffer; "Off-Balance-Sheet Liabilities, Deposit Insurance, and Capital

Regulations,” by Arnoud W. A. Boot and Anjan Thakor; “Risk-Based Capital and Deposit Insurance Reform,” by Robert B. Avery and Allen N. Berger; “Risk-Weights, Risk-Based Capital and Deposit Insurance,” by Michael G. Bradley, Carol A. Wambeke, and David A. Whidbee; “Risk-Shifting Incentives of Depository Institutions: A New Perspective on Federal Deposit Insurance Reform,” by Kose John, Teresa A. John, and Lemma Senbet; “The Effects of Closure Policies on Bank Risk-Taking,” by Sally M. Davies and Douglas A. McManus; “The Effect of Subordinated Debt and Surety Bonds on the Cost of Capital for Banks and the Value of Federal Deposit Insurance,” by William P. Osterberg and James B. Thomson; “Market-Based Risk-Adjusted Examination Schedules for Depository Institutions,” by Kathleen Kuester King and James M. O’Brien; “Pricing Deposit Insurance When the Insurer Measures Bank Risk with Error,” by Mark J. Flannery; “A Simple Approach to Better Deposit Insurance Pricing,” by Sarah B. Kendall and Mark E. Levonian; and “Aggregate Deposit Insurance Funding and Taxpayer Bailouts,” by Sherrill Shaffer.

Thomson, James B. 1989. Economic Principles and Deposit Insurance Reform. Federal Reserve Bank of Cleveland *Economic Commentary* (May 15).

The system of federal deposit insurance subsidizes risk-taking by depository institutions and therefore increases failure-resolution costs and decreases efficiency for the entire financial system. Reforms to the deposit insurance system should consider both the policy objectives of deposit guarantees and the attendant economic consequences and costs.

Thomson, James B. 1990. Using Market Incentives to Reform Bank Regulation and Federal Deposit Insurance. Federal Reserve Bank of Cleveland *Economic Review* 26, no. 1:28–40.

The author believes the system of bank regulation and federal deposit insurance is not working and requires a massive overhaul. This article looks at the issues involved in reforming the regulatory structure of the financial-services industry, including the issue of the financial safety net, and presents the case for adopting market-oriented reforms.

Thomson, James B. 1993. A Market-Based Approach to Reforming Bank Regulation and Federal Deposit Insurance. In *Research in Financial Services: Private and Public Policy: 1992*, vol. 4, edited by George G. Kaufman, 93–109. JAI Press.

This article reviews the proposals for market-oriented reform and provides an overview of how one would structure a market-based system of financial regulation. Section I proposes a market-based system of financial regulation. Section II proposes reforms to the regulatory infrastructure. Section III presents the author’s conclusions.

U.S. Congressional Budget Office (CBO). 1990. *Reforming Federal Deposit Insurance*. CBO.

Requested by the House Banking Committee, this study analyzes a wide range of strategies that had been proposed to reform the existing (1990) deposit insurance system. The authors propose to transfer and control risk by strengthening capital and enhancing supervision, so as to contain moral hazard and reduce the exposure of taxpayers. Strengthening capital requirements can mean any or all of the following: increasing the amount of capital an institution must hold, making the closure rule more explicit with regard to a minimum level of capital, and assigning risk-based capital requirements. Enhancing supervision can mean improving regulatory practices or placing greater reliance on market forces or both.

U.S. Congressional Budget Office (CBO). 1991. *Budgetary Treatment of Deposit Insurance: A Framework for Reform*. CBO.

The Omnibus Budget Reconciliation Act of 1990 directed the Congressional Budget Office (CBO) to “study whether the accounting for federal deposit insurance programs should be on a cash basis, on the same basis as loan guarantees, or on a different basis.” The CBO’s study states that the FSLIC’s budgetary treatment did not give timely warning and thus contributed to the S&L disaster. The government needs to be able to recognize events as they occur, to prevent disasters from building up. The CBO does not recommend policy action but presents options. This report discusses several options in detail: maintain current policy, create an account for working capital, link accrued deficits to fee adjustments, transform insurance funds into government-sponsored enterprises, or recognize past losses. Many tables and charts are included. One table reflects net outlays for federal deposit insurance from 1977 to 1996 for banks, thrifts, and credit unions. Other tables represent total deficit with and without deposit insurance for 1975–1996; effective insurance premiums for deposit insurance funds 1970–1989; and annual budgetary resources for deposit insurance 1986–1992.

U.S. General Accounting Office (GAO). 1991. *Deposit Insurance: A Strategy for Reform*. GGD-91-26. GAO.

In keeping with a legislative requirement, the GAO reviewed issues associated with reforming the federal deposit insurance system, focusing on whether such reforms would result in a safer, sounder, and more stable banking industry. The GAO presented a comprehensive three-part reform program that could change the way banks are regulated and supervised as well as the way the deposit insurance system functions. The program deals with (1) strengthening supervision, bank internal controls, and financial reporting requirements so that regulators can more effectively protect the Bank Insurance Fund (BIF) from losses; (2) changing economic incentives (through strengthened capital requirements, risk-based premiums, and other means) to ensure that owners, managers, and creditors bear most of the bank failure costs; and (3) updating the bank holding company

structure and regulation to reduce risks to the banking system and to modernize the financial system if Congress should wish to expand the powers of banks and other financial institutions.

U.S. House. 1990a. Committee on Banking, Finance, and Urban Affairs. *Deposit Insurance Reform: Hearing*. 101st Cong., 2d sess., February 21.

Witnesses include Charles Bowsher and William Seidman.

U.S. House. 1990b. Committee on Banking, Finance, and Urban Affairs. *Deposit Insurance Reform: Hearing*. 101st Cong., 2d sess., September 13, 19, 25, and 26.

Witnesses include Alan Greenspan, Carroll Hubbard, Gerald Kleczka, William Lehman, Stan Parris, Charles Schumer, Richard Fogel, William Seidman, and Robert Reischauer.

U.S. House. 1991a. Committee on Banking, Finance, and Urban Affairs. *Deposit Insurance Reform: Hearing*. 102d Cong., 1st sess., February 27.

Witness is Nicholas Brady.

U.S. House. 1991b. Committee on Banking, Finance, and Urban Affairs. *Core Banking Proposals: Hearing*. 102d Cong., 1st sess., June 18.

Witnesses include Thomas L. Ashley, Lowell Bryan, Timothy Hartman, Jerome Powell, and William Seidman.

U.S. Senate. 1990a. Committee on Banking, Housing, and Urban Affairs. *Deposit Insurance Reform and Financial Modernization, Hearing 101-973*, 101st Cong., 2d sess. Vol. 1 (April 3, 18, 24, and 26).

The issues discussed include reforming federal deposit insurance, modernizing the regulation of financial services, and maintaining the international competitiveness of U.S. financial institutions. Witnesses include Robert F. Downey, Thomas G. Labrecque, Sherry Ettleson, Peggy Miller, Jane Uebelhoer, Kenneth Whipple, Philip Vallandingham, David Silver, Norman Flynn, Stephen Friedman, and William V. Irons.

U.S. Senate. 1990b. Committee on Banking, Housing, and Urban Affairs. *Deposit Insurance Reform and Financial Modernization, Hearing 101-973*, 101st Cong., 2d sess. Vol. 2 (May 3, 17, 22; June 13, 20).

Issues discussed include reforming federal deposit insurance, modernizing the regulation of financial services, and maintaining the international competitiveness of U.S. financial institutions. Witnesses include E. Gerald Corrigan, Lawrence Connell, Bert Ely, Kenneth Scott, James Barth, Lowell L. Bryan, George G. Kaufman, Peter Leslie, Ulrich Cartellieri, Toru Kusukawa, W. Peter Cooke, Jeffery S. Chisholm, and David D. Hale.

U.S. Senate. 1990c. Committee on Banking, Housing, and Urban Affairs. *Deposit Insurance Reform and Financial Modernization, Hearing 101-973*, 101st Cong., 2d sess. Vol. 3 (July 12, 19, 25, 31).

Issues discussed include reforming federal deposit insurance, modernizing the regulation of financial services, and maintaining the international competitiveness of U.S. financial institutions. Witnesses include Alan Greenspan, Richard C. Breeden, Nicholas F. Brady, L. William Seidman, and Robert Clarke.

U.S. Treasury Department. 1991. *Modernizing the Financial System: Recommendations for Safer, More Competitive Banks*. U.S. Treasury Department.

This report finds that the federal safety net has been overextended and that taxpayers are exposed to substantial losses through federal deposit insurance. The government can and should place prudent limits on taxpayer exposure by returning the scope of deposit insurance to its historical purpose—protecting small, unsophisticated savers. The most effective way to minimize taxpayer exposure is with a strong, competitive, well-capitalized banking system. This report examines the problems with the deposit insurance system; it also examines possible reforms, including streamlining the regulatory system, reducing overextended insurance coverage, and restoring competitiveness.

Wall, Larry D. 1989. A Plan for Reducing Future Deposit Insurance Losses: Puttable Subordinated Debt. Federal Reserve Bank of Atlanta *Economic Review* 74, no. 4:2-17.

The author presents a market-oriented approach—issuing bonds redeemable at the holder's request—to reduce taxpayers' exposure to the costs of future bank failures while retaining deposit insurance.

Wallison, Peter J. 1990. *Back from the Brink: A Practical Plan for Privatizing Deposit Insurance and Strengthening Our Banks and Thrifts*. American Enterprise Institute.

The author feels that the S&L crisis seems likely to produce the greatest government financial loss in the history of the United States. The central causes of this debacle, according to the author, lie in the decision to substitute government regulation for the discipline of the market. The author proposes to correct this mistake by introducing market incentives: a private system of deposit guarantees, supported by risk-based deposit insurance premiums and backed by the enormous capital of the banking system itself. Decisions to close insolvent banks and S&Ls would become market judgments, driven by market signals, rather than the judgment of a government administrator. The book not only explains the proposal but also presents tables detailing how the plan would work and showing the feasibility of risk-related deposit insurance.

Wells, F. Jean. 1989. Banks and Thrifts: Restructuring and Solvency. Congressional Research Service *Issue Brief* no. 1B89002.

The author briefly reviews the policy issues involved in the proposals for strengthening the deposit insurance funds.

Wheelock, David C. 1992. Government Policy and Banking Instability: “Overbanking” in the 1920s. Working Paper no. 92-007A. Federal Reserve Bank of St. Louis.

Excess capacity, or “overbanking,” was cited by contemporaries as the leading cause of bank failure during the 1920’s. Many states that had high numbers of banks per capita in 1920 had high bank failure rates subsequently. This article finds that the number of banks per capita was highest in states that provided deposit insurance, set low minimum capital requirements, and restricted branching. Banks per capita declined the most over the 1920’s in states where branching expanded, and in those suffering high failure rates because of falling incomes or instability caused by deposit insurance. Deposit insurance and the relative dominance of agriculture also explain the composition of state banking systems between state and federally chartered institutions. (©1999 EconLit)

White, Lawrence J. 1989. The Reform of Federal Deposit Insurance. *Journal of Economic Perspectives* 3, no. 4:11–29. Also 1995. The Reform of Federal Deposit Insurance. In *Financial Intermediaries*, edited by Mervyn K. Lewis. International Library of Critical Writings in Economics, vol. 43. Edward Elgar Publishing.

This article reviews the deposit insurance system and advocates a set of necessary reforms. Suggestions include risk-based deposit insurance, the option of co-insurance, limits on the amount of insurance available, easier cancellation of insurance, and increased penalties for bank misconduct.

White, Lawrence J. 1990a. Problems with the FSLIC: A Former Policy Maker’s View. *Contemporary Policy Issues* 8, no. 2:62–81.

The 1980s were searing for both the thrift industry and its regulators. The author points out that much has been learned, and remedial measures either have been put into place or are in process. However, four major regulatory changes are still necessary to improve the efficacy and efficiency of the thrift regulatory system. Only one—higher net-worth levels, based on the risks embedded in a thrift’s portfolio—has achieved wide acceptance within the policy community. The other three—requiring market-value accounting and reporting by thrifts, instituting a system of risk-based premiums, and strengthening the regulator’s power to intervene earlier and take control of an errant thrift—languish since they are still considered too controversial and/or too hard to implement. The proper task of public-policy is to find the right balance for a financial services sector that is competitive and efficient but does not impose undue risk or cost on the deposit insurer.

White, Lawrence J. 1990b. Reforming Regulation and Insurance. *Journal of Retail Banking* 12, no. 3:31–42.

Although some blame the deposit insurance system for the savings and loan association crisis, the author explains why the cause of the problem was the creation in the early 1980s of a specific set of opportunities, capabilities, and incentives for risk-taking by thrifts, reinforced by a set of federal policy actions that weakened the safety-and-soundness regulatory system. The author proposes

a set of recommendations for the fundamental reform of bank and thrift regulation and of the deposit insurance system. The recommendations call for, among other things, (1) market-value accounting; (2) realistic risk-based net-worth requirements based on a portfolio, rather than an asset-by-asset concept of risk; (3) risk-related insurance premiums; (4) extended coverage of deposit insurance to include all deposit obligations of insured depositories; and (5) prompt disposal of institutions that are insolvent or close to insolvency.

White, Lawrence J. 1992a. Change and Turmoil in U.S. Banking: Causes, Consequences, and Lessons. Working Paper no. S-92-23. Salomon Center, New York University.

This paper proceeds as follows: Section II analyzes the special characteristics of banks that have caused them to attract political attention and to be heavily regulated in the U.S. Section III explores the reasons for the four decades of banking tranquility that preceded the turmoil of the 1980s and then highlights the changes of the 1970s and early 1980s that led to the turmoil. Section IV describes the current state of change and turmoil in American banking. Section V discusses the prospects for continued turmoil for banking in the 1990s. Section VI analyzes three alternative “visions” of reform of U.S. deposit insurance and bank regulation. And Section VII draws the conclusions from this study of the recent U.S. Experience. (©1999 EconLit)

White, Lawrence J. 1992b. What Should Banks Really Do? *Contemporary Policy Issues* 10, no. 3:104–12.

With banking in turmoil, a new formula for bank structure and activities, for deposit insurance, and for bank regulation is necessary. This paper reviews the dilemmas of the then present structure of banking in the United States and explains how the banking sector arrived at its state of crisis. The author then suggests three alternative formulas, along with their advantages and disadvantages, that could provide the future framework for banking, deposit insurance, and regulation. (©1999 EconLit)

Whitesell, William E. 1991. Deposit Insurance, Reforms, and the Savings and Loan Crisis. In *Pennsylvania Economic Association: Proceedings of the Sixth Annual Meeting, May 23-25*, edited by Stanley G. Long. University of Pittsburgh.

The United States has faced a number of financial difficulties. This paper considers one of them—the savings and loan crisis. The author focuses principally on regulation and deregulation in the industry, deposit insurance, and the role of each in contributing to the failure of so many S&Ls. The author’s goal is to help dispel some of the misunderstanding about elemental causes of banking sector problems.

Woodward, Thomas G. 1989a. *The Economics of Deposit Insurance*. Report for Congress no. 89-32E. Congressional Research Service.

This paper seeks to reassess deposit insurance in light of costs to the economy. The author reviews the benefits, costs, and economics of reforming the deposit insurance system.

Woodward, Thomas G. 1989b. *The Dilemma of Deposit Insurance*. Congressional Research Service *Review* (October): 6–7.

The author discusses the rationale for deposit insurance and the problem that bank runs on insolvent institutions create. To remedy the problems associated with deposit insurance, the author discusses changes imposed by FIRREA that include strengthening capital requirements and restructuring the bank insurance funds.

Woodward, Thomas G. 1990. *Deposit Insurance Reform: Evaluating the Proposals*. Report for Congress (August 27). Congressional Research Service.

Having absorbed between \$100 billion and \$200 billion in losses as a result of insuring deposits at insolvent savings and loan institutions, the federal government is reexamining its deposit insurance system. This report examines the principal competing proposals. Limitations on the benefits provided by deposit insurance could reintroduce discipline at the margin. Some macroeconomic stability would be lost under these reforms, however, and—more important—they are highly interdependent. Some would do little by the way of reform without the adoption of others. In particular, the too-big-to-fail problem affects most of the proposals. Finding a workable solution to the too-big-to-fail problem is critical if limitations on insurance benefits are to work.

Woodward, Thomas G. 1991. *Long-Term Deposit Insurance Reform Options*. Congressional Research Service *Review* 12, no. 5/6:3–4.

Losses to the government's deposit insurance systems seem to indicate a need for reform. The author discusses three ideas: (1) proposals to impose more depositor discipline on the system; (2) proposals to alter the incentives faced by owners and managers of banks and thrifts; and (3) reforms to change the way the government deals with troubled institutions. The trick is to balance the goal of macroeconomic stability against that of microeconomic efficiency.