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ECONOMIC COMMENTARY

FDIC Policies for Dealing with Failed and Troubled Institutions

By Daria B. Caliguire and James B. Thomson

Bank failures reached a post-Depression high in 1986. One hundred thirty-eight banks, including one mutual savings bank, were closed by their primary regulator; an additional seven banks needed assistance from the Federal Deposit Insurance Corporation (FDIC) to prevent them from failing.

In the first half of 1987, 100 banks failed or required assistance from the FDIC. Failures and assistance cases for 1987 are projected to reach the 200 mark by year-end. Moreover, the number of banks on the FDIC's problem bank list is at an all-time high (see figure 1), indicating that the rate of bank failures might continue at or exceed the 1986-1987 pace in the near future.

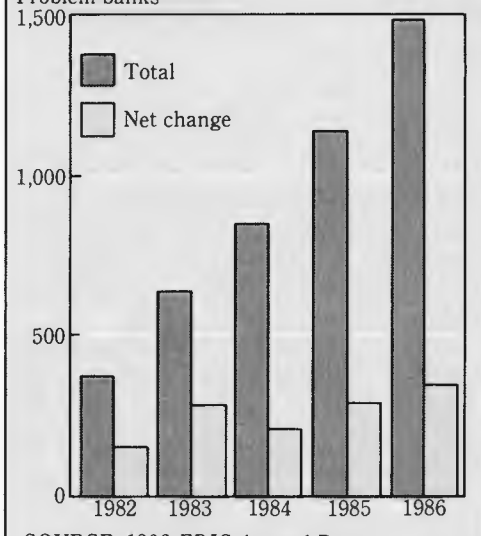
For the banking industry, the increasing incidence of troubled and failing banks reflects the changed economic environment in which they operate. Technological innovations, combined with a trend toward deregulation, have increased the competitiveness of banking markets and, consequently, have increased the degree of exposure of banks to changes in market conditions.

These factors, coupled with regulations restricting geographic and activity diversification in bank portfolios, have limited the ability of banks to protect themselves against national and regional economic shocks. In recent years, for example, depressed agricultural and energy markets have contributed to the solvency problems of an increasing number of banks in the southwest.

The FDIC has a mandate to maintain confidence in and provide stability to the commercial banking system through its regulatory and insurance functions. In addition, it is empowered to preserve that confidence and stability through the quick and efficient resolution of bank failures. The recent wave of failures has challenged the FDIC's ability to achieve these objectives. The FDIC insurance fund increasingly is threatened with illiquidity. Secondly, FDIC failure-resolution policies followed since 1984 have eroded market discipline by expanding de facto deposit insurance coverage far beyond the coverage originally intended for insured depositors.

This *Economic Commentary* examines the FDIC's policies for handling bank failures and discusses both the intended and the unintended outcomes of those policies. We conclude that the evolution of FDIC policies can be linked importantly to FDIC actions that have undermined market discipline on banks.

Figure 1 FDIC Problem Banks 1982-1986



SOURCE: 1986 *FDIC Annual Report*, Washington D.C.

Background

At the lowest point in the Depression, the Banking Act of 1933 was enacted as a comprehensive reform package aimed at restoring public confidence in the stability of the banking system. Congress was concerned with eliminating the destabilizing contagion of bank runs. The banking industry was perceived as being unable to withstand "failures" in the same sense that other industries could withstand bankruptcies. Consequently, safety and soundness were placed before the "survival of the fittest" principle of market efficiency in the order of governing principles of banking. The Banking Act attempted, among other objectives, to insulate banks from some market forces by separating commercial banking from investment banking. One component of the total reform package, federal deposit insurance, was put in place to enhance the long-run stability of the banking system.

Federal deposit insurance was instituted to prevent the contagion of bank runs by protecting the small depositor. Originally, the FDIC was authorized to cover insured deposits up to a $2,500 limit.[1] In this way, stability and public confidence in the banking system were to be restored at the grass-roots level. By offering insurance only to small depositors, it was intended that large depositors, general creditors, subordinated debtors, and shareholders still would be subject to the risk of financial loss that

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The views stated herein are those of the authors and not necessarily those of the Federal Reserve Bank of Cleveland or of the Board of Governors of the Federal Reserve System.

1. Even in 1934, the first year the FDIC operated, $2500 was not much money, equivalent to about $22,000 today, as measured by the consumer price index. Currently, the deposit insurance ceiling is $100,000.

is a normal part of market discipline.

Even at such low levels, however, deposit insurance was controversial because it was well understood that any insulation against risk impedes the effective restraint on a bank's risk-taking ventures that is imposed by its depositors.[2] Uninsured depositors monitor a bank's risk-profile. As banks pursue riskier investment strategies, these depositors demand higher interest rates as compensation for bearing the additional risk. When deposits are insured, however, the deposit guarantor (the FDIC, for example) bears the risk of the deposits, and the depositor's incentive to monitor conduct of the bank's affairs is reduced.

Traditional Methods of Resolving Bank Failures

Deposit insurance was instituted to eliminate the contagion of bank runs, not to eliminate bank failures altogether. Given that bank failures are part of a normal functioning of the financial market, the FDIC was empowered under the Banking Act with two initial means of resolving them: payout, and purchase and assumption.

Here is how the process works. Once a bank is declared legally insolvent, and is unable to meet the demands of its depositors, the FDIC is appointed receiver by the bank's chartering agent.[3]

The FDIC operates in two capacities, as a corporation and as receiver. In its corporate capacity, the FDIC pays off insured depositors and provides necessary funding and guarantees to the receiver. As receiver, the FDIC's primary obligation is to distribute the failed bank's assets equitably, to both depositors and general creditors. Under either resolution option, the FDIC assumes a fiduciary obligation to maximize the amounts recovered from the assets and liabilities sold.

In a payout, the FDIC (in its corporate capacity) first advances funds to the receiver to pay off the insured deposit claims. The receiver, with respect to that advance, then joins the pool of uninsured depositors and general creditors as a claimant on the proceeds of the liquidation of the failed bank. Subordinated debtors and shareholders normally are subject to partial or complete losses if the proceeds of the liquidation are insufficient.

A purchase and assumption (P&A) transaction is a sale of the banking franchise, rather than a liquidation. The FDIC solicits bids for the failed institution, with the successful bidder purchasing the assets and assuming the liabilities, and with the FDIC absorbing any negative difference between the two.[4]

An attempt is made to make the bidding process as competitive as possible by attracting the maximum number of potential acquirers in order to attain the highest premium.[5] However, the pool of potential bidders can be limited severely by state branching laws, by the absence of state interstate banking laws, by federal antitrust laws, by the quality of the failed bank's assets, and by the size and 'fit' of the failed bank in relation to its potential acquirer.[6]

P&A vs. Payout

The Banking Act of 1933 did not specify exact guidelines for the FDIC to use in choosing between payout and P&A. Instead, it gave the FDIC an implicit mandate to balance two goals: to preserve market discipline and to minimize disruptions to local banking services. In view of the debate surrounding deposit insurance, market discipline concerns were given priority over service disruption considerations throughout most of the history of the FDIC.[7]

The payout better accomplishes the market discipline objective because it more closely approximates the consequences of a bank failure in an unregulated market. In a payout, only the insured depositors are guaranteed full reimbursement if the bank fails; in a P&A, both insured and uninsured depositors receive protection, as well as most general creditors. On the other hand, the P&A is less disruptive to the community because entire blocs of banking relationships are sold intact and, therefore, are preserved. By contrast, these banking services are dismantled under a payout.

The difficulty of measuring the costs of decreased market discipline, versus the community impact of a loss of banking services, initially led the FDIC to adopt a cost test for choosing between a payout or a P&A: a payout was to be performed unless a P&A was less costly to the FDIC. In practice, however, the FDIC preferred the P&A to the payout.

During the 1930s and 1940s, the P&A was employed more often because it frequently proved more cost effective. Over time, however, the political attractiveness of the P&A led to its exclusive use in resolving failures, whether or not it was the most cost-effective policy. By 1950, de facto, previous FDIC policy was reversed; a purchase and assumption was to be transacted unless it was impossible to find a buyer due to prohibitive branching or holding company laws, or if contingent liabilities or fraud were extensive enough to render the cost-test inaccurate.

The almost exclusive use of P&As in failure resolution, irrespective of cost or market discipline considerations, prompted a revision of policy in the 1950 Federal Deposit Insurance (FDI) Act. The cost test was named explicitly as the primary criterion for determining FDIC action in individual bank failures. Congress felt that such a restatement of purpose was a necessary reminder to the FDIC that its mission was not to eliminate bank failures, but to dispose of failed banks in the least costly and most efficient manner.[8]

Problems in Application

The extensive use of P&As instead of payouts, and the ensuing debate over the use of the cost test in 1950-1951, and again in recent years, highlights a fundamental flaw in the FDIC program for bank failure resolution: the assumption that the long-run impact of payouts and P&As are the same. They are not, because the payout preserves the operation of market forces while the P&A reduces market discipline by extending de facto insurance coverage to uninsured depositors and general creditors.

A fundamental defect in using the cost test as the primary determinant for choosing between payouts and P&As is that the cost test considers only the short-run fiduciary costs to the FDIC fund. While the costs associated with the loss of banking services and the out-of-pocket costs of resolving failures tend to be short-run in nature, the costs associated with the erosion of market discipline occur in the future. Thus the choice of a resolution policy based on short-term cost considerations alone has a natural bias towards the use of P&As over payouts.

The second defect in the cost test is that it does not include the value of FDIC guarantees and indemnifications against unforeseen liabilities routinely given to the acquiring banks in a P&A. The seriousness of this defect is magnified by the ease at which out-of-pocket costs (counted in the cost test) can be translated into off-balance-sheet contingent claims on the FDIC (which are either not explicitly counted, or can be seriously understated in the cost test). Thus, discretion in the application of the cost test can result in actions either not consistent with the intent of the law or not consistent with sound economic practice.

By itself, the ability to redefine the costs associated with resolving bank failures would not necessarily lead to FDIC actions that systematically would favor P&As over payouts. However, it does make the resolution policy choice sensitive to political pressures and to other noneconomic considerations. These factors may be expected to operate in favor of P&As instead of payouts also because P&As create no large class of disgruntled claimants, while payouts usually leave large classes of unhappy uninsured depositors, shareholders, subordinated debtors, and general creditors who are not paid quickly, if at all.

Given the difficulty of defining failure resolution policy costs, coupled with the pressures favoring P&As, the cost test is an inherently flawed criterion for choosing between different failure resolution policies. Therefore, using the cost test to choose between payouts and P&As has had some serious unintended effects on the equity and efficiency of the banking system, which include a 'large-bank bias' and a decrease in market discipline on banks.

Table 1 Insured Deposits for the 10 Largest United States Banks

Bank	Insured deposits (billions of dollars)	Insured as a percent of: Domestic deposits	Insured as a percent of: Total deposits[a]
Citibank	21,687	58.09	22.53
Bank of America	38,967	68.63	43.96
Chase Manhattan Bank	15,389	56.27	26.11
Morgan Guaranty Trust	1,467	12.32	3.48
Manufacturers Hanover	8,293	34.82	18.28
Chemical Bank	11,518	48.77	32.73
Bankers Trust	2,738	25.88	9.55
Security Pacific	16,677	63.56	51.37
Wells Fargo Bank	25,577	81.10	78.50
First National Bank of Chicago	4,858	43.18	19.57
10 Largest Banks	147,172	56.52	53.68
20 Largest Banks	189,014	54.26	56.36
All Insured Banks[b]	1,634,302	75.40	N/A

a. Total deposits equals the sum of domestic deposits and deposits in foreign offices.
b. Based on December 31, 1986 numbers. Source: The 1986 FDIC Annual Report, Washington, DC.
SOURCE: Federal Financial Institutions Examination Council's Consolidated Reports of Condition and Income.

A large-bank bias, in the administrative sense, has emerged from the established pattern of FDIC bank failure resolutions. Large banks may be difficult to liquidate due to their size and to the complexity of their banking relationships. Consequently, the perception of bank regulators generally has been that large-bank failures pose a greater threat to both depositors' confidence and the safety and soundness of the financial system than do small-bank failures. In addition, the political pressures to bail out some or all parties in a bank failure are directly related to the size of the failing bank.

As a result, large-bank failures are rarely paid out. In fact, no bank over $600 million in assets has been liquidated. This is all the more striking because, at large banks, insured deposits typically constitute only a small percentage of all deposits (see table 1). The 100 percent de facto coverage of all large-bank depositors tends to produce a fundamental inequality, a large-bank bias in the banking system.

The implicit insurance protection provided by nonpayout failure-resolution policies has led to a public perception that the FDIC provides de facto coverage of all depositors and most creditors. Over the extended period (1934-1970) when the P&A was used almost exclusively to resolve bank failures, the claims of creditors and uninsured depositors were preserved continually. Such an unintended yet pervasive public expectation of insurance coverage becomes a corrosive agent on the forces of market discipline.

The greatest danger inherent in deposit insurance coverage is its tendency to make the uninsured depositors less cautious.[9] Even when coverage is limited, insurance insulates depositors against risk and inadvertently encourages management's risk-taking behavior. Whether a bank follows a cautious or a speculative path in an insured system, the payment to insured depositors is the same in either scenario; however, the rewards are much greater for the risk-taker in management.

2. See Guy Emerson, "Guaranty of Deposits Under The Banking Act of 1933," *Quarterly Journal of Economics,* vol. 48, 1934, pp. 229-44.

3. For state-chartered banks, the FDIC does not have to be, but almost always is, appointed receiver, and it always is receiver of national banks.

4. Traditionally, the FDIC extracts all the bad assets and sells the bank on a "clean-bank basis" in order to make the offer more attractive to the bidders. As a result of placing all the bad assets on the FDIC's books, however, the liquidity of the fund increasingly is threatened. These assets now account for two-thirds of the assets in the FDIC's $18 billion fund. Operating under the philosophy that loan collection is best accomplished locally, the FDIC has begun experimenting with leaving the delinquent loans in the failed-bank package. Rescues of BancTexas Corp. and First City Bancorp in 1987 illustrate this principle.

5. Potential acquirers are willing to offer a premium for the entire bank because the value of the bank charter is preserved. See Steven A. Buser, Andrew C. Chen, and Edward J. Kane, "Federal Deposit Insurance, Regulatory Policy, and Optimal Bank Capital," *Journal of Finance,* vol. 36, no. 1, March 1981, pp. 51-60.

6. When a billion-dollar bank nears failure, such as the Bank of the Commonwealth in Detroit, the pool of eligible bidding banks is often very limited. See Irvine H. Sprague, *Bailout: An Insider's Account of Bank Failures and Rescues.* New York, Basic Books, Inc., 1986, pp. 53-76.

7. *Id.,* pp. 24-25.

8. See *FDIC: The First Fifty Years.* Washington, D.C.: Federal Deposit Insurance Corporation, 1984, p. 86.

9. See George G. Kaufman, "The Truth About Bank Runs," paper presented to Cato Institute Conference on the Financial Services Revolution. Washington, D.C., February 27, 1987.

The erosion of market discipline, via 100 percent de facto insurance coverage, poses a long-term threat to the FDIC's ability to close banks and slowly undermines the solvency of the FDIC's insurance fund.

New Resolution Policies

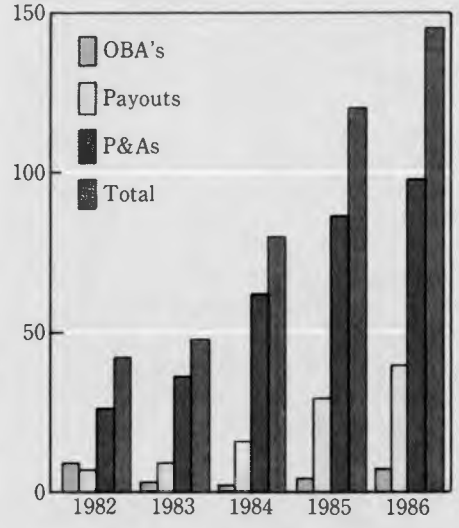
The need for reform of previous FDIC policies resulted from a changed economic environment. Interest-rate volatility and the collapse of the commodities prices in the 1980s destabilized a large number of banks. When the wave of failures began (see figure 2), there was an urgent need for new ways to cope with them. Unlike failures in previous years, the 1980s failures were concentrated geographically (see figure 3). Moreover, large banks now populate the ranks of troubled and failed banks. The development of new resolution policies, for example, began in the early 1970s as a response to the first megabank failures.

The 1980s bank failure experience has led to an accelerated series of FDIC policy initiatives producing new options that are adaptations of the earlier payouts and P&As, corrected for their more obvious shortcomings. One set of policies is designed for failed banks, another set for troubled and failing banks. Although FDIC failure-resolution policies are still in the mainstream of the FDIC's explicit statutory authority, the new assistance programs for troubled and failing banks stretch the limits of that authority. These programs include modified payout, open bank assistance, capital forbearance, and bridge banks.

Modified Payout

The FDIC devised the modified payout plan in 1983 in reaction to the 100 percent de facto coverage previously associated with widespread use of P&As. As in a straight payout, the modified payout created a receivership and liquidated the failed bank's assets. However, rather than waiting until assets were sold to begin payments, the FDIC estimated the current value of the remaining assets as the basis for an immediate advance to the receiver for payments to the uninsured depositors and other claimants. In this way, the market discipline of potential losses to uninsured depositors was joined with the disruption-free timeliness of the ordinary P&A. As a result, the modified payout showed promise as a policy that could be applied equally to both large and small banks.

Figure 2 Bank Failures 1982-1986



SOURCE: 1986 *FDIC Annual Report,* Washington D.C.

The modified payout first was used in 1984 as an experimental procedure with small failed banks. In the two months prior to the collapse of the Continental Illinois National Bank and Trust Company of Chicago in May 1984, nine of 17 failures involved a modified payout. Given that this procedure had been tried only on small banks, the FDIC argued that the policy was too early in its development to be applied with the requisite degree of assurance to the $33.6 billion Continental Illinois.[10] Based on its prior successful application before Continental Illinois, however, the modified payout still could be used as a possible nondiscriminatory failed-bank policy option.

Open Bank Assistance

The most significant developments in FDIC policy initiatives have come under the umbrella of the open-bank assistance program (OBA). Under the FDI Act of 1950, the FDIC obtained authority to intervene prior to a bank's failure in order to 1) facilitate the merger of a failing bank or 2) prevent failure of a bank that is deemed 'essential.' Up to this time, capital assistance to open banks to prevent failure, had been the job of the Reconstruction Finance Corporation (RFC).[11]

The first provision, section 13(e) of the FDI Act, is an extension of the P&A powers to enable conversion of a closed-bank merger into an open-bank merger when failure is imminent. The FDIC's financial assistance is predicated upon the condition that the failing bank be absorbed by another bank. The open-bank merger was an innovation intended to expedite the arrangement of a P&A and, thus, to minimize further disruption of banking services. It was not intended to save the troubled institution from failure.

The second provision, section 13(c) of the FDI Act, allows the FDIC to prevent the failure of a bank "...when in the opinion of the Board of Directors [of the FDIC] the continued operation of such bank is essential to provide adequate banking service in the community."[12] This interventionary power was intended to be restricted by the condition of essentiality attached to it. In this way, the status of such OBA as an exception rather than a rule was to be preserved.

Although authorized by statute in 1950, this essentiality doctrine was not actually used until 1971 with the "bailout" of Unity Bank of Boston. Within the span of the subsequent 10 years, however, a finding of essentiality was made, and OBA was provided four more times (the Bank of the Commonwealth in Detroit [1972], American Bank & Trust in South Carolina [1974], Farmers Bank of the State of Delaware [1976], and First Pennsylvania National Bank in Philadelphia [1980]).

The greatest logical criticism of OBA has been made on the grounds that it

10. See Hearings before the House Committee on Banking, Finance and Urban Affairs, Subcommittee on Financial Institutions, Supervision, Regulation and Insurance, *Inquiry into Continental Illinois Corp. and Continental Illinois National Bank,* October 4, 1984 (98th Congress, 2nd session). Washington, D.C.: Government Printing Office, 1985, pp. 466-467.

11. See Jesse H. Jones, *Fifty Billion Dollars: My Thirteen Years with the RFC, 1932-1945,* MacMillan, New York, 1951.

12. See Section 13(c) of the Federal Deposit Insurance Act, 12 U.S.C. Section 1823(c).

Figure 3 Bank Failures by State 1982-1986

SOURCE: 1986 *FDIC Annual Report,* Washington, D.C.

expands implicit insurance coverage to stockholders and creditors of parent bank holding companies who are not protected under a P&A or a payout.[13]

A second source of criticism surrounds the broad interpretations given to the essentiality test that arise from the vague definition of "community" and the role of opinion in assessing OBA.[14]

Third, the case-by-case basis on which the FDIC has bailed out large banks has propagated the general belief that certain banks are "too large to let fail." If depositors act on this belief, it can lead to an undesirable concentration of assets in large banks. Furthermore, such a belief has dangerous repercussions for the effectiveness of market discipline on the risk-taking of big banks. Overall, the criticisms of OBA highlight the danger that it poses to the continued efficient operation of market discipline in the long run.

As the number and complexity of bank failures has risen in recent years under deregulation, so has the adoption of new OBA programs. Within the last five years, the FDIC has revised the OBA guidelines twice to afford greater flexibility in preventing the closure of a failing bank.[15] The 1982 Garn-St Germain Act removed essentiality as the prime consideration for OBA and replaced it with cost-efficiency: only if the cost of assistance exceeds the cost of closing and liquidating does a finding of essentiality have to be made. The underlying design is "...to lessen the (financial) risk to the Corporation posed by such insured bank under such threat of instability."[16] Since OBA enables the FDIC to accrue losses as off-balance-sheet contingent claims, there is a strong incentive for the FDIC to infuse capital into a failing institution rather than to arrange a payout or P&A, which would require immediate recognition of losses.

The replacement of essentiality with cost-efficiency as the main determinant reflects the changed role of OBA as a policy tool of the FDIC for resolving bank failures. In 1950, the OBA provision was issued as a last-resort measure, intended to save a failing bank in a rural, unit-banking area in which that bank actually did provide essential banking services. Essentiality was an extreme condition that needed to be met in order to override the FDIC's noninterventionary role.

By 1987, however, OBA had lost its status as an exceptional measure and has become a mainstream policy. The September 10, 1987 bailout of First City Bancorp of Texas became the 41st case of OBA by the FDIC. Of the 41 OBAs, 37 have occurred in the 1980s. Although the OBA policy affords greater flexibility for the FDIC to resolve failures, such assistance packages usually have some benefit for shareholders and move the FDIC closer to 100 percent de facto coverage of all parties in a failed bank, which further insulates banks from market discipline.

Capital Forbearance

The most recent FDIC policy initiatives have been in the area of capital augmentation. Initially, a number of techniques, such as warrants and net worth certificates (before 1982, called income capital certificates) were employed to "create" capital through alterations in regulatory reporting methods. Since 1985, the FDIC has moved toward a relaxation of capital standards for troubled institutions. Regardless of which technique is used, the policy allows a troubled bank, operating with substandard capital, to remain open in the hope that the bank will eventually recover.

In March 1986, the FDIC and the Comptroller of the Currency announced a joint effort to forbear regarding the enforcement of minimum capital-asset ratios below 7 percent, but above 4 percent, for sound banks with concentrations in agriculture or energy lending.[17] A sizable proportion of recent bank failures have occurred in agriculture and energy-belt states (see figure 3). Accordingly, the capital forbearance plan is aimed at troubled banks within these regions that are seen to have been destabilized more by depressed markets than by mismanagement. The plan is designed "... to provide greater operational flexibility to well-managed banks" in the hope that they will recover and thus spare the FDIC considerable liquidation costs.[18]

Within seven months of the beginning of the forbearance plan, fewer than 20 banks had been accepted, and 17 banks had been denied acceptance into the program.[19] The FDIC and the Comptroller of the Currency then announced a revision of their guidelines, making more banks eligible for capital forbearance. According to the Comptroller of the Currency, capital forbearance is a worthwhile program, although it has not "... covered as many banks as it should have."[20]

Consequently, the program has been broadened in two significant ways: first, capital forbearance has been made available to all insured banks whose problems are seen to be the result of economic conditions, not just energy and agriculture banks; second, the minimum capital-asset ratio of 4 percent has been abolished (that is, any positive capital ratio conceivably may be enough to satisfy minimum regulatory requirements).

By broadening its availability, the FDIC made capital forbearance a more mainstream policy instrument, which is the same pattern previously noted in the development of the OBA programs. An early criticism of capital forbearance in its currently revised form is that it poses the same moral hazard problem that surfaces when troubled banks are insulated from market forces. Counter to the plan's intent, it encourages even greater risk-taking on the part of the failing institution as a last chance to gamble its way out of a weakened capital condition.[21]

Bridge Banks

The latest policy response to the increasing bank failure rate came with the August 1987 banking bill, the Competitive Equality Banking Act, which affords the FDIC more time and greater influence in the decision-making processes of troubled institutions. The FDIC is empowered to construct "bridge banks," which can run ailing institutions for up to three years. Under such a provision, the FDIC can charter a national bank with new management to guide troubled institutions to recovery. Rather than being subject to urgent time constraints, the bridge bank solution allows the FDIC expanded flexibility in pursuing many options.

Conclusion

Over the last two decades, the FDIC has assumed a more active role in the resolution of bank failures and particularly in the regulation of problem banks. Each expansion of FDIC powers has occurred in response to needs that have arisen out of a changed economic or regulatory environment. Due to the recent rise of bank failures, most of the new initiatives attempt to address the problems of troubled banks before they actually fail. Many of the programs under OBA, for example, were developed to prevent banks from failing, albeit with generous infusions of FDIC financial assistance.

In addition, capital forbearance provides banks with time to recover from problems created by depressed market conditions. Bridge banks have been created to combat the increased incentive for the management of troubled banks to "gamble" out of their problems. In this way, bridge bank arrangements could provide sufficient time for the other programs to take effect.

The greater flexibility afforded by an increased number of options allows the FDIC to meet the challenges of problem banks innovatively. However, there is a cost to the more active failure intervention by the FDIC: the erosion of market discipline in the banking system. The trend in bank failure resolution policies has reached a point of 100 percent de facto insurance for all depositors and most creditors, and at least some protection for stockholders. Some of the new FDIC policies, such as the modified payout, have tried to correct for such misallocations and inefficiencies while maintaining the economies associated with preserving ongoing banking franchises.

However, the areas in which the FDIC's failure-resolution policy is being expanded the most, such as OBAs or capital forbearance, tend to insulate problem banks even further from market forces and arguably encourage risk-taking. This could have a perverse effect on the banking system and on the ability of the FDIC to do its job. Thus, a better balance between market regulation and FDIC intervention needs to be more clearly addressed in future FDIC failure resolution policy initiatives.

13. See James B. Thomson, "The Use of Market Information in Pricing Deposit Insurance," *Journal of Money, Credit, and Banking,* vol. 19, no. 4 pp. 528-537 (November 1987).

14. See Sprague, *supra* note 6, p. 28.

15. See FDIC Policy Announcements of August 25, 1983 and December 8, 1986.

16. See Section 13(c), Federal Deposit Insurance Act, *supra* note 12.

17. An agriculture or energy bank is customarily defined as one in which 25 percent of its assets is in farm or energy lending.

18. See FDIC Announcement of Capital Forbearance, March 27, 1986.

19. See A. Bennett, "Regulators Report Slow Beginning For Capital Forbearance Program," *American Banker,* December 5, 1986, p. 3.

20. See B. Rehm, "FDIC Will Expand Forbearance Plan For Ailing Banks," *American Banker,* June 9, 1987, p. 1.

21. See "Thrift Industry: Forbearance for Troubled Institutions, 1982-1986," May 1987, U. S. General Accounting Office Briefing Report.

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