Change To Win FDIC Recommendations

Our view of the FDIC and its role under an Obama administration is premised on our support for a comprehensive reregulation of the financially system, the principles of which we describe in "Re-regulation of the Financial Markets." We believe that regulatory reform along these lines is vital for future economic progress, and that the FDIC will continue to have a critical role in ensuring the safety and soundness of financial institutions following such reform.

With respect to the specific role of the FDIC, we note that the current financial crisis was not solely or even primarily caused by poor lending practices at FDIC insured banks: many unregulated mortgage brokers, investment banks, private equity and hedge funds participated in the origination, distribution, and derivative distribution of mortgage loans that were never likely to be repaid. Moreover the FDIC, in its role as conservator of Indymac Bancorp, has taken the lead in developing innovative loan restructurings that have helped to prevent thousands of foreclosures, setting a template that should be widely applied to delinquent and potentially-delinquent loans.

Nevertheless, that fact that 22 FDIC insured institutions have failed so far this year, far more than in any year since the early 1990's, suggests that the Corporation should consider some changes to its regulatory practices in order to better assess the safety and soundness of the institutions it supervises. Our recommendations are based on the following observations:

- Institutions with state or thrift charters have been much more likely to fail than banks chartered at the federal level and regulated by the Office of the Comptroller of the Currency (OCC). Data from the FDIC website indicates that, of the 22 failures this year, 12 were state regulated banks with $10.5 billion in assets, and 5 were thrifts with at least $32 billion in assets.[1] In contrast, of the OCC regulated banks, only 5 with $5.9 billion in assets have failed this year, even though nationally chartered commercial banks account for 51% of deposits, vs. 35% for state chartered banks and savings associations, and 13% for Federally chartered savings associations.

- Larger institutions have been much more prone to failure than smaller institutions: using FDIC data, we find that only 0.15% of institutions with assets under $300 million have failed this year, compared to 0.32% of institutions with assets between $300 million and $1 billion, and 1.19% of institutions with assets over $1 billion.

Recommendations

1) The FDIC should develop further revisions to its supervisory standards and to the Risk Based Assessment system reflecting the recent experience with the housing

[1] We believe this figure does not fully reflect the assets of Washington Mutual, which is being acquired by JP Morgan Chase.

bubble: clearly, many of the assets institutions held on their balance sheets were reported at prices inflated by the bubble, thereby understating the true risk to the Insurance Fund. The FDIC should develop a systematic method to discount asset values that may be inflated by a price bubble, in order to ensure that in the future such bubbles do not endanger the solvency of insured institutions or the Insurance Fund.

2) Until the full package of financial system reforms Change to Win recommends is put in place, the Risk Based Assessment system should be modified to reflect the higher risk evident in institutions for which either a state banking regulator or the OTS is the primary regulator. Additionally, the Risk Based Assessment system should not directly incorporate long-term debt issuer ratings established by private ratings agencies: these agencies have proven to be subject to significant conflicts of interest, and their recent failures to accurately assess risk have already generated significant damage to the financial system and the economy.

3) In addition, until the full system reform is accomplished, supervisory standards for large banks, especially those primarily regulated by the states or the OTS should be increased, making early intervention by the FDIC more likely. Such early intervention could help to prevent the economic damage generated by the failure of banks that are "too big to fail."

4) The FDIC's mortgage restructuring plan should be continued and expanded to all institutions that are either a) placed in receivership or conservatorship by the FDIC; b) receive or have received equity injections under the TARP or any successor program; or c) participating in one or more of the Federal Reserve's non-traditional lending programs, for instance those who have used mortgage backed securities as loan collateral or who have sold the Fed commercial paper.

5) Deep at the core of our current crisis was the failure to properly enforce consumer protections built into current financial regulations. Under no circumstances should the enforcement of consumer protection be relaxed in order to temporarily (and unsustainably) improve the balance sheets of insured institutions.