FDIC
FEDERAL DEPOSIT INSURANCE CORPORATION

NEWS RELEASE

FOR IMMEDIATE RELEASE PR-57-85 (5-6-85)

FDIC REQUESTS COMMENT ON WAYS TO ACHIEVE MARKET DISCIPLINE

The Board of Directors of the Federal Deposit Insurance Corporation is requesting public comment on alternative methods of enhancing market discipline of banks in a deregulated environment. The approaches under consideration include using a "modified" deposit payoff procedure rather than merger to handle failed banks, and increasing bank capital requirements.

The Board invited comment on these measures in the interest of developing a dialogue on ways to increase market discipline, and thus increase the safe and sound operations of banks and decrease risks to the deposit insurance fund.

Most bank failures, including all large bank failures, have been handled by merging the failed institution into another bank. Under current law, such a transaction results in full protection for all depositors and creditors, including uninsured depositors.

In a modified payoff, the FDIC makes insured accounts available to the failed bank's customers, either by direct payment or by transferring such accounts to another bank. In addition, the FDIC makes a cash advance to uninsured depositors and other general creditors based on an estimate of the present value of net collections on the failed bank's assets. Because they would face some likelihood of loss in a modified payoff, uninsured depositors and creditors would have a strong incentive to choose their bank based on its strength, rather than solely on the rate of interest offered.

The FDIC requires no additional legal authority to effect modified payoffs in individual instances or to use the technique in all failures.

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However, the agency is interested in public comment on whether using the modified payoff in all failures will increase market discipline without creating other problems.

The Board's alternative suggestion for achieving greater market discipline and reducing the FDIC's risks is to raise the total capital requirement for insured banks to about nine percent of assets, keeping the primary capital requirement at about six percent and permitting the balance to be satisfied by selling subordinated debt. The objective of this approach would be to subject banks to a greater degree of scrutiny by suppliers of capital, particularly purchasers of the subordinated debt.

The FDIC is seeking comments specifically on whether either approach will achieve the goal of discipline, which one is preferred, and how best to implement them. A copy of the request for comments is attached. Comments must be received within 60 days of the date of publication of the request for comments in the Federal Register. Interested parties may send their comments to Hoyle L. Robinson, Executive Secretary, Federal Deposit Insurance Corporation, 550 17th Street, N.W., Washington, D.C. 20429. Comments may be hand-delivered to Room 6108 between the hours of 8:30 a.m. and 5:00 p.m., Monday through Friday, and will be available for public inspection during that time.

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Attachment

DISTRIBUTION: All Insured Banks