LEABHARLANN CHOLÁISTE NA TRÍONÓIDE, BAILE ÁTHA CLIATH | TRINITY COLLEGE LIBRARY DUBLIN
Ollscoil Átha Cliath | The University of Dublin

Terms and Conditions of Use of Digitised Theses from Trinity College Library Dublin

Copyright statement

All material supplied by Trinity College Library is protected by copyright (under the Copyright and Related Rights Act, 2000 as amended) and other relevant Intellectual Property Rights. By accessing and using a Digitised Thesis from Trinity College Library you acknowledge that all Intellectual Property Rights in any Works supplied are the sole and exclusive property of the copyright and/or other IPR holder. Specific copyright holders may not be explicitly identified. Use of materials from other sources within a thesis should not be construed as a claim over them.

A non-exclusive, non-transferable licence is hereby granted to those using or reproducing, in whole or in part, the material for valid purposes, providing the copyright owners are acknowledged using the normal conventions. Where specific permission to use material is required, this is identified and such permission must be sought from the copyright holder or agency cited.

Liability statement

By using a Digitised Thesis, I accept that Trinity College Dublin bears no legal responsibility for the accuracy, legality or comprehensiveness of materials contained within the thesis, and that Trinity College Dublin accepts no liability for indirect, consequential, or incidental, damages or losses arising from use of the thesis for whatever reason. Information located in a thesis may be subject to specific use constraints, details of which may not be explicitly described. It is the responsibility of potential and actual users to be aware of such constraints and to abide by them. By making use of material from a digitised thesis, you accept these copyright and disclaimer provisions. Where it is brought to the attention of Trinity College Library that there may be a breach of copyright or other restraint, it is the policy to withdraw or take down access to a thesis while the issue is being resolved.

Access Agreement

By using a Digitised Thesis from Trinity College Library you are bound by the following Terms & Conditions. Please read them carefully.

I have read and I understand the following statement: All material supplied via a Digitised Thesis from Trinity College Library is protected by copyright and other intellectual property rights, and duplication or sale of all or part of any of a thesis is not permitted, except that material may be duplicated by you for your research use or for educational purposes in electronic or print form providing the copyright owners are acknowledged using the normal conventions. You must obtain permission for any other use. Electronic or print copies may not be offered, whether for sale or otherwise to anyone. This copy has been supplied on the understanding that it is copyright material and that no quotation from the thesis may be published without proper acknowledgement.

DEPOSIT INSURANCE PROTECTION AND A FINANCIAL SAFETY NET IN NEED OF MENDING

Lessons Learned and the Case For Further Integration, Harmonization and Rational Improvement Following The 2008-2009 Worldwide Financial Pandemic

A Doctoral Dissertation Submitted In Partial Fulfillment

of the Degree of Doctor of Philosophy (Law)



Trinity College Dublin

Dublin, Ireland

October, 2009

Submitted By,

Alan Brent Rabkin,
Ph.D. (Law) Candidate

©2009 Alan B. Rabkin. All Rights Reserved.

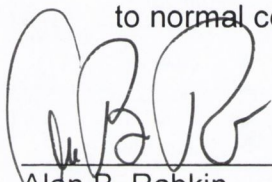
DECLARATION

I hereby certify that:

a) This doctoral dissertation is my original work and has not been previously submitted by me as an exercise for a degree at this or any other University;

b) This dissertation is entirely my own work; and,

c) I agree that the Library may further lend or copy this dissertation upon request. This permission covers only single copies made for study purposes and subject to normal conditions of acknowledgment.



Alan B. Rabkin,
Doctor of Philosophy (Law) Candidate
School of Law
Trinity College Dublin

October, 2009

TRINITY COLLEGE
2 4 MAR 2011
LIBRARY DUBLIN
Thesis
9029

SUMMARY AND MAJOR FINDINGS

The latest financial crisis has exposed many ongoing deficiencies in the design, implementation and funding of deposit insurance programs in the United States, similar schemes in the European Union, and protective programs around the world. As an important part of the financial safety net, deposit insurance is designed to provide a major part of the package of protections against catastrophic bank failure. However, the financial pandemic of 2008 and 2009 has demonstrated that the programs and schemes worldwide generally remain significantly underpowered and many are obviously deficient and often come to near collapse in the face of Systemic Risk.

This work has approached these issues in several ways. First, historically; then, through the evolution of legislation; and, finally, against the backdrop and reality of the current financial crisis which, as of the time this dissertation was being published, has yet to abate. The major findings include:

1. That deposit insurance schemes around the world vary widely and the design differences are now fully exposed and consistently is urgently needed.

2. That concepts related to deposit insurance (such as Moral Hazard, Systemic Risk and Banks Too Big to Fail) have entered into our public debate and must be harmonized across deposit insurance programs and schemes in the United States, the European Union and internationally.

3. Savers, and to a lesser extent, taxpayers, are and must always be the prime focus of deposit insurance plans. They are not always put in this position.

4. Bank capitalization remains clearly insufficient. Bank oversight and prudential regulation remains weak and, at times, alarmingly inadequate. Large bank management has too much control over financial policy and should never be rewarded for taking unacceptable risk. Yet, they clearly have been.

5. Opportunities to harmonize have arisen with the current crisis and this unique opportunity should not be missed to implement the many recommendations set forth in this work and before complacency once again sets in. Otherwise, the Boom and Bust financial cycles (which regrettably appear to be steepening and accelerating) will perpetuate further mistrust in banking which only fuels a corrosive and unnecessary result. While many world problems are difficult and resolution is far off, this is one area where the international financial community can and must create meaningful and coordinated change.

ACKNOWLEDGEMENTS

What you are about to read is a work that took years to complete in an area of bank law that might initially appear rather drab but is actually quite central to our lives and is, at this current time, very vibrant. Had this topic not been in such turmoil during my several years of research and writing, even to the point of my wincing after seeing new releases from the FDIC, EU Commission, IADI and the Basel Committee almost daily in the month of my final edits, it would have been a more relaxed, theoretical effort. I am afraid it was anything but relaxed and developments and changes continued to the day of my submission and this has been one continuous roller-coaster ride in the midst of the current financial storm and with no clear end to the journey.

I am both a long-time practicing bank solicitor and a seasoned financial services lawyer of over 30 years experience in focused bank law practice and I follow this area daily and with real interest. Although this is my second financial crisis as an adult, the first being the S&L Crisis of the 1980's I was involved in as a governmental financial services' lawyer, the rapid change surrounding this financial pandemic has surprised me with its ferocity and tenacity. There were many days when I was deep in research on this work, especially in the worldwide bank meltdown period starting with the shocking cases of Northern Rock, Indy Mac, Lehman Brothers and Bear Stearns in 2008, and continuing right to the present day, when institutions continued to fail at an alarming and daily rate and this dissertation had to be stopped; reversed; and, revamped once again to remain relevant as each new major failure created its new and changing global issues *du jour*.

Many a draft chapter that seemed so well-crafted wound up in the rubbish bin and this work never seemed to have any final form or real end to it. While I believe my recommendations will have lasting value, it still feels evolutional and unfinished as daily events have again changed many pages of it. There is no *'happy ever after'* ending to this work (at least not yet). Instead, this paper can be characterized as a continuous series of starts and edits; followed by more restarts and more edits; and, continuing until no more edits are possible as no more time remained to add or subtract them. If my discussion has already been outpaced by world events, and it undoubtedly has, please know I tried to keep it relevant to the very end of October 2009 (and possibly a little beyond) which was my final deadline to submit.

The list of those to offer my thanks in getting this work finished is unusually brief for me. Most of all, my dear wife Diane, has been the reason this work was finished at all. Those who know her appreciate that aside from being a beautiful lady of proud Irish ancestry she also encompasses all the best virtues a person can aspire to. Always supportive, I have spent weeks and months apart from her in residence at Trinity (or goodness knows where else). Also, my appreciation to my brother-in-law, Edward, and my sister, Sheryl, for their patience while I did my research and talked about my 'paper' in so mysterious of terms that it would make a U.S. spy agency proud.

My special thanks to my dissertation panelists who assisted me throughout the process of dissertation review and my ultimate *Viva Voce* review. To the Chairman of my *Viva Voce* panel, Dr Caoimhin Mac Maolain of Trinity's wonderful Law School, as well as the two diligent and hard-working examining members of my *Viva Voce* panel, American lawyer and very well known business law scholar Alan Berkeley; and, the equally admired lawyer and Dean of the School of Business of the University of Nevada Reno, Dr. Gregory Mosier. To both of you, my personal gratitude and thanks for your collective kindness, agreement to serve on my panel and in your intelligent and interesting reflections on my area of work.

Last, but certainly not least, I wish to deeply thank my adviser, Dr. Neville Cox, head of post-graduate education at Trinity College's Law School and a Barrister with a keen insight on people, places and things, who can now use this work to remind older students that they too can return to the world of academia even when they are very late career (as I am a mid-50's scholar). I may give new meaning to the phrase 'mature student'. Neville, you were always very supportive of me and it is so very much appreciated as this was more of a challenge than I ever first appreciated; and, I am relieved (and just a little stunned) that I am still here to tell about it. I hope this work merits your significant trust in me. Now I can add 'kind friend' to your many other roles.

To all the others who supported me in my darkest hours of daily writing and research tasks, including the always thoughtful Kelley McCabe at the Trinity College Dublin Law School who deserves special note; Don MacLean (another law lecturer at Trinity); the well respected Jones Vargas statewide law firm in Nevada where I worked as Of Counsel from 2006 to the completion of this work and who offered me the time to balance the rigors of law firm life as a bank lawyer with this effort; and, all those loyal post-graduate students of the past four years who attended my classes at Trinity College Dublin (and now Loyola Law School in Los Angeles) and still e-mail me with their progress and updates (but mainly reference requests). You each humble me in your own way and I thank you all in return for making this academic pursuit so inspirational. Finally, to our dear cat, Zoe, who decided to leave us and went over the Rainbow Bridge as this work was being finished in the summer of 2009, Diane and I miss you and we will never forget you. I will explain what all this was about when we next meet.

Alan B. Rabkin, Esq.,
Stateline (Lake Tahoe), Nevada
arabkin@earthlink.net

TABLE OF CONTENTS

TITLE PAGE

INTRODUCTORY MATTERS

DECLARATION

SUMMARY AND MAJOR FINDINGS

ACKNOWLEDGEMENTS

DECLARATION

TABLE OF CONTENTS

DEFINITION OF ABBREVIATIONS AND ACRONYMS

PREFACE

Endnotes, Preface

CHAPTER ONE

1. INTRODUCTION TO WORLDWIDE DEPOSIT INSURANCE SCHEMES

a. *Historical Development Of Banking and Deposit Protection Concepts From The Middle Ages To The Great Depression*

   i. *The Roots of Banking: Confidence and Trust*

   ii. *Religious Influence on Banking*

   iii. *Influence of Civilizations and City States On Banking*

   iv. *Banking Further Matures…and Becomes More Impersonal*

   v. *The New Scourge: Unbridled Optimism In Risk-Based Bank Products*

b. *Separation of Banking From Other Financial Services and the Advent of Deposit Insurance: A Critical Legal Response to the Devastation of the Great Depression*

i. *The (United States) Financial Panic of 1907: Precursor To The Great Depression?*

ii. *The Creation of a (U.S.) Central Bank: The Federal Reserve Act and Reserve Banking.*

iii. *The Run-Up To The Great Depression and the United States Response: The Glass-Steagall Act*

iv. *The Creation Of The Federal Deposit Insurance Corporation (FDIC)*

c. *Further Development of Deposit Insurance Schemes (From 1940 to 2007)*

d. *Rapidly Changing Deposit Insurance Solvency: The 2008 Banking Sector's Full Collapse and Extraordinary Bank Bailout Of 2008 Through 2009*

e. *Deposit Insurance As A Safety-Net Participant: Why Is Deposit Insurance Necessary At All With Other Protections?*

Endnotes, Chapter 1.

CHAPTER TWO

2. THE TYPES AND PURPOSES OF CURRENT WORLDWIDE DEPOSIT INSURANCE SYSTEMS

a. *Introduction To The Recognized Design Types of Deposit Protection Systems*

b. *Types of Deposit Protection Plans, Schemes and Systems*

i. *Type 1: Deposit Premium Funded; Government Guaranteed (Ex Ante Funded Plans)*

ii. *Type 2: Government Backed and Unfunded Mandates (Ex Post Funded Plans)*

iii. *Type 3: Industry Shared; Private Insurance; or, 'Pooled Risk' Funded Plans*

iv. *Comparison Of Funding Methods For Types*

c. *The Concept of 'Moral Hazard'*

d. *'Too Big To Fail' and The Growing Problem of Mega-Banking and Risks Posed By Institutional Size and Systemic Risk; The Bypass Strategy of Direct Lending to Troubled Banks*

e. *Consumer Rules and Awareness (Or Lack Thereof) Regarding Deposit Insurance Programs: Who Is This All For, Anyway?*

i. *Consumers Are Not Always Considered In Designing Deposit Insurance*

ii. *Reality Check: Consumers Do Not Understand Deposit Insurance*

f. Responsibility and Accountability: *Who Really Pays The Final Price For Bank Failure?* We All Do.

g. *Private Sector To The Rescue? The Possible Use Of Third Party Private Insurance To Guarantee Deposits.*

Endnotes, Chapter 2.

CHAPTER THREE

3. THE EUROPEAN DEPOSIT INSURANCE SCHEME; AN ANTIQUATED DIRECTIVE UNDER MOUNTING PRESSURE FOR RAPID MODERNIZATION

a. *Overview Of The European Deposit Insurance Scheme*

b. *The Underpinnings of the EU's Deposit Insurance System and the EU Directives (1994 to 2008)*

c. *Revised Minimum Coverage: European Directive 2009/14/EC*

d. *Variations Amongst Member States Above Base Levels; Topping Up Arrangements; and, Concerns About Double Recovery*

e. *Involvement of the European Central Bank In Deposit Insurance and Direct Payments to Troubled Banks (Bailout and Recapitalization)*

i. *ECB CON/2008/44 (3 October 2008) (Ireland)*

ii. *ECB CON/2008/46 (8 October 2008) (Belgium)*

iii. *ECB CON/2008/48 (15 October 2008) (Ireland)*

iv. *ECB CON/2008/69 (17 November 2008) (Ireland)*

v. *ECB CON/2009/16 (25 February 2009) (Ireland)*

vi. *ECB CON/2009/20 (10 March 2009) (Cyprus)*

vii. *ECB CON/2009/31 (26 March 2009) (Latvia)*

viii. *ECB CON/2009/51 (5 July 2009) (Romania)*

f. How Well Are The European Deposit Insurance Schemes Funded Currently?

g. How Solvent Are Member States Deposit Insurance Reserves?

h. The Current EU Consultation On Deposit Insurance

i. An EU Member State Case Study: The Irish Deposit Insurance Scheme; Its Changes; and, Its Evolution During This Financial Crisis

i. *Development of the Irish Deposit Protection Scheme, 1995 to 2008*

ii. *Irish Bank Failures and the Current Deposit Protection Scheme In Ireland: Ireland Adopts An Elevated €100,000 Threshold and Unlimited Account Guarantees Until 2010*

Endnotes, Chapter 3

CHAPTER FOUR

4. THE FEDERAL DEPOSIT INSURANCE ACT DEPOSIT INSURANCE SCHEME: THE U.S. TAKES THE LEAD IN DEPOSIT PROTECTION REGULATION; AND, SEVENTY FIVE YEARS LATER, FACES SERIOUS CHALLENGES WITH SYSTEMIC RISK AND BANKS ADJUDGED TOO BIG TO FAIL

a. *Overview of the FDI Act and the FDIC Deposit Protection System*

i. *One Deposit Insurance Regulator To Rule Them all (Well Almost); Coverage Development From FDIC's 1933 Inception To 2008*

ii. *American Coverage*

iii. *The FDIC's Reluctance To Offer Blanket Coverage; The Fallacy Of Spreading Deposits—A Serious Trap For The Unwary? De Facto Blanket Coverage*

iv. *FDIC Increases Coverage To $250,000 For Some Accounts; Then To All Accounts.*

v. *Use of Account Types For Separate Insured Account Status; Another De Facto Blanket Coverage Device?*

vi. *Immediate and Prompt Assumption or Pay-Out Is the Hallmark of FDIC Deposit Protection*

b. *The Alphabet Soup of Bank Bailout: TARP and TAGP*

i. *The Troubled Asset Relief Program (TARP)*

ii. *The Temporary Liquidity Guarantee Program (TAGP)*

c. *Other Coverage Exceptions and Special Deposit Insurance Situations:*

i. *'Sweep' or Zero Balance Accounts*

ii. *'IOLTA' Coverage For Interest On Law Office Trust Accounts*

d. *American Deposit Insurance Fund Solvency: Ex Ante In Name; Ex Post In Operation?*

e. *Comparison Of Deposit Insurance to Competing Non-Bank Depositories in the U.S.: The NCUA (Credit Union) and the SPIC (Brokerage Money Market) Forms Of 'Deposit Insurance'.*

i. *Credit Unions and an Unfair Playing Field; The NCUA Fund*

ii. *The SIPC Fund: Insurance or Simply Protection Against Theft?*

Endnotes, Chapter 4.

CHAPTER FIVE

5. OTHER WORLDWIDE DEPOSIT INSURANCE SCHEMES: COMPARED AND CONTRASTED.

a. *Introduction To General Worldwide Deposit Insurance Protection and Trends*

b. *Deposit Insurance On The Continent of Asia*:

i. *Country of China, Including Hong Kong*

ii. *Country of Japan*

iii. *Country of (Republic of) Korea*

iv. *Country of India*

v. *Country of Russia (The Russian Federation)*

vi. *Country of Malaysia*

vii. *Country of Vietnam*

c. *Deposit Insurance In The Pacific Region:*

i. *Country of Australia*

ii. *Country of New Zealand*

d. *Deposit Insurance In The Americas (Other Than The United States):*

i. *Country of Canada*

ii. *Country of Brazil*

iii. *Country of Mexico*

iv. *County of Jamaica*

v. *Country of Argentina*

vi. *Country of Peru*

vii. *Other Caribbean Countries*

e. *Deposit Insurance In Europe (Other Than The European Union):*

i. *Country of Iceland*

ii. *Country of Switzerland*

f. *Deposit Insurance On The Continent of Africa:*

i. *Country of Nigeria*

ii. *Country of South Africa*

iii. *Country of Zimbabwe*

iv. *Country of Kenya*

g. *Deposit Insurance In The Middle East/Mena Region (Including Issues of Islamic Banking and Deposit Insurance)*

i. *Country of Israel*

ii. *Country of Jordan*

iii. *Country of Egypt*

iv. *Country of Bahrain*

v. *Other Middle East/Mena Region Countries; The Special Case Of Islamic Banking and Deposit Insurance*

h. *Summary of Worldwide Deposit Insurance Systems*

Endnotes, Chapter 5.

CHAPTER SIX

6. OPTIONS, MODELS AND CORE PRINCIPLES NECESSARY FOR EFFECTIVE DEPOSIT INSURANCE SYSTEM OPERATIONS: AN ANALYSIS OF THE FDIC, EU, IADI AND BASEL COMMITTEE'S BEST PRACTICES PROPOSALS

a. *FDIC's August 2000 'Options' and FDIC's April 2001 'Keeping The Promise' Papers.*

   i. *The FDIC's 2000 'Options' Paper*

   ii. *The FDIC's 2001 'Keeping The Promise' Paper*

b. *The EU's Latest 'Models' For Funding Deposit Insurance*

c. *IADI and Joint IADI-BCBS Suggested 2008 'Core Principles' For Deposit Insurance Systems*

d. *Basel Committee on Banking Supervision/IADI Joint Core Principles For Effective Deposit Insurance Systems (June, 2009)*

Endnotes, Chapter 6.

CHAPTER SEVEN

7. RECOMMENDATIONS AND CONCLUDING REMARKS

a. *The Current Outcomes Of Our Global Deposit Insurance Systems: A Very Stressed Scenario Where Stressed Banks (and Deposit Insurers) Abound*

b. *Specific Recommendations To Improve Deposit Insurance Worldwide*

- *Recommendation 1:*

  Deposit Insurance Should Be Universal; All Deposit Taking Institutions Should Be Subject To Basic Governmentally-Sponsored Deposit Insurance Coverage; Only One Plan Allowed Per Country; Coverage Should Include Not Only Account Balances—*But The Account Bargain.*

- *Recommendation 2:*

  Excess Cover For Deposit Accounts Above Core Governmental Protection Levels Should Be Offered And Easy For Those Wishing Cover To Obtain.

- *Recommendation 3:*

  Deposit Insurance Is Weakened By Hyper-Complex Rules; Avoid Netting Loans Against Insured Deposits.

- *Recommendation 4:*

  A Deposit Insurer Must Always Have A Strong and Decisive Role In The Life Cycle, Recapitalization or Closure of Troubled Deposit Institutions.

- *Recommendation 5:*

  The Rate of Deposit Insurance Premium Should Be Assessed At A Differential Or Risk-Rated Rate; Bank Risk-Ratings Must Be Made Public; Do Not Make Depositors Guess As To Information Regarding The Risk Profile Of Their Institution.

- *Recommendation 6:*

  Deposit Insurance Only Serves Its Public Policy Goals If It Is Adequately Funded In Advance (Ex Ante); Governments Need To Assist Banks In Recapitalizing Deposit Insurance Funds Promptly; Thereafter, Banks Must Fund Deposit Insurance Themselves At Sustainable High *Ex Ante* Levels.

- *Recommendation 7:*

  All Banks In Every Country Should Report Individual Bank Performance At The Same Time and In The Same Manner; Review of Bank Performance Should Be Easy To Obtain and Quick To Compare; An Early Warning System For Failure and Competition Will Be Heightened By Such An Effort.

- *Recommendation 8:*

  Regulators Should Not Be Allowed To 'Dump' Failed Bank Assets and Thereby Transfer The Risk Of Loss From Poor Bank Management To Governments and/or Taxpayers.

- *Recommendation 9:*

  Coverage Levels Must Be Harmonized In Amount or Formula Between Countries To The Greatest Extent Possible.

- *Recommendation 10:*

  Capital Standards For Banks Must Be Raised Significantly From 6 to 8% Levels to At Least10%; Lending Limits and Lending Concentrations Must Be Reciprocally Lowered.

- *Recommendation 11:*

  Non-Bank Activity Must Be Greatly Restricted As To Banks; *Glass-Steagall*-Type Laws Should Be Immediately Restored, *Globally.* Traditional Banking Is Not Compatible With Investment Banking.

- *Recommendation 12:*

Banks Must Periodically Explain Deposit Insurance For Specific Accounts To Savers; Deposit Insurance Must Be Fully Transparent To All Depositors.

- *Recommendation 13:*

Account Rules Must Reflect Realistic Market Values For Bank Investments and Assets and Fairly Value Loans So Declining Asset Values Can Be Monitored; Impose *Sarbanes Oxley*-type Obligations On Outside Directors To Certify the Monitoring of Investments and Strength of Loans.

- *Recommendation 14:*

  Bank Executive Compensation Must Be Curbed; Executive Pay For Bank Officers and Directors Must Have Caps or Limits Or Mandated Stock-Based Compensation Should Be Substituted.

- *Recommendation 15:*

  Improve Bank Supervision; Impose Significant Civil Money Penalties; Terminate or Suspend Deposit Insurance For Noncompliant Institutions; and, Restrict the 'Shopping' of Regulators By Institutions.

- *Recommendation 16:*

  Annual Bank Self-Assessments Should Be Mandatory For Bank Lending, Operations and Governance Areas.

- *Recommendation 17:*

  Work to Dismantle (Break-Up) Banks TBTF (Too Big To Fail).

- *Recommendation 18:*

  Create a Coordinated International Approach and Offer Incentives To Avoid Future Risk.

c. *Concluding Remarks.*

Endnotes, Chapter 7.

APPENDICES

APPENDICES:

Appendix A:	*List of Countries Currently With Deposit Insurance Programs*
Appendix B:	*Letter by Alan B. Rabkin, Esq. on behalf of the Nevada Bankers Association and the Arizona Bankers Association to the FDIC dated March 27, 2009 Regarding Emergency Special Assessment*
Appendix C:	*Excerpt of Keynote Address by Alan B. Rabkin at the Nevada Business Summit, November 17, 2008*

LIST OF REFERENCES (BIBLIGRAPHY)

LIST OF REFERENCES (BIBLIOGRAPHY)

DEFINITION OF ABBREVIATIONS AND ACRONYMS

1994 Directive	The original directive in the EU establishing minimal cover for deposit insurance of €20,000; providing plan design flexibility to Member States; setting periods for pay-out, amongst other aspects.
2009 Directive	The amending directive in the EU that increased deposit insurance to €50,000 (and possibly further to €100,000); removing Co-Loss; and required faster pay-out of deposit insurance amounts, amongst other aspects.
Account Balance:	The dollar amount of an account which includes the invested sums lodged or deposited plus any interest due.
Adverse Selection:	The tendency for higher-risk institutions to opt for deposit insurance and lower risk institutions to opt-out of deposit insurance when membership in a DIF or DIS is voluntary.
Asset Purchaser:	The purchaser of the assets (loans or deposits) of a failed institution. As to purchased deposits, this is always another licensed financial institution.
Assessments:	The premium, charge or fee assessed against an institution for deposit insurance protection. Usually, an assessment is made within an *Ex Ante* scheme (although any shortfall even in an *Ex Ante* scheme may result in a special or emergency assessment). In *Ex Post* schemes, this is almost always a special or emergency assessment.
Authorized Institution:	A properly licensed financial institution in Europe.
Authorization:	Similar to licensing of a financial institution.
Bank Bailout:	The propping up of a failing institution by one or several of the following means: guarantees (usually governmental), cash infusion, purchase of troubled assets, reduction in taxation, increase in deposit insurance or liberalization of governing laws.
Bank Charter:	Normally in reference to banking in the United States. Banks that are chartered by an American State have their charter approved and issued by that State.
Bank Directives:	The governing legislation for the authorization and maintenance of credit institutions (banks) in the European Union. There has been a gradual series of such directives in the 1970's, 1980's, 1990' and 2000's in the form of the First, Second, Recast and Consolidating Banking Directives.
Bank Failure:	When an institution is taken over and closed, liquidated or merged by the governing body or regulators of that institution. A bank normally fails due to insolvency or illiquidity; however, a bank can fail (and be taken over) due to

serious board or management issues or unsafe policies or conduct even if it otherwise appears solvent or liquid.

Bank Rating: This is normally a numeric score that ranks an institution as an excellent, good, average, below average or troubled bank. See Camel Rating for the U.S. standard. See, also, *CAMELS*.

Bank Run: A rapid loss of deposits precipitated by fear on the part of the public that a financial institution may fail and depositors may suffer loss.

Basel II Accords: As proposed by the Basel Committee, these accords set forth risk standards for the operation of banks. They also provide a method to compare risk to the amount of capital needed to manage that level of risk. These are suggested policies presented to all countries by the Basel II Committee. *See www.bis.org.*

Billion: One Thousand Million, or 1,000,000,000.

BIS: Bank of International Settlements

Blanket Coverage: A DIF or DIS that insures all of a saver deposits. Examples include current deposit insurance systems in Australia and Turkey. Such plans are believed to have significant Moral Hazard.

Blanket Cover: See, *Blanket Coverage.*

Blanket Protection: See, *Blanket Coverage*.

Board: Often countries with a DIS or DPS have a board or governmental corporation oversee the Fund created under Ex Ante schemes.

Bridge Bank Direct lending by governments and/or central banks to weather the storm of a bank failure cycle.

Brokered Deposits: Deposits, usually of a higher interest time certificate nature, that are acquired from customers who are not the regular customers of an institution and are usually acquired by promises of higher rates of interest. Troubled banks are usually prevented or restricted from acquiring such deposits (or must maintain an average rate of interest promised that is similar to their service area competitors). Brokered deposits can be evidence of a troubled bank and could increase deposit insurance liability as the Indy Mac Bank failure in the State of California in the U.S. demonstrated in 2008.

Building Societies: A form of financial institution, normally found in the UK and Ireland, that is owned by it members and offers banking services (especially mortgage lending). In the United States, a variant of this institution is called a 'Thrift'; however most Thrifts are not owned by their members as with many building societies. Also, building societies often allow reciprocal lending opportunities for funds held on deposit or lowered mortgage rates in consideration of compensating balances.

'CAMELS' (Rating): This is the U.S. rating system and stands for Capital, Asset Quality, Management Ability; Liquidity, and Market Risk Sensitivity. A grading of 1, 2, 3, 4 or 5 is

assigned for a bank. CAMELS 1 being the best rating in the United States and a '5' Rating being a severely troubled institution (often near closure). See also *Uniform Interagency Bank Rating System*, *Capital Groupings* and *CRA ratings*.

Capital Group Assignments: This is a U.S. rating different than CAMELS. It is a capital rating that ranges from well capitalized to adequately capitalized to inadequately capitalized with well-capitalized exceeding the capital thresholds for capital required for the peer group of the institution. See, also, *CAMELS* and *CRA ratings*.

C&D: A Cease and Desist regulatory order. A strong administrative action, normally made public, to caution an institution that continued violation of the law, rules and regulations of the competent authority(ies) regulating the institution could result in removal of offending officers and directors, monetary fines or closure and liquidation of the institution. There must be grounds of unsafe or unsound banking to issue a C&D. Often jointly issued by all competent authorities of the institution. This is a more formal process that requires notice; the right to a hearing; and an order. Currently many institutions are subject to a C&D in the United States during the current financial crisis. In the United States C&D's are made public on the FDIC website.

CDARS A convenience program in the United States that allows a customer to place with one bank deposits that exceed that institution's deposit insurance coverage limits and then authorize that bank to spread the excess amount of deposits amongst many banks to take advantage of FDIC maximum coverage levels. Normally the rate and term for the entire range of deposits is the same one.

Central Bank: The central money supply and rate setting governmental entity in a country. For example, the Federal Reserve in America or the European Central Bank (ECB) in the European Union. In Europe, Member States in the Eurozone also participate in the central bank functions under the greater umbrella of the ECB.

Clean Bank: A failed bank sold to another institution without problem loans, operational issues and/or excess staff. Also known as a stripped bank or a 'P&A' Transaction, referring to a purchase and assumption of a clean bank.

Coinsurance: An arrangement whereby depositors are insured for a portion less than 100 percent of their deposits and bear some of the risk for bank failure through their own account balances.

Co-loss: See, *Coinsurance*.

Commission: The Commission of the European Union.

Competent Authority: In the case of deposit insurance usually the corporation or board designated to regulate the area.

Conservatorship: The legal procedure, normally undertaken by the entity that maintains the deposit insurance system, for the interim management of a failed institution. Sometimes referred to as receivership.

CRA:	Community Reinvestment Act. This U.S. Act requires a bank to be rated for its dedication to reinvestment in certain loans and programs within its service area. The rating ranges from Outstanding to Satisfactory to Unsatisfactory with Outstanding being the best rating.
Credit Institution:	The common term for a financial institution in Europe.
Credit Union:	A type of financial institution normally owned by its members. Credit Union members normally pool their deposits and their pooled deposits serve as the capital for the institution for loans and other lines of business. Normally, a credit union must abide by similar laws as banks and other financial institutions. Also known as *Friendly Societies*.
Deflation	The reduction in prices. Prices for goods or services decline. At any rate of deflation, this is usually an extremely negative economic indicator as it demonstrates that the output of a country is falling (deflating). Japan is an example of this concept in the later part of the 1990's. It is difficult to reverse deflation once it begins and is normally avoided by massive intervention of governments and central banks.
Depositor:	Person who invests monies with his, her or its financial institution. Also known as a *Saver*.
Depositor Preference:	A resolution method wherein the institution's depositors are paid, up to the mandated limits, deposit insurance before any other debts of the institution are resolved. In essence, the depositors are deemed to have a super priority to the remaining bank assets (up to the limits of the DIF or DIS).
Deposit Priority	Depositor ranking above other priorities. See, *Depositor Preference*.
DDA Account:	This is an account that usually is easily accessible, is not invested for any time and normally bears little or no interest. Often called a "checking account" or "current account" throughout the world. In contrast, a certificate of deposit, savings account, guaranteed certificate or other time oriented account promises a rate of return in return for the longer term investment of funds.
Deposit:	The investment of funds in a financial institution with an expectation of use of those funds and/or return of the funds with an investment return (normally interest). A deposit is considered to be a liability of a financial institution as a financial institution has the obligation to repay the investment to the customer who originally made it.
Deposit Risk:	The risk that an institution, such as a bank, will fail and a depositor will not be repaid their investment in the institution as agreed.
Differential Premium:	See, *Risk-Based Premiums*.
DIA	Deposit Insurance Agency.
DIF:	Deposit Insurance Fund (see, also, 'DPS'). Normally, this is what a deposit insurance scheme or plan is called in North America.

DIS or DPS: Deposit Insurance or Protection Scheme (see, also, DIF). Normally, this is what a deposit insurance plan is called in the European Union.

ECB: The European Central Bank, the central bank to member state central banks in Europe. It is considered to be one of the primary legal institutions in the EU.

ECU: The predecessor of the euro. References to "ECU" can generally be translated into reference to the euro. It was a way to establish a price for something in all the many currencies of Europe,

EDI Excess Deposit Insurance, which is private insurance that extends (and often doubles) the protection of governmental deposit insurer. This form of excess private insurance is popular in American credit unions.

EFDI EU Committee of the European Forum Of Deposit Insurers

Emergency Special Assessment: A special assessment on American banks reflecting the ongoing financial crisis to assist in recapitalizing the FDIC's deposit insurance fund more rapidly as it is depleted by failing banks. This assessment is in addition to the normal deposit premiums paid by banks to the FDIC DIF.

ESCB European System of Central Banks. The ECSB includes all 27 Member States, including the 16 Eurozone Members.

Eurozone: Those member states of the EU who actually utilize the euro as their official currency. Currently, there are 16 Member States in the EU who are within the Eurozone.

EU: The European Union.

EU DIS: The EU's mandated deposit protection scheme found at 94/19/EC (1994) and amended in 2009 by the 2009 Directive.

EU-15: The 15 members of the EU just prior to accession of the Eastern European countries in 2004.

EU-25: The entire 25 members of the EU as of the 2004 accession of Eastern European Countries.

EU-27: The full European Union as it stands at the time this dissertation is published.

Ex-Ante Funding: The accumulation of a fund before and in anticipation of the failure of insured institutions. The fund is an approximation of the risk to the system. Often once it accumulates sufficient funds, the fund reduces or eliminates premiums or pays dividends to the member institutions. Often called a funded plan.

Express System [of DPS]: A deposit insurance system created by legal statute, regulation or ordinance. As opposed to an Implicit System, an Express System of deposit insurance guarantees some degree of protection as noted in the

	applicable laws; provided, however, that funding may be immediately available (Ex-Ante Funding) or the funded may not be available and must be raised after the fact (Ex-Post Funding).
Ex-Post Funding:	The assessment of premiums or the aggregating of funds necessary to protect deposits after the failure of one or more institutions. In essence, accumulation of protection funds from healthy banks, governments or third parties after one or more other banks fail. Often called an unfunded plan or an unfunded mandate.
Failed Bank:	An institution that has been closed by its government or regulatory authority. However, closure is only the first step in a longer process of liquidation or merger of the failed institution that could take many months or year.
FCIC:	Financial Crisis Inquiry Commission. A Federal legislative Committee designed to advise the America Congress how the financial crisis of 2008-2009 got started and how to avoid similar crises in the future. The Commission has 10 Commissioners (6 Democratic and 4 Republican).
FDI Act:	The primary law in the United States Regulating Deposit Protection.
FDIC:	The Federal Deposit Insurance Corporation of the United States. A governmental corporation, the FDIC is created by the banking statutes of the United States Code and is the regulator of the DIS and the DIF in the United States. It is considered to be the first organized and leading DIS or DPS of an Explicit System nature in the world.
FDIC DIF:	See, *DIF*.
Fed:	The Federal Reserve. The Federal Reserve is the central bank of the United States and has similar powers and responsibilities as the European Central Bank in the EU.
Federal Reserve:	See, *Fed.*
Federal Savings Bank:	Also known as 'FSB's'. An American form of thrift institution that replaced the now defunct S&L's. Several large FSB's have failed in the current financial crisis of 2008-2009.
FFIEC:	Federal Financial Institutions Examination Council. This is a U.S.-based standards setting group (primarily for examination and bank ratings)
Financial Institutions:	Banks, credit unions, building societies, and similar institutions.
Financial Regulator:	The competent authority to regulate financial institutions. For example, in Ireland, the Irish Financial Regulator. See, also, Competent Authority.
Financial Safety Net:	Together with prudential supervision, this constitutes the oversight of financial institutions.

Flat Rate Premium:	A uniform premium charged to financial institutions under a specific deposit insurance system.
Friendly Societies:	See, *Credit Unions.*
Full Coverage Plans	See, *Blanket Coverage.*
G-8	The 8 richest/largest industrial nations. There is a regular meeting of this group. The members, in addition to the European Union, is the United States, Canada, Russia, France, Germany, Japan and the United Kingdom. There is discussion of expanding the G-8 by 5 members taken from the G-20 (Brazil, China, India, Mexico, and South Africa).
G-20	The 20 largest industrial nations represented through finance ministers or central banks. There is a regular meeting of this 'Group of 20' and for economic purposes the G-20 will now lead financial issues as of September 2009. In addition to the G-8 members, the following additional members belong to the G-20: Argentina, Australia, Brazil, China, India, Indonesia, Italy, Mexico, Saudi Arabia, South Africa, South Korea and Turkey. The G-20 countries represent over 80.00% of world trade and GNP.
Glass Steagall (Act)	A post-depression era law that placed a separation between the activities of banking (commercial and retain) and the investment activities of banking to avoid conflicts and to remove speculative risk. This law was effectively repealed in 1999 by GLB.
GLB	The Graham-Leach-Bliley Act. This American law eliminated most of the safe-guards of the Glass-Steagall Act in 1999.
Home Member State:	A European concept. The Member State where a financial institution is authorized. This Member State (and its competent authority) would be the primary prudential supervisor of an institution.
Host Member State:	A European Concept. Operations of a financial institutions in a Member State that is not the authorizing authority of a financial institution. The competent authority would remain the Home Member State. Host Member State's have limited authority to restrict the activities of a financial institution in the Host Member State except pursuant to the "General Good" doctrine of the European Union and the various Banking Directives.
IADI:	[The] International Association of Deposit Insurers. The members of the IADI are the deposit insurance plans and schemes from around the world.
IOLTA Accounts:	In the United States, special accounts are established by banks for lawyers to deposit short-term client funds. The account remains owned by the law office and the client; however, the interest is paid to the governing bar, society or counsel regulating lawyers. These forms of accounts have special blanket (unlimited) coverage for deposit insurance in America.
IMF:	[The] International Monetary Bank
Implicit System [of DPS]:	An informal deposit insurance system without express laws mandating it. Usually where a governmental central bank, a political body or a province or local authority would insure that depositors do not lose all or part of their deposits.

Inflation — The gradual to rapid increase in prices. Low to lower moderate inflation is usually containable. High moderate to rapid inflation is usually an extremely negative economic indicator. Measured by various indices, including the Index of Consumer Prices, commonly called the 'CPI'.

Informal System [of DPS]: See, *Implicit System*

Insured Deposit: That portion of a deposit, possibly all, that is protected from loss by a deposit insurance plan or scheme.

ITF Accounts: See, *POD Accounts.*

Latent System [of DPS]: See, *Implicit System*

Legacy: A type of plan, account or system that has been updated and replaced but still exists in some form.

Lender Of Last Resort: Usually the central bank or monetary authority who backstops failing bank systems with loans or other liquidity programs. The TARP Program in the United States is a very recent example of government lending when no other options are available. See, *TARP.*

Limited Coverage: A DIF or DIS that places ceilings or co-insurance requirements on depositor recovery. In comparison, blanket coverage insures all deposits.

Liquidity: The ability of an institution to return deposited funds when due or demanded if not subject to a term.

Loan Sale: A sell-off of loans by the deposit insurer after the failure of a financial institution. For example, in the United States the FDIC allows other banks and non-banks to vie for the purchase of loans previously owned and serviced by a failed bank. Often these loans sell for a fraction of their face amounts.

Member State: A European county that is also a member of the European Union.

Moral Hazard/Risk: An argument that deposit protection creates an incentive for financial institutions to engage in risky behavior. This is especially as to lending but could also be as to lines of business; corporate governance; or staffing. This concept is sometimes linked with a related concept called Adverse Selection.

MOU: A Memorandum Of Understanding. Often used in the United States (and elsewhere) to document promises of an institution to correct deficiencies with Prompt Corrective Action. Usually a confidential agreement unless dishonored. Sometimes referred to as a regulatory or written agreement. An MOU is normally not revealed—which is why it is preferred over a C&D.

National Bank Supervisor — A proposed combined regulator for all national banks in the United States (currently only a proposal).

NCUA: National Association Of Credit Unions (U.S.).

NCUA DIF Fund: The deposit insurance fund for credit unions. This fund currently has a $6 billion line of credit with the U.S. Treasury.

Netting: Taking the deposit insurance guarantee owed to a customer and reducing that deposit guarantee by any loans or obligations in default owed to the failed bank.

P&A Transaction A purchase and assumption transaction that allows a deposit insurer to sell the accounts and/or loans of a failed institution to a healthy institution.

Pass Through: A coverage concept where deposit insurance also protects a sub-level of beneficiaries. This is common in pension plans, trust accounts, fiduciary arrangements and similar accounts. However, the account must bear some evidence of the proper status on its account title to even be eligible for such Pass Through Coverage. This could allow an account that appears to offer only protection for one holder to actually insure large blocks of beneficiaries and multiple sub-holders of the account. For example, in the U.S., this could change the $250,000 deposit insurance for each account into millions of dollars of deposit insurance for that same account if the rules for Pass Through Coverage are followed.

POD Accounts: In the United States and often called a poor-man's trust, or a Totten Trust. Funds are informally held "in trust for" or ITF another. These accounts normally read "Bank Customer A payable on death to Person B". They are a mechanism to immediately pass ownership of an account to another at one's passing. However, they are flexible as the beneficiary, in this case Person B, can be deleted or changed before one's passing and Person B will likely not know of their naming until after the passing of Bank Customer A. Most U.S. banks offer this form of account ownership.

Premiums: The amount paid by an institution to fund a DIF. Normally a percentage of the average deposit balance of an institution. May be a flat rate or risk-rated.

Problem Bank: See, *Troubled Institution.*

PCA See, *Prompt Corrective Action.*

Prompt Corrective Action: An institution with serious deficiencies requiring immediate action to correct those deficiencies. Often set forth in an MOU or C&D, or their equivalent, which are regulatory agreements or regulatory enforcement orders. This status is highly cautionary and may be a prelude to bank failure or closure without further notice or warning.

Prudential Supervision: Oversight of the licensing, operations, capitalization, and enforcement of financial institutions.

Receivership: Placing a failed institution into the hands and subject to the management of one of the following: a governmental agency, another institution or the courts. This is a form of custodial or trust arrangement wherein fiduciary duties are owed and proper management and conduct is expected.

Regulator: The governmental or quasi-governmental agency charged with the Prudential Supervision of licensed and authorized financial institutions.

Reinsurance: A concept wherein the risk of the DIF or DIS is partially off-set by another insurer (governmental or private). For example, a DIF may offer Blanket Coverage and,

to protect itself from large actual claims, the fund may reinsure all or part of that risk by arranging for coverage by another insurer (governmental or private).

Repudiation: The power many deposit insurers have to arbitrarily deny liability for many liabilities of a financial institution. In the United States this issue was subject to the landmark U.S. Supreme Court case of *D'Oench Dhume*. This right of repudiation, purportedly, increases recovery for depositors.

Risk: There are many forms of risk. The Basel II Accords and the EU's Capital Adequacy Directive describe these forms of risk in detail, for example.

Risk Based Premium: An assessment on an institution for deposit insurance based upon the risk that institution currently has to the overall financial system. The risk of an institution is usually set by periodic examination and is often expressed as a number (i.e., a "2" rated institution). The U.S. system is an example of such a risked-based premium system. Also known as a 'risk-rated' premium or assessment.

RTC: The now defunct Resolution Trust Corporation that liquidated the failed S&L's in the 1980's in the United States. The FDIC has decided not to use an 'RTC'-type entity to liquidate failed banks in the latest economic downturn. Instead it is engaging other healthier institutions to acquire all or part of the assets of failed banks or auctioning pools of loans to the highest bank or non-bank bidder.

Safe Deposit Box: Safe Deposit Boxes are normally a safe storage of physical assets. Many institutions limit the amount of cash that may be kept in a box. However, deposit insurance normally does not cover the contents of safe storage boxes (although bank or personal casualty insurance may cover any loss). If a bank fails, the contents of the Safe Deposit Box are usually surrender to the owner as it is deemed by liquidators not to be property owned by the institution.

Safety-Net: The major participants in keeping banks safe and sound. These include prudential bank regulators, central banks, deposit insurers, consumer agencies, law enforcement agencies, and others.

SAIF: The defunct and insolvent Savings and Loan Insurance Fund (hence the abbreviation SAIF) which previously existed in the United States prior to the 1990's. Also, see, *S&L's*.

Saver: See, *Depositor*.

S&L's: The now-defunct Savings and Loan Institutions in the United States. The S&L's were formerly regulated by the FSLIC (no longer existing). The S&L's had their own deposit insurance fund, the SAIF, which was merged into the FDIC's DIF when the S&L's failed by the hundreds in the 1980's and early 1990's. Many of the surviving S&L's converted to 'Federal Savings Bank' (FSB) status in the 1990's. Some of the FSB's have now subsequently failed as institutions.

Set-Off: Similar to Netting. Also could apply to the net cost of a failed institution after comparing deposit liability to assets and loans. As the institution has failed, it is

likely that the deposit liability exceeds the liquidation value of the assets and loans. This creates a DIF or DIS liability which reduces the reserves of that fund.

SIPC: Securities Investors Protection Corporation (U.S.).

SIPC Fund: A protection system for securities. Not the same as the FDIC as to scope or type of coverage. Covers cash and securities held by brokerage firms that is improperly handled and not returned but does not protect principal from market forces. See, www.sipc.org.

Sovereign Wealth Funds: Lending by governments to other governments or institutions. CIC is an example of the Chinese Fund. Once popular, these funds retreated from their high visibility position of the mid-2000 period due to losses in the current financial markets. Some banks, like Citibank, have sought capital from such funds when stock markets would not recapitalize.

State Aid Normally considered as the improper or impermissible financial or other support for commercial undertakings by a Member State in the EU that are precluding by Treaty or other obligations. Deposit insurance is not normally considered as State Aid if equally applied, as with the 1994 and 2009 Directives. However, selective direct lending or TARP-type lending coupled with ownership interests could violate State Aid requirements.

Sweep Accounts: Deposited funds transferred to and from a bank account to an account outside the institution which is, in essence, an uninsured investment vehicle. The issue is whether the funds are insured or not.

Systemic Risk: Rather than the failure of isolated institutions, this risk is the spread of loss or failure (and related potential bank runs and financial panic) to multiple financial institutions (usually large) or geographic regions (usually broad). This form of risk is usually not solely controllable by deposit insurance. Rather, this form of larger risk requires governmental, regulator or central bank intervention in one or more countries to take prompt corrective action (usually by massive liquidity or recapitalization programs). During 2008-2009, worldwide governments, central banks and regulators identified a system risk to world economies and utilized this concept to justify massive supplementary assistance, bailouts, purchases of toxic assets, state aid (and other programs going well beyond deposit insurance) to failing institutions and which assistance was measured in the trillions of (U.S.) dollars. For example, programs like TARP in the United States would be an example of a program used to combat an emerging systemic risk. If systemic risk is not counteracted, it could lead to a widespread failure of financial institutions in the nature of the Great Depression and the emergence of deflation.

TAGP: The *Transaction Account Guarantee Program (TAGP)* in the United States. This program, administered by the FDIC, boosts deposit guarantees from $250,000 to a blanket and unlimited guarantee for non-interest bearing transaction accounts. This Program is set to expire at the end of 2009 for banks that do not opt for continuation status. The 2008 final rule and the 2009 extension rulemaking proposal can be found at www.fdic.gov/regulations/TLGP/index.html.

TARP: The *Troubled Asset Relief Program (TARP)* is a program of the United States government to purchase assets and equity from financial institutions to strengthen its financial sector. It is the largest component of the government's measures in 2008 to address the subprime mortgage crisis. It is seen as an alternative to declaring these banks insolvent and placing them into receivership. Banks of all sizes sought loans under this program and had to relinquish certain ownership rights as part of the arrangement. The larger banks have started to repay their TARP funds; the smaller banks have not repaid sums in similar amounts; the insurance companies, like AIG who borrowed massive sums, have yet to repay TARP funds; the car makers, such as General Motors, Chrysler and others, who received TARP funds, will likely never repay funds back due to intervening bankruptcies. The government will take many years to exit the TARP (at least to the extent they can be repaid). See, also, *lender of last resort.*

TARP Oversight Committee A Committee, headed by Professor Elizabeth Warren of Harvard Law School, that determines if the $700 Billion in U.S. TARP funds are being properly spent and deployed.

'Too Big To Fail': An institution that is so large that its collapse could bring down entire groups of financial institutions due to inter-relationships and cross-commitments. Usually, an institution that is of this class is accorded special treatment although certain regulators, such as the FDIC, have announced in 2009 that the days of institutions being *'Too Big To Fail'* may be a thing of the past and should not be relied upon. An example of such an institution in banking is Citicorp in America or BNP (*Banque Nationale de Paris*) in France. An example of such an institution in the insurance industry is AIG in America or Allianz in the European Union.

TBTF See, *Too Big To Fail.*

Thrift Institutions: A specialized type of bank that focuses on using its deposit to invest in residential mortgages. Normally found in the United States. See also *S&L's* and *Building Societies*.

Trillion: One thousand billion, or 1,000,000,000,000.

Troubled Institution: A bank in the United States (or elsewhere) that is on a watch list for banks with serious difficulties is capital, liquidity or governance. A bank labeled as such is predicted to fail without Prompt Corrective Action.

Undertaking Another name for a company (primarily used in Europe).

Uniform Interagency Bank Rating: See, *CAMELS.*

Uninsured Deposit: All or part of a sum invested with an institution which carries no deposit insurance. However, if a security, a loss may be insured by a separate insurer (for example, in the U.S., the SIPC); or, if there is an asset backing the investment, the owner may be entitled to the value of the asset equal to their interest in it.

Wholesale Deposits: See, *Brokered Deposits.*

PREFACE







"We cannot grow complacent. We cannot wait for another [financial] crisis to cooperate."

Barack Obama, President of the United States, addressing the G-20 Conference, Pittsburgh, Pennsylvania, United States, September 25, 2009

Why treat banks in a special way with special guarantees?[1] Over 150 years ago, a famous English court decision stated that the relationship between a bank and its bank depositors is nothing more than a simple debtor-creditor relationship founded in contract and it is not about trust and fiduciary duty at all[2]. If that was ever true, it is not true today. If banking is only about contract relationships, the concept of deposit insurance we are about to discuss appears to be like a fish out of water and the work of madmen as we treat banking uniquely different than almost any other commercial or financial relationship. Instead, we believe that banks are special and depositor protection is very much about confidence, fiduciary duty and the social contract in any society concerned with its depositors and to protect them from the failures, abuses and demise of banking institutions, bank regulators and others.

We are currently mired in difficult times and so our attention has turned to banking and its place as a financial safe haven. The worldwide situation at present throughout the entire range of financial services is serious and difficult; and, although the tide may be turning somewhat as this work comes to an end, the outlook remains

uncertain at best. Since the beginning of 2008, over 125 banks have failed in the United States[3]. Investors in the United States have lost at least (U.S.) $13.0 trillion[4]. Some feel worldwide losses from all industries may be in the hundreds of trillions of U.S. Dollars at this time[5]. Twenty-five million persons are currently out of work in the United States alone[6] and in some places the rate of America's unemployment exceeds 14.0% (a modern day record)[7]. Insolvencies in the United States have surpassed one million filings in 2009 and the courts are flooded with cases[8]. Gross Domestic Product in the U.S. and U.S. inflation rates are each negative or barely positive[9]. In the United Kingdom, the jobless rate stands at almost 8.00%[10]. The U.S. has used so-called TARP funds and directly lent to and bailed out 650 banks and other financial services to the sum of (U.S.) $787.0 billion and only half of this sum has been repaid to date[11].

Europe has not been spared hardship, either. Both Ireland's stock exchange and major banks nearly failed[12]. In the United Kingdom the largest of UK banks have been buffeted and the bailout number is still very costly at (U.S.) $290 billion[13], several Belgium banks have failed[14] and the entire Icelandic banking system is in shambles[15]. Germany has lent to numerous Eastern European countries who cannot repay their debts[16]. The IMF has had to bail out several European countries, such as Hungary and Romania[17]. Banking in Europe remains very difficult.

But it gets even worse. Over two million residential homes are in foreclosure or have already been foreclosed in the United States[18]. More in Ireland, the UK and throughout Europe. The IMF predicts worldwide banking sector losses alone to be between three and four trillion U.S. Dollars[19]. Every bank across the globe is worried about capital. Over 400 U.S. banks remain on the so-called troubled bank list as of the

Fall of 2009 for this very reason. The pain is not even close to an end as several hundred more banks in the U.S. alone are predicted to fail[20] and more around the world. At least that many European banks have been restructured, nationalized, closed or have received some form of aid from their respective central banks, including the ECB and the IMF[21]. Two massive American back-room or 'corporate' credit unions are near collapse[22]. Hundreds of banks and credit unions worldwide have either collapsed or are deemed to be 'troubled' or have been forcibly combined with other institutions[23]. It is exhausting to even track the negative news it is all that bad.

Welcome to the economic calamity of our lifetime—our *Great Crash*. While this a tragic time for so many, it is also an interesting laboratory to gauge how our financial safety-net is performing[24]. At first it appears to have done well. We likely, and narrowly, averted a financial global catastrophe the likes of which only those over the age of ninety years would ever appreciate from the last era of systemic failure. This time we were luckier than those who faced the *Great Depression*. Yet, others feel we have not done well at all. We came very close to a different result and possibly we are not completely safe even now as we have a badly torn safety-net that needs prompt mending and this is no time for a quick succession of calamities. At the G-20 Summit in Pittsburgh, Pennsylvania reported in late September, 2009, there is a greater urgency to act than ever as we remain tragically vulnerable.[25]

Let me offer some early comparisons. In the years after the *Great Depression*, 10,000 banks closed in three years (1930-1933) in the United States. However, and thereafter, bank closings in the United States would not exceed 100 in any single year for approximately 50 years. In 1997, only one bank failed in the United States. In 1998,

2001 and 2003, only three banks in America failed. Through 2003, the largest aggregate amount in U.S. Dollars of all banks that failed in a single year did not exceed (U.S.) $53 billion[26]. This was all to change with our current financial crisis. We have exceeded all those numbers with the current financial crisis—*except for the number of institutions closed.* However, was the period of calm before 2008 due to an effective safety net, or was it just our good luck? This work will demonstrate that it was probably more luck than planning. We were very close to the edge of the cliff with this crisis and had we not acted when we did, and as dramatically as we did, matters could have become most difficult.

This work examines this latest financial crisis with a focus on deposit insurance as a key and changing safety net player and to improve the future use of deposit insurance worldwide. It recognizes that deposit insurance has clearly done some good in this period of financial turbulence and before. However, it also asks us to be realistic in our assessment of deposit insurance from the very start. By the end of this work we will know that deposit insurance did not really save us from this latest financial disaster. In many nations of the world, deposit insurance appears to be as much a 'slogan of protection' and a large dose of confidence building as it has been real, deep and lasting protection. That is because deposit insurance as it now exists is dependent on many assumptions that are proving to be different today than 75 years ago when the concept of deposit insurance first was introduced in the United States in our post-Depression laboratory of ideas. We will see that the design of deposit insurer must quickly change; its funding must greatly improve; the transparency of its laws, rules and regulations must vastly increase if this experiment is to continue; and, like weeds in the garden

there are many negative influences that need to be removed that keep popping up in different places. Deposit insurance in its current form is neither completely trustworthy nor is it a fully functioning system.

As this latest severe financial crisis starts to subside, it also leaves one important problem in its wake—*our complacency*. We failed to get the incentives right to maintain solvent and safe banks after many warnings and to keep a watchful gaze over the banking landscape after our last financial crisis in the 1980's; and the crisis before that in the 1920's; and the crisis before that in early 1900's; and before that in the late 1800's. However, being cynical will not improve the situation for the next crisis a decade from now; and the next crisis three decades from now; and the next one after that one. The fact that our financial safety-net still needs serious mending[27] means we have not gotten the balance of banking under control as yet; we have not found the right mixture of regulation and open competition; and we do not have a fully integrated plan to brake our fall soon enough to avoid the tragic outcomes we have seen and the new and terrible things to come if we do not correct our ways. However, those long-held deficiencies do not mean that we do should not weigh in to mend and improve our net; deepen our understanding of it; learn by our prior bad examples; and, cause the laws governing banks and deposit insurance to be more responsive and realistic rather than to serve as window dressing to the next generation of trusting savers.

Being a thrifty saver is what we hold as a virtue. For when we first encourage savings, and protect bank deposits as part of that process, we affirm that in a civilized society that certain basic functions such as saving and thriftiness should not be subject to chance, luck or fate but are a key societal goal to avoid uncivilized frustration. Saving

makes us proud; makes us feel accomplished; and gives us confidence, Deposit insurance is meant to not only protect money but to confirm banks as a refuge from excessive risk; to lend predictability; and, engender confidence. Deposit insurance reminds us that banking is that important and the direction it leads us represents one of our *better financial angels*.

So the financial crisis we now find ourselves in also calls to us to review and rethink the design, implementation and usefulness of what we do with the financial safety-net and why we do it in the area of banking, generally, and deposit insurance area, specifically. Together, we can learn from the past and craft it to better track desirable, core principles so it can function better and lend the confidence it intends to establish in us as savers. It would be an utter waste and serious missed opportunity not to focus global banking, and all the central banks, prudential banks and politicians who depend on its smooth functioning, upon the importance of harmonizing deposit insurance before this moment once again passes back in the record books as the 'Financial Crisis of 2008-2009' without real reform or solid change. Let's hope that there is an asterisk after that date reference saying, in essence, **but they did something about it!*

Please turn back and look at the pictures at the start of this section. Some are recent; some much older; and, even one from a famous 'bank run' movie scene in a holiday classic *It's a Wonderful Life*. This could be any of us in line or a member of our family. This is the actual aftermath of bank failure. These pictures make real what the mundane topic of deposit insurance, and all its design, laws, rules and regulations we will soon look at, seems to keep theoretical and numbingly distant. Each visual scene

needs to be remembered throughout this work as it reminds each of us of the worry and brings out all of the visceral emotion of why we even care about bank failure rather than allowing banking to live and die in a normal business life cycle like the other mere mortal trades, professions and businesses. Why banking *is* special.

These are real people in actual lines in the United States, Europe or any other county across the globe. They are worried about their financial future and they are lined up at their local bank branch after a bank failure and seizure is announced by prudential regulators pursuant to some law or statute designed by well-intentioned legislature. They are rightfully confused and worried about their life savings and they are desperate to understand their options and often know little about what is really occurring and what is to come. They may be told their account is at risk, or the interest rate of their savings is being adjusted long before it should be or something else much, much worse. These people are not bankers or experts in the troubles of banks. They have not read this work or the deposit insurance laws and likely have not heard of differential deposit insurance schemes, *ex post* funding, risk-based premiums, deposit insurance directives or the concept of Moral Hazard and they likely care little to learn about those ideas beyond what is immediately necessary to preserve and maximize their deposits and save themselves from loss. They placed funds in an authorized bank because we all believe that banks are highly regulated, examined, and that was the most conservative choice and safest place for one's savings. When a bank suddenly fails, savers are left uncertain and in a sort of financial shock-- like being told that one had a sickness when all signs pointed to being in good health. It leads to despair; then anger; then hopelessness.

If deposit insurance laws, rules and regulations in any nation are to work well and serve any viable purpose, they must serve depositors such as those in the pictures above as they are the object of why such an intricate system exists in the first place. Deposit insurance must protect bank savers from excessive risk. If it does not, and only serves to make it appear they are protected, and creates bureaucracies that only serve themselves, it becomes a grand illusion… *a self-defeating ruse.*

The following work critically examines deposit insurance and its worldwide rationality and complexity. The topic of the need for, the wisdom of, and the best practices design regarding deposit insurance we are about to explore over hundreds of pages is far from simplistic[28]. At times, it makes great sense and seems to be finely tuned like a great symphony playing together. At other times, it is embarrassingly clumsy, crude, with little plan and appears to almost insure its own failure such as in its own miniscule funding and coverage roadblocks.

Deposit insurance is also one part of a larger, complex group of safety-net players which involves intricate laws, governments, institutions, costs and, possibly most important to all of us, the safe and sound handling of the measure of our societal productivity, namely, our life savings. However, these players do not always like one another, are not always coordinated, often fail to act in concert and this is why this work concentrates critically on this topic. There is still so much left to do to complete the vision of deposit insurance for the benefit of depositors.

Therefore, while analysis and theory are all very interesting, and laws are all very understandable when looked at narrowly, in the end this area is driven by savers, the

banks they invest in, the political will of governments, good coordination of safety-net players and a nation willing to allocate some (or lots) of its wealth to core protections in banking—whichever nation that may be. It is an area that is highly emotive, very personal and deeply disturbing for anyone who has suffered from receiving less than they bargained for or for which they feel they are entitled. In many ways, financial crises and bank failure are the gateway to the ugly land of financial betrayal. We can never eradicate that land from our world. However, as reality sets in, controlling the fiscal costs of any banking crisis through containment stages is the rational course of most efficient and productive pursuit.[29]

This work is divided into seven Chapters that have an evolutionary aspect to them. In Chapters 1 and 2, the topic of how deposit insurance developed historically is examined (Chapter 1) and how the deposit insurance systems are designed and funded (Chapter 2). In Chapters 3 and 4, a targeted, historical and then very current look at the two major deposit insurance systems in the European Union (Chapter 3) and the United States (Chapter 4). These two systems, separated by an ocean, have a different focus and level of consistency as even their approach to minimum-maximum coverage levels is not in agreement. In Chapter 5, the analysis will broaden out to compare the American and European systems with deposit insurance systems from, quite literally, around the globe and, in some cases, the designs of deposit insurance will look quite familiar, even routine, while in other respects it will look odd and different. In Chapter 6, the current schemes will be woven together and will return to the problem of harmonization and examine very recent options, models, core principles and best practices discussed or offered to guide the development of deposit insurance and of

which there are many, believe me. Finally, in Chapter 7, my own recommendations and thoughts will be added to the large heap of other ideas and broad ranges of opinions regarding best deposit insurance practices and unfortunate practices in this area. Through these seven chapters recognizing where deposit insurance fits into the financial safety-net will become clear; how deposit insurance comes up short will be, hopefully, exposed; and the need for greater coherence and fuller harmonization will be obvious as a series of recommendations are made and justified.

This area has an extensive terminology; *'banker's speak',* if you will. Many a reader is not a member of the world of banking where this odd language rolls off tongues like water. Therefore, I have created a lengthy Glossary to explain the words I use as there does not appear to be any recent equivalent that includes all the newest 'Alphabet Soup' terminology that has recently come about since the latest crisis began two years ago.

However, there are other words and phrases of a more generalized usage I also refer to this work. For example, it is often mentioned herein that an implicit 'promise' exists between a depositor and his or her bank; or, 'the social contract' that a saver has (or thinks he or she has) with his, her or its financial institution or bank in this work. This is not some sort of New Age mystical concept. Rather, it is a highly evolved moral and legal promise very much centered in very special areas such as banking. One will soon see in Chapter 1 where that concept developed from and why it resides so deep in the trust area of our collective thought. For now, it is only important to understand that bank savers invest in bank products when they are risk intolerant and seek a type of refuge in banks for their savings. It is where we go when the financial world scares us badly.

Banks are, quite literally, sold to each of us as having a profile that precisely includes all those safe and sound features and more. Deposit insurance helps back up that promise. When it fails to do so, or is oversold, or is all puffed up, it amplifies the frustration as banks soon appear to be something other than what they are sold to us as being.

Finally, a prefatory word about the 'saver' and 'depositor' that will be mentioned frequently in this work. He or she is the person lined up at the start of this section in the pictures presented. While there is certainly blame to allocate for the current financial crisis between bank, regulator and financial markets, it is equally critical to always recall that the depositor is the odd man or odd woman out and normally only the next victim of bank failure. So let us not forget that the depositor did not push banking into the abyss it now finds itself. Savers did not create exotic securitizations, or sell credit default swaps or lend on pooled subprime loans. Just the contrary is true. So they are not getting a 'Free Lunch' with deposit insurance. Just the opposite; it is their entitlement. They thought they were investing funds at relatively modest rates of interest in the safe confines of a bank. Modest financial returns traded for refuge and safety—a logical formula that banking was built upon. The depositor likely did nothing to cause the bank to fail except trust their financial institution (and the regulators in their oversight of it) to keep the 'promise', honor the social compact and to protect their savings. In essence, to honor an age-old banking formula. It is normally banks themselves, and their shockingly inept asset management, or *Keystone Cops* prudential regulators, that bring banking first to its knees and then to their ruin. Savers only lent one thing to that effort—*they lent their savings*.

Therefore, throughout this work we will keep a keen eye on the many ways to avoid, first and foremost, a risk of failure in banks and banking through the proper operation of banking rather than a clever restructuring of deposit insurance. Our most intensive focus must include an avoidance of bank failure that would cause a loss to any deposit insurance scheme or system. A bank not at the precipice of failure is a bank that will not use deposit insurance funding schemes to begin with. Sound banking and credit management, early intervention, strict enforcement, adequate capital in good times and bad are part of the best safety-net of all—one guaranteed to work—which is healthy banking prudentially supervised. Keeping the bank failure 'wolf' away from our collective 'door' is better than all the deposit insurance schemes combined. Simply put, deposit insurance should never, ever be the first line defense to deposit risk and we should think of it last and only as a back-stop.

In a Preface to a work much like this one written 88 years ago, and a dozen years before the American's implemented deposit insurance in 1933, a researcher writing about the earliest days of deposit insurance research found about the same thing we find today:

> *"Finally, the reader is warned that this subject [deposit insurance protection] is still surcharged with controversial heat. It yet gets "vitriolic attack or sublimated adulation". Time having not yet furnished a perspective; no one can be certain that he is free from bias which is so fatal to scientific work."*
>
> *From The Guarantee of Bank Deposits, Author's Preface, Houghton, Mifflin, 1921 by Thomas Bruce Robb, Ph.D.*

Over seventy years later, during the bitter American *S&L Crisis* which we shall soon discuss, a former Chairman of the United Stated Federal Deposit Insurance Corporation, the late William Seidman, added this comment about deposit insurance:

> *"A deposit insurance system is like a nuclear power plant. If you build it without safety precautions, you know it's going to blow you off the face of the earth. And even if you do, you can't be sure it won't."*
>
> L. William Seidman, Former Chairman, Federal Deposit Insurance Corporation (1988)

Finally, in the past few months, this well respected work in its Fourth edition had this to say on the topic of deposit insurance in the United States:

> *"Federal Deposit Insurance is probably the defining policy issue in U.S. banking regulation. Few governmental programs enjoy such broad support. Few banking issues are so politically sensitive. Few provisions of banking law have such momentous consequences."*
>
> From T*he Law of Banking and Financial Institutions, Fourth Edition,*, Richard Scott Carnell, et al., Chapter 6, Wolthers Kluwer/Aspen Publishers (2009)

Therefore, this area has remained continuously unsettled for decades. Yes, as more than one author has stated, deposit insurance and its prevention of another *Great Depression* is fundamental to safety-net design[30]. Yes, it involves all sorts of intended consumer protection aspects. But our masterpiece remains unfinished and this work will not finally resolve the debate over the best design regarding deposit insurance and conclusively establish all recommendations needed. However, this work may add to the effort as it is the result of years of being in the trenches on these issues for decades. This is the next small effort to open our collective eyes to the fact that deposit insurance has just faced a major challenge in the latest financial crisis...*and did not come through it with very good marks*; it remains a defused and unfinished concept; it may be broke but not permanently so; and, despite the regulatory puffery of governmental obligations

to give it full faith and credit, governments need to lend more respect to it. Therefore, we need to pull ourselves up, dust ourselves off and cheerfully create a more refined and coherent plan that will better and more effectively cushion the blow of the next *Boom-to-Bust* bank cycle because its coming and it may be just around the corner[31].

Therefore, as we next step back thousands of years to see where deposit insurance likely came from, and together explore this conflicted area, keep in mind that you are entering a dangerous intersection of strong opinion and unsettled and spirited debate; an area where economic formula and theory runs head-long into zany politics and politics swerves into the path of naive laws and all must please the nervous consumer, edgy bank lobbyists and do it all without 'breaking the bank' with costs that have so many zeros to it that one is not sure there is a word for the amount.

So this paper will be in part informative and in part a rallying call. We need to act quickly and get tough and do it now[32]. More banks are failing each day that we do not complete our work to improve banking and deposit insurance. Savers, who might be like us, are lining up once more somewhere in the world as you read this work. They are asking *how difficult could it really be to realize the promise to make banking safe?* They are baffled by what we do and argue about and ask *why can't the system be changed to make it safe and predictable?* It's time to solve these issues and answer those questions—or, as others have argued, let's be candid and end the charade and abolish deposit insurance and, if we can, find a more practical refuge for our savings and end the ruse and illusion[33].

PREFACE--ENDNOTES

---

[1] Carnell, p. 56-60.

[2]The case is *Edward Thomas Foley v. Hill*, II HLC 27 1002 (1848).

[3] See the FDIC's comprehensive 'Failed Bank Listings' updated every Friday (with new U.S. financial institution closures noted) at www.fdic.gov. Also, see web article *cnn.com 7*.

[4] This includes more than banks and is the estimate of the entire bailout cost to date. In other words, this is the amount that must be repaid to the U.S. Treasury for the auto, insurance, banking and other bailout costs, plus the financial losses, before the current financial crisis can be deemed to have no continuing impact.

[5] This is admittedly a difficult number to determine. Projected losses range from a fraction of this sum to even more than this sum. What is agreed to, however, is that this will be the worst financial crisis worldwide since the *Great Crash* in terms of amounts. The IMF has stated that the effects of the world wide crisis have had a profound financial effect on every country in lost trade, lost employment, lost property value and the decline in productivity.

[6] Bureau of Labor Statistics, U.S. Government, see: http://www.bls.gov/news.release/empsit.nr0.htm

[7] Bureau of Labor Statistics, U.S. Government, see: http://www.bls.gov/news.release/empsit.nr0.htm

[8] For the first nine months of 2009, consumer bankruptcies filed in the United States exceeded one million. It is estimated they will exceed 1.4 million filings by the end of 2009. See
, http://online.wsj.com/article/SB125451530375860305.html

[9] For example, the Eurozone's Gross Domestic Product (GDP) was down 0.2% in the Second Quarter of 2009 and the EU-27;s GDP was down 0.3% in the same period. See, *Eurostat News Release/Indicators* dated 7 October 2009 STAT/09/44 found at:
http://europa.eu/rapid/pressReleasesAction.do?reference=STAT/09/144&format=HTML&aged=0&language=EN&guiLanguage=en.

[10] This is the highest UK rate in 13 years; however, the rate of increase has been slowly leveling-off. In certain socio-economic groups and regional areas hardest hit, the UK jobless rate now exceeds 17.0%. See, http://online.wsj.com/article/SB125006273172925327.html.

[11] The direct lending 'TARP' watchdog has announced that a large slice of the TARP funds will never be repaid as they went to failed automakers or other business concerns who will never have the ability to fully repay the massive funds lent; also, a large slice went to assist in restarting the mortgage market and those funds are clearly lost forever and are not recoverable. See, http://www.washingtontimes.com/news/2009/oct/21/tarp-watchdog-says-full-repayment-unlikely/.

[12] See Chapter 3, below, for a full discussion of this issue. The value of the domestic banks in Ireland, traded on the Irish Stock Exchange, was falling so far and so fast in the Fall of 2008, that the Irish governmental guarantee of bank obligations was deemed essential and was months ahead of similar EU proposals. See, web article, independent.ie 2;

[13] Many claim this is low in values set for the cost of the UK bailout and the recent bailouts of Lloyds TSG and HBOS/RBS (Royal Bank of Scotland), alone, are more appropriately valued at between £1.0 Trillion and £1.5 Trillion, respectively. http://www.money.co.uk/article/1002877-bank-bailout-to-add-up-to-1-5-trillion-to-public-debt.htm.

[14] The Belgium Government actually collapsed over its multiple efforts to bailout Benelux banking giant Fortis. Ironically, the word 'Fortis' means strong in its Latin root. The latest infusion into Fortis is $16.4 billion and is from various Benelux countries. See, http://www.bloomberg.com/apps/news?pid=20601092&sid=apId6E6jA.0M.

[15] The crisis has basically set back the economy of Iceland for decades and has rocked the Icelandic Government. An excellent timeline on the many woes of the Country of Iceland and its banking system can be found in the Buiter Article.

[16] See, CEPR, Policy Insight No. 26, *The Icelandic Banking Crisis and What To Do About It*; Also, see: http://online.wsj.com/article/SB122308508391204449.html.

[17] In October 2008, the IMF provided the Country of Hungary with a substantial bailout for its stability. See, http://www.telegraph.co.uk/finance/financetopics/financialcrisis/3278156/Hungarian-shares-and-currency-rally-on-IMF-bail-out-financial-crisis.html. Romania had an IMF package negotiated, at least in principle, in April 2009;

however, the Romanian's Governments collapse in the Autumn of 1009 has placed the package in jeopardy. See, http://online.wsj.com/article/BT-CO-20091013-708792.html.

[18] When all the foreclosures are tallied, the number of foreclosures may well exceed 25.0 million in the United States alone. Worldwide, the foreclosure problem in the United Kingdom, Ireland, Canada and elsewhere make the problem very serious and the 'bottom' of the foreclosure cycle does not yet appear to be in at all in sight. See, http://www.reuters.com/article/domesticNews/idUSTRE59705J20091008.

[19] Latest estimate, as of September 2009, can be found at: http://www.bloomberg.com/apps/news?pid=20601100&sid=aCHss4gvkku8. An earlier April, 2009 estimate can be found at: http://current.com/items/89993634_imf-estimates-4-1-trillion-loss-during-financial-crisis.htm.

[20] In fact, the regulators have stated that it is a certainty a high percentage of the remaining 'troubled banks' will also fail. See, http://www.ajc.com/business/more-banks-will-fail-163411.html; cnn.com 11. The increase of deposit premiums will almost assure this happens as it directly impacts bottom line bank profitability at its core and at the very time losses need to be abated and more capital is needed. The smaller banks are losing money in multiple ways including loan losses, high operational expense and deposit premiums and the trend, if continued, will cause a new round of bank closures. See, Chapter 4.

[21] Often these efforts are referred to as 'partial nationalizations' in the hope that the institution can buy its way out of the financial assistance from the country involved. The UK has handled several of its bank liquidations in this way. In doing so, they are using a form of direct 'lender of last resort' lending that programs, such as TARP, rely upon. See, http://www.spiegel.de/international/business/0,1518,581068,00.html.

[22] Many credit unions object to a 'bailout tax' that has been imposed on them to rescue the so-called corporate credit unions. See, http://online.wsj.com/article/SB123318420520726249.html.

[23] See, ABA, The International Lawyer, *The Global Credit Crisis of 2008*, p. 91.

[24] See, Kane, *Designing Financial Safety Nets To Fit Country Circumstances* for general information regarding how information and country circumstances affect financial safety-nets. Kane sees the term 'safety-net' as a metaphor and it evokes the image of a falling circus acrobat avoiding harm.

[25] See *IMF Notes For The Group Of Twenty (G-20)* at http://www.imf.org/external/np/g20/090309.htm.

[26] All figures are from Lovett, p. 138-139.

[27] Campbell, p. 183.

[28] See, Kunt, *Deposit Design and Implementation: Policy Lessons From Research and Practice* (2006)

[29] See, Honohan, *Controlling the Fiscal Costs of Banking Crisis*, p. 3-7

[30] Lovett, p. 136

[31] Rothbard, p. 54.

[32] For getting tough during financial crises and credit crunches, see Mishkin, p. 300.

[33] See, Lovett at 155 for complaints about how deposit insurance affects free markets. As an example of the cogent arguments for abolishment, see Salsman, *The Collapse of Deposit Insurance—and the Case For Abolition*. Salsman argument is that deposit insurance creates artificial winners and losers; is full of myths; and, has had a poor track record (at least in the United States). That the deposit insurance concepts have evolved into guarantee systems; deposit insurance cannot contain Moral Hazard; and such a system actually undermines other sound banking principles by distracting us from them. See, also, Calamiris Article 1.

CHAPTER ONE

1. INTRODUCTION TO WORLDWIDE DEPOSIT INSURANCE SCHEMES

a. Historical Development Of Banking and Deposit Protection Concepts From The Early Times To The Great Depression

As with many financial concepts, and being of a lineal mind, in order to better understand the development of deposit insurance, it is helpful if one takes a step back in history and better understands the development of early banking in the world and then progress forward to our recent times[1].

To admit what we are unsure of, Professor Bogaert reminds us that we are not entirely sure that we exactly can define the term 'banker' and 'bank' in the periods of classical antiquity.[2] There are at least two reasons for this:

- first, banking laws, as they then existed, varied between countries; there was broad diversity in activities we might refer to as 'banking'; and,
- second, the activities were much simpler than our current versions of the modern age. By the time we reached the 18th Century, it is firmly established that the term 'banker' means a person who is allowed to use the money of someone else.

Our very distant ancestors were, of course, unaware of their creating many modern banking concepts as they did so; and, they were also unaware they were infusing risks into systems of banking systems that later developed. Instead, they created practical systems that grew more and more complex and finally evolved into our banking industry

of today. However, the gradual and steady development of these practical systems were evolutionary. However, of late, our claimed development of banking may be devolutional as we are losing the progression, the reason and the solid footing of the many years of development and turning banking in the modern age into something that banks were never intended to be and would cause head-scratching by our bank-founding ancestors.

Banking involves an essential, core compact; what will be termed 'the promise' in this work[3]. The fact is that the business of banking is historically a trust-based pursuit. It is taking something I own (assets, money, whatever) and giving it to you as an intermediary. Your promise is not to run away with it or spend it on anything other than productive pursuits to provide revenue for you to pay me back. It developed from the same branch of the law as bailments, the law of trusts and fiduciary duty[4]. The compact is simple and understandable by even the most simplistic among us: I will give you something if you will return it to me or who I instruct you to give it to and we will both benefit in some way from the arrangement. The promise is fixed and unconditional. It is a firm commitment. Banking absolutely rests and functions on this reciprocal promise.

So it is no secret that adding the concept of deposit insurance seems immediately to raise a red flag of warning and causes one to ask: Why doesn't the mere existence and concept of insuring a promise to return a deposit run counter to the very promise being made?

The existence of and the need for deposit insurance acknowledges that there are times when one may not be repaid one's originally invested amount for a reason that

could not be anticipated—or, possibly, could be anticipated but was not found. The reasons are, of course, endless; however, the outcome is the same—that being nonpayment.

This reflects the reality of that outcome. Banking is not as riskless as this reciprocal promise connotes[5]. Here the original promise is backed, in essence, by a promise within a promise which has evolved into a financial safety-net. This, then, is the land of deposit insurance that we are considering throughout this work. A special land where risk is ameliorated by the existence of a governmental or other guarantee and additional financial safety net features[6].

Therefore, and even with the troubling issues of unplanned risk that requires deposit insurance to counter unexpected violations of our promise, it must be remembered that banking exists because of the reciprocal promises that people, called savers or depositors, believe will be carried out with those who hold and use on a temporary basis their money, or in the modern age those we call our 'bankers'[7]. If this core promise was not believed to be true, at least true in most cases, banking would quickly collapse due to fear, worry and suspicion.

For decades, at least since the Great Depression in the U.S., deposit insurance was available to correct the unique, the rare or the occasional failure of a bank due to unplanned for deposit risk. It was a filler to plug holes and gaps in the promise. It was never intended to replace the promise itself or save a failed state or economy.

The reasons quickly come to mind why a bank failed in past times. Possibly a major investment of a bank failed causing the bank to fail itself; or, the bank was in a declining

market; or, there was outright fraud by its directors or owners. There are countless other examples. But deposit insurance was never designed to fend off systemic risk[8] or substitute for poor regulatory supervision or address bankers who did not even understand their own financial products. Therefore, it is necessary to keep firmly in mind the vast difference between the deposit risk of a few troubled institutions in a region failing periodically due to localized risk (and the effectiveness of deposit insurance to combat that risk) as compared to the failure of an entire depository system, such as the American or Icelandic banking collapse of this current crisis, where deposit insurance is but a mere straw man ready to be flattened by an approaching and swamping wave of financial calamity. Localized deposit risk is likely correctable and reversible by well-funded deposit insurance systems; in contrast, systemic failure is likely only correctable by a massive infusion of bailout funds by governments[9]. The former instills confidence; the later reminds us that modern financial, monetary and banking systems are subject to much broader forces that are only controlled by complex mechanisms apart from deposit insurance and may be more fragile than one thought and may entirely undermine a banker's promise even though he or she did everything possible to honor it.

The ebb and flow of deposit risk, which is the risk of not receiving one's deposited funds back at a given time or place from a particular institution and which is the reason for deposit protection, becomes more crystallized as the troubles of banks and banking are seen in historical context. It will shortly be noted that in more recent centuries, the boom and bust of speculative risk creates problems for us. As speculators have learned ways to try to guess the price of bank stock, or fluctuations in exchange rates or which

loans will default, banks became subject to stability concerns, risk and fragility. History shows us where banks have suffered following such risk and what has happened in the aftermath. Risk and speculation are the collective enemies of banking, which is designed to be a non-volatile and stable pursuit. After all, if banking never deviated from riskless investments and sound management, deposit protection would be wholly unnecessary.

Not every banker succumbs to risk. However, risk and speculation will get to some of our weaker bankers in every age and they will not heed the call of safety and soundness that banking depends upon. This is why any coherent banking regulatory regime includes an authorization element to weed out those who do not belong in banking; a prudential supervisorial element to guide those who have failed at maintaining a safe and sound bank; and, an enforcement and liquidation element to close those banks deemed to be unsound or insolvent. In addition, our financial safety-net has grown to act as a backstop to all of those regulatory ways to safeguard against bad banks and bad bankers.

In 2009, we know that in Europe dozens of banks are subject to rescue plans and receiving direct loans and have not come clean on actual losses[10]; and, in America more than 125 banks have failed since the beginning of 2008[11]. Despite all the billions of dollars, euro's and other currency spent worldwide on prudential supervision and oversight, protection and schemes, more worldwide banks have failed in the past two *years* than failed in the two *decades* of bank operations before. So there is a real concern that banks are growing less safe with time and all who are involved in the financial safety-net must be ever more vigilant and on guard regarding banking as it

drifts from controllable institutional risk (correctable by deposit insurance and the occasional bailout) to a new systemic risk that grows every day and remains ever-present all the time and is far less susceptible to cure by deposit insurance. In essence, that banks are moving from individualized deposit risk of particular localized institutions to the 'full collapse potential' of systemic risk on a pan-national or even a pan-global basis that might not be caught or controllable by the deposit insurance safety-net, bailout or the other safety-net devices as recent events have shown.

This, then, is the essence of the debate: keeping banking on an even keel through regulation versus free choice by savers and open, unregulated competition in banking[12]. Regulation versus competition—two concepts in tension and constantly shifting the balance between the two[13].

The debate seems to have been resolved, at least for purposes of the current economic crisis, by the need for still more regulatory control inputs (here, improved and more deeply rooted deposit insurance) over open competition due to historical confidence issues that we shall soon see. However, the case is by no means ended that letting the natural buoyancy of banking better take shape through open competition would not offer an equally valid approach and that there is always a risk that we are simply regulating this area into cross-purposes[14].

So how can history help us to understand if these regulatory and control inputs guiding our actions are sound or, in the alternative, are at cross-purpose? History can, of course, show actual responses under different fact patterns to financial and bank crises that have failed; as well as those that have succeeded. That certainly is helpful in

allowing us to decide if our inputs taken were sound when made and if they acted as expected to restore markets and preserve confidence. However, historical outcomes are even more important to show the rational (and irrational) origins of confidence that savers have to this day in banking and the perceptions of savers in response to those various inputs designed to hold their confidence. The history of banking and the evolution of deposit insurance will help us to focus and understand why we hold a special place in the 'trust zone' region of ourselves for our banks and banking. Therefore, our 'banking past' will next be analyzed to see why we control the 'banking present' so tightly with laws, rules and regulations.

i. The Roots of Banking: Confidence and Trust.

To 'bank' something is to save it[15]. There is no doubt that before the development of coinage the elemental roots of banking likely go back millennium in asset form[16]. However, 'banking' in very early times was, at best, a crude and communal affair that included group 'savings' efforts and division of food, supplies and the like and most such efforts were usually familial, clan or tribal-based[17]. As weather changed throughout the year, one can quickly imagine that firewood, food and water must be stockpiled, or 'saved' and savings was considered most helpful to end hunger, cold or even death in the leaner days of a hot summer or a chilly winter or for nomadic tribes on the move. All depended on the others of the group not to inappropriately or prematurely use these 'saved' resources until they were actually needed and to ration the resources in the harder times. In essence, it was necessary that there be mutual trust that surplus would be available later and would not be stolen or misused. Already, the thriftiness of savings and the trust relationship was upon us and apparent. Also,

someone already trusted as a figurehead likely had to account and safeguard the stockpile from those who would not exert self-control to preserve resources or to defend the stockpile from other marauding tribes[18]. That person was likely someone of greater wisdom or a person respected for their discipline or, more probably, just the biggest and most powerful of the bunch. Someone who would commit to and honor his or her promise to preserve and save the resource. Someone very much like the entrustment concepts we will find with our banker of a much later age.

This continued from prehistoric hunting and gathering times until the ancient, classical civilizations of the Egyptians, Greeks and Romans developed. Until that time, the activity of 'banking' was still elemental and involved religion and the governing city-states and empires that impacted daily living[19]. Trusted rulers and religious leaders began to collect and hold communal assets and 'savings' were 'banked' for the benefit of larger groups and not just for families or tribes. These cultures were demonstrating a communal aspect to the division of labor and resources.

It is probably Ancient Greeks[20] and the Roman Empire[21] that laid the main foundational stones for our modern banking systems of today. Evolved systems of deposit banking, credit and exchange were created in Greek and Roman times so that one would not have to cart items of value and heavy coinage from here to there and risk the rigors of the land, sea or the most dreaded of all, armed highwaymen, raiders and robbers. Practicality was the *Mother of Invention* of the evolution of banking during those times. So barter evolved into a system of rudimentary credits and exchange to allow one to leave her valuables at Point A and receive funds equal to her valuables, less a fee, at Point B. These points were likely tens, hundreds or thousands of

kilometers or miles apart. While not in its nature classic depository banking, the faint outlines of branch banking begin to come into view and emerge[22].

However, these early classical period deposit, credit and exchange systems were focused on coinage and safe-keeping[23] and they were nothing close to our present formal bank lodgments or deposit facilities. The concept was not one of monetary savings; rather, the focus was more on safety and convenience. One did not 'go to the bank' or 'save money'. Rather, one exchanged coin, arranged for credit, and sought the safeguarding of assets and protected wealth from criminal activity. However, it is clear that the Greek's and Roman's furthered the entrustment system dramatically.

The safe keeping, which later was refined into the depositing of monies, was usually held by the moneychanger, or *Argentarii*, as he likely already had the safest place in the community to store his own reserve coinage.[24] So we see two important trust aspects occurring and the moneychanger-client relationship at the center of it. First, the moneychanger was relied upon to assess the value of foreign coinage; and, second, the moneychanger was relied upon for safekeeping[25].

As far as prudential supervision, the ancient Romans are credited with actually starting modern age bankers on their current path of 'safe and sound' operations by the first clear regulation of financial institutions and the implementation of decreed financial practices to mirror the Roman systems of fairness and equity in commercial transactions[26]. They also had a convenient built-in banking regulator in the form of the Roman Legions, who exerted an impressive hand in combating abuse, including sharp practices, with sword and shield.

However, recall that in these ancient times wealth was measured in land and possessions more than in units of monetary measurement or savings. Therefore, deposits and loans were not widely known and few valued their wealth in such terms. In Ancient Greece or Rome, being rich was having innumerable things and fine possessions such as land, wives, servants, slaves and sheep; rather than having an impressive 'bank' balance.

But for those fortunate to have a surplus of asset-based wealth, matters of savings became more difficult. One had to monitor the surplus (which would be in the form of surplus of things) from theft and also had to plan for the periods when their fortunes might not be as favorable or easily obtained. The concept of representational forms of 'savings', that being in monetary unit form, was a concept whose time had come and was recognized as a necessary extension from the ancient communal sharing arrangements of 'things' within tribes and families we have seen above to a representational form of wealth[27]. In essence, surplus physical items created a burden or expense to supervise and we needed to be able to save in a form other than buying more things. One needed the translation of surplus wealth into a representational form of wealth (coinage and currency) that was easier and more convenient to maintain and watch over—and cheaper as well to amass. In essence, we needed a *financial* form of wealth.

Banking and the concept of saving was also becoming a cross-cultural and cross-border affair[28]. Through restless conquest, far-flung exploration and trade, various cultures were moving about in Europe, the Middle East, the Far East and Africa—and soon even to the Americas. The concept of savings expanded and evolved with this

movement and the trade it engendered. We needed ways to trade this for that after we could speak the local language and understand the local customs. If our culture trusted another's culture to have a reliable monetary and exchange systems, we may be willing to exchange our reliable coins for their reliable coins to buy what we needed rather than bringing exchangeable things in a pure barter trading environment. Then, when the trader from that country came to our country, they could bring our reliable coins back to us and buy things from us or exchange their coins for ours.

At the same time, concepts of thriftiness began to emerge. This is the stuff of parable, legend, tale, and story. One may recall the Old Testament story of the plight of ancient Egypt with its seven good years followed by the seven drought years and the interpretation of the Pharaoh's visions by Joseph who curried the favor of the Pharaoh in suggesting the 'saving' of certain commodities for the 'bad years'[29]. This is a parable of thriftiness (albeit with divine intervention). When the bad times did come, Joseph was handsomely rewarded for his visions—but in reality he was rewarded for his thriftiness. We treat savings as synonymous with being thrifty even in our current times. Cultures passed their varying concepts of savings and thriftiness to later generations and along to other cultures in story, song and saying even to this day. Examples include 'thrifty' cultures like the Scots, the Indians or certain Asian cultures[30].

Savings, therefore, is an observed and learned behavior; is to be congratulated and lauded; moves easily into other cultures; makes people wealthier; is organic; and has a history of thousands of years in various physical asset contexts. The concept of being thrifty, then, is one of the foundational stones of banking and has colored its development and impacted its progression because, in the end, savings is being thrifty.

So we see an intersection of representational monetary units, excess wealth, and the virtue of thriftiness. This created the need for a form of monetary savings that would comport with thriftiness. In this way, wealthier families could retain and build family fortunes with wealth or, in our case, the representation of wealth (coinage and currency). Money provided a nice form to save surplus, divide surplus, devise it at one's passing and even pay for mundane, ordinary things with it. It also allows for credit that bridges a gap (often found in agricultural pursuits of early periods) between the costs of growing a crop or livestock and the reaping of a harvest or sale of a product. So these coalescing thoughts opened the door to banking as a profession and the entrustment of money has been closely linked with thriftiness ever since. This is why the source of money for a nation (or at least a country's monetary reserves) is normally housed in and regulated by its 'central bank' as banks preserve money and are seen as thrifty institutions[31].

But the concept of monetary savings, in the end, depended upon two important and added concepts for it to work and thrive: first, the further strengthening of the concept of entrustment, shortened to trust[32]; and, second, the promise of a trusted intermediary to do something with the wealth so entrusted. In essence, if we are to lodge excess wealth (money) with another to hold, can he or she be trusted (entrusted) to follow our instructions?

Trust is obviously a major ingredient to representational savings in financial terms as handing over units of wealth in any non-asset form created its own new and frightening risk of loss, theft, misuse or deception in other and more 'white collar', ways[33]. Wealth in representational, monetary form was much easier to hide than a goat,

did not need to carefully transported like gold and could easily be stored. That was good in some ways...*such as portability* by its owners. It was very bad in others situations...*such as embezzlement or theft*.

Therefore, a second concept of safeguarding the representational wealth and using a trusted intermediary to do so was required as one needed a network to transfer wealth and one also needed a professional money handler of knowledge and good character to advise as to the worth of our representational wealth and guard the wealth and fulfill any instructions or promises made by our holder of financial wealth who we will call our saver or at the saver's direction. A saver likely had no time or expertise in matters such as coinage to do this task himself or herself and professional money handlers were needed to do this work for them while they were active in their own lines of business or vocation, or in case they died, became incapacitated or simply forgot they had the wealth in the hands of the intermediary due to old age or senility. These funds were trusted to be placed into the hands of intermediaries who usually were entirely known, of reasonable honor and good character and who likely were relatives or close friends and the promise was that they would do this for us[34]. These are the intermediaries who later evolved into our moneylenders, pawnbrokers, 'Lombard's'[35] and, finally, the banks and bankers of our modern day. They were our special intermediaries and our fiduciaries. They were the trusted ones who held our representational wealth so we can fulfill the virtue of thriftiness.

As banking left the sphere of ancient Greece and Rome and entered the Middle Ages, these factors would continue to dominate the nature of banking until the Renaissance period[36]. The factors were further refined into: *religion* (whether in the form

of the safety and trust offered by orders of religious clerics or the promise of religion to insure the turn-over the wealth of someone to their proper families if they perished in battle); and *civilizations* (such as the earlier Roman and Greek civilizations) who continued to develop the concepts of recognized civic duty and honor and where contributions were collected and utilized for common good.

As legendary and now epic empires expanded, enlarged and matured, the concepts of lending, currency exchange and coinage in tribute to rulers and others would make the expansion of pursuits of banking possible. Let us examine each of these factors more completely as they have become deeply engrained in modern age depositor's minds as a result of these ancient events.

ii. Religious Influences On Banking.

Regarding the first criteria, religious influence, early Judaism, Christianity and Islam all contributed in their own way to the added clarity and formalization of various banking concepts[37] such as receipt of the deposit of funds, the payment and computation of added interest on utilizing the funds of another[38] (or, in the case of Islam, the potential impropriety of paying interest which has framed an entire branch of modern banking known as Islamic Banking[39]); the concept of pledging security for repayment[40] (which we now know as collateral for loans); and, the moral obligation, often inspired by the word of God in this period, to return and repay representational monetary units at the end of an agreed-upon term whether that be a deposit or loan which we now refer to as an indenture of trust[41], or when not honored, a default or breach of that trust, or when stolen a mortal sin (as in the Biblical Commandment 'Thou

Shall Not Steal'). These are all the forerunners of banking through an intermediate entity as we know it now[42].

Also, the evolving banking systems in the late Middle Ages actually expanded the banking profession. Certain discriminated religious and ethnic groups, shut-out of more traditional professions of higher calling and status by a Europe that was rapidly becoming Christian undeniably existed. It is worth recalling that at the time, moneychangers and moneylenders were generally held in rather low esteem and this work of exchange was seen as the work of the lowly and downtrodden[43]. It is further worth remembering the biblical criticism on greed of such vocational types whether it be the moneychangers whose tables were overturned by Jesus Christ[44] or those who paid Judas Iscariots his thirty coins of silver[45]. Our early bankers were not a well respected group a Millennium ago and it was not until centuries later before that reputation would begin to improve.

But certain ethic groups found a calling in handling representational wealth of coin and currency despite the low regard for this form of vocation. This is especially true of those of the Jewish faith. Because of discrimination suffered during the Pre-Renaissance periods in Europe and the rippling of that influence around the globe with migration, early financial services was often seen as one of the few areas of work that members of the more downcast religious faiths, such as the Jewish faith, could engage in aside from farming or the low caste peasant-type pursuits[46]. So those of Jewish faith were increasingly drawn to the emerging banking and financial services profession for no other reason than it was a pursuit more fully open to them and more attractive than the next option (which was back-breaking labor on a farm or feeding livestock)[47].

From these early times, centuries ago, until the near destruction of Europe in the Second World War, bankers of a Semite background and Jewish religion were seen as greatly influential as to the development of the financial, insurance and securities areas in Europe (and, in addition, gemstone production which remains a popular profession of those of the Jewish faith in certain Benelux countries, such as the City of Antwerp, to this day)[48]. For centuries, financial services were at the center of concentration of activities those of the Jewish faith focused upon and felt they were the leaders of. From this tradition, great Jewish bankers, such as the House of Rothschild, with various branches in Germany, Austria, Italy, France and England would emerge centuries later[49].

However, in more modern times, this concentration of financial services in the hands of certain religious and ethnic groupings, along with their large tantalizing fortunes and physical assets, would prove too tempting a target for despots like Adolph Hitler and they later simply took this wealth for their own and reparations continue to this day for lost wealth in Europe during World War II. However, the world at war in the 20th Century would also diffuse the Jewish bankers forever and those that survived would be spread in a kind of banking Diaspora of Jewish bankers around the world. However, this influence has seen its highest point and the Jewish faith is no longer synonymous with banking and finance[50]. But it did have its definite imprimatur even to our present day in the form of the latest scandal of rogue traders such as Bernard Madoff, and in the two most recent U.S. Federal Reserve Chairmen, Ben Bernanke and Alan Greenspan, all being of a historic Jewish banking tradition and background tracing back far back into financial history[51].

Historical Christianity is certainly no stranger to banking, either[52]. Religious wars and the crusades to drive the Moors from Europe[53] and keep the important sites in the Holy Land free from Islam also provided changes in banking as an institution. A knight of the realm, let's say of England, might travel thousands of miles and be gone for a dozen years to fight in Moorish Spain, the Middle East or North Africa for his King, County, the Holy Land and his Christian religion. During this time, soldier families remained home and were cared for by other nobles, those who had not yet departed for battle or those that had already returned from service. Living allowances were required by these extended family groups; payments for essentials; and, supplies for the crops and daily living needed to be purchased[54].

However, the knight's riches, his home, his family possessions and the like were thousands of miles away from where he was. Also, under antiquated laws impacting the rights of married women, those assets were not freely usable by law unless word came of a knight's death and arcane primogenitor laws became operative[55]. Aside from access concerns, there was also real fears that a helpless widow with children would be at the mercy of overlords who would seek to deny her inheritance or seize her lands upon hearing of the death of her husband during the Crusades or much worse. It was a time when '*might made right*' and power often prevailed over justice. The legends of Robin Hood[56] are built upon just such a fear of the archetypal wicked sheriff and the need for assistance by those who would otherwise be subjugated. The main counterbalance to injustice was the Holy Church, the Knights Templar and those of strong religious faith when that faith was not in a corrupt state itself[57].

An enforceable system of payments built upon trust was, therefore, needed or knights would be reluctant to serve or return to lost fortunes. So the earliest concepts of trust and the 'trust indenture' intervened to support the absent or deceased Knight's family and allow his wealth to purchase future safety and security no matter what his own fate might be[58]. To protect the knight and his family, in our example, and allow him to focus on his bloody work abroad, a fiduciary system of safe-keeping of wealth was created by the Holy Church and church-like organizations such as the Knights Templar[59]. As the Catholic Church had massive wealth of its own (as exhibited by thousands of valuable objects and real property of great value) and as the Holy Church was the indisputable representative of one's creator on Earth and often even held the power of state through Catholic monarchs, it was deemed to be one of the most trusted institutions during the Middle Ages and into the early Renaissance periods. It was also a trusted intermediary that complied with our need for one[60]. Therefore, our dual notions of trust and a responsible intermediary are satisfied and the Church had the makings of our perfect early banker or, when not the actual banker, the perfect quasi-'bank regulator'.

If a knight was absent, died in battle or become injured or sick, the Holy Church or a church-affiliated group, would intervene as a form of representative or trustee of the absent or dead person to insure that payments were made, income was distributed and inheritance passed according to the ancient laws of succession and the family received its finances, title and peerage[61]. Also, during life and along the way of travel, a knight could issue 'scrip'[62] (similar to our more modern "IOU's" and a private system of currency) to, in essence, finance his own travels to the Holy Land or to access the

wages for his knight's service and paid by his King, lords or noblemen. This scrip would be repaid from his wages or from plunder as he traveled or at the end of service or otherwise from the estate of the knight in an elemental system of encashment.

It is from this system of succession and encashment that the future laws of inheritance and probate evolved[63]; and, its more distant cousin, a coherent system of banking, drafts and foreign exchange[64] also started to fully emerge and further develop. Once more, practicality became the Mother of Invention.

The Christian religion itself had also discovered banking as an aid to its own efforts. Even some of the early Popes, for example Pope John XXII, developed and fostered the system of medieval trade and assistance to pilgrims by systems of pawn brokerage (pledging assets in return for immediate funds to be repaid at a later date or to forfeit the items pledged) and currency[65]. In fact, when the Papacy was still located in Avignon, France[66] and before its later relocation to the Holy Sea near Rome, Italy, the nearby town of Lombard[67] featured a bevy of brokers who traded the use of money for the security of a pledge of valuable nature, or the *pan*, which evolved into their being the takers of a pawn (pan) and ultimately these persons became known as brokers of the pawn, or later our modern *pawn brokers,* and these early 'Lombard's' later became a branch of our modern banking world that we know of today[68].

Religions did not always have all the funds they needed, either. Loans to finance ambition, territorial expansion and conquest were also emerging. Maximilian, the great Holy Roman Emperor, took out two private loans in 1491 (before ascending to his Emperor status)[69] and in 1505 (after doing so)[70] and provided security in the form of

certain feudal rights in the Austrian region to these private moneylenders. This demonstrates that governments and religions borrowed monies from others over five centuries ago and the concept of collateralized lending was developing rapidly with interesting and creative forms of collateral being offered.

Islam has made its mark on banking and the concept of trust banking engenders[71]. From earliest times, Islam and Islamic banking has addressed the special trust nature of banking. Islamic banking has the same purpose as conventional banking except that it operates in accordance with the legal rules of *Shariah*[72], known as *Fiqh al-Muamalat* (Islamic rules on transactions). The basic principle of Islamic banking is the sharing of profit and loss and the prohibition of Riba (usury). Common terms used in Islamic banking include profit sharing (Mudharabah), safekeeping (Wadiah), joint venture (Musharakah), cost plus (Murabahah), and leasing (Ijarah).

In the Islamic concept of *Wadiah*, a bank is deemed to be a keeper and trustee of funds[73]. A person deposits funds in the bank and the bank guarantees the refund of the entire amount of the deposit, or any part of the outstanding amount agreed, when the depositor demands it. The depositor, at the bank's discretion, may be rewarded with *Hibah* as a form of appreciation for the use of funds by the bank during this period; however, interest is normally paid at modest rates, at best, as excessive interest, or usury, is prohibited in Islam. Many of these concepts found their way into Western financial thought[74]. So, Islam also sees banking as a trust-related business and we will also see later in Chapter 5 that Islamic Banking is not necessarily adverse to the

concept of deposit protection as some predominately Muslim nations have such coverage in some form.[75]

Therefore, the three main religions of the world historically agree upon the same basic principles during the later part of the Middle Ages and into the early Renaissance Period. Banking involved the concept of trust. That trust is to be delivered by an intermediate fiduciary that is entrusted and must follow the wishes of the depositor. The fiduciary, as intermediary, owes a responsibility to not cheat the depositor; to (at best) charge modest rates of interest; and, to safeguard the deposited wealth and return it when due. This, indeed, is sounding very *bank-like* and the special relationship between owner of wealth and holder of wealth is becoming much clearer to us.

iii. Influence of Civilizations and City States On Banking.

Religion was not alone in fashioning the evolution of banking into the business of the trusted retention of wealth. Money was often seen as a way to combine and unify far flung empires and to pay tribute and demonstrate all-consuming power of far away and distant emperors and kings—as if the money itself sprung from the coffers of Emperor Caesar or Napoleon themselves[76]. As the various empires enlarged, and coin and currency became more accepted; intensive money changing efforts became necessary; and, trade also created unique money substitutes such as 'bills', 'notes', 'drafts' and 'deposits'. These instruments, often backed by the empire, nation or state of issue, and along with coinage and currency, were developed as further refinements to representational wealth. They, too, were money-related promises backed by a

responsible, trusted intermediary who, in turn, was likely backed by something of real wealth or certainly something of powerful force[77].

Also, and related to the last thought, was the State's willingness to enforce the growing range of commercial promises made including those promises involving the retention of funds or assets of another in trust or the enforcement of bills, notes or drafts and payment for the use of funds[78], or, if necessary, reliance on the state to assist the intermediary in resorting to any collateral pledged, pawned or provided to the intermediary to back the promises made[79].

By the weight of the State, such obligations and promises became increasingly trusted because they had predictability and were more consistently enforceable. Our investors and savers were willing to participate in bank-like promises when the rules of the emerging systems became better understood and the power (including judicial power) of a State would stand behind the promises made to insure the bargain was carried out. In essence, the promises of our intermediary had judicial or other recourse if those promises and trust were found to be dishonored[80]. Recourse implies predictability. Predictability was a positive development for the business of banking as it gave the maturing system credibility.

Also starting about five centuries ago, and continuing through the Modern Age, banking was seen as a good way for an intermediary to profit from the thriftiness of a saver. The depositor would realize benefits, of course, from savings (the savings itself being that benefit); however, so would our intermediate bank and banker. Others could profit along the way, as well, such as exchanges of currency or safekeeping of property.

Great bank and finance-related families began to emerge from the shadows of this new intermediary industry of banking. These families often had (or soon would) gain civic prominence as they would, themselves, grew wealthy assisting the thrifty savers with their wealth.

For example, the prominent Florentine Medici Family[81] emerged as Europe's first banking dynasty. They likely were headed for overall banking dominance in Europe (in the later mold of the Rothschild Family[82]), but, as history has documented, their political disputes and well publicized intrigue caused them to lose their way and others filled the void while the Medici's squabbled about political alliances and territorial conquests[83].

Various regional and dynastical banking families developed in their respective regions and banking began to flower and more firmly take root. One such family to rise to become one of the greatest of all banking families in history was the Rothschild's with influence over German, Austrian, French, Italian and English banking for centuries and with many branches of the family spread out over Europe[84]. These banking families were growing rich along with the wealthier families of Europe and abroad. Bankers were becoming more respectable (and more essential) to professions, nobles and religions[85].

Banking was maturing all over Europe. The influence on banks and banking in France, for example, starting with the fairs in Lyon and lead to the creation of the Bank of France to assist Napoleonic conquests[86], German banking assisted the Prussian government in the financing of aggressive armed conflict[87], the Bank of St. Charles (later to become the Bank of Spain) financed ambitious sea explorations[88] and the need to finance the political unification of Italy amongst the various City-States[89] was partially

financed by the bankers of its period. It is within this circle of European countries that banking began to rapidly flourish, cross-pollinate and mature in Europe. The ring of banking family dominance coupled with state need for banks continued to expand outward with trade. Soon the rough circle of banking had enlarged to include the more distant European cities in England, Scotland, the Netherlands and other far-flung European commercial centers and territorial conquests of Imperial Europe[90].

However, there was a natural impediment in the development of banking and that was the need for ever-increasing capital, the so-called need for 'capital inflow'[91]. Capital was necessary to fuel the growing engine of banking. Without an inflow of capital, large project financing was not feasible, timing for repayment of deposits was unpredictable, loans were restricted to a banker's own resources and, even if one was a relatively rich intermediary, his or her resources were finite and limited and those resources could only go so far and be used for one purpose at a time. Bankers needed a broader source of capital.

This led to a truly foundational idea of banking being born and that is the 'deposit'. What if an intermediary, our bank, could, in essence, 'rent' other people's money[92]? In essence, create a short-term base of capital from the wealth of many others in the community. He or she could rent the shopkeeper's surplus funds; the miller's surplus funds; and, even the church's surplus funds. These people knew of the intermediary and trusted him or her (and likely knew what the intermediary did with the funds, as well). Without ceding any ownership of the intermediary's business to others through the sale of stock, expansion of the bank could suddenly become unlimited or certainly grow exponentially.

However, these cash infusions would not be secured obligations and rested upon the confidence of the person allowing the use of funds by the intermediary in the intermediary's ability to later repay those funds. The deposits made would be informal book entries with the added promise of an added return. Would an investor ever agree to such a weak lending arrangement not backed by much except an intermediary's good reputation?[93] As it turns out, many did because it was predictable, mutually advantageous and easy to understand. The 'deposit obligation' we know of today was born[94].

In essence, the depositor is not an equity owner of the intermediary in the nature of holding stock or equity ownership; but, instead, an unsecured depositor who lent his or her wealth for a defined term and with the intermediary's reciprocal promise to repay the borrowed funds back at that defined time (with additional sums) after an agreed upon period of use by the intermediate bank. The 'additional sum' element quickly took the form of a percentage of the original sum deposited. We have come to refer to this additional element as 'deposit interest'[95].

Basically, those with surplus funds were depositing those funds with an entrusted banker as a short term loan to a bank so the bank had ample capital to use for other reasons. The depositor received deposit interest for the use of his or her surplus deposited funds. From a modern accounting perspective, this is why deposits are still to this day considered not as assets of a bank but are scheduled on the liability side of a bank's balance sheet as they are *obligations owed* to savers of varying maturities[96]. The assets of a bank are the other things the intermediate bank did with the value of the deposits, such as loans held and other investments made with the deposits.

However, these short term loans were only backed by the general worth and assets of the bank and the reputation of its bank family owners and the capital they injected to get the bank started. That could cause suspicion and distrust regarding repayment as it could appear to be a shaky proposition to receive repayment if any unforeseen situation occurred. Yet, somehow the weakness in this concept was overcome by the symmetry of it all and, of course, its enforceability. The concept of the trusted intermediary managed to leap over this significant issue which one would have expected would be a radical change from banking of earlier days.

Deposit gathering was no longer a matter between church and parishioner or between known and trusted relative or friends acting as intermediaries but was now becoming an expanding and distinct commercial concept and a defined profession and, of course, a profitable way for a banker to earn a living (if our banker could find a more profitable use for the rented funds) and for the depositor to be profitably repaid his or her principal and earn interest (if our banker was still around to repay those rented funds)[97]. In essence, two people were exchanging considerable sums of wealth and making reciprocal promises for reciprocal benefits.

Yet, while the concept of banker as a business is second nature in contemporary terms, it was not then. Most often, a banker knew his or her depositors. But this was not always the case. Raising money from depositors meant, of course, that some depositors were unknown to the banking enterprise except by general reputation and the opposite was true as well—depositors did not always know their banker closely. Here we see the beginning of both the mutual benefit and the shared tension between

banker and deposit customer. Each as potential beneficial and symbiotic commercial partner; and, each as potentially the reason for loss that could be caused to each other.

This movement from trusted banker as close friend or relative to this more arms-length commercial pursuit where the banker was simply a businessman with profit motives that had evolved was new. What allowed this change to occur was essentially the promise of significant return (interest) to the saver. That promise of significant return to the depositor from the use of funds by the intermediary bank overcame resistance in dealing with someone not a close relative or friend; a cleric; or a civic leader and when coupled with state enforcement of the promise seemed to provide adequate protection.

But banks had to foster a business beyond safeguarding assets as there was little profit in simply protecting wealth. They needed to make profits of their own from the deposits to pay the deposit interest. So banks sought to use the funds entrusted to them in various ways, but especially loans, and this need evolved into a commercial intermediary form where a banker promised one rate of return to those who provided the funds (our depositor) and that same banker promised another rate of return to those who needed to borrow the funds (our third party debtor or borrower) and, of course, the intermediate banker, in classic middleman style, retained the difference, gap or 'spread'. Over literally centuries, this 'spread' in rates became the banker's primary business revenue. It is what kept the doors of the bank open.

Also, banks now being more impersonal and not exclusively dealing with intra-family relationships where favors would be requested, could extract higher lending rates from those who borrowed and, therefore, could also afford to pay higher deposit rates to

those who deposited and saved. Suddenly, banking was appealing to many as it returned handsome returns and profits to savers who made the initial deposit.

However, the door swung both ways as the bankers also knew fewer of their borrowers as close family members as lending expanded and certainly many an honest banker must have worried about repayment issues and enforcement problems with suspect obligors of loans. The challenge for banking as it evolved was, first, to encourage investment of funds by savers while, second, minimizing the risk of borrower defaults by only lending to reputable, credit-worthy borrowers.[98]

If this inter-relationship between saver, banker and borrower was correctly managed, this allowed money to be invested, reused, and, in essence, to become fungible and freely interchangeable[99]. Money was no longer a personal passion but rapidly was becoming its own form of commodity like potatoes or goats. No longer was it clear that 'my deposit' was used to fund 'your loan'. Rather, my deposits were likely funding some loan—but it was not clear which one. This decoupled deposit relationships from lending ones[100]. They were two different sides of banking. Now a depositor was twice removed from their deposits—they might only know their banker remotely and they may never know precisely where their funds were actually lent. The banking relationship was becoming more distant and impersonal. But the attractive deposit interest made it all bearable.

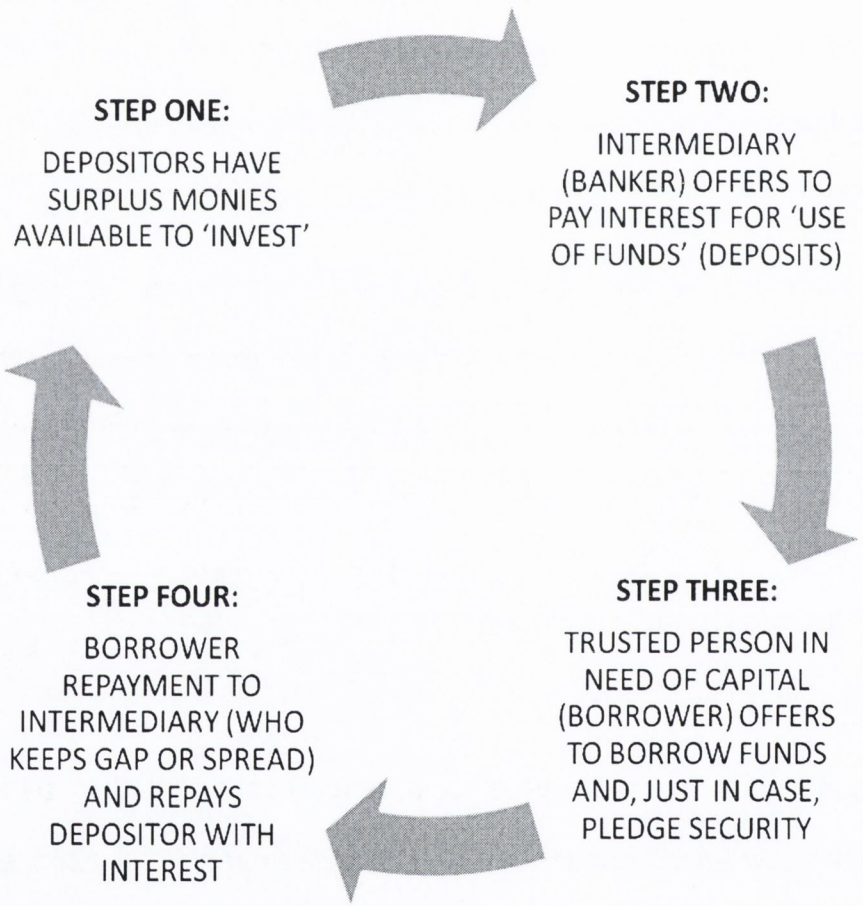
The result, then, is a long way from ownership of things as wealth or investing representational wealth with a relative or close friend. Here we are investing representational wealth with intermediate bankers and we may not be aware where the

funds are going to next. Money is, in essence, harvested from the many and placed into the hands of the intermediate 'institutions' of trusted bankers whose mandate was to find trustworthy borrowers of good character and with strong business or personal uses for the borrowed funds or investments for the deposits that would pay more than the interest promised back; then, repayment of the lent funds from the borrowers; followed by repayment to the depositors of the original investment plus the promised return and the ultimate closing of what I refer to as the circle or cycle of banking. Satisfied as to the return, this circle or cycle often repeated itself over and over again between depositor, bank and various borrowers until the depositor had other needs for his or her own funds and the circle for that depositor was halted in an orderly manner. The circle could be going with a dozen, a hundred or even thousands of depositors and borrowers at the same time. Many depositors were also borrowers and they participated on both sides of the cycle, as well. It was all very profitable for the bankers as they sat at their desk and watched the circle of banking for each loan turn and turn and turn and their spread between rates paid more and more money to them as their deposits increased and their loans grew. If done carefully (both as to rate settings and selection of obligors on the lending side), this was a 'cash cow' and virtual money machine for them.

So gone were the bundles of coin or currency placed in a ribbon-wrapped package with a customer's name on it which were held solely for safekeeping behind a heavy, locked door[101] but without any secondary promise of return (interest) being earned thereon. Instead, bankers had devised an ingenious system of using the capital and surplus wealth of others (depositors) entrusted to them to lend to another group of those appearing responsible and needing capital (borrowers) and in simply brokering

this transaction and keeping the intermediate profit or spread, a very profitable banking industry was born. Banking, at least until the middle of the 20th Century, remained in this mold. Money had become a fungible commodity to be deposited for an interest payment and used for an interest cost. Thus, we have the now classic deposit-loan cycle that forms the basis of most banks to this day:

Figure 1-6: The Deposit-Loan Banking Cycle



This cycle was predictable; it could repeat over and over again; or, it could be stopped at any 'maturity' point if the saver (investor) needed his or her funds or part of them. This was by no means an unfamiliar system, either, even in the early days of

banking. Similar comparative models abounded. For example, potatoes bought in the field could be sold to a wholesale 'aggregator' who then resold those same potatoes along with other farmer's crops for more in an organized marketplace in more urbanized areas (allowing the farmer to remain a farmer and not to have to assume the role of retail seller of his crops). Or, in manufacturing, diamonds bought from diamond traders could be mined, rough polished and sold at a wholesale rate and cut into gemstones that were in sellable quality by professionals and sold as finished jewelry for far more than the worth of the stones purchased at wholesale.[102]

Using coinage and currency wealth is not all that different as an example of the intermediate system than existing wholesale-retail commodity systems in farming, gemstones, manufacturing or the like. Bankers' creatively turned money into a fungible commodity and used loans as the method to enhance and add value to that commodity of wealth. Depositors provided the wholesale product of capital (in this case money); banks provided the organized market to lend it to qualified borrowers and borrowers received monies that they, in essence, rented; and the system benefitted all participants (although some more than others). This conversion of wealth from a physical set of assets devoid of any return (other than appreciation of assets purchased) into representational monetary units capable of wholesale and retail use by others and repaid with more monetary units than were initially deposited was a brilliant system founded on handsome returns for all and was far too lucrative to despoil with embezzlement, theft, absconding with funds or trickery.

Of course, this is a simplistic explanation as various problems could and often did intervene in our circle of banking to foil our best intentions and disrupt it. The list is long

as to the headaches a banker from a hundred or two hundred years ago might face[103]. Changes in governments and sovereign seizure could certainly impact the ability to repay loans and that failure would certainly upset the banking cycle[104]. As Europe had a frequent problem with changes of government at this time, this could quickly ruin the profitable circle of profitability. Even worse, early forms of bankruptcy or defaults by the borrower could result in partial or total loss[105]. Also, if the collateral taken back for a loan was later found to be obsolete, damaged, altered or difficult to salvage and was not worth the value of the deposits lent, or if the borrower also went missing, there was trouble and potential loss. All these and more precluded the completion of the banking cycle and when that occurred the result was clear: the banker had to dip into his or her purse to make up the difference. This we refer to as a *default* or *breach*[106].

As defaulted loans arose, were addressed and finally resolved, and losses from the pockets of our bankers tallied, lessons were learned about what we would call in the modern age 'easy credit' and it is no wonder that bankers, over time, became a rather conservative lot as they examined lending risk carefully as a reason to avoid the coextensive deposit risk they owed to bank customers and the trouble of loan liquidation. On this point little had changed until just a few decades ago as the normal banking cycle was applied and reapplied. Bankers, certainly up to the mid-twentieth century, detested defaults and took them very personally. Borrowers, not wanting to be shamed in their communities by dishonoring repayment, thought twice about borrowing and thought several times about defaulting on obligations.

Still, over-optimistic pursuits have a way of clouding judgment and loans, of course, did default. Therefore, the risk of default hung heavy on the minds of bankers,

primarily, but also depositors as they had learned through history that high levels of default impact the stability of even their trusted banker. The depositors felt more confidence with a banker who knew his risks and lent prudently.

Therefore, critical to this system of trust is confidence that the banker knew what he or she was doing, understood the banking cycle and was an honest and clever intermediary; that this bank system was not an excuse to part a depositor from his or her money; and that some external element would not intervene to preclude repayment like a shaky nation or political instability.

If risk intervened to cause a default, and the element of trust was broken, depositors would be disinclined to ever invest their funds with certainly that banker again and bankers more generally would be out of work as their essential source of capital would dry up. This is why bad borrowers and even careless bankers were often quickly rooted out as being bad for ongoing business. In these periods, banking was surprisingly self-regulating[107] as we shall see in the panics in the United States that occurred late in the 19th Century and into the 20th Century. Although less personal than in the earlier periods in the infancy of banking, the bankers of the 18th and 19th Centuries understood depository risk and understood borrowers and tried to make both savers and borrowers happy while keeping their investment safe. It was good for business all around.

All these factors combined and early deposit and interest rates were, therefore, high by today's standards in order to entice depositors to initiate the investment (in essence, make the short term loan or deposit); and, as the deposit rates set the "floor"

for the loan and its returns due to the need for adequate spreads, lending rates were also relatively high[108]. Loan rates are documented as high as 45%[109] in the early age of banking and such rates would be considered usurious[110] or near so in many nations of today. Even at more normal percentage rates, the risk-reward continuum of banking enticed many investors to make the deposit and accept the manageable uncertainty of bankers acting as intermediaries.

The full impact of trust and confidence in banking that was necessary and built-up over considerable time is now clear. It is important to appreciate that what held this all together was the entrustment inherent in the expectation of repayment and trust in the banker as a sound, experienced intermediary. The opposite is also true. The most corrosive element that could have occurred during this development, would be a sudden realization that the deposits would not be repaid or that our banker was misguided and that loss of trust would cascade down into a refusal to deposit or continue to deposit (or, as we now call it, an attempted withdrawal from that banker's efforts). Hence, even to this day, withdrawal of funds at a bank implies loss of confidence in a banker.

In fact, the banking cycle places many depositors in opposition against a single banker when financial conditions turn difficult and they wish to halt the cycle and get off the ride. This could easily lead to a race to attempt to withdraw one's deposits before others could do the same. Many a rumor or unsubstantiated claim could trigger a loss of confidence and this 'race' for the banker and bank would start. A major loan in default, the illness of the banker-owner, governmental turmoil and many other world events could unleash a wave of fearful expectation of no repayment; loss of trust; and the corrosive elements fueling a race would begin. All those panicked would rush, *no run*, to

see their banker to gauge what was going on, and, if necessary, to withdraw their money. Therefore, we have aptly named the concept as the recipe for the classic 'bank run' or financial panic most feared by governments and financial institutions.

iv. *Banking Further Matures…and Becomes More Impersonal.*

To control or curb risk, and to understand both deposit risk and borrower default risk better, and to avoid the financial panic just described, bankers began to specialize and focus on directing deposits into certain types of loans that they understood better. In essence, this entailed narrowing the loan default risk by keeping a closer ear to the ground about their particular line of business or borrowers to avoid default at all cost. This is the character or relationship aspect of lending. A banker who lent to finance the shipping of materials by boat, for example, might be an expert at seaworthy vessels or the qualifications of particular captains but might refuse to consider agricultural loans or offers to finance a country estate as not being within his expertise. Those that lent to build supply wagons might, coincidentally, own the forests where the lumber was ordered from and fully understand the worth of the collateral but might refuse to finance the distant voyages or the importation of salt from far off lands as not being a risk they understood well at all. There were bankers to governments, bankers to trade, business bankers and others. These were all efforts to balance the need to make loans pursuant to our banking cycle with controlling risk or default and 'KYC', or *knowing your customer.* In this way bankers gave themselves the advantage; controlled risk; and, were ready to repay deposits when due.

In the 18th and 19th centuries, banking continued to mature and became better defined with financial products better targeted and customized to suit the expanding commercial markets[111]. There were certainly many defaults, and some panics, but profits more than outpaced them and the rate of default was manageable and still left bankers profitable. Risks seemed manageable although the occasional panic did wipe out the select bank or two at times; however, never an entire bank industry all at once. Banks had their own make-up, often their own diversity of depositors and borrowers, and each was intent upon becoming part of the community landscape and most were seen as exhibiting prudential conduct and anchoring communities. In fact, the early term "bank" actually made reference to the bench that supported the moneychangers and, later, the physical offices of those who engaged in the accepting deposits, making loans and other products of finance (and we still use the phrase a 'bank of offices' to this day)[112]. Banks were sturdy like benches and offices and they held business up.

Banks also started to be physically located more and more in a permanent location where they could actually be visited during business hours and with staff to assist them in their banking activities. This fixed place of business allowed loans to be repaid and deposits to be made and physical security to be maintained. It also provided a central location within a community to visit one's money. Of course, as these businesses dealt in coin and currency, they were usually located within more secure cities and in better protected buildings with strong walls and sturdy locked rooms or vaults. We refer to such banks as being made of "brick and mortar" for such strength and permanence.

The classic bank façade of heavy iconic columns to show strength and the stone exterior to show integrity were each intended to portray the physical security and '*solid as a rock*' presentation of a bank and this added to the confidence, if not the illusion, to the depositor that when they deposited their funds and walked away from the bank that their funds would be safely returned to them days, weeks or years later precisely as promised. In essence, that the bank was as solid and permanent as a rock and the deposit-loan banking cycle would be fully honored come '*hell or high water*'. The promise would be kept in bad weather, if robberies occurred or if the occasional borrower went broke.

Bank notes, letters of credit, bankers' acceptances and other evolving forms of more complex promises of a bank made their appearance in the 18th and 19th Centuries[113]. In time, coin and currency would not be worth their actual face value and would decouple from being backed by storehouses of gold or silver somewhere else. Rather, systems of national reserves to back-stop various country currencies were slowly introduced and emerged into the 20th Century. In essence, governments, and in some cases the banks were trusted to honor the value of currency whether they had gold or silver to back that promise or not[114]. This is because governments controlled the money supply and could always print more currency or tax more to support the printing of more[115].

With the dawn of the 20th Century, and despite various banking crises that had occurred along the way, a heady optimism existed about banking. Bankers, too, were optimistic. The long course of history had brought them from the downtrodden days of being moneychangers to respected pillars of the community. Despite several major

panics in the late 1800's and the early 1900's, including the panic of 1907 that lead to the creation of the Federal Reserve (discussed below), banks continued to realize profits and appeared to have an enviable business plan of using other people's money to make much more of their own.

However, wealth often breeds competition. New forms of investment and financing emerging businesses were developed and new ways to earn high returns came along to compete against attractive bank deposit rates. Competing financial markets, such as equity or 'stock' markets and various related 'exchanges', appeared and started to entice away bank deposits for the expectation of even higher return rates to depositors who owned portions of companies, bonds or even commodities. These new forms of investments called out to bank depositors and offered something banks could not offer based upon a bank's prudent and stiff structure—*they offered almost a fantastical level of return*. Rather than offering only mundane deposit interest or the classic banker's spread of interest between deposit rates and lending rates of a few percent per annum, these equities, insurance and real estate investments offered the promise of exponential rates of return of companies based upon profitability, speculation and growth that were many times higher—and often much higher—than bank deposit rates.

Over time the other forms of financial investments competing against bank deposit rates acquired footholds. Banking, in its charmingly but rather old-fashioned way, appeared tired as an investment and increasingly out of step as a way of making money. The real money was in stocks, bonds and real estate. Many, to their later regret, heard this call and left the world of banking for the world of stock, bonds and insurance.

v. *The New Scourge: Unbridled Optimism In Risk-Based Bank Products*

By the 1920's, often called the *Roaring Twenties*, and in the major cities of America and Europe, bankers had noted their declining fortunes that were being siphoned off by stock exchanges, real estate ventures and insurance schemes across the globe. Some agreed that the interest rate charged on a bank's home mortgage loan of 5.00% per annum gave them a paltry profit of, a few percent per annum after paying 2.00% per annum interest on deposits harvested and utilized. They understood that they were losing depositors to brokers who could offer margin loans, insurance agents and realty specialists a few offices down the road that advertised rates of return of 20.00%, 30.00% or more per annum in return for changing from a bank investment form to equities or the like. It must have been irksome and annoying to see it all unfold. But after advising customers of risks, many bankers had an idea they felt would allow them to better compete. It might have seemed like a good idea at the time; or, possible a response in desperation. The bankers would compete against these new upstarts by playing the same game and by using the deposits entrusted with their institutions to invest in the same high-yielding but much more volatile investment choices their competitors offered rather than in the tried and true traditional lending sources of income. This would prove to be a life-changing and disastrous decision for many.

While there is no doubt that some bankers kept to the traditional banking cycle model, other bankers, despite their role as conservative fiduciary, would not be able to steer their moral compass through the quest for riches in the 1920s (and would once more succumb to a similar call eight decades later in the current financial crisis). Their idea was to change the way they invested their bank capital and deposits; and, in so

doing, raise their return rates geometrically by their own self-perceived cleverness in finding higher yielding underlying investments while still retaining their banking clientele. That if they made much more money with the deposited funds in this way, they could afford to pay much more interest and retain bank customers and share a larger spread of profit along the way. In fact, based upon current returns for these non-loan investments, a year of risk-based investing could be worth a decade of paltry traditional bank lending returns. It seemed prudent as the market just seemed to go up and up worldwide with the conclusion of the First World War. Of course, it was not prudent at all. In fact, it bordered on reckless gambling and the source of the wager was bank assets and customer deposits.

Predictably, the bankers were moved in this way to change their form of investments and how they earned income from depositor's funds from low risk models of known borrower lending to heavily risk-laden schemes of investments managed by others that ranged from speculative to downright fraudulent schemes. Worldwide bankers, many with centuries of collective experience as conservative business people, and certainly not seeing themselves as aggressive speculators or risk takers, made disastrous and often fatal decisions to change deposit investment strategies from relatively riskless lending to full blown speculation in securities, real estate, insurance and other investments and over a relatively short period. The siren call of profit and greed was just too strong for many to resist. There was little due diligence, diversification or structuring of this risk. The banks simply redirected depositor funds and waited for the money to be returned with a handsome profit so they could reward their depositors with equivalent high returns. It seemed to be a well laid plan.

But as many bankers diverted depositor funds from lending into speculative stock markets, risky insurance contracts and volatile real estate, they were unaware that they were about to materially upset the deposit-loan bank cycle by investing the entrusted deposits into far riskier items than the classic, well-placed collateralized loans or conservative investments of banks of prior periods[116]. This giddy expectation would later be given a name decades later; 'irrational exuberance'.[117] It might be better referred to by its name which is far better known for centuries: *unbridled greed.*

Why did the depositor not stop this reckless conduct? They were simply unaware of the mounting risk. As the banking system had grown more complex and impersonal, depositors were generally oblivious to this risk. They were encountering a range of investment choices and they were focused on returns; not bank investment strategies. Depositors did not feel the need to question their bankers in 1928—*or even in 2008 for that matter*. The trust relationship was strong between bankers and customer in the 1920's and it remains strong today. Bankers were assumed to understand risk. The banking cycle seemed strong and vibrant. That assumption would prove to be as bad an assumption in 1929 as it would later prove to be in 2008.

Just before Halloween in 1929, the market had seen the investment bubble grow as big as a market would allow and on Black Tuesday, October 29, 1929 that bubble simply ruptured and then split apart.[118] Starting on that fateful date, and in the many years of unrelenting suffering thereafter, vast wealth was simply vaporized and the ensuing mayhem took nearly every security, insurance and real estate product crashing down to the ground without logical selection or measured mercy and so we refer to it by what it truly was--*the Great Crash*. The Great Crash was 100% raw financial panic in its

base, inhumane form. Banks were in the way of this panic and bankers were particularly ill-equipped to and could not stop it.[119] Banks collapsed in the path of it starting in 1929 and for the several years thereafter. They almost did it again with a new and different array of risk-based products in 2008.[120]

It is now well known that the result was fully predictable, obvious and maybe part sadly comical; however, in the end, tragically inevitable. Our bankers should have known better and should have seen it all coming. They should have been at the front of the group of those blowing the loud whistle of concern. However, most were not around at all. They had grown complacent and felt that as other bankers were making risky investments pay-off that they could, as well[121]. No one wanted to be left behind. All felt they were the smartest person in the room and could easily read the financial tea leaves and be out of the risk of volatility before any calamity descended and they would know the signs. 'All' were, of course, ridiculously wrong. They all fell over the cliff together and never saw the ground disappear from beneath them.[122]

With the deposits vanishing, the banks had nothing to repay to their depositors, no safety-net, nothing left to back their own solemn promises and the commitments based on trust would largely go unmet. The deposit-loan bank cycle fully failed to function and the carefully evolved and crafted circle of banking came undone and then imploded with the country's economic collapse. The depositors would, then, not repay their own debts and were shamed into their own insolvencies; those owed funds then also defaulted; and so on and forth on and so the world markets collapsed in serial fashion like tipping over dominos and the unwelcome ripples eroded financial institutions across the globe in due time[123]. World institutions were sucked dry of capital,

liquidity and reserves (or nearly so) and either perished instantly in the process or remained significantly weakened and badly wounded from 1929 until entry into World War II almost a decade later[124].

It is essential to note that the *Great Crash* leading to the *Great Depression* was the first time that the promise of repayment and the compact of trust by and between a growing world full of depositors and their financial institutions had been clearly breached on such a truly massive, pan-global scale[125]. While localized bank panics, runs and failures certainly had occurred many times before in the centuries before the Twentieth, this was a true '*financial pandemic*'—and, not to push the medical analogy too hard, thousands of banks died a terrible financial death as a result of it. The confidence all had placed in the banking system, tracing back to feudal days, the church, civilizations and the like, were all now laid bare to be a system where, indeed, every irrational fear and tendency to panic was uncovered because financial panic is self-fulfilling and rationality is not its best antidote[126]. Without confidence, all that was left was base fear and it was uncontrollable for almost a decade and many say for the lifetimes of those that experienced it firsthand. Being hungry and destitute can be life-changing.

Fear erodes markets like acid erodes metal and banking and their credit markets clearly seeing the approaching devastation headed their way quickly froze, locked-up and failed to function before they were leveled to the ground by the evaporation of capital or the gridlock of liquidity. Commerce halted and the engine of business simply stopped, ceased to have any reason to run, or actually started to move in reverse (deflation) which led to a general reluctance to buy anything as prices fell lower and lower. This is also the same deflation that occurred 65 years later in Japan; and, that

started to occur in the Summer of 2008 with the latest financial crisis before the world's central banks quite literally flooded the markets with liquidity to arrest the deflationary tendencies and maintain the flow of capital and stem the spread of fear and gridlock that results when there is a lack of it.

With the *Great Crash*, the financial system of America in 1929 was caught unprepared and was ill-equipped to address such a huge systemic failure and the serial defaults by most of America's banks[127]. Unable to back the promises that trust in banking so heavily relies upon, that being the fact that a deposit invested with a bank will always be patiently waiting for its owner when due and with interest earned, the American system came apart and collapsed upon itself and thrust the other nations of the world into collective and global poverty as well. That's all it took to convert the once civilized depositor into the uncivilized customer in full irrational panic—*and fear*. Panic and fear following loss of deposits causes markets to collapse and they did just that.[128]

When deposits were not returned, and so-called 'bank holiday's' were declared, frustrated anger turned to others. Our trusted bankers were, predictably, branded as liars, cheats and thieves—a new form of gangster; *the bankster*[129]. After all, they had broken their solemn promise, betrayed their financial trust and failed to repay savers their deposits on an industry-wide grand scale. Calls abounded for bankers to be publicly disgraced and, in extreme cases, imprisoned[130].

This was the literal opposite of trust that had started from the communal days and the elders guarding the supplies needed for hard times. This was unrelenting chaos, panic and the worst of human fear set loose and when many could not save their

deposited worth they turned on the system with calls for retribution, civil unrest and even worse[131]. The savers wanted vengeance as this was their only recompense to having, quite literally, nothing of their finances left.

However, there is one player in the drama we have not yet discussed. Where were our various governments, prudential regulators and governmental oversight in all of this? Why had not the governments of the world prevented imprudent bank investment; or, the growing financial bubble; or, at least created a shock absorbing system or let some air out of the bubble before it burst?

While it is certainly true that governments had entered the equation of banking well before the start of the Great Depression, they were not trained bankers themselves. It appears they could not keep up with supervision[132], understand the risk profiles[133], control the zeal for high returns and they were kept inherently weak by the irrational vibrancy of the marketplace and the dominance of banking by a small group of wealthy individuals[134]. They did it again before the 2008 and 2009 financial crisis and at the highest levels[135]. They should have taken preventative action earlier but did not stop it and maybe could not do so even if they wanted to. That is because banking supplied revenues and taxes to governments and governments actually profited from this irrational frenzied financial system in full motion. This dysfunctional private-public system helped to create its own ruin by legitimizing imprudent banking as bearing the governmental seal of approval.

But that all changed with the *Great Crash*. Suddenly market regulation[136] or lack thereof) around the globe was the new and real villain. Governmental oversight or,

better put, the significant lack or failure thereof was seen as a major reason people lost all or a good portion of their money. It was now clear that the governmental response was weak and anger turned to punishment of entire industries. Making matters worse, excuses were around each corner as each bank director or government regulator took cover amidst the collapsing economies.

Needless to say, confidence in banks and bankers first collapsed with the *Great Crash* and then disintegrated as tens of thousands of worldwide banks closed and millions of depositors received virtually nothing from their banks and savers who felt confident in their savings were instantly turned into paupers. Their bank deposits were simply gone along with their other investments. Where the deposits went to is more the subject of an economics dissertation[137]. However, there was nothing left to buy and what could be bought was sold at a fraction of its prior price as prices deflated. As businesses could not afford staff, jobs were lost. At a point, with almost no business at hand, stores closed. Productivity actually went into the negative column as the economy slowed, regressed and for all intents and purposes stopped in many sectors.

Day 1 after the crisis began in late 1929, and cries went out that something dramatic was needed to restore the promise and trust and it needed to be done quickly or banking as an institution could be discredited for generations if allowed to entirely fail. In addition to what governments could do now, future protection against this ever happening again was needed and savers required significant reassurance that all was finally better and this global situation would never again reoccur. Something akin to a guarantee or an insurance fund to protect billions of dollars of investments—and especially bank deposits--in the future as the past was simply not salvageable.

Ideas abounded on the issue of safeguards and the growing concept of safety-nets[138]. There had been studies on insuring deposit bases and there were some small-scale deposit protection systems that had been utilized along these lines, such as in Czechoslovakia[139]. However, a system covering wide-scale deposits of a major country like the United States remained purely theoretical and might not even be practical[140]. Also, it was uncertain who would regulate such a system or fund; would there be independence of thought to deploy it; how could any developed nation or private insurer afford it; and, in the midst of such chaos and depression how could it get started with funding?[141]

Against this backdrop of collapsing economies and abject poverty, and the growing bread lines forming, the United States took the lead and felt bold action was sorely needed and stepped up to the challenge and delivered the first comprehensive scheme for deposit insurance in a major Western country. Some of this may have been cover for the remaining open institutions who needed to restore some semblance of confidence in banking rather than true concern for the masses of savers[142]. However, the fears were real that deposit insurance was combating and the risks were great that it would not work or be accepted. Along the way, the United States managed to restart its central bank, the Federal Reserve, and keep banks from investing deposits in speculative areas, with the Glass-Steagall Act. Let us next look at the responses that they made.

b. *Separation of Banking From Other Financial Services and the Advent of Deposit Insurance: A Critical Legal Response to the Devastation of the Great Depression*

Against the backdrop of despair and poverty, it was a bleak time in the 1930's. It changed an entire generation and lowered the expectations of all born before 1929. Banking was seen as having made it possible for the dramatic plunge to have occurred as financial institutions represented a huge source of parked and available funds in the greater marketplace of investable funds.

So our scene is now set as to why deposit insurance was created. Before this is relayed, however, it is important to look back one last time at a financial panic that should have caused deposit insurance to gain earlier notice long before the *Great Crash* and that many of the warning sides were never heeded or were ignored regarding its need.

i. *The (United States) Financial Panic of 1907: Precursor To The Great Depression.*

Predating the Great Depression by decades were two important banking events in the United States that had influence on deposit insurance and the financial safety-net worldwide: the 'bank panic' of 1907 and the signing of the Federal Reserve Act in 1913 which finally gave America back a central bank after decades of it being absent.[143]. In this section we will discuss the Financial Panic of 1907[144].

It is critical to note that the Panic of 1907 in America occurred 22 years *before* the 1929 *Great Crash*. What is so important about this event is that it demonstrated how

to combat panic and why panics begin and end. In doing so, it demonstrated that much of the reason for panic is illiquidity and the fear of loss of deposits—the classic bank run recipe. As we shall soon see, if countermeasures are employed to reverse illiquidity and stem the fear of loss, panic subsides.

At this period of history, 1907, there were many shocks to the financial systems occurring worldwide and almost together. There were disputes in exchange systems[145]. There were the huge costs of various wars and conflicts[146]. The way currency was backed was changing[147] and many other potentially disruptive scenarios. However, markets had also matured to the point where speculators and those who would use financial systems to manipulate others had come into vogue. There were some laws regarding conduct of this type[148]; however, they were tentative and tepid and were not nearly suited to root out the abuses and problems occurring at the time. Instead, this was the age of the monopolies, the money trusts and great influence of big business over governments, including corruption.[149]

The financial panic that erupted in 1907 was not the first of its kind but it was a more significant event. It should have been a very distinct wake-up call to the issue of financial market risk, including deposit risk. Instead, the result of the panic was to mildly investigate those that held wealth or controlled markets. While that was a noble effort, regulation missed the critical issue of bank risk and, more appropriate to our discussion, deposit risk. Only after the *Great Crash* would that point be fully understood.

The Panic of 1907 occurred because of an October 1907 attempt to corner the market on raw copper metal by a consortium attempting to acquire control of the United

Copper Company using money borrowed from a group of important American banks[150]. This would have monopolized the market in copper as a commodity. Certain American banks had lent vast sums for this effort and when the scheme failed the underlying banks that participated in the banking group were caught off-guard and were unprepared for that outcome and were severely weakened. Depositors in those banks panicked after realizing there banks could be rendered insolvent by their ill-fated promises[151].

The panic was seen as occurring because of three essential failures: first, many banks became illiquid when fearful depositors with various impressions of what had occurred 'raced for the exits' with their deposits as they lost confidence in banks facing known, adverse situations (our classic bank run scenario we have already discussed); second, investor confidence was shaken when large and well-known financial institutions, such as the Knickerbocker Trust Company, simply failed and this reaffirmed in the minds of depositors that banks were mortal and more vulnerable than they seemed as this was a grand institution; and, finally, the United States did little to intervene as they did not have a well-defined 'lender of last resort' role as the United States had, in essence, no central bank at that time[152]. In essence, there was no governmental safety-net for banking in America at the time and the banks rose or fell based upon their own private efforts.

Adding to the problem was an inflationary market and an unsettled world economy. All this converged into what should have been a full collapse of banking and possibly a deep depression occurring two decades *before* the ensuing *Great Crash*. But this huge risk was averted for reasons which will soon be clear. What is most important

about this panic, then, is not that it occurred at all but the countermeasures that were deployed by private bankers to stem its rush to swamp banking and that those countermeasures, through rather unbelievable personal efforts, actually worked and beat back the challenge.

The reason why the Panic of 1907 did not bring down all of the United States financial system, and possibly thrust the world into the darkness of depression decades before the *Great Crash*, comes, unbelievably, in the form of a single man—albeit a single *very rich* man. J. P. Morgan, the legendary financier, in a Herculean effort, intervened in the 1907 Panic and placed large sums of his own money (and those of companies he controlled) into the market as a liquidity flooding device.[153] By sheer force of personality (and during a few occasions by more drastic means of locking the doors in meetings and refusing to allow other bankers to leave), he convinced other banks to do the same[154]. By creating, in terms of funds of that day, massive liquidity in financial systems, Morgan propped up the American banking system independent of governments, safety-nets or deposit insurance.[155]

Morgan, in essence, acted as a private central bank and rogue deposit insurer by flooding the market with one's own capital, and that of other like-minded bankers, to correct the illiquidity gridlock issue created by exiting depositors, rising fear and growing panic[156]. In so doing, he was preserving the promise, the social contract of banking. When most banks he assisted managed to stay open, depositors looked back, saw the doors still open, felt reassured, confident and returned to the banks they had fled with their money to redeposit[157]. In essence, they realized that the link of trust had not really been broken and the promise had actually been kept.

While Morgan's efforts would be impossible today with the vast monetary sums in play in this more modern era; in essence, one banking leader 102 years ago shored-up a good portion of the entire American banking system because he sensed that what would bring down all investments collectively was the gridlock of illiquidity coupled with the panic of loss and his and all fortunes would be lost along with all the others if he did not counteract this problem[158]. In this case he was entirely correct. It worked by simple intuition and will; but it worked nevertheless. J.P. Morgan saved American banking in 1907.

The Financial Panic of 1907 was short-lived because markets had not locked up[159]. However, it was clear the larger financial market had come dangerously close to the precipice of collapse and financial ruin. Something needed to be done beyond such an *ad hoc* individualized effort of a Morgan or another wealthy banker.

In the period following the Panic of 1907, the American Congress sought to study what had gone wrong and how to stop it from ever reoccurring again with new laws[160]. The climate was ripe for this investigation as U.S. President Theodore Roosevelt had come to power and was generally against cartels and money trusts that he believed had been leading financial marketplaces around by the nose and down very dangerous roads. Roosevelt felt that cartel efforts may have created the irrational underpinnings for this Panic of 1907 to begin with and rich bankers were not to be trusted to act in the interest of the average person or saver.

There were many Congressional committee investigations and studies. Two conclusions were reached by those studies: first, that the American financial system

required a central bank; and, second, that this central bank needed so-called *lender of last resort* authority using the reserves of the retail and commercial banks. This is why the United States central bank is even today called the Federal Reserve Bank[161]. However, creation of a central bank and a lender of last resort authority would still prove to be an inadequate response to the crisis to come in 1929. These aspects of the safety-net would not provide a full and viable level of protection. After the Great Crash, we will learn that much more needed to be done including the implementation of deposit insurance and the intense regulation of non-bank financial markets.[162]

What is important to our discussion about the Panic of 1907 was the influence that the injection of liquidity by J.P. Morgan and his affiliates and friends into the financial markets had on stemming the collapse.[163] This was something new and rather eye-opening. It seemed like J.P. Morgan was on to something. Unlocking the liquidity gridlock seemed to be, at least in part, an antidote to financial panic. In essence, if you can keep the bank doors open, panic will never occur or quickly subside. As a student of the Great Depression, this fact was not lost on Fed Chairman Ben Bernanke in 2008.

What is deeply concerning, however, was that financial markets depended on one person and a finite amount of resources available to Morgan to save itself. This is not a safety-net; rather, it was only a chaotic unilateral response. Had any new emergencies occurred at all this effort would have failed and all would have been lost.[164] This fact was also not lost to governments, including the United States. Bank panics should not be counteracted through uncoordinated action and willy-nilly deployment of finite resources.

Another lesson was learned about Morgan's actions in 1907. That lesson would become a mainstay of deposit insurance years later. The lesson was that limited resources should be deployed to save what banks one can save and let the mortally injured and doomed banks simply fail. Morgan, acting in a quasi-deposit insurance mode, wisely used his finite capital available to him to shore up healthier institutions that were unfairly being subjected to runs just because of the irrational panic. As to institutions that looked like they could be resuscitated and saved, he acted decisively[165]. Banks that were not healthy, and could not be saved, were left by Morgan to fail and go into a failure mode and receivership.[166] We have seen precisely the same strategy employed 100 years later in our current financial crisis.[167]

Of course, when the panic returned to normal, and despite the fact that the financial world had generally avoided collapse and was intact, it was time for the usual recriminations and charges[168]. The aftermath of the Panic of 1907 was not pretty and devolved into a renewed debate on the concerns with what was, in essence, systemic failure and the lack of real backstops and safety-net to the American and world financial systems. Also, wide ranging discussion occurred as to the appropriateness of a governmental response rather than a Herculean effort by a single wealthy individual such as Morgan.[169].

ii. *The Creation of a (U.S.) Central Bank: The Federal Reserve Act[170] and Reserve Banking.*

The second important event that predated the Great Crash was the creation of the United States Central Bank, the now legendary Federal Reserve[171]. F or nearly

eighty years, the U.S. had been operating without a central bank after the charter for the Second Bank of the United States had been allowed to expire[172].

The 'reserve' portion of the central bank of the United States has meaning. A 'reserve' requirement means that authorized banks are expected to adhere to certain reserve requirements, or setting-aside a percentage of their assets in liquid form. Banks in the United States have an actual account with the Federal Reserve to maintain these reserves. While they may be able to borrow against their reserves under controlled circumstances, this reserve is designed to insure that a bank has sufficient liquidity to meet normal depositor demands to withdraw funds[173]. It also acts as a shock-absorber for financial calamities.

However, after various financial panics, including the Panic of 1907 just explored above, there was a growing consensus in the American financial community that banking in America needed far more structure, form and substance and some sort of banking and currency reform was needed as well which could provide a ready reserve of liquid assets in case of financial panics, a lender of last resort function and a government agency that would also provide for currency control that could expand and contract as the seasonal U.S. economy dictated[174]. A living, breathing flexible banking system. It is actually shocking that America still did not have a central bank only 100 years ago.

After months of hearings, debates, votes and amendments, the proposed legislation was enacted as the 'Federal Reserve Act' of the United States[175]. The vote was close when one considers the 'no' votes along with the 'non-votes'[176]. The plan

adopted in the original Federal Reserve Act called for the creation of a financial system that contained both some private and some public features and entities. There were to be at least eight private regionalized 'reserve' banks spread throughout the United States and no more than twelve private regionalized 'reserve' banks in total. These regional or district banks were not retail banks but were banks designed to house the reserves required to safeguard the financial system and to monitor the activities of retail and commercial banks.

The full twelve reserve bank system was actually established from the start in the United States and remains in place to this date. Each has its own branches, board of directors and geographic reach and boundaries and the 'Fed" System was later to be unified by a seven member Federal Reserve Board of Governors made up of public officials appointed by the President of the United States which was later given additional authority and retitled as the Board of Governors of the Federal Reserve System in 1935 with the Secretary of the Treasury and the Comptroller of the Currency then being dropped from the Board.

Also created as part of the Federal Reserve System was a 12 member 'Federal Reserve Bank Advisory Committee' and, most directly applicable to bank customers, a single new United States currency, the Federal Reserve Note. These were all very important changes and the U.S. economy has rested on this foundation ever since.

It is worth remembering that the United States, from largely historical accident, continues to have an unusual, and many believe dysfunctional, dual system of allowing the chartering of national banks and a separate process of allowing the fifty American

States to also charter their own state-created banks[177]. They compete in the same markets but often have different authorities. This created complexities for the new Fed. Congress decided in the enacted Federal Reserve Act that all *nationally* chartered banks were *required* to become members of the Federal Reserve System[178]. It required each national bank to purchase specified non-transferable stock in their most applicable regional Federal Reserve Bank and to set aside a stipulated amount of non-interest bearing reserves in their institution with their respective regional bank[179]. Since 1980, *all* depository institutions, even state chartered banks, have been required to set aside specified reserves with the Federal Reserve to be entitled to certain Federal Reserve services[180]. However, state chartered banks have the option of becoming members of the Federal Reserve System or not and to thus be supervised, at least in part, by the Federal Reserve Bank as their primary federal regulator rather than the FDIC if they elect to become members of the Federal Reserve[181].

So what does the laws underpinning the Federal Reserve Bank system do as a safety-net player to assist banks and avert financial crisis? Member banks are entitled to have access to discounted loans at the discount window in their respective regional reserve bank (this is basically short term liquidity for banks that may or may not be collateralized and in 2008 even investment banks were allowed to access this 'window')[182]. 'Fed-Member' banks are also able to access a myriad of other services to avert adverse financial conditions. The Act also permits the Federal Reserve Bank to, in essence, act as the nation's bank and thereby act as fiscal agents for the United States Government and as a lender of last resort during crises. Of course, the Fed always can deploy countermeasures with its reserves to fend off an entire host of problems.

President Wilson signed the Federal Reserve Act in 1913. Liquidity in the form of deposit insurance was not yet part of this safety-net scheme and would not be for two more decades. However, one can see a growing safety-net concept through the willingness to regulate banking more tightly, create a 'reserve system', and to allow special bank borrowing programs by eligible banks when liquidity or even capital gaps occurred. The actions of Morgan are clearly being adopted into governmental structures. This changed the nation's (and likely world) view of banking from the playground of the rich tycoon-like bankers like J. P. Morgan to an increasingly more tightly regulated industry that the United States Government considered a core business and must be controlled for the broader public's good by governmental institutions. But the tactics were similar. This was a new attitude and a new remit for government. The problem is the implementation of these new powers was slow—and as shown by the *Great Crash* 16 years thereafter, inadequate.

iii. The Run-Up To The Great Depression and the United States Response: The Glass-Steagall Act[183].

Books have been written about the run-up to and onslaught at the *Great Crash* followed by the *Great Depression* that are well beyond this work[184]. However, after the 1907 Panic and the adoption of the Federal Reserve and before 1929, several interesting trends were present.

When devastated and defeated Germany could no longer afford war payments[185], Wall Street invested heavily in European debt to keep the European economy afloat as a large consumer market for American mass produced goods. By the middle of the decade, economic stability returned to Europe, and the Roaring Twenties

broke out in Germany (the Weimar Republic), Britain and France, and the second half of the decade becoming known as the "Golden Twenties"[186]. The effect spilled over to America, as well. This was a time of optimism and change. All things appeared possible including new roles for women and a new and independent spirit.

The 1920's was also a decade of increased consumer spending and economic growth fed by classic supply side economic policy[187]. The post war, post progressive era political environment in America and elsewhere in the world saw a close relationship between those in government and those who promoted big business. It was not a healthy alliance.

When President Warren Harding first took office in America in 1921, the national economy was in the depths of a depression with an unemployment rate of 20.00% after a period of runaway inflation. Harding proposed to reduce the national debt, reduce taxes, protect farming interests, and cut back on immigration. While Harding never lived to see it,[188] most of his agenda was actually passed by Congress[189]. These policies led to the "boom" of the Coolidge Administration years throughout the 1920's[190]. One of the main initiatives of both the Harding and Coolidge Administrations was the rolling back of income taxes on the wealthy which had been, by necessity, raised during World War I. This allowed increased savings and investment activity even down to the level of more modest savers.

Therefore, as one approached the critical year of 1929, it is easy to see the irrational exuberance of the type that decades later former Federal Reserve Chairman Greenspan described where the poor can become wealthy and hopes become

irrational[191]. There is also a herd aspect to this irrationality. The thought process of even rational savers and investors starts to erode as they do not want to be left behind; or, the last one on board; or, 'to miss the boat'—*all clichés born of this period*[192].

However, in truth, the full attention of world governments was tuned elsewhere in the first two decades of the Twentieth Century. The First World War and the containment of Germany; financing Europe's reconstruction; the regulation of emerging industries such as communications, auto production and creating the much needed infrastructure for all of it. Plus, global banking had not yet come to pass and alignment and coordination of even exchange rate regimes would be years in the future with agreements like the Bretton Woods system[193].

Despite what the popular culture portrays[194], which is that a wealthy person on Monday, October 28, 1929 became an instant pauper with the *Great Crash* on Tuesday, October 29, 1929, the fall was not instantaneous. Some governmental effort was made to stem the full weight of the *Great Crash* and to regain control of the exchanges and markets as they fell[195]. While the injection of money to maintain liquidity is now seen to have been greatly underpowered for what would have been required[196], some attempt was made to prop up the financial markets[197]. Unlike Morgan's efforts with the Panic of 1907, however, they were not dramatically assertive and would have required massive injected liquidity which was never provided. As the United States slipped into depression and deflation[198], the world followed in time like climbers on a mountain being dragged backwards into a crevasse on a common rope.

As governmental monies dried up following the *Great Crash* and little more could be done financially for the sins of the past, future regulatory reform was the logical focus of *Great Depression*-era financial legislation for politicians who wished to keep their jobs. This was for several reasons: (a) the banks that failed had likely already failed and there was no saving them; (b) regulation costs would mainly fall upon the banks in the future; and, (c) the public was in no mood to see the bankers escape what had been done or allow it to be repeated a second time.

Two important banking concepts emerged in the years following the *Great Crash*. The first was the need to separate traditional banking with its deposits and loans that is evident in the cycle of banking from banks who use their assets as investments or banking we call investment banking[199]. The second was the need to consider insurance of deposits and to create an agency that would monitor such activities.

About three years after the *Great Crash*, American Senators Carter Glass and Henry B. Steagall, both very powerful men in American politics at the time, introduced the now legendary Glass-Steagall Act of 1933 into the United States Congress.[200] This bill was later renamed the Banking Act of 1933. For 66 years in America, this law would come to be the primary means by which to stop banks from thinking they were more than retail or commercial banks and drifting into investment areas that posed far greater risks. There would be a clear division between these two types of banking activities.

The *Glass-Steagall* legislation was clearly a rushed piece of legislation as it was signed by President Franklin Delano Roosevelt soon after his inaugural on June 16, 1933 (just a few months after its introduction) and this bill would became effective

immediately[201]. This was not legislation favored by the prior administration but the change of political parties in the White House from Herbert Hoover, the Republican choice, to Roosevelt, the Democratic candidate, in 1932 made this legislation possible[202].

The *Glass-Steagall Act* was intentionally designed to do each of the following things[203]:

- It was to stop the continual run on banks that had been occurring. This continuous run and panic saw an astounding 4,004 banks closed in America by 1933 with an average of about (U.S.) $1 million in each bank for deposits.[204] This means that about (U.S.) $4.0 billion in bank deposits were lost in just a few years—an unbelievably large sum for its 1930's time. In essence, for banking to survive, these runs and ensuing closures had to stop.[205]

- It was to end the unholy "mixing" of commercial and investment banks and the conflicts of interest and fraud that such a "mixing" created. A virtual legal wall needed to be erected by law and regulation between the two broad forms of banking by the Act[206]. It would keep separate bank investment activities from regular commercial bank or retail bank operations. This barrier would actually stand in America for 66 years until its removal in 1999 in America during the administration of American President William Clinton. That removal would prove to be a

serious miscalculation and a strong contributing factor to the 2008-2009 financial crises that occurred less than a decade later[207].

- It was to end speculation by banks in securities, insurance and real estate by prohibiting a bank holding company (basically the stock exchange parent of a bank) from *also* being the owner of non-bank financial services companies (such as those who sell securities, insurance or offer investments)[208]. Basically, bank holding companies were to own only one or more subsidiary *banks*[209] and any other businesses would be frowned upon and would need to be approved and such approval was unlikely.[210]

- It was to respond to the obvious failure of the fledgling Federal Reserve to address and counter the utter collapse of banking following the *Great Crash* and precipitating the *Great Depression* and to better assert a lender of last resort role[211] In essence, discover why Morgan has succeeded in stemming the Bankers Panic of 1907 and why the newly created 'Fed' had failed to avert the Great Depression of the 1930's and provide new tools to fix the problem.[212]

- It was to immediately stem the tide of withdrawal of deposits by foreign depositors who had generally lost confidence in the American Dollar and who feared that the American Dollar would be removed from being backed by the gold standard (and which it did just before the Glass-Steagall Act was made effective)[213].

- It was to control and regulate permissible rates of interest paid on time certificates and savings accounts so speculation in these products would end and the so-called 'brokered deposits' would not be used to entice deposits into failing banks to keep them afloat while amassing even larger risk profiles[214].

- It was, finally, and primary for our discussion, to create a new governmental corporation known as the Federal Deposit Insurance Corporation, or the 'FDIC'. The FDIC was intended to insure America's bank savers with regard to their bank deposits in United States banks from loss. It was a strategy intended to regain and/or restore confidence in banking after the closure of, literally, thousands of American banks.[215].

As this is a work about deposit insurance, there is no need to discuss other bulleted point of the *Glass-Steagall Act* listed above except to say that in deepening the financial safety-net and curbing the expansion of banks into areas well outside of core banking, laws such as the *Glass-Steagall Act* helped to focus banks back on its banking cycle and prudent lending and investment of bank assets.[216].

iv. *The Creation of the Federal Deposit Insurance Corporation (FDIC)*[217]

The creation of a deposit insurer in the United States, which is considered in greater detail operationally in Chapter 4, has very modest and humble beginnings and actually started life as a feeble and underpowered temporary agency.

As part of the Act, the U.S. House Banking and Currency Committee sought to insure all deposits in U.S. banks up to (U.S.) $5,000, and after that would insure the remaining deposits on a 'sliding scale'[218]. The program would be financed by a small fixed premium assessment on the banks[219]. Depositors who held accounts in failed banks would suffer no loss at these levels and they would have full cover for these amounts. However the U.S. Senate Banking Committee in the other legislative house of the United States Congress created a bill that excluded banks that were not members of the Federal Reserve System from this scheme altogether[220].

There was opposition to both bills because neither bill contained a ceiling on the deposit guarantee's and this created open-ended liability for an already hard-pressed U.S. Government[221].

Compromise was reached for a deposit insurance program covering all banks, beginning by the U.S. Government funding a temporary deposit insurance fund based upon a maximum (U.S.) $2,500 ceiling per protected account[222]. This was modest protection even by 1933 money standards. This compromise was passed as the *Glass-Steagall Deposit Insurance Act* in June 1933 with Steagall's amendment that the program would be managed by a new entity, the Federal Deposit Insurance Corporation, added[223]. While this $2,500 is firmly in mind it is helpful to compare it to the current maximum coverage level of deposit insurance of $250,000 in the U.S.[224] This is a 100.00% increase in deposit insurance maximum coverage over the 75 years of the existence of deposit insurance in America, or over 13.00% increase in each decade the program has existed. Compare that always ascending and ever-increasing level of coverage to the European base-level threshold for deposit insurance which started out

at a much lower minimum coverage level and remained virtually unchanged as to its modest floor limitations from 1994 to 2009.

The Act established the FDIC as a temporary American governmental corporation[225] and gave the FDIC the authority to regulate and supervise state non-member U.S. banks as well as national U.S. banks for this purpose[226]; second, it extended federal-level oversight to all commercial banks for the first time as to their operations and solvency[227]; and, third, it prohibited all U.S. banks from paying interest on demand checking accounts, often called demand accounts in America and current accounts in Europe[228]. The Act then funded the FDIC with (U.S.) $289.0 million in initial loans[229] to create the initial DIF which it took the FDIC 15 more years thereafter to repay from bank premiums and which the FDIC finally did repay in 1948.[230]

The bill was actually not widely supported by banks at all[231]. Francis Sisson, the then-president of the American Bankers Association, said that concept of banks paying into an insurance fund that would protect individual banks against loss was "unsound, unscientific, unjust, and dangerous."[232] It is not at all clear why banks would be resisting confidence-building measures in their own operations after thousands of banks and their branches had closed except as to the issue of cost (through bank paid fixed deposit premiums) and the creation of more bank oversight which few banks welcomed in that business driven era. Possibly, it is founded more in the unpleasant effects of deposit insurance—a sort of back-door regulatory peek under the tent leading to the regulation, supervision and even nationalizing of banks[233].

Therefore, the FDIC lacked support from its constituents as it got its programs going and its operations started as a deposit insurer in 1934. Think of the difficulties it experienced: first, a full depression underway; second, limited governmental resources in a new but fledgling program; third, resistant constituent banks; and, fourth, suspicious bank savers who already did not trust banking or insurance arrangements after the *Great Crash*. Hardly the solid start one would hope for (and later in Chapter 6 we will see that times of adversity are not the best or most desirable time to start a deposit insurance program). Despite the considerable odds, the FDIC was to survive its first few difficult years of existence and begin to thrive and expand its authority and influence.

Initially led by Chicago banker Walter J. Cummings, Sr., the FDIC started operations four years after the *Great Crash* and at the beginning of January in 1934. A former banker himself, American President Franklin D. Roosevelt was personally opposed to the concept of 'deposit insurance' because he thought it would, in the end, only protect irresponsible bankers[234]. This thought process, in essence, was the start of the Moral Hazard argument; however, and politically, it was pushed aside when Roosevelt saw Congressional and public support was overwhelming in favor of doing something with the state of banking and deposit account protection seemed to be amongst the most visible and productive idea of those proposed[235].

Soon thereafter, Cummings left the FDIC. In early 1934, Roosevelt appointed Cummings successor, Leo Crowley, a Wisconsin banker, as the second head of the FDIC[236]. Crowley, Roosevelt soon learned, and to his great dismay, that Crowley had been poorly vetted and did not have the best record as a banker as he had thought he did when he nominated him and he was roundly attacked as a bad choice. After

discussion and debate about the embarrassment of withdrawing the nomination already in play and seeking another candidate, Roosevelt decided to keep Crowley on at the FDIC and ignored his detractors who remained rather vocal well into his reign and pushed through the appointment[237]. Crowley proved to be a good leader and he offered fine service to the FDIC and helped to solidify many of its most important programs and gave a firm footing to the FDIC to continue on to this point—now, unbelievably, completing its seventy-fifth year of service and by far the longest and oldest operating deposit insurer of its size in the world.[238]

The role of the FDIC, and scope of that role, is also critical to understand before the FDIC's place in the financial safety-net can be seen. By law, the FDIC is not only a deposit insurer but it is also a major part of the entire and larger safety-net of financial protection in America. In addition, it is a permanent member of a larger team of prudential regulators of banks, the Federal Reserve, the Treasury and Congressional oversight of banking in America[239]. Every bank operating in America must have either a primary federal or state regulator (such as a state banking commissioner, the OCC or the OTS)[240] and, in addition, the FDIC, quite literally, comes along with that regulator in every branch of every bank to also regulate a bank[241].

The division of duties between prudential regulators and the FDIC is often vague and ill-defined and both seem to have many overlapping powers[242], or disapproval rights, over actions. The FDIC is often described as having back-up enforcement authority[243]. If the bank is also a member of the Federal Reserve or has a bank holding company structure, it simply adds the Federal Reserve[244] as an additional regulator. If it

is involved in financial activities with other Federal agencies, such as the Treasury Department with regard to TARP lending, the U.S. Housing and Urban Development with regard to mortgage lending or other and more peripheral agencies such as the U.S. Department of Agriculture or the U.S. Small Business Administration regarding each of those agencies specific guaranteed agricultural, small business or disaster-related lending programs, even more regulators are added to the regulatory recipe. Many American banks are regulated by a dozen or even more federal and state regulators and many of these widely disparate regulators and quasi-regulators have a different focus but similar remit and overlapping authorities.[245] This makes banking amongst some of the most heavily regulated industries in America and adds substantial costs to the product and service delivery of banks to its range of customers.

The Fed becomes another player in this scenario with, again, overlapping and duplicative supervision and approval rights. But the FDIC never disappears as a regulator through all these permutations. Along the way, other federal agencies, such as the IRS, HUD, SBA, FINCEN, and others may be added or subtracted by specific events or activities[246]. But, not to make the point too sharp, the FDIC is always present and always involved. So it is not unusual for a state-chartered, Fed-member bank to have the FDIC, the Federal Reserve and its state banking commissioner regulate the same activities along with a host of other activity-specific regulators. The FDIC is often at the cross-roads of the information flow between the various other prudential regulators (the Fed, OCC, OTS, state banking commissioners and many others) and no branch of a bank in America can be opened without a numbered FDIC Certificate of Insurance literally hanging on its wall.[247]

It is also important to note that at the beginning of the FDIC's existence in 1934 the FDIC insured banks but did not insure all deposit-taking institutions and even to this day there continues to be one major exception to its deposit insurance remit that may be in the process of changing[248]. The FDIC DIF has expanded to encompass virtually all other U.S. governmental deposit insurance funds, however, over the years. For example, until the *S&L Crisis* of the 1980's, the financial institutions known as Savings & Loan Associations were subject to a separate form of regulation (by the regulatory agency, now defunct, known as the FSLIC) and a separate insurance fund appropriately referred to as the SAIF (the 'Saving and Loan Insurance Fund'). This SAIF fund, effectively, was rendered insolvent with the *S&L Crisis*[249], and, after that crisis dissipated, was merged into the FDIC's BIF (bank insurance fund) fund following the S&L meltdown as to any S&L's that survived that debacle. The S&L's became part of the Thrift (OTS) system insured by the FDIC[250].

As noted above, the FDIC has never insured deposits held in credit unions and does not insure such institutions to this day[251]. This is not insignificant as there are thousands of credit unions in America and they hold significant deposits measured in the hundreds of billions of dollars or, as they refer to them, share drafts. Those deposits are, instead, insured by the deposit fund of the National Association of Credit Unions[252], or NCUA, and also known as the NCUSIF, or at times even by private insurance. The NCUA is also a governmental deposit insurer. This lone exception to the remit of the FDIC remains troubling as credit unions continue to fail in the current financial crisis and payouts from the NCUSIF and private insurers become uncertain in such times[253]. The

NCUA fund and the NCUSIF (the National Credit Union Share Insurance Fund)[254], is discussed in greater detail below.

Finally, 'deposits' in the United States received or held by securities brokerage firms and other investment concerns are well outside of the bank-related remit of the FDIC. If the brokerage company is eligible, funds 'deposited' in U.S. brokerage accounts have limited protection as to loss or theft under the SIPC, or Securities Investor Protection Corporation, which is also compared and contrasted below[255].

There have been several increases to the FDIC insurance ceilings since the creation of the FDIC in the early 1930's. The Banking Act of 1935 established the FDIC as a permanent agency of the government and doubled deposit insurance up to the originally sought $5,000[256]. The Federal Deposit Insurance Act of 1950 doubled the coverage again and further increased the insurance limit to $10,000[257] and gave the FDIC the authority to lend to any insured bank in danger of closing if the operation of the bank is essential to the local community. It also authorized the FDIC to examine national and state member banks for their insurance risk[258].

The FDIC deposit insurance limit was then increased to $15,000 in 1966[259], and just a few years later in 1969 to $20,000. In 1974[260], Congress doubled that limit to $40,000[261]. A deposit insurance limit more than doubling that amount to $100,000 was initiated in 1980 by the Depository Institutions Deregulation and Monetary Control Act of 1980[262]. There was then a long, static period of no further increases of 28 years. On October 3, 2008, as of the result of the current crisis, the U.S. based deposit insurance coverage was 'temporarily' raised and more than doubled to $250,000 per depositor

through December 31, 2009 and this 'temporary' increased level was extended just a few months ago (Summer of 2009) for three additional years to 2013[263]. Should no further action be taken, the deposit insurance limit would return to $100,000 in 2013 as to United States banks (except as to retirement accounts which have a permanent increase to the new, higher level); however, that appears highly unlikely. Most predictions are that the $250,000 new limit is now, effectively, permanent in the United States and would be nearly impossible to reduce without political repercussion.

It is also noted that certain types of accounts in America have full, or Blanket Guarantee Coverage on a temporary basis. For example, certain non-interest bearing commercial accounts and IOLTA accounts[264] currently have Blanket Coverage under the TAGP program[265] although, in the case of the commercial deposits, and as discussed below, these excepted accounts may not retain that Blanket Coverage past 2010 and banks must now pay additional fees and 'opt-in' to remain in the program.[266]

c. *Further Development of Deposit Insurance Schemes From 1940 to 2007.*

While development of deposit insurance was occurring in the United States, elsewhere in the world many countries chose not to adopt deposit insurance at all or ignore the concept. The war years immediately following the FDIC's creation in 1934 turned attention away from routine banking matters in Europe, Asia and the South Pacific and placed many banks on a special war footing. Few new banking initiatives, such as deposit insurance, were accomplished in banking in Europe, the Far East or Asia during the period of the late 1930's through the late 1940's for obvious reasons of survival and ending of conflict being more important.

By the 1950's, with the war ended and economies returning to a more normal business plan, American blossomed with its industrialized economy and Europe began to once again fall behind financially. By that time, only a handful of countries of that period maintained deposit insurance programs.[267] As Europe developed its early 'community' concept in the 1950s and into the 1960s, its efforts turned inward to stop the relentless internal wars and struggles and promote financial and social integration and fostering the fledgling European Community goals. Deposit insurance was a concept whose time had not yet come to Europe on a pan-European basis.

In the 1970s and 1980s, several prominent countries entered the deposit insurance 'club' of countries. They included India[268], France[269] and Canada[270]. However, coverage during this period still remained relatively modest, even spotty, and the programs had widely differentiated rules and requirements and there was little coordination of worldwide standards.

For purposes of issues of deposit insurance, the 1980's was a period when the existence of deposit insurance hit the United States especially hard and all eyes turned to see how the FDIC and the FDIC's BIF (as to banks) and the SAIF (as to S&L's) would handle the issues[271]. The answer was not very well with regard to S&L's and mixed as to banks.

In the mid-1980's, the American Savings and Loan industry began to quickly unravel as residential, investment and commercial loans in mainly the Southern tier of states in the United States failed along a wide swath from Florida to California. This event is called the "S&L Crisis"[272] and led to the closing of 745 bank-like S&L

institutions[273]. It also led to the insolvency of the insurance fund that covered the S&L's regulated by the FSLIC, the SAIF[274]. The cost to the United States government for the S&L Crisis is at least (U.S.) $160.0 billion of which the majority of this sum went to cover deposit losses caused by defaulted loans[275].

The reasons for the S&L Crisis are complex[276] but there are three areas of greatest blame: first, a sea change in tax laws; second, the end of the post-war housing boom; and, third, imprudent lending. Each of these areas will now be considered.

Because of tax changes that occurred in the middle of the 1980s, the housing boom that had been occurring in the United States since World War II had ended. These tax laws made it less favorable to use real estate as a tax dodge or shelter. At the same time, under various Republican administrations, S&L's were being deregulated to give them similar powers as those of traditional commercial and retail banks. S&L's tried to take advantage of a deregulated environment coupled with the high rates of interest at the time and they lent considerable sums on risky 'joint ventureships' where they might have both a major developmental loan booked with its borrower along with an equity stake in the project of the borrower being funded with the loan and all at the same time. This created an odd and dangerous combination of lender and equity partner.

This unsound method less-than-independent lending, coupled with a practice of gathering deposits from outside service areas by offering unrealistically high rates of return and for which the depositors had no other relationship or loyalty with the S&L, created a shaky asset base coupled with highly volatile and expensive deposits that

could depart the bank on relatively short notice. Together with low levels of internal capital, often in the ranges well below 8.00%, this created highly leveraged banks and a volatile recipe just ready to fail if there were any disruptions in the market. Add to this recipe weak FSLIC rules allowing a bank to be owned by as little as one person; boards of directors that abdicated the responsibilities of the S&L to the very managers who were acting imprudently and being rewarded financially based upon that very imprudence; along with a tepid level of oversight and supervision; and, we have arrived at the door of a very costly S&L financial disaster in America that in fact was inevitable in its dire outcome and resulted in, quite literally, a lost decade of American banking.

As markets changed and declined, the S&L's found themselves backed into the proverbial corner and selling assets at a small percentage of their real worth to stay a step or two ahead of insolvency. In essence, they were chasing new capital as their existing capital was already bottled up into marginal to bad loans or they could not escape their involvement as equity partner and act as a real and prudent lender. As still greater numbers of S&L customers defaulted and failed, S&L's stalled, gridlocked and failed with them. In just three years, from 1986 to 1989, and before closing itself, the FSLIC shut almost 300 of the American S&L's down and placed them each into receivership. This was only the start of massive closures and, in the end, the United States had to create an entirely new and special governmental agency, the Resolution Trust Corporation, to handle the serial liquidations of hundreds of additional S&L's that had to be closed and liquidated before the crisis finally came to an end in the mid-1990's. Reports, including one issued by the Federal Reserve, stated that the S&L system was poorly supervised and had actually incentivized Moral Hazard and in so

doing had actually greatly compounded the final cost to the taxpayers[277]. Few escaped withering criticism and scrutiny was intense. One institution in Florida, Silverado Savings & Loan, had as a member of its board of directors the son of a former President of the United States and the brother of another President and this S&L, alone, cost the American taxpayers (U.S.) $1.3 billion in depositor loss. This son of a U.S. President, Neil Bush, later sued, paid a significant fine and was restricted from banking activities well into the future. This was only one example of the hundreds of bank receiverships that occurred during this period and many of the others were also declared fraught with poor decision-making or far worse. Many directors, officers and others were named and shamed by the regulatory bodies that had been lurched awake by the need for heightened and enhanced scrutiny. However, the now fully alert regulatory watchdogs would soon be lulled back to sleep with the coming Millennium. Once more an opportunity being lost to the regulators to fine tune the banking system to make it more secure and stable.

When all the dust settled, the total number of S&L's had been decreased by half and of those that survived most later converted by strong pressure to other forms of banks, and especially a form of bank designed for them called FSB's, under liberalized rules encouraging them to do so. The SAIF did not survive this scenario, as stated above. The S&L form of regulated banking has, in essence, simply disappeared as being tainted and not salvageable.

The S&L Crisis certainly demonstrated many structural deficiencies with the American brand of deposit insurance[278]. Most important among the lessons of the S&L Crisis was the loss of public confidence and the huge costs for liquidation of over 700

S&L institutions and banks. However, and most happily for the banks, following the S&L Crisis in the mid-1990's, complacency promptly returned once more.

In 1990's, prosperity returned to the United States after the *S&L Crisis* and continued until stock market disruptions with the so-called '*Dot Com Bubble*' crash late that decade. However, by the start of 2000, the events of Y2K being of no consequence, the Clinton Administration leaving a surplus, and the beginning of the younger George Bush Presidency, prosperity once more appeared to return to America and across the globe. Of course, when the '9-11' terrorist attacks occurred on September 11, 2001, an event that deeply shook the core of financial systems worldwide for that year and for the next one or two years thereafter, a haze would enveloped the financial world as an entire range of anti-terror rules were introduced or required that placed a note of caution on to companies financial activities. Yet, that haze lifted as security of world markets was seen as remaining viable during the period of 2002 through 2006.

Distracted by the improving economy of the late 1990's, and anxious to restart the economies of the world, the American Congress was lobbied by several major banks to repeal the *Glass-Steagall Act* discussed earlier in this Chapter (which Act separated investment activities of banks from commercial and retail banking). After 66 years of separation, several large American 'money center' banks and financial conglomerates wanted to expand their banking products and services into other financial service areas to obtain cross-sale 'synergies' and this Act blocked and precluded that expansion. They wished to, purportedly, compete with other worldwide financial services conglomerates so they could sell insurance, securities and a host of

other investment products to existing customer bases and participate in financing specialty line of business such as mergers and acquisitions, takeovers and advice on such products and services as investment bankers. The *Glass-Steagall Act* was in their way as it precluded just this sort of activity and they aggressively sought its repeal[279]

In 1999, and despite significant opposition stating this was truly an unwise unraveling of laws that had successfully controlled many of the risks that had fueled the *Great Crash* for over six decades, President Clinton, buoyed by the first surplus in American history since the war and good financial times that appeared to be ahead, and anxious to leave a legacy and to be rid of personal scandal problems himself, signed the *Gramm Leach Bailey Act*[280] into law which effected this repeal and brought the wall between investment banking and commercial and retail banking down. This allowed commercial and investment banks to once more operate together as unimaginably huge mega financial conglomerates—with near fully vertical and horizontally integrated activities that had been banned since the *Great Crash*.

Along with the merger activity that was occurring at this time, American and European banking conglomerates were increasing in size at a rapid rate and were becoming diversified. As part of that diversification they were regulated by mutiple regulators and, in the case of some of their more exotic operations, by no regulators at all. The mega-banks played regulators against each other and flourished and the early part of the first decade of the 2000's saw the consolidation of banking and the rapid growth in assets of major financial institutions in America at an unprecedented rate.

For example, Citibank became part of the same company as Traveler's Insurance. Bank of America became aligned with one of the leading brokerage firms, Charles Schwab. Credit card companies, such as American Express, added banks. Major retailers, such as Wal-Mart, created banks. The resulting companies were becoming leviathans in size and complexity. It was argued by those against this repeal that America was unleashing forces that had earlier been found to be in conflict and that increased risks significantly for her banks. In reply, it was argued by those in favor of this repeal that the *Glass Steagall Act* was no longer practical or appropriate to the world we operated in today[281] and systems were sophisticated and far better than comparable *Great Depression*-era mechanisms to monitor any risk that removing this legal wall between investment banking and commercial banking could raise. In essence, it was argued that the marketplace would much more cleverly regulate (or punish) the exercise of these powers in 1999 than 70 years earlier at the point of the *Great Crash.* They were right—the market did punish the exercise of these powers and most severely.

The promise of smooth and transparent regulation proved to be pathetically untrue; the regulators missed some (if not most) of the most troubling of issues and were unable to monitor the new risks this change imposed effectively and in some cases the type of activity that caused loss was not even on any regulators 'radar screen' and was almost wholly unregulated at all, such as in the areas of exotic derivatives, swaps and securitizations. Repeal of the *Glass-Steagall Act* proved to be an unquestioned disaster when almost every investment bank has failed between 2008

and 2009. Less than a decade after the repeal of the *Glass-Steagall Act*, the American Congress is once again debating putting the protective wall right back in place[282].

Yes, until 2008, the disaster of the repeal of *Glass Steagall* was, as yet, still unknown. The remainder of the 2000s, at least after the concerns with Y2K abated[283], and before the financial crisis seven years later, was a period of uneasy worldwide calm overlaid by the fear of terrorism and yet with many feeling they were growing richer by the day so long as the world stayed intact due to their real estate appreciation. However, there was real fear that a new property bubble was forming that could cause markets to collapse. Markets, both stock and bank, were increasingly profitable and reaching new high water marks weekly. There seemed to be no end to the *Boom* and no *Bust* in sight. However, there was much discussion of how long this long run of the 'bulls' could last[284].

With some prosperity returning after the events of September 11th, and with deposit insurance claims at a low point worldwide in the first half of the 2000s, the concern about the adequacy of deposit insurance was entirely lost in complacency between 2003 and 2007. Around the world, various so-called 'tiger' economies were progressing at full steam—in Southeast Asia[285], China[286], Brazil[287] and Ireland[288]. Large executive salaries based on literal leaps in profitability were being paid[289] (and banks were certainly in the lead and included and bank executives received some of the highest salaries even well into the financial crisis[290]); construction cranes dotted cities around the globe and the banks were financing major investments in infrastructure; new housing was going up quickly in every developed nation; relatively stable employment spread around the world; massive borrowing and debt was being incurred as people felt

wealthy and banks lent against their appreciating real estate; new financial products were developed to pay for much of it and banks, now merged with their investment bank cousins, created new ways to finance old and new commercial, residential and other debt. Many saw the bubble forming but few were willing to withdraw money from such a upwardly profitable market. The scene looks like almost a repeat of October of 1929—*and, in fact, it almost was.*

Unfortunately, once more much of this effort turned out to be based upon an unstable financial house of poorly conceived financial investment products packed with risk. Financial products that preyed upon the weak and uninformed and had many unfair attributes; prudential supervision that seemed more inclined to support its authorized parties and licensees in creating a so-called open marketplace of opportunity rather than to focus upon staggering risks emerging and regulating them; financial statements, when truthful, that would later prove to be self-serving numbers on a page without transparency through use of special purpose vehicles and designed to maximize compensation; along with, of course, the later need for restatement of such misrepresented finances and inaccuracies. Along with the poor stewardship of companies by their boards came little governmental proactive intervention and a shadow economy of private equity markets riddled with their own transparency problems. This created the basis for a toxic soup of trouble for banks and their ilk and the latest run-up to a financial crisis not as yet seen since the *Great Crash*.

However, once again (as in 1929) warning signs were all clear and present; at least now in 20-20 hindsight they seem clear. First, there was the much publicized collapse of large companies like Enron[291], WorldCom[292] and others[293] whose fraudulent practices

were well known long before the financial crisis and for which additional laws, such as the well known *Sarbanes Oxley* law[294] were passed to create better information and more transparency. There was also repeated and incessant warnings about the real estate bubble; but all that gloomy talk did not stop high growth areas like Atlanta, Las Vegas, the coastal regions of France and Spain, Dubai and Dublin property from appreciating in wildly speculative ways that almost seem mindless, childlike now[295]. Still, and similar to the tunnel vision that had occurred between the Financial Panic of 1907 and the *Great Crash* of 1929, the more basic, core problem was present like the proverbial elephant in the room--but that elephant trumpeting disaster was unwelcome as a party spoiler and it was simply being ignored by many as a harbinger of doom that could be willed away. The banks were, once again, accumulating volatile, unstable and 'toxic' debt[296] and making promises and incurring huge counterparty risk that was not well defined or even intelligently measured; and, few, including the many bankers involved, even knew it was like a tightening rope around their corporate necks and about to pull even tighter and strangle many of them into actual or near failure[297]. Maybe they knew and did not care as it was a race to milk the system before the system came apart at the seams. We will likely never know.

At the very time attention was diverted to very large public companies acting arrogantly, and we were complaining about rigged energy trading[298] and high fuel prices[299], a virtual financial cancer was, quite literally, spreading under our feet through property deals and infecting banks around the world. As we shall next see, all of this was about to unravel like a badly stitched cloth and deliver us into what can only be called the Financial Pandemic of 2008-2009.

d. *Rapidly Changing Deposit Insurance Solvency: The 2008 Banking Sector's Full Collapse and Extraordinary Bank Bailout Of 2008 Through 2009.*

The current financial crisis for banking arose from a combination of factors that, together, created one of the most difficult situations that banking has ever faced and may ever face again. Part of this is the immense size of the problem that now is measured in the trillions of U.S. Dollars lost and the trillions of dollars the United States must now pay to bridge that loss until it can breathe new life into its failing financial services industries and restore confidence in the systems that remain.

A trillion of anything has 12 zeros after the designated amount of trillions and each trillion dollars is actually a thousand billion of that thing. The numbers in the American crisis are, therefore, astounding. Recent disclosures by the IMF state that the world banks during the current financial crisis have lost nearly four trillion (U.S.) Dollars[300]. That means that world banks have lost almost four thousand billion dollars. An unimaginable sum expressed as +/- $4,000,000,000,000.00.

So, if governments, investors and financial institutions combined are expected to lose about (U.S.) $25 trillion, as predicted, when this crisis finally ends, they will have lost (U.S.) 25,000 billion dollars—a mind-bending sum of +/-$25,000,000,000,000.00. This would be the entire economy of many nations. Literally, the foundation of banking has been shaken to its core by the massive extent and obscene size of this problem. However, even more important, banking has been shown the renewed face of a dangerous foe that it had thought had been contained in 1929 and that it may not be able to keep contained for very much longer—that foe is one of 'systemic risk', or the failure of an entire system, worldwide, at one time due to global interconnections and

the globalize financial marketplace[301]. This is why the current economic calamity is so significant. It is the failure of many financial systems around the world together at one time and the need for coordinated action. In essence, the days when J.P. Morgan could intervene to save American banking in 1907 have long passed into the modern age where the American Government now requires the coordinated intervention and response of numerous other financial systems of other nations, including the European Central Bank and its Member States central banks, to collectively save the global financial markets. This is certainly a long way from the individualized efforts of Morgan meeting with friends and plotting liquidity strategies from his spacious New York offices in 1907.

It may be recalled that since the creation of the FDIC in 1933, and for decades thereafter, and pursuant to the banking cycle already discussed, banks underwrote, funded and placed into their own portfolio 'traditional loans' for the governments, businesses and people within their community or service areas. They often specialized in certain types of loans to better assess and control risk and keep the riskiest of the borrowers away from their banks in order to, correspondingly, keep loan losses low and often to incredibly low loan loss levels[302]. This is why banking was always profitable—it was predictable and there was some control possible in managing loss. Bankers understood their borrowers, they monitored the loans and bank management was directly accountable to moneyed and experienced directors and shareholders for defaults. The loans were also manageable in size and no single borrower could ever bring down an institution and often any maximum loans to a single borrower standard was never even reached[303]. This balancing and allocation of risk with avoidance of

excessive concentrations in any one person or industry reduced loan loss and increased profits. Even more important, one institution could not bring down all the other financial institutions in serial fashion as the share of the market normally held by one bank was usually quite manageable by the rest if a few failed and the interconnections were occasional, at best.

However, with the banks increasing in size, and career, experienced bankers giving way to bankers-as-salespeople service delivery models pushing bank products and services with little comprehension of what they are pushing, this advantage diminishes to disadvantage. Prior to 2000, few ever heard of institutions as being TBTF, or *"Too Big To Fail"*[304]. Today, it is common. The size of banks of modern times would have been unimaginable (and declared as unmanageable) just a few decades ago. While growth in the size of banks usually was coupled with claimed reduction in overhead and retention of less experienced staff so the combination of two banks could be delivered to markets with cost savings so as to justify the merger, that does not make such an institution the model of transparency, functionality or understandability.[305] An acquiring bank often cuts its workforce of the combined banks by heavy percentages to justify the premiums over net asset book values in merger consideration during the decades of the 1990's and into the 2000's. This has been and still is applauded by markets as efficient but often left banks significantly understaffed and unable to assess risks or manage accounts and often with entire layers of oversight or management excused to pay for it all in synergistic savings[306].

However, two factors fueled the rapid growth in banking in the 1990's and into the first half of the 2000's. First, higher stock prices for exchange-traded bank stock

gave larger public market banks the stock-based 'currency' to go out and acquire regional banks at impressive book value multiples of two, three even four times and that phenomena is once more remerging as this work concludes[307]. The second reason is the rapid growth of the concept of securitizations and the pooling of loans allowed something very new in banking—*the easy recycling of its precious capital*[308].

Regarding mergers and the currency of bank stock, in the 1990's and 2000's, larger banks were acquiring their rivals at a very brisk pace[309]. One might acquire a bank its size (a so-called merger of equals), smaller than its size (an acquisition or combination) or even a smaller bank might acquire a larger bank due to declining profitability of the larger bank (the smaller 'fish' swallowing the bigger one). Banks, financed by their own ascending stock price or by investment banking groups, increased asset size quickly and grew from a few percentage points in market share to triple that size in a few months as the investors of the acquired bank were willing to take stock-for-stock in the hope of a future flip or double dip[310]. Plus, they did it over and over again in the 1990's and the first half of the 2000's. Bank America, alone, acquired Continental, Nations, Security Pacific, Valley Bank, MeraBank, Charles Schwab and a long list of others all in the span of just a decade. Other banks have similar histories. Obviously, this led to fewer banks controlling more of the banking sector and greater concentrations of similar products and larger sector loans to select institutional borrowers. Or put in plain English, it exposed markets and nations to these very big banks.

Second, securitizations grew the banking industry. Starting in the 1980s and accelerating into the 1990s and 2000s, banks learned about the concept of securitizing

of loans. In essence, the concept of securitization creates from physical assets, such as loans, units in a company whose sole and special purpose is to own a very large pool of those same physical assets. These special purpose companies allow ownership of a loan or a bank card receivable or another form of lending obligation to be converted from a single owner type (normally the bank of origin) to ownership similar to a stockholder in a company. The single assets are pooled, packaged and sold as unitized interests. The bank that generated the credit is repaid.

This concept of conversion of single asset ownership into pooled ownership of assets allows an institution to create loans, package those loans into pools of like loans and resell millions of dollars of like loans into special-purpose securitized companies. These special purpose companies will fund and unitize ownership and repay the banks for the face value of their loan product with, normally, a premium.

By this process of securitization, banks accomplish several things which they find complimentary to their banking business: first, they continue to serve their local borrowing base and continue to make loans and in doing so will not anger local regulators by being at capacity for lending or refusing to deploy scare capital in their service area; second, they are able to recycle their capital to make repeated rounds of loans in serial (and seemingly endless) fashion; third, they receive several premiums for the sale of each loan or loan series to the pool and, in addition, receive still other fees for the ongoing servicing of the loan for the benefit of the pool purchasers and all along appear to the borrower to remain the pooled owner of the loan so as to preserve deposit relationships; and, fourth, these loan sales to fund and securitized pools were normally without recourse to the bank packager, meaning that any loss of any loan sold to a pool

fell upon the securitizing purchaser of the pooled loans, absent fraud, and this eliminated the need for loan loss reserves or contingency funds as well as the need to monitor loans closely. In essence, securitization allowed banks to package loans, sell loans, earn fees, and get out and to avoid the obligation to monitor the loans made and sold.[311] They then did it all over again and again.

Banks became conduits for loans churning out large quantities of debt at an impressive pace. Often the underlying loans were 'table funded' by banks and initially packaged by brokers who received still other fees[312]. The loans were swept up into banks, then into pools and then unitized and sold in offerings that closed weekly and were marketed globally to those in need of assets yielding significant returns with claimed high investment grade ratings[313].

Although more conservative, the European banks were not to be excluded from the securitization effort. As European banks looked for high-yielding investment grade assets to place their deposits and surplus capital into, securitized loans appeared to suit their needs perfectly, as well. They were composed of loans that had purportedly high investment grading by Fitch's, Moody's or Standard & Poor's[314]. They were often pools of residential mortgage products secured by favorably located residential real estate that was continuing to appreciate. Also, with some exceptions for early reset loans, the pools had experienced low default rates prior to the Fall of 2007. They looked like safe and secure investment-grade assets and certainly had an attractive return when compared to other bank investment options.

What was occurring, in actuality, is that the loans being funded into the securitized pools, or the risk that was being addressed by related products (the so-called swaps and derivatives), was not a risk fully understood by the banks who bought into these exotic financial products. The institutions buying these products assumed the assets being acquired were high-yielding investment grade loans when they were loans with unusual adjusting features and often involved weak income ability for the borrowers to maintain the loans to full term. In fact, many of the pools consisted of loans normally considered to be significantly substandard in rated credit quality and many lawsuits are occurring now as to how they could be rated as they were[315]. These substandard loans, often called 'subprime' loans[316] often failed to meet one or more of the essential investment grade criteria for loans considered appropriate for banks and institutions in prior years. Possibly income was not sufficient to repay the loan; or, the collateral was in a blighted area; or, the loan lacked credit verification.

However, as these pools were highly rated by some of the leading rating agencies in the world; and, since the banks did not plan to retain the loans for very long (whereupon risk passed quickly to the pools); and, the collateral appeared adequate in a rising market even if income and repayment appeared weak, the banks had only passing concern about the questionable loan quality and very much liked the higher yields these products afforded and the recycling of capital they allowed. If risk was considered at all, it was felt that the issue of default would move to the pools if and when it might occur and they felt the risk of getting caught between the pool purchase and defaulting borrower was negligible[317].

Therefore, the banks ignored the risk or neglected their review of it, fueled the conduit and pipeline of loans and created record numbers of the subprime loan product and continued to move ever lower into the depths of credit-worthy lending and finally into very difficult to justify credit quality ranges, home improvement loans and obviously substandard loan product and to allow the falsification of income and other criteria to enter the approval process. It now is clear that these loans were not creditworthy and would default at record rates if any changes occurred to them.

One of the most critical features of many of these loans is that they had a variable rate of interest and started at an artificially low 'teaser' rate of interest as an enticement[318] which often reduced payment amounts to mere fractions of regular payments for the initial period of the loan; at times negatively amortizing the loan so that principal was actually increasing by the underpaid interest; while, all along, appearing to our naive borrower to free up additional payment savings or borrowable equity for other consumer purchase driven uses. However, this was often a short-lived benefit. The interest rate later sharply adjusted, or stopped negatively amortizing or normally reset to current rates at various points to bring the rate of interest closer to promised yields promised to investors and often this reset was well above conventional or market rates over the life of the loan because lost time had to be made up for the teaser rate periods. Borrowers were often not clearly advised of the nature of these tricky resets, negative amortizations and abrupt rate changes that were an integral and preplanned part of this loan pricing and terms. If they did read about these items, and questioned them, they were often advised that should the reset payment be unmanageable, that they could always sell the underlying real estate and realize a substantial profit after paying off the

loan and that they would profit in that way as well. Many gave up perfectly acceptable traditional and fixed rate loan products for teaser-rate variable-reset loan products.[319]

Starting in 2007, although some resets showed earlier concerns, the predictable happened. Resets of initial teaser rates started to occur; new rates were dramatically greater; and, there was a rush for the exits to sell the collateral to pay-off the loans and avoid the increasing payment which many borrowers could not afford. Property prices started to erode as more and more property came on to the property markets and prices were dropped to hasten sales. The erosion became more dramatic as inventory of property began to flood the marketplace in the first two quarters of 2008[320]. As more and more of the earliest loans began to reset as to interest rates, or reamortized, or even became due, and hence became clearly unaffordable, the dwindling supply of eligible buyers of property withdrew from the market entirely and the borrowers on these poorly conceived loans were cornered and trapped into their loans and forced to address higher payments they could not even begin to afford.

In addition, and to add to the perfect storm, concurrent with these issues, worldwide production slowed and unemployment increased throughout the Westernized world. Defaults and insolvencies began to rise at a steepened pace. Panic began to emerge in the property market followed by a steady progression of defaults and foreclosures. By early 2009, the property markets in America had declined sharply or had simply collapsed[321]. The same was true in many parts of Europe.

Banks were forced to downgrade loans and 'mark collateral to market', or, in layman's terms, value loans at the declining value of collateral securing them[322]. Bank

balance sheets were literally dropping daily with the daily corresponding fall of property prices. As bank balance sheets reflected reduced asset values for loans and other assets such as bank branch properties, the deposit obligations on the liability side of a bank's financial statement remained fixed and often at full values. In essence, the banks were likely to recover only a portion of their outstanding loans but all of their deposit obligations remained due and payable. This turned profitable banks into unprofitable, illiquid and wholly marginal banks in rapid fashion. Bank failure soon followed.

In 2008, these cross-currents of problems led to the, seriatim, shocking collapse of Northern Rock Bank[323], the investment bank houses of Lehman Brothers[324] and Bear Stearns[325], the need for Citicorp, owner of Citibank, to seek recapitalization from sovereign funds[326], the multiple near-failures of insurance giant AIG[327]; and, finally, the full collapse of the final purchaser and guarantor of standard residential loans in the United States, Fannie Mae and Freddie Mac[328], both quasi-governmental. Hundreds of worldwide catastrophic failures then ensued in serial fashion.

By the end of the Summer of 2008, the market was in near free fall and central banks from around the world did what J. P. Morgan had done 101 years before—they were forced to fully flood the market with liquidity and injected billions of dollars, yen, pounds and euro into global financial markets to maintain, at the minimum, the illusion of liquid markets and to prevent panic, runs and further failure. It was as if the 1907 Bankers Panic had occurred all over again-- except this time it wasn't measured in millions but in trillions of these currencies and the world's central banks, deposit insurers and prudential regulators coordinating the flood of liquidity rather than J. P. Morgan calling these moves from his New York offices.

World banks—*large, regional and community*--were immediately impacted by these events as they had pipeline and conduit loans out to packagers of the securitizations in progress; they had already financed land loans for future securitization projects; they held some of the securitized products as assets; and, their commercial loans were starting to stumble with the slowing economy and high unemployment. But then a product far worse was discovered in the investment areas of many banks—that product actually was an exotic financial product designed to take positions with regard to the pools of securitizations and to, in essence, insure their performance. The yield on these products, often referred to as derivatives or 'swaps', was impressive and the risk seemed low as the securitized portfolios were risk rated by credible rating agencies and were backed by appreciating real estate collateral.

These derivatives and swaps, however, also promised that if the pools so insured did default that they held counterparty financial risk to those who might be harmed by nonpayment after liquidation of collateral. In essence, large numbers of borrowers defaulting plus rapidly declining collateral values would trigger the swap liability to a pool. Few felt this would occur; however, and once more quite predictably in hindsight, that is precisely what has occurred. As the underlying borrowers securitized into the pools in fact defaulted at a massive and increasing rate, and the collateral securing the pool went into near free-fall decline, these products turned from a swap product with impressive yield to the holder and with manageable exposure to a staggering financial liability to the parties with counterparty risk on these instruments.

The creator of this product and one of its largest holders was the parent company of an international insurance conglomerate by the name of AIG[329] and AIG has more

than once suffered near collapse over the credit-default swap issue[330]. To avoid insolvency, and anticipated chaos in international insurance markets, the United States made the decision to loan a staggering (U.S.) $148.0 billion to this one insurance giant. This loan has been severely criticized as being a waste of taxpayer funds[331]. As it is, AIG is not expected to repay all of the sums it has been loaned to date to avoid a systemic collapse of the insurance industry globally[332].

However, this was not the extent of the fallout. General economies went into decline with these events. Banks with normal banking loan relationships (that were not securitized) faced defaults in traditional commercial loans and especially loans dealing with vacant land or home building. As banks realized their emerging liabilities, and saw their growing credit losses, and received negative stress testing by their regulators, they drew back in the way banks often react to crises and tightened credit to preserve precious capital and liquidity and, in some cases, would not lend at all to preserve their ratios and growing loan loss commitments. The dreaded gridlock was emerging and credit became deadlocked and businesses understandably failed from failure to obtain business credit.

As businesses failed, loans failed and there has been a surge in credit losses and insolvencies that has continued through the autumn of 2009. Hundreds of thousands of businesses around the word have since failed, over a million persons in the United States have filed for bankruptcy[333] in the past year, and rates of unemployment are at historic highs for recent decades. This has created waves of loan defaults moving through the mortgage[334], small commercial[335], automobile[336] and credit card[337] loan markets that is predicted to continue unabated well into 2010 and beyond

with commercial real estate loans held by community banks[338] the latest wave to be passing through the American system as this work was being finalized.

As banks and related institutions like credit unions suffer these heavy rates of lending defaults, while still maintaining full liability to repay deposits, they are forced to inject new capital to cover the gap and use capital to reserve as to any shortfall loan loss liability expected with the loan liquidation[339]. This promptly depletes available capital and earned income and renders many banks unprofitable for certainly the short term and, possibly the long-term. This also precludes the ability of banks to acquire more capital at reasonable prices as their current failure to maintain profitability and now-exposed balance sheet risks remain a major concern of the securities industry (although there have been select bank capital offerings to raise capital during the summer and early Fall of 2009 and, as noted, certain banks appear once more to be the darlings of Wall Street)[340]. In the case of 26 banks in 2008 and almost 100 banks to date in 2009 in the United States, the restart of capital markets have come too late and this has resulted in bank closures due to lack of capital, Illiquidity or insufficient management. Worldwide, it has resulted in the closure, nationalization or forced merger of hundreds of other institutions and trillions of (U.S.) dollars of loss to the sector worldwide[341].

This brings us full circle back to deposit insurance. A deposit insurer, then, is the end of the line to these issues and is the recipient of their wake—at least the financial end of the line for the tidal wave known as the current global financial crisis. As can be expected, such a huge wave of closed or soon to close banks and their various loan products that are failing has quickly swamped and depleted the resources of many

deposit insurers' reserves, including that of the FDIC which was thought to be in an over-funded surplus condition approaching a statutory dividend just a few years ago[342]. As banks fail due to improvident lending programs, they drain resources from any DIF. The DIF of most countries have gone from strong surplus to basically, a fully depleted 'beggar' fund seeking *ex post* funding from governments.

As will be seen in Chapter 4, the FDIC is under a mandate to recapitalize and restore the DIF in America[343] and, if necessary, draw borrowings from the United States Treasury pursuant to a (U.S.) $100.0 billion credit line which will increase to a (U.S.) $500.0 billion credit line[344]. The same principle applies under many other deposit insurance funds across the globe. This imposes on the remaining institutions increased premiums assessment rates (and special assessments). Currently, this is a double challenge for banks in America and elsewhere. First, the bank ratings for many institutions have dropped which raises risk levels and differential premium rates.[345] Second, in the United States, the FDIC is now proposing to collect the next three years of increased premiums all at one time for institutions in the United States[346]. This could exacerbate another round of bank failure and seems improvident.

For as many as 416 banks as of this time in the United States on the troubled bank list[347], the increase in deposit insurance will be the final straw that renders them insolvent. As such, more assessments will be necessary to cover the losses of the next round of bank failures and the next and so on and so forth and only a mathematician or actuary could finally and fully assess the final effect. It is without a doubt one of the most serious events ever to face the FDIC in its 75 years of existence. The FDIC is, at best, midstream in the current financial problem but without substantial deposit

insurance funds now in reserve to combat it aggressively. As will be seen in Chapter 5, below, it is also a major concern for other deposit insurance funds around the world and for many their dreams of an *ex ante* funded scheme with fully stable deposit insurance outcomes has been delayed by years, decades or maybe even for a lifetime.

e. Deposit Insurance As A Safety-Net Participant: Why Is Deposit Insurance Necessary At All With So Many Other Protections?

We have seen in this Chapter how the argument for guaranties of deposits as part of a financial safety-net is easy to picture and much harder to maintain. There is a tension between the desired protective aspect of deposit insurance and the significant cost aspect that such protection engenders.

The positive case for the guarantee of deposits is that, first, to a great extent deposit insurance is funded in healthy times by the banks who benefit and is only a modest marginal cost; second, it spreads deposit risk over many banks of various types and acts as a financial market shock absorber; third, it avoids bank panic and runs of any serious note; fourth, if funded *ex ante,* it can be implemented immediately to curb a crisis; fifth, it normally deflects bank crises to a governmental entity well positioned to combat it in a coordinate manner.

However, the argument against the guarantee of deposits is also equally easy to construct. First, deposit insurance is unable to withstand the merciless assault of systemic risk and there will always be an element of public funds used *ex post* to maintain such a system when systemic crisis comes 'a knocking at the door'; second, protection is, in some cases, so inadequate (due to fear of Moral Hazard) so as to border on almost the illusory; third, it seems to provide cover to prudential regulators not

performing adequately and might even prevent other intervention; fourth, it is an excuse to withhold transparent information from depositors; and, fifth, deposit insurance is difficult to square with capitalistic pursuits as it singles out banks as a special case and for exceptions from market forces that apply to all the rest of mere mortal investment markets.

As this work next proceeds to analyze more deeply the design and implementation of deposit insurance systems today which our next Chapter 2 will explore, it is helpful to stop and ask if we really need deposit insurance or is deposit insurance our excuse and flimsy line of defense that gets blown down like a poorly designed straw house by any wolf at the door over a few banks deep and results in *ex post* taxpayer bailout anyway. Better put, is repayment of insured deposits coming from the DIF in the end or is it really coming, at least for any material, major crisis, from taxpayers, governments, central banks and healthy banks? This highlights the need for stronger design of deposit insurance plans which will be our next area of consideration.

ENDNOTES—CHAPTER 1

---

[1] Banking and financial services have a particularly lineal development. There is a very helpful set of chronologies on this issue referenced in Kindleberger, p. 10-16 that demonstrate the progression of banking in Europe and Asia (and later the entire world) from 1252 to 1991. For even earlier historical analysis, see Part I of Bogaert where there is a fascinating account of ancient and classical age banking.

[2] Bogaert, p. 13

[3] This is a classic legal bilateral promise—something given for something received on both sides. Kindleberger states that many paths led to banking and this promise. Many of them are receipt-based such as a goldsmith who issues a receipt for the gold that was left; or tokens to pay wages; or the concept of barter. Kindleberger, p. 37.

[4] Bailment describes a legal relationship in common law where physical possession of personal property (chattels) is transferred from one person (the 'bailor') to another person (the 'bailee') and who subsequently holds possession of the property. No matter how a bailment arises, the bailee has both a duty of care and a duty to re-deliver the bailment property. The bailee is expected to take (as a minimum) reasonable precautions to safeguard the property,

although this standard sometimes varies depending upon who benefits from the bailment and is not as high a duty as a fiduciary one.

[5] Risk associated with banking was discovered early. Financial 'crises', while not as complex as today's versions, were already well known by the mid-1500's in England, the Netherlands and elsewhere. Kindleberger, p. 278.

[6] For a discussion of the integrated safety-net, and the inter-relationships between the various 'players' in the integrated financial net, see ASBA, p. 37. An excellent discussion of the European financial safety-net can also be found in Kremers, p. 107.

[7] The name 'bank' derives from the Italian word banco, which means desk or bench and was used during the Renaissance by Florentine bankers, who used to make their transactions above a desk covered by a green tablecloth. However, there are traces of banking activity even in ancient times. In fact, the word traces its origins back to the Ancient Roman Empire, where moneylenders would set up their temporary stalls in the middle of enclosed courtyards called a 'macella' on a long bench called a 'bancu', from which the words 'banco' and 'bank' are likely derived. As a moneychanger, the merchant at the bancu did not so much invest money as merely convert the foreign currency into the only legal tender in Rome—that of the Imperial Mint. The earliest evidence of money-changing activity is depicted on a silver drachm coin from an ancient Hellenic colony 'Trapezus' located on the Black Sea, modern Trabzon, c. 350–325 BC, present in the British Museum in London. The coin shows a banker's table (trapeza) laden with coins. In fact, even today in Modern Greece the word Trapeza (Τράπεζα) means both a table and a bank. See, also, Kindleberger, p. 37.

[8] As we will soon see, systemic risk is actually the great scourge and worst enemy of deposit insurance. Instead of deposit insurance being able to counteract isolated bank failures, systemic risk weakens great swaths of financial institutions together and their collective failure quickly overwhelms it and renders it ineffective. The work often refers to the 'swamping' of the system because in the United States swamps are places where those persons who unfortunately fall in are overwhelmed and often disappear. See, also, Carnell.

[9] This is why deposit insurance is only one of the many legs of the financial safety-net stool in any nation. Deposit insurance, alone, is almost always insufficient. It needs other players in the financial net to tackle other issues. The other 'legs' of the safety-net stool, those of direct lending/ lender of last resort status and cooperation between central banks as to monetary control that played such an important part in the current financial crisis to help hold back the flood waters of bank failure when deposit insurance cannot do so itself. Put more simply, and at times, financial crises can only be averted by flooding the market with money the deposit insurer simply does not have itself.

[10] See, web article, www.telegraph,co.uk, Evans-Pritchard, *IMF Tells Europe To Come Clean On Bank Losses,* Daily Telegraph (8 June 2009)

[11] The complete up-to-date U.S. failed bank list can be found here: http://www.fdic.gov/bank/individual/failed/banklist.html From June 2004 to February 2007, there were no failed banks at all in the U.S. From 2000 to 2007, a period of 7 years, only 24 banks failed. Since February, 2007, to the date this work concluded in early October 2009, a period of approximately 30 months, over 125 U.S. banks have failed. In addition, 14 U.S. credit unions have also failed in the latest crisis. See, http://www.bankinfosecurity.com/articles.php?art_id=1827.

[12] See Fraser's Online Article at bbc.co.uk entitled '*More Banks Please'*.

[13] See, Rabkin, Alan, *Push Me! Pull! Cross Purpose Regulation of Banking In Ireland,* Trinity College Law Review, Vol. 8, p. 177-196 (2005); see, also: Weill, *On The Relationship Between Competition and Efficiency In The EU Banking Sectors* (2003).

[14] This is the major argument behind Moral Hazard. One could plausibly argue that if deposit insurance did not exist, and *caveat emptor* applied to banking as it does to every other form of investment, that one would be more guarded with one's investment and institutions would be forced to become more conservative to earn the business of investors with surplus wealth. As stated above, that the bank and bank saver would not be distracted by deposit insurance. See, Mishkin. Also, see, Calomiris Article 1.

[15] Webster's Dictionary states that the definition of the word bank includes "a place where something is held available". To 'bank on' something is to rely upon it or to depend upon it.

[16] Bogaert, at p. 15, states that Egyptian Scribes from 2600-2400 BC recorded 'banking purposeful records' on papyri and that by the neo-Sumerian period, the III rd Ur dynasty, roughly 2112 to 2004 BC, there were crude loans of agricultural products (in this case the crop of barley). The Assyrians created special words for the lending of things by 1900 BC. By 1792-1750 BC, the temples and palaces of Babylon were making what appear to be crude loans during the reign of Hammurabi where the borrower had to make repayment to a 'bearer of the sealed tablet'. By the 7th to 5th Centuries BC, private banking had emerged but was very elemental. An actual receipt for a banking

transaction has been discovered issued by an Egyptian 'banker' and recording payment for several donkeys dated 257 BC. However, these efforts pale in comparison to the leaps the Greeks and Romans made in banking evolution.

[17] This is certainly true prior to 2600 BC.

[18] This is typical hunting and gathering conduct. See, http://www.mc.maricopa.edu/dept/d10/asb/lifeways/hunt_gather.html.

[19] Russell, *Banking Credits and Finance (Introduction, Part 2)*; Gilbart, *History, Principles and Practice of Banking* (1899, 1907, 1919).

[20] Bogaert, p. 19. The ancient Greek's practiced diverse banking operations as early as the 5th Century BC. They reverted from inconvenient representational wealth in the form of trivets, cauldrons, axes and spits to the emerging system of metal coinage. In classical Greece, there were no fewer than 265 cities and most had their own metal coinage and there was enormous diversity. The moneychangers became important as they were the professionals who could 'spot' counterfeit coins and by 527 BC they were already mentioned in Byzantium and by 457 BC they were already in Greek documentation. In essence, they were the 'coin police' as they could alert authorities to counterfeiters.

[21] Bogaert, pp. 43-49.

[22] Chapman, Branch Banking: Its Historical and Theoretical Position In America and Abroad (The Rise of Commercial Banking) (1980)

[23] Baker, *Tight Fists or Open Hands: Wealth and Poverty In Old Testament Law*, p. 62.

[24] Bogaert, p. 21.For example, the so-called argentarii operated at the banks known as *tabernae argentariae* which were set up in the forum. The chief occupation of the argentarii was to exchange coins. *Permutatio* was the exchange of foreign coins for Roman ones, and was one of the prime responsibilities of the argentarii. They also kept sums of money for other people as they were trusted to do so. Argentarii might be custodians of money in order to pay interest on behalf of those who entrusted them with the money. While in their custody, the argentarii would use the capital for their own profitable purposes. Argentarii could also act as agents, as at public auctions. They also tested the value of coins. During the imperial period, the argentarii were responsible for the circulation of newly-minted coins. See, Gill, *The Argentarrii* at http://ancienthistory.about.com/od/lawgovernmentpolitic1/g/Argentarii.htm

[25] Bogaert, p. 21.

[26] In a country where commerce was looked upon with some contempt, Roman banking was not deemed very respectable. Amongst most of the ancient agricultural nations there was a prejudice against the taking of interest for the loan of money. Hence the private bankers at Rome were sometimes held in disrepute, though those whom the government had established as' public cashiers', or receivers-general, as we may term them now, held so exalted a rank that some of them went on to become consuls in Roman society—a very high rank for those times.

[27] Money, which is the representational form, allows markets to stay liquid and had advantages over bartering forms. Here is an example: If a wheat farmer needs what a fruit farmer produces, a direct swap is impossible as seasonal fruit would spoil before the grain harvest. A solution is to trade fruit for wheat indirectly through a third, "intermediate", commodity: the fruit is then exchanged for the intermediate commodity when the fruit ripens. If this *intermediate commodity* doesn't perish and is reliably in demand throughout the year (e.g. copper, gold, or wine) then it can be exchanged again for wheat after the harvest. The function of the intermediate commodity as a' store-of-value' can be standardized into a widespread commodity or money, reducing the 'coincidence of wants' problem. By overcoming the limitations of simple barter, a commodity driven money supply makes the market in all other commodities more liquid. See, http://en.wikipedia.org/wiki/History_of_money

[28] See, McCusker, *Money and Exchange In Europe and America and Europe: 1600-1775* (1978)

[29] The Old Testament. Book of Genesis, 41:1, et seq.

[30] See, Kindelberger, pp. 76-96. There are hundreds of jokes about thrifty cultures (some rather offensive and others downright funny). For example, according to one tale the great trench in the United States known as the Grand Canyon was started by a Scot who lost a coin in a ditch. There are less humorist depictions of 'cheap' cultures and religions that show real bias and even scorn. For example, the character of *Shylock*, the infamous Jewish moneylender in Shakespeare's The Merchant of Venice, is the epitome of the stereotype that all Jews are 'cheap' and shrewd in business. Being a 'shylock' in many countries means being 'cheap'. The list of funny and debase examples extends to many other cultures and religions.

[31] For the evolution of central banking, see Kindleberger, p. 85. A central bank, reserve bank, or monetary authority is a banking institution granted the exclusive privilege to lend to a government its currency. Like a normal commercial bank, a central bank charges interest on the loans made to its 'borrowers', primarily the government of whichever country the bank exists for, and to other commercial banks, typically as a 'lender of last resort'. However,

a central bank is distinguished from a normal commercial bank because it has a monopoly on creating the currency of that nation, which is loaned to the government in the form of legal tender. It is a bank that can lend money to other banks in times of need. See, http://en.wikipedia.org/wiki/Central_bank.

[32]Trusts developed rapidly in England at the time of the Crusades and throughout the 12th and 13th Centuries. Trusts are part of the tradition of equity and 'doing equity' and the equitable powers of the courts exhibited in a Lord Chancellor or similar position, At the time, land ownership in England was based on the feudal system. When a landowner left England to fight in the Crusades, he needed someone to run his estate in his absence, often to pay and receive feudal 'dues'. To achieve this, he would convey ownership of his lands 'in trust' on the understanding that the ownership would be conveyed back to him on his return or to his descendants if he did not. Roman law recognized a similar concept hundreds of years before that which it referred to as the *fidei-commissa*. It has been suggested that the crusaders adapted the concept from the Islamic tradition of *waqf* and may have been exposed to the concept during the Crusades. See Trust History found at http://www.trustabc.com/trust-history/.

[33] Banking brought about new and different ways to create economic crime. Prior to the development of banking, classic theft was the normal way that wealth was taken by one from another. Banking, and its entrustment aspects, created new crimes of embezzlement, entrustment, unjust enrichment and breach of fiduciary duty; in addition, breach of trust; and various theories of failure to follow instructions and directions. These all remain as theories to address abuses by fiduciaries to this day. See: Villa, *Banking Crimes*, Clark Boardman (1987)

[34] The classic definition of an intermediary is a third party that offers intermediation services between two trading parties. The intermediary acts as a conduit for goods or services offered by a supplier to a consumer. Typically, the intermediary offers some added value to the transaction that may not be possible by direct trading.

[35] Bogaert, p. 77

[36] For many, even today, remaining trustful of one's bankers and knowing one's banker personally is more important than receiving the highest rates or the best banking deal. However, that belief is likely in its steady decline since the 1950's and the depersonalization of the bank-customer relationship.

[37] Bogaert has an excellent discussion of religious influence in banking at p. 77.

[38] The history of interest is fascinating but is beyond this work. Interest is the price paid for the use of savings over a given period of time. In ancient (biblical) Israel, it was against the Law of Moses to charge interest on private loans. During the Middle Ages, time was considered to be 'Property of God'. Therefore, to charge interest was considered to be engaged in 'Commerce with God's property' and, obviously, not in accord with religious teaching. Also, St. Thomas Aquinas, one of the leading theologians of the Catholic Church, argued that the charging of interest is wrong because it amounts to a "double charging": charging for both the thing and the use of the thing. The church officially regarded interest as a 'sin of usury'; nevertheless, this rule was never strictly obeyed and eroded gradually until it disappeared during the industrial revolution almost entirely. See, http://en.wikipedia.org/wiki/Interest. No religion, save Islam, speaks to the sinfulness of interest now; however, many speak to taking advantage of a neighbor with sharp practices and setting loan interest so high so as to shock the conscience and constitute usury. See, Cantor, *The Civilization of the Middle Ages: A Completely Revised And Expanded Edit*ion (Harper, 1994); Bishop, *The Middle Ages* (Mariner, 2001).

[39] See, also, IMF article Cihak, *Study Shows Larger Islamic Banks Need Prudential Eye* (May 19, 2008)

[40] For an ancient example of an actual security pledge from the Year 1169, see http://www.fordham.edu/halsall/source/1169landpldg.html.

[41] Friedman, *Dead Hands: A Social History of Wills, Trusts and Inheritance Laws* (2009)

[42]The definition of intermediary includes acting as a mediator or 'link'. http://www.merriam-webster.com/dictionary/intermediary

[43] Bogaert, p. 19, 77.

[44] The Holy Gospel of Matthew 21:12; The Holy Gospel of Mark 11:15; The Holy Gospel of Luke 19:45.

[45] The Holy Gospel of Matthew 26:15; 27:3. See, also, Wright, *One Nation Under Debt* (McGraw Hill, 2008).

[46] See, Kindelberger, p. 15. Also, see, Caselli, *Government Debts and Financial Markets In Europe* (Pickering, 2008). Jews were actually expelled from Spain entirely in the year 1492—just 10 years before all the Moors were expelled. Jewish life in the Middle Ages was, for the most part, a story of social and economic isolation, persecution and massacres. Jews were isolated both physically and socially from the fabric of life in the Middle Ages and the period following the Middle Ages. Yet they filled an important niche. Christianity outlawed (or at least frowned on) the charging of interest (usury) and the lending of money. Jews were permitted to fill this vacuum by acting as moneylenders and 'financiers' in that disreputable business so non-Jews would not have to. For extensive discussion of this topic, see Poliakov, *Jewish Bankers and the Holy Sea: From The Thirteenth to the Nineteenth Century* (Law Book Company, 1978).

[47] The daily life of a peasant was anything but romantic and was back-breaking work and is described in this article: http://www.mnsu.edu/emuseum/history/middleages/pdailylife.html.

[48] The current head of the U.S. Federal Reserve, Chairman Bernanke, is, offensively, accused of being the latest 'Jewish Money Lender" by his critics. His predecessor, Alan Greenspan, is also Jewish. However, the Fed Chairman before Alan Greenspan, Paul Volcker, was raised Protestant in the Lutheran and Episcopal churches.

[49] Ferguson, *The House of Rothschild, Vol. 1, Money's Prophet's*; Bogaert, p.298-300

[50] The globalization and corporatization of banking has caused the great banking families to fade drastically in the later part of the 20th Century. The Rothschild's, Morgan's, Chases's, Giannini's and others are essentially gone.

[51] Of particular and sad note about the *Bernard Madoff Ponzi Scheme* is the fact that Madoff, who is himself Jewish, had as clients some of the most prominent Jewish philanthropists of the Modern Age and he has caused the failure of many. See: http://jta.org/news/article/2008/12/14/1001530/madoff-scandal-rocks-jewish-philanthropic-world.

[52] http://en.wikipedia.org/wiki/History_of_banking

[53] The word 'moors' derives from the Latin 'mauri', a name for the Berber tribes living in Roman Mauretania (which is modern-day Algeria and Morocco). It has no ethnographic meaning but can be used to refer to all Muslims, Berber or Arab, who conquered the Iberian Peninsula.

[54].http://www.castles-of-britain.com/castle35.htm.

[55] Primogeniture is Latin for and means 'first born,' In feudal England (except in the County of Kent), the oldest (first born) son would inherit the entire estate of his parents (or nearest ancestor), and, if there was no male heir, the daughters would take (receive the property) in equal shares. The intent was to preserve larger properties from being broken up into small holdings, which might weaken the power of nobles. This has carried forth to today where 'boy babies' are preferred over 'girl babies' in some cultures.

[56] Robin Hood remains an unproved legend. For an informative website, see: http://www.robinhood.ltd.uk/robinhood/index.html.

[57] A knights first and basic pledge was for 'duty, honor and fidelity (loyalty)'. http://www.medieval-castle-siege-weapons.com/knight-in-medieval-times.html. Madden, *The New Concise History of the Crusades* (Rowman, 2005); Maaloof, *The History of the Crusades Through Arab Eyes* (Schocken, 1989)

[58] A knight was bound by a form of law, or code, called the *Chivalric Code*. We refer to this now as 'Chivalry' See, http://en.wikipedia.org/wiki/Knight#Chivalric_code.

[59] Kleinhenz, *Medieval Italy* (2004), p. 90; Bogaert, p. 102. Also, see, Riley-Smith, *Oxford Illustrated History of the Crusades* (Oxford University, 2001)

[60] This has lingered on until the Modern Era. Many still see the church as an honest broker or 'go-between' in disputes, relationship matters, labor disputes and the like. In many societies, the church is called into disputes to settle them fairly for this reason.

[61] In fact, the church maintained some of the best records of birth, death and estates available for this period.

[62] Scrip is representational of money and can usually be exchanged for it. See, Kindelberger, pp. 19-36 for the evolutionary aspects of money and its equivalents.

[63] Often known as the 'Strict Settlement'. Spring, Eileen, *Law, Land & Family, Aristocratic Inheritance In England, 1300-180.* (University of North Carolina Press, 1993), pp.123-147.

[64] Drafts and bills of exchange look much like our modern day checks. See, Ferguson, *The Ascent of Money: A Financial History of the World* (Penguin, 2008).

[65] Setton, Kenneth, *A History of the Crusades* (University of Wisconsin Press, 1955, 1969)

[66] http://www.avignon-et-provence.com/avignon-tourism/popes-avignon/index.html.

[67] Believed to have started in China, the pawnshop came to England with William the Conqueror, with the Italian name, Lombard. In 1338, Edward III pawned his jewels to the Lombard's to raise money for his war with France. King Henry V did much the same in 1415. The Lombard's were not a popular class and Henry VII Tudor harried them a good deal. In the very first year of James I Stuart, an Act against 'brokers' was passed and remained on the statute-books until Queen Victoria had been on the throne thirty-five years. It was aimed at the many counterfeit 'brokers' in London. This type of broker was evidently regarded as a 'fence' (a reseller of stolen goods). It is also known that Queen Isabella of Spain pawned her jewelry in order to send Christopher Columbus out to what he believed was the conquest of the Indies, China and Japan. http://www.ezcashofpanamacity.com/history2.html.

[68] Indeed, it is now quite difficult to define the word 'banker' or 'bank' to cover all the diverse and varied activities and functions of these times. Essentially, there are two reasons why one needs to know who a banker is. First, the nature of the relationship between bank and customer has certain legal characteristics which may, to some degree, distinguish it from other relationships. Secondly, a variety of statutes refer to banks, or to bankers, or to the business

of banking and it needs to be determine who these laws apply to. See, http://law-khailiza82.blogspot.com/2007/07/definition-of-banker.html.

[69] Maximilian I expanded the influence of the House of Habsburg through both war and marriage, but also lost the Austrian territories in today's Switzerland in the battle of Dornach 22 July 1499, where the Swiss won a final decisive victory. Ironically, as it was later to become the home city of the Bank of International Settlements we shall discuss in Chapter 6, Maximilian I had no choice but to agree to a peace treaty signed on 22 September 1499 in Basel granting the Swiss Confederacy de facto far-reaching independence from the Habsburgs. Maximilian I is often referred to as 'The Last Knight'.

[70] Maximilian was not always a fully just emperor as he allowed the arbitrary deduction of interest owed to Jewish moneylenders from the principal owed to them as part of their banishment in the 1500's. http://www.jewishencyclopedia.com/view.jsp?artid=442&letter=R.

[71] See an extensive review of the concepts of Islamic banking and finance here: http://www.islamic-banking.com/what_is_ibanking.aspx.

[72] An excellent summary of *Shariah law* prepared by the Council For Foreign Relations can be found here: http://www.cfr.org/publication/8034/.

[73] An actual *wadiah-form* of bank account is explained here: http://www.standardchartered.com.my/islamic-banking/about-islamic-banking/islamic-concepts/en/.

[74] As well as finding its way into deposit insurance methodology. For example, see Kane, p. 87 where he analyzes the correlation between interest rates and deposit insurance risk. In essence, that risk-based premiums must consider the aspect of interest rate volatility for specific institutions.

[75] This presents unique challenges in regulating Islamic banks prudentially and unique challenges specially to deposit insurance. See, Regulation and Supervision of Islamic Banking in the United States, http://www.newyorkfed.org/newsevents/speeches_archive/2005/rut050422.html.

[76] It was common for emperors, monarchs and similar heads of state to put their own likeness upon the coinage of the realm. Caesar and Napoleon are just two examples.

[77] Kindelberger, p. 41-42.

[78] One recalls the concept of 'debtors prison' where you either pay one's debt or suffer imprisonment. http://myvesta.org/history/history_debtorprison.html .

[79] Richard Morris, one of the founders of the United States and signatory of the Declaration of Independence, was tossed into debtor's prison. Unfortunately, he was not as astute with his own finances as he was in financing Washington and the war of independence with Britain. In 1798 he was arrested for debt resulting from his speculation in land and confined to the Prune Street prison, Philadelphia, Pennsylvania from February 1798, until liberated by the passage of the national bankruptcy law in 1802 (almost 4 years!). This willingness to enforce the repayment of one's debts, or face imprisonment in return, even as to the highest level of gentlemen, lady or citizen, was a major deterrence to nonpayment.

[80] The recourse, of course, was imprisonment as stated in the prior note.

[81] Barth, p. 37. Kindleberger, p. 45.

[82] Few other names have become more synonymous with the *Illuminati* than the Rothschild's. Mayer Amschel Rothschild (1743-1812) was born in Frankfurt-on-the-Main in Germany, the son of Moses Amschel Bauer, a banker and goldsmith. Their name 'Rothschild' was derived from the 'red shield' ('rotschildt') that hung over the door of their shop, and had been the emblem of revolutionary Jews in Eastern Europe. A few years after his father's death, he worked as a clerk in a Hanover bank, which was owned by the Oppenheimer's, another famous financial family. He became a junior partner, and soon left to take over the business started by his father in 1750. He bought and sold rare coins, and later succeeded in buying out several other local coin dealers. In 1769, he became a court agent for Prince William IX of Hesse-Kassel, who was the grandson of George II of England, a cousin to George III, a nephew of the King of Denmark, and a brother-in-law to the King of Sweden. Soon Rothschild became the middleman for large Frankfurt bankers like the Bethmann Brothers, and Rueppell & Harnier. After expanding his business to antiques, wineries, and the importing of manufactured materials from England, the Rothschild family began to amass a sizable and significant fortune. Ultimately, the House of Rothschild would be the favorite financier of kings, emperors and rulers. Ferguson, *The World's Banker: The History of the House of Rothschild* (1998),

[83] Butters, *Governors and Government In Early Sixteenth Century Florence: 1502-1519* (Oxford University Press, 1985), Chapter 8.

[84] Ferguson, *The House of Rothschild* (Vol. 1/1798-1848 and Vol. 2/1849-1999) (Penguin, 2000).

[85] Corti, *Rise of the House of Rothschild*, p. 28 (Cosmopolitan, 1928)

[86] Kindleberger, p. 97

[87] Kindleberger, p. 118
[88] Kindleberger, p. 147
[89] Kindleberger, p. 137
[90] Kindleberger, p.77
[91] Kindleberger, p. 306
[92] Phillips, *Do Banks Loan Money?,* Journal of Business Ethics, Vol. 1, No. 3 (1982)
[93] Kindleberger, p. 38
[94] Deposit obligations for a bank that has not failed are legally enforceable and include amount of original deposit, less withdrawals, plus interest, less agreed-upon and legal fees. Here is a typical example of a statute in the American State of Nevada (and other statutes exist for 'savings' and 'time' deposits:

> **NRS 657.035 "Demand deposits" defined.** "Demand deposits" means all deposits the immediate withdrawal of which can be legally required upon a proper written request for such payment.
> (Added to NRS by 1971, 965)

[95] See, Kindelberger, p. 41-44. This concept gets caught up with the problems of usury as usurious rates of interest cast a long shadow over the use of interest for deposits in banks.
[96] See, Lovett, p. 144 where he presents a sample bank balance sheet (Chart III-2) showing this clearly. Also, see, Carnell, p. 267-272 for additional samples reflecting this liability.
[97] In essence, money is now more than savings and thriftiness. It is a way to make still more money. The saver makes this additional wealth through deposit interest; the bank makes it through loan interest and loan fees.
[98] This has come to be known as credit risk or lending risk and needs to be monitored and managed. The BIS has an excellent article entitled *Principles For Managing Credit Risk*, which can be found here: http://www.bis.org/publ/bcbs54.htm.
[99] See, Clarke, *Money is Still Fungible and Banks Are Not Nonprofits*, The Atlantic which can be found at http://business.theatlantic.com/2009/02/money_is_still_fungible_and_banks_are_not_nonprofits.php.
[100] Berlin, *Deposits and Relationship Lending*, Wharton Financial Institutions Center, Paper 99-03 (1998).
[101] Cotter, Section 2.1.
[102] This developed into the general concept of '*Keystone Pricing*', which is doubling the wholesale deposit 'costs' for retail pricing. Therefore, when applied to banking, it was not unusual for a banker to double the deposit rate to arrive at the lending rate. So a promise to pay a depositor 3.0% would result in a borrower paying 6.0%. The 3.0% difference is the 'Banker's Spread'. A recent survey of rates in America shows the average deposit rate to be an abnormally low 2.0% and the average borrowing rate to be about 5.0% as of the end of September, 2009. This is more than double and would seem to be inconsistent with *Keystone Pricing*. But it is not. This is because rates of borrowing interest are so low that certain interest rate minimum 'floor' provisions have been triggered under lending documentation which the interest rates for loans, especially commercial loans, will not go below by agreement. So the 'Banker's Spread' has actually increased in these difficult times if such rate protection was anticipated. Still, as so many loans are in default, this is little comfort to bankers as their general profits are being sopped up by huge credit risks still emerging and earning a slightly larger spread on some paying loans will not save many banks.
[103] See *Types of Default* in the following article: http://en.wikipedia.org/wiki/Default_(finance).
[104] Many a loan has never been repaid due to change in government, war or imprisonment of the very banker who made the loan. Such level of failure seems to be the ultimate systemic risk.
[105] Tolmie, *Corporate and Personal Insolvency Law*, (Cavendish Publishing, 2003), pp. 8-10.
[106] In finance, a default occurs when a debtor has not met his or her legal obligations according to the debt contract, instrument or document (e.g. has not made a scheduled payment), or he has violated a loan covenant (condition) of the debt contract. A default is the failure to pay back a loan or honor its terms. Default may occur if the debtor is either unwilling or unable to pay their debt. This can occur with all debt obligations including bonds, mortgages, loans, and promissory notes.
[107] See, Selgin, *Bank Self-Regulation*, Vol. 14, No. 3, Cato Institute (1995), available at this location: http://www.cato.org/pubs/journal/cj14n3-6.html.
[108] The Bible's Old Testament is replete with cautions against usurious interest rates: The following are just some: Exodus 22:25, Leviticus 25:36 and 25:37; Deuteronomy 23:19 and 23:20.
[109] In 1275, Edward I of England passed the *Statute of Jewry* which made usury illegal and linked it to blasphemy, in order to seize the assets of the violators. Scores of English Jews were arrested, 300 were hanged and their property went to the Crown. In 1290, all non-converting Jews were expelled from England, and allowed to take only what

they could carry; the rest of their property became the Crown's. The violation of usury was cited as the official reason for the Edict of Expulsion.

[110] Usury was both a political and religious problem. See, Kindleberger, p. 43. Of course, usury is now declared illegal in most countries but rates are still set high before usury, maximum ceilings and'loan sharking' provisions are triggered. However, banks are often more tightly regulated on the issue of usury. See, Carnell, p. 335-339, for example, where national banks in the United States are subject to tight usury standards. Also, see, *Marquette National Bank v. First Of Omaha Service Corporation*, 439 U.S. 299 (1978) upholding various usury laws; *Smiley v. Citibank*, 517 U.S. 735 (1996), giving a broad interpretation to the term 'interest'.

[111] As it matured, banking became quite refined and many of the large 'name brand banks' in Europe that still exist got their start in this era. See, http://www.georgianindex.net/banking_economics/banking.html.

[112] A 'bank of offices' is a group of offices on the same level.

[113] A Banker's Acceptance, for example, is a draft drawn on a bank, which when accepted by the bank, constitutes the bank's obligation to pay the draft writer's bills from a specified creditor when the bills are due. It is similar to a letter of credit. The bank literally stamps "Accepted for payment by (name of bank) on (date)" across the face of the draft. Acceptance converts a depositor's "order to pay" into an unconditional "promise to pay" by the accepting bank. Banker's acceptances are effectively a Guarantee of payment for a purchase and are usually used in financing the import, export, transfer or storage of goods, and qualify as liquid assets when held by a thrift institution.

[114] See, Cooper, p. 45. See, also, Kindelberger, pp. 57-73.

[115] See, Federal Reserve Bank's article on '*The Money Supply*', See. http://www.ny.frb.org/aboutthefed/fedpoint/fed49.html.

[116] Assessing credit risk is one thing. Entering into new forms of investment of deposits is quite another. The risks may be drastically increased as one moves from collateralized lending and known borrowers to complex instruments and guarantees that may have unintended outcomes and unknown parties.

[117] Former Federal Reserve Chairman Greenspan's actual comment was made on December 5, 1996 (emphasis added in excerpt):

> [...] Clearly, sustained low inflation implies less uncertainty about the future, and lower risk premiums imply higher prices of stocks and other earning assets. We can see that in the inverse relationship exhibited by price/earnings ratios and the rate of inflation in the past. But how do we know when ***irrational exuberance*** has unduly escalated asset values, which then become subject to unexpected and prolonged contractions as they have in Japan over the past decade?

[118] Galbraith, *The Great Crash of 1929* (Mariner, 1997); Bernanke, *Essays On The Great Depression* (Princeton University Press, 2004)

[119] Kindelberger, p.p.358-365.

[120] Kindelberger, pp. 354-355.

[121] See, Ahamed, *Lords of Finance: The Bankers Who Broke The World* (2009)

[122]For a comparison of 1929 and now on this issue, see: http://www.abc.net.au/news/stories/2008/09/17/2366540.htm.

[123] Rothbard, *America's Great Depression, Fifth Edition* (The Ludwig von Mises Institute, 2000)

[124] See, Higgs, *Regime Uncertainty: Why The Great Depression Lasted So Long and Why Prosperity Resumed After The War*, which can be found at http://www.independent.org/pdf/tir/tir_01_4_higgs.pdf.

[125] Up to the Great Crash, most panics, at best, affected only a single country or geographic area.

[126] Zimper, *Assessing the Likelihood of Panic-Based Bank Runs* (2006)

[127] Herring, *Financial Regulation In The Global Economy* (Brookings National Economic Series, 1995) pp.50-52

[128] Without immediate intervention, panic leads to a fear of being "last out" and further fuels the panic to the point where all that matters is the need to exit and not the elegance of the exit strategy.

[129] This name arises from a book written by Murphy, *The Banksters*: *How A Corporate Elite Destroyed Ireland's Wealth* (Hodder, 2009).

[130] This is one of the sore points of the Great Crash. A surprising few of those who fueled speculation and greed were actually tried, convicted and imprisoned.

[131] In the current financial crisis, the IMF has warned of a new round of civil unrest. See, *IMF Warns of Civil Unrest*, http://www.theage.com.au/business/world-business/imf-warns-of-civil-unrest-20090311-8ucj.html

[132] Mitchener, *Bank Supervision, Regulation and Instability During The Great Depression*, Journal Of Economic History (2005), Vol. 65, pp. 152-185,

[133] In our Modern Age, we have highly refined models to predict credit risk under normal market activity. See, for example, de Servigny, *The Standard & Poor's Guide To Measuring and Managing Credit Risk* (McGraw Hill, 2004).

[134] This dominance ended with the *Great Crash* and most of the market forces (and risk) have been institutional ever since. This makes them even more complex than the motives of a few wealthy banking tycoons.

[135] The irrationality of the latest, 2008-2009, crisis is admittedly a different form and degree of irrationality. It is the quest for a higher and higher, but supposedly predictable, return so as to fuel ever increasing profits to exchanges and investors. As common investments fail to safely deliver these higher returns sought, the center-point of what is an acceptable investment is moved closer to the risky side of the equation to allow for the gap to be filled. The 'added risk' side of the equation is justified and balanced by the belief that the added risk still remains understood and 'predictable' and is covered by some other means of off-set, guarantee or protective device. However, in today's world of complex markets and serial defaults, the old models of predictability fail to work as expected and entire market sectors are placed at risk at once leaving no one sector to shoulder the expected weight of a default or change in marketplace. The safety net is all there is when the smoke clears and this results in irrationality causing taxpayer loss through lender of last resort activity and deposit insurance recapitalization. This is why the public is so angered with the latest financial crisis. It gives all the upside (profits) to corporate risk takers; and, all the downside (loss of capital and financial market failure) to the taxpayers.

[136] Carnell, p. 505.

[137] This involves sophisticated concepts of deleveraging and consumption and that is why it is well beyond this work. However, there is an excellent hypothetical example of "*Where Did Our Money Go*?" that will not require much economics thought at this website: http://Baselinescenario.com/financial-crisis-for-beginners/.

[138] These ideas were not foreign to other countries. For example, see: Brock, *Financial Safety Nets: Lessons From Chile*, The World Bank Research Observer, Vol. 15, pp. 69-84 (2000)

[139] Garcia, p. 29.

[140] The real uncertainty is if the insuring of deposits of the remaining 'good' banks would stem the flow of money from bank accounts. As the New Deal would not have worked if this continued, there was little choice but to hope for the best and do this; however, there was no assurance it would not simply be another costly project that the Government would be expected to pay for it as well.

[141] The revenues received by the American Government after the *Great Crash* fell steadily until the late 1930's. Funding deposit insurance, then, would appear to be a luxury that that the United States could hardly afford. However, the correct analysis revealed that it would be more expensive to not prefund the deposit insurance liability than to wait of fund as the economy had receded and the confidence prefunding created was essential to demonstrating that the U.S. Government was serious about protecting accounts (at least at the initial level of $2500 and that sum being quickly raised to $5000 shortly thereafter).

[142] The banks were actually not great initial supporters of deposit insurance; however, once implemented, they quickly embraced deposit insurance when they saw the confidence it restored in banking. Kindleberger, *Manics, Panics & Crashes: A History of Financial Crises* (Wiley, 5th Edition 2005).

[143] Rothbard, p. 39-40.

[144] It is noted that there were smaller financial panics in the United States in 1819, 1837, 1857, 1873 and 1893. It is interesting to note the roughly similar spacing between these panics of roughly two decades. Reinhart, *The Time Is Different: Eight Centuries of Financial Folly* (Princeton, 2009)

[145] Rothbard, p. 240-242.

[146] Rothbard, p. 465-466.

[147] Rothbard, p. 240; Starting with the Act of 1900, there were various concerns with coming off of a gold standard in the United States that created instability and uncertainty. Rothbard, p. 160.

[148] Kindleberger, *The World In Depression, 1929-1939* (University of California Press, 1986), pp. 117-141.

[149] Galbraith, *The Great Crash 1929*, p. 181

[150] Rothbard, pp. 240-242.

[151] See, Richardson, *Bank Distress During The Great Contraction, 1929-1933*, NBER Working Paper No. W12590 (October, 2006).

[152] Rothbard, p. 240; See, also, Barth, p. 246-258 for an extensive analysis of lender of last resort functions.

[153] Bruner, *The Panic of 1907: Lessons Learned From The Market's Perfect Storm* (Wiley, 2009), p. 127.

[154] Bruner, p. 83.

[155] Rothbard, pp. 188-207.
[156] Bruner, p. 77.
[157] Bruner, p. 135.
[158] Bruner, p. 121
[159] In essence, restored confidence counteracted the fear and panic that had been unleashed.
[160] Bruner, p. 141.
[161] Federal, as it is the national central bank of United States; reserve, as it may legally require retail and commercial banks to reserve deposits for its use in financial crises.
[162] At least we seemed to learn this lesson for about 63 years. In 1999, we will see that pressure was placed on the U.S. Congress to undo a key protection in this area, *the Glass-Steagall Act*, that many believe contributed to the Financial Crisis of 2008-2009 being so severe.
[163] Bruner, p. 151.
[164] In fact, it was not until much later that the extent of the problem was fully appreciated; whereas, Morgan clearly saw the problem as it emerged.
[165] One of the tenants of Best Practices in the area of financial safety nets is to act quickly and decisively. See, Chapter 6.
[166] Bruner, p. 65.
[167] While the problem in terms of actual dollars was much more severe in 2008 than in 1907, increasingly ominous calls were being sounded by President Bush and President Elect Obama during the Presidential transition period in the Late Fall/Early Winter of 2008. The repeated calls were that the economy was not well and severe consequences could result if something was not done immediately.
[168] Bruner, p. 127.
[169] In the end, it became a governmental pursuit and the consensus is that banking may never be, in essence, entirely self-regulating as no single bank can intervene successfully in the Modern Age to save the entire system.
[170] Pollard, p. 2-19.
[171] Rothbard, p. 183.
[172] Rothbard, p. 185.
[173] Farrell, p. 212. In the United States the reserve requirements are contained in Regulation D of the Federal Reserve Regulations.
[174] Rothbard, p. 234.
[175] The full statute can be found here:
http://usgovinfo.about.com/gi/dynamic/offsite.htm?site=http://www4.law.cornell.edu/uscode/12/ch3.html
[176] http://en.wikipedia.org/wiki/Federal_Reserve_Act
[177] The dual banking system is explained extensively in this OCC Report: http://www.occ.treas.gov/ftp/release/2003-83a.pdf.
[178] http://www.llsdc.org/attachments/files/105/FRA-LH-PL63-43.pdf
[179] http://www.llsdc.org/attachments/files/105/FRA-LH-PL63-43.pdf
[180] A Q&A on the advantages of membership in the Federal Reserve is found here:
http://www.dallasfed.org/banking/apps/faq.html.
[181] Wells, *The Federal Reserve: A History* (MacFarland & Company, 2004)
[182] See, *Federal Reserve Membership*, http://www.bos.frb.org/bankinfo/members/index.htm
[183] Pollard, p. 2-21.
[184] There are books written on any topic imaginable related to the Great Crash. A book list containing just a few are listed here: http://www.hclib.org/pub/bookspace/myBooklists/ShowList.cfm?ListID=1799
[185] http://history.howstuffworks.com/world-war-ii/war-reparations.htm/printable
[186] The 'Golden Twenties' was the period of vibrant economic growth following World War I and before the *Great Crash* in 1929.
[187] Supply-side economic policies are mainly micro-economic policies designed to improve the supply-side potential of an economy, make markets and industries operate more efficiently and thereby contribute to a faster rate of growth of real national output. Most governments now accept that an improved supply-side performance is the key to achieving sustained economic growth without a rise in inflation. But supply-side reform on its own is not enough to achieve this growth. There must also be a high enough level of aggregate demand so that the productive capacity of an economy is actually brought into play.
[188] http://www.whitehouse.gov/about/presidents/WarrenHarding/.

[189] The subsequent administration of Calvin Coolidge also pushed the same agenda See, http://www.whitehouse.gov/about/presidents/calvincoolidge.

[190] Greenberg, *Calvin Coolidge* (American Presidents Series) (Henry Holt & Co., 2006)

[191] See Footnote 149.

[192] These idioms fuel the irrational expectations of investors in any period or era.

[193] See, Kindelberger, pp. 375-389; ABA, International Lawyer, Comment on the Developing Transactional Networks in the Area of International Financial Regulation: The Underpinnings of a New Bretton Woods II Global Financial System Framework, p. 175.

[194] Which is instantaneous devastation.

[195] The Great Crash occurred on October 29, 1929. An interim bottom occurred on November 13, 1929 with the Dow closing at 198.60 that day. The market actually recovered for several months from that point, with the Dow Jones average reaching a secondary closing peak (commonly referred to as a 'dead cat bounce') of 294.07 on April 17, 1930. The market embarked on a steady slide starting in April 1931 that did not end until 1932 when the Dow closed at 41.22 on July 8, concluding a shocking and shattering 89.0% decline from its 1929 peak—in essence, almost 90% of the market was wiped away. This was the lowest the stock market had been since the 19th century.

[196] The crash followed a speculative boom that had taken hold in the late 1920s, which had led Americans to invest heavily in the stock market. The problem was that a significant number borrowed money to buy more stocks. By August 1929, brokers were routinely lending small investors more than two-thirds of the face value of the stocks they were buying 'on margin'. Over $8.5 billion was out on margin loan which was more than the entire amount of currency circulating in the U.S. at the time. When the market crashed, this debt imploded.

[197] The amounts deployed as a liquidity flooding device are in the range of several billion dollars over the early years of the Great Depression. However, that was woefully underpowered according to most researchers. Bernanke, *Essays on the Great Depression* (Princeton, 2004)

[198] Systemic failure leading to deflation is the great fear of any financial crises. See, Krugman, *Can Deflation Be Prevented?* Which can be found at http://web.mit.edu/krugman/www/deflator.html.

[199] Major, significant conflicts between investment activities of banks and commercial and retail activities are inevitable if product is being created by one and sold to customer of the other. The problems is similar to dual agency in real estate sales where one broker represents both buyer and seller. This is why the marriage of such activities creates real and dangerous risk to deposits and places larger risk levels upon deposit insurance schemes. See. Carnell, pp. 588-593.

[200] Williams, p. 269.

[201] http://www.whitehouse.gov/about/presidents/franklindroosevelt/.

[202] It didn't help in 1932 that the two men neither liked nor trusted each other at all and it got pretty personal. Hoover called Roosevelt a "chameleon on plaid," while Roosevelt preferred the image of Hoover as a "fat, timid capon." In the final days of the campaign, Hoover denounced Roosevelt's "nonsense ... tirades ... glittering generalizations ... ignorance" and "defamation" on his way to losing to him in 42 of 48 states. Since Inauguration Day was not until March 4, 1933, and with the global financial system in complete disarray, there was urgent need for action — but Hoover's efforts to reach out to Roosevelt in the name of bipartisan cooperation were dismissed by critics as his trying to reverse the election results and force Roosevelt to agree to an agenda that would have effectively gutted the New Deal. That was something strong-willed Roosevelt would never do. See, http://www.time.com/time/politics/article/0,8599,1857862,00.html.

[203] See, *Glass-Steagall Act,* http://en.wikipedia.org/wiki/Glass-Steagall Act

[204] http://www.fdic.gov/about/learn/learning/when/1930s.html.

[205] See, Chu Article; Chari Article; Calamiris Article 2; Diamond Article; England Article 2.

[206] The *Glass-Steagall Act* actually passed after several bank officials were hauled in front of the U.S. Senate Banking and Currency Committee to answer for their role in the stock-market crash and exposing the abuses in maintaining a combined commercial, retail and investment banking system. Benson, *The Separation of Commercial and Investment Banking: The Glass Steagall Act Revisited and Reconsidered* (Oxford Publishing, 1990).

[207] The danger of GLB is that not only did it allow the traditional activities of banking and financial investment activities to once more continue within the same company, which creates all sorts of potential risks, but it also allowed affiliation with non-financial firms. In essence, GLB went farther than the original post-depression concern that was addressed by Glass-Steagall. It joined banking and commerce—not just traditional banking and investment banking. See, Carnell, p. 479-480.

[208] The restrictions did not stop with *Glass-Steagall*. In 1956, the Bank Holding Company Act is passed in the United States and extending the restrictions on banks, including requiring that bank holding companies owning two

or more banks cannot engage in non-banking activity and cannot buy banks in another state without permission. These restrictions were relaxed in 1999.

[209] Carnell, p.489.

[210] The Bank Holding Company Act of 1956 (12 U.S.C. § 1841, *et seq.*) is a United States Act of Congress that regulates the actions of bank holding companies.

[211] By restricting banks to operate only as to traditional banking, a clearer focus as to prudential regulation can be undertaken. By restricting bank holding companies to address the needs of their subsidiary bank operations they can act as a source of strength. See, Ashcraft, *Are Bank Holding Companies A Source of Strength To Their Banking Subsidiaries?,* FRB of New York Staff Report No. 189 (June, 2004) .

[212] Stratton, *The Feds 'Depression' and the Birth of the New Deal'*, Hoover Institute, Stanford University, No. 108 (2001). This massive destruction of liquidity began when the Federal Reserve responded to the 1929 stock market crash by allowing the quantity of money to *decline* by 2.6 percent over the next year. This extremely tight monetary policy put the economy into severe recession. Many, including well known economist Milton Friedman, believe the wayward policies of the Fed actually created the Great Depression.

[213] Several events resulted in the U.S. gradually abandoning the 'Gold Standard'. The Gold Standard Act of 1900 first abandoned the bimetallic standard and defined the dollar as 23.22 grains (1.505 g) of gold, equivalent to setting the price of 1 troy ounce of gold at $20.67. Gold coins were confiscated in 1933 and the gold standard was changed to 13.71 grains (0.888 g), equivalent to setting the price of 1 troy ounce of gold at $35. This standard persisted until 1968. Between 1968 and 1975, a variety of pegs to gold were put in place.

[214] Brokered deposits are explained in Carnell, p. 325. Brokered deposits have been a long-standing problem. For example, see Kane, p. 131 (written in 1985).

[215] FDIC (The First Fifty Years), Chapter 3 which may be found here: http://www.fdic.gov/bank/analytical/firstfifty/

[216] For discussion of the framework these laws try to maintain, see Nier, *Financial Stability Frameworks and the Role of Central Banks: Lessons From The Crisis* (April 2009)

[217] The history of the FDIC in this section is based upon the following two works: FDIC, Federal Deposit Insurance Corporation: The First Fifty Years; and, FDIC, A Brief History of Deposit Insurance In The United States.

[218] http://www.fdic.gov/bank/historical/brief/brhist.pdf, P.20

[219] http://www.fdic.gov/bank/historical/brief/brhist.pdf, P.22

[220] http://www.fdic.gov/bank/historical/brief/brhist.pdf, P, 25-28

[221] It is interesting to put the events that occurred before and after the Great Crash into perspective. This timeline makes clear all the events that led to the Great Crash and the consequences of it thereafter: http://www.amatecon.com/gd/gdtimeline.html.

[222] This was clearly a compromise amount to keep the Republicans and Democrats together on the issue

[223] It was felt that deposit insurance should be monitored by its own regulator and not assigned to the bank regulators.

[224] Prior to the Obama Administration taking office, the Bush Administration rejected any increase in the 2003 fiscal budget. See, Malloy, p. 185.

[225] It was uncertain if the FDIC would be needed after the economic climate improved.

[226] In essence, the FDIC would insure all banks—both state and national.

[227] This made the FDIC a type of prudential regulator, as well,

[228] It was felt that paying interest on short term deposits increased volatility.

[229] So the FDIC DIF was prefunded, ex ante, from the very start of its existence,

[230] See, FDIC (The First Fifty Years), p. 58.

[231] Economides, *Federal Deposit Insurance: Economic Efficiency?* , which may be found here: http://www.cato.org/pubs/regulation/regv22n3/fdi.pdf.

[232] These arguments are not as ridiculous as they may seem. Even though the deposit premium paid starting in 1934 was relatively modest, many banks were on the edge of failure and any new cost was seen as potentially ruinous.

[233] Kane, p. 13.

[234] Roosevelt was a banker himself and felt that to insure a banker's promise was to protect those bankers with slight honor. It would divert attention from the responsibility of the bank and the bankers that operate it.

[235] Basically, deposit insurance got its start with the concept of political expediency foremost in Roosevelt mind rather than the soundness of its design. Roosevelt wanted to stem the loss of deposits from American banks and any popular program was in the realm of reason under those circumstances.

[236] FDIC (The First Fifty Years), Chapter 6, which can be found at http://www.fdic.gov/bank/analytical/firstfifty/chapter6.html.

[237] Weiss, *The President's Man: Leo Crowley and Franklin Roosevelt In Peace and War* (Southern Illinois University, 1995)
[238] FDIC, *A Brief History Of Deposit Insurance In The United States*, p. 33-39
[239] FDIC, *A Brief History Of Deposit Insurance In The United States*, p. 49
[240] Malloy, p. 13.
[241] The FDIC, being the deposit insurer has, in essence, a veto over all other regulatory decisions impacting a bank.
[242] See, Lovett at p. 153.
[243] Carnell, p. 670.
[244] The Federal Reserve is the primary regulator pursuant to the Bank Holding Company Act.
[245] In fact, banking in the United States has been described as one of the most intensely regulated businesses.
[246] Many of these additional agencies recognize the authorized status of financial institutions and provide a streamline process for approval of the type of activity regulated. Also, many of these regulators assign the oversight for their programs to the primary bank regulators. There are also special rules for banks being listed on stock exchanges of less importance than the Nasdaq (such as the OTC 'Bulletin Board' or the 'Pink Sheets'), and for when a bank must seek initial public status with the U.S. Securities and Exchange Commission.
[247] A bank branch must have such a certificate before it can open. This allows the FDIC to understand where every branch of every bank in the United States is located in the event closure is needed. In addition, the primary regulator is normally aware of each location where cash is retained, such as vaults and remote automatic teller machines.
[248] The NCUA insures credit unions in the United States.
[249] It was formally merged with the FDIC's bank insurance fund in the mid-1990's.
[250] The S&L Crisis placed huge enforcement issues upon the FDIC and prudential regulators. While there are fewer banks involved in the current crisis as severely troubled institutions, the aggregate size of the banks has increased since the 1980's. This is why the current crisis is less of an enforcement problem but more of a financial problem for the FDIC. See, Carnell, p. 627-631.
[251] Although the funds look similar, and insure similar account balances, they are separate government funds. The reasons why there are different funds for all banks and credit unions are complex. Part of the reason traces to the independence that the credit unions seek to retain as they receive special privileges under the current regime including no operating entity taxation of profits and certain exemption from state regulation.
[252] http://www.ncua.gov/ .
[253] A special letter, 09-CU-20, was sent to all credit union members in October 2009 announcing two types of assessments designed to restore the NCUA DIF to proper solvency. The first is to restore the fund to a 1.30% level of overall solvency. The second is to implement a 15 basis points to assist in repayment of the Stabilization Fund for failing corporate credit unions. See, http://www.ncua.gov/Resources/Letters/09-CU-20.pdf. The NCUA acknowledges in this letter that the rate of failure of credit unions in the United States is greater than expected and more failure in United States credit unions is expected
[254] Lovett, p. 294.
[255] See, http://www.sipc.org/.
[256] There was a quick realization that deposit insurance was slowly restoring a sense of confidence to the marketplace and that increasing the amount would not immediately cause more loss to the American Government..
[257] Lovett, p. 141.
[258] This is the critical second remit of deposit insurers. Not only is a deposit insurer responsible for liquidation of banks 'at failure' but, in addition, a deposit insurer should also participate in the regulation of operating banks to 'avoid failure', when possible. A deposit insurer in most countries, then, is a participant in the prudential regulation of every bank.
[259] http://www.fdic.gov/deposit/deposits/insured/faq.html
[260] http://www.fdic.gov/deposit/deposits/insured/faq.html
[261] http://www.fdic.gov/deposit/deposits/insured/faq.html
[262] This was a major increase and after only six years after the equally large increase to $40,000 previously made in 1974.
[263] This increase is effective as of October 3, 2008. See, http://www.fdic.gov/news/news/financial/2008/fil08102.html.
[264] The IOLTA Accounts receive blanket cover under the Temporary Liquid Guarantee Program. It was felt that lawyers would have to abandon the IOLTA form of client trust account if they did not receive Blanket Coverage. See, web article, www.abanet.org, *FDIC Rules On IOLTA Protection.* See, Acello Article.
[265] ABA Compliance Article 1.

[266] One of the greatest fears with Blanket Coverage is that it creates the expectation of repeated use in future situations and this could threaten 'market discipline' in the long run. See, web article, www.zawya.com, Pathak, *Deposit Insurance May Help Ease Flow of Credit* (1 April 2009).

[267] Only 12 countries had explicit programs by 1974. Today, the number of countries with deposit insurance exceeds 100 and is increasing in the current economic environment. See, http://www.iadi.org/deposit.html.

[268] India introduced deposit insurance in 1962. See, http://www.rbi.org.in/scripts/fun_deposit.aspx.

[269] Although the current form of fund was initiated in 1999, France has had various forms of guarantee of deposits for decades. See, http://www.garantiedesdepots.fr/spip/spip.php?article48&id_rubrique=16

[270] http://www.cdic.ca/e/whoisCDIC/whoisCDIC.html. Canada has had deposit insurance since 1967. It is expected that developed, Westernized countries would be early adopters of deposit insurance. The presence of India seems to be due to the legacy and ties that India has to the United Kingdom.

[271] The FDIC (and their liquidating entity, the Resolution Trust Corporation, or RTC) actually handled the *S&L Crisis* well (and its hundreds of Savings and Loan failures); however, the SAIF was rendered insolvent and was merged with the FDIC fund and the FDIC DIF required a recapitalizing payment to return to solvency following the outflows from the FDIC's DIF.

[272] The crisis was not restricted to Savings & Loan Associations and the FSLIC; however, because of special rules governing S&L's, the crisis hit those forms of banks particularly hard. After the crisis abated, the S&L's would generally be forced to convert to bank forms; the FSLIC was disbanded; and the SAIF was no more. The crisis wiped out an entire branch of American banking.

[273] Barth, *The Savings and Loan Crisis: Lessons From A Regulatory Failure* (Springer, 2004); Lowy, *High Rollers: Inside The Savings and Loan Debacle* (Praeger Publishing, 1991).

[274] The FDIC published an extensive analysis of the costs of the S&L Crisis. See, The Costs of the Savings and Loan Crisis: Trust and Consequences (2000), which is available here: http://www.fdic.gov/bank/analytical/banking/2000dec/brv13n2_2.pdf.

[275] There were significant political causes for the S&L debacle. See, Barth, p. 167-202.

[276] See, FDIC, *The S&L Crisis: A Chrono-Bibliography*

[277] For an example of this concern, see web article, www.economist.com, *A Useful Fiction: In Deposit Insurance We Trust.* Sort Of. (10/02/08)

[278] Kane, p. 59.

[279] Citibank and its Citigroup was particularly aggressive in this area. For example, Citicorp (a commercial bank holding company) merged with Travelers Group (an insurance company) in 1998 to form the conglomerate Citigroup, a corporation combining banking, securities and insurance services under a house of brands that included Citibank, Smith Barney, Primerica and Travelers. This combination, announced in 1993 and finalized in 1994, would have violated the *Glass-Steagall* Act and the Bank Holding Company Act of 1956 by combining securities, insurance, and banking, if not for a temporary waiver process. The law was passed to legalize these mergers on a permanent basis after intense lobbying by this entity and other like it. Of course, Citibank nearly failed (but for massive TARP funds) in the recent crisis.

[280] This law is known by the acronym 'GLB" and accomplished other things apart from partial repeal of the *Glass-Steagall* Act. The GLB Law can be found at http://www.gpo.gov/fdsys/pkg/PLAW-106publ102/content-detail.html.

[281] For an assault on this assumption, see web article, www.counterpunch.org, Kaufman, *Shattering the Glass-Steagall Act;-The Bi-Partisan Origins Of The Financial Crisis* (09/19/08)

[282] One author refers to this as the '*Back to the Future*' of bank regulation. See, *Back To The Future With Glass-Steagall?,* http://www.finreg21.com/content/back-future-with-glass-steagall.

[283] The Year 2000 Problem, or Y2K, potentially exposed banks to massive computer failures at Midnight on December 31, 2009, because the computers, it was thought, would become unreliable and might revert to believing the date was, in fact, January 1, 1900 rather than January 1, 2000 or might stop functioning altogether. This could have impacted many bank functions and caused large loss. As it turns out, almost no failure was reported after massive preparation and widespread replacement of computer hardware and back-up equipment.

[284] As it turned out, the increasing worldwide markets has one of the longest upturns in history and many analysts were proven wrong as they predicted downturns in the market—except those that predicted a decline after 2007.

[285] See, Feller, *Southeast Asia Tiger Cubs Roar On: The Latest IMD Rankings Show Growth and Fortitude In Southeast Asia* (2003), which can be found here: http://findarticles.com/p/articles/mi_m0NTN/is_48/ai_111026244/.

[286] China's Tiger Economy (2009), which may be found here: http://www.theworld.org/2009/09/10/chinas-tiger-economy/.

[287] See, https://www.cia.gov/library/publications/the-world-factbook/geos/br.html.

[288] https://www.cia.gov/library/publications/the-world-factbook/geos/ei.html.

[289] The current compensation paid to senior management in many large global companies is without question out of control. For a pay comparison between executive salaries in 1970 and 2008, see here: http://blogs.payscale.com/content/2008/07/ceo-salaries--1.html.

[290] Executive managers of banks are seen as not fully comprehending the governmental concern with the need for bailout coupled with extremely high salaries. http://www.usatoday.com/money/industries/banking/2009-10-06-fed-rules-bank-pay_N.htm.

[291] McLean, *The Smartest Guys In The Room: The Amazing Rise and Scandalous Fall Of Enron* (Portfolio, 2004)

[292] http://news.bbc.co.uk/2/hi/business/2077838.stm; Clarke, *Indecent Disclosure: Gilding The Corporate Lily* (Cambridge University, 2007)

[293] The 'others' include Global Crossing, Tyco and a parade of others.

[294] The Sarbanes–Oxley Act of 2002 (Pub.L. 107-204, 116 Stat. 745, enacted July 30, 2002). Sarbanes-Oxley was enacted in the wake of several international scandals featuring Enron, WorldCom, Tyco and others dealing with reporting irregularities and misleading disclosure. See, http://www.soxlaw.com/.

[295] The property bubble is fueled by a herd mentality. See, http://latimesblogs.latimes.com/laland/2008/04/the-global-hous.html.

[296] http://www.telegraph.co.uk/finance/newsbysector/banksandfinance/2971683/QandA--All-about-toxic-debt.html;

[297] You know there is going to be a significant knowledge gap when it takes 72 pages to describe just one of the exotic derivatives known as Credit Default Swaps. See, Rottleb, *Credit Default Swaps: Features, Valuation and Use* (VDM, 2009)

[298] It now appears that the events of Enron and rigged energy trading not only cost many of the world's markets hundreds of millions of dollars in unnecessary costs, but also diverted attention so that the subprime market and the entire CDS (Credit Default Swap) debacle could fester undetected.

[299] Fuel prices are actually cited as one of the reasons the economy became unstable in 2006 and 2007 as it left the nations vulnerable to other triggers. See, *World Bank Safety Nets: Food and Fuel Prices:* http://web.worldbank.org/WBSITE/EXTERNAL/TOPICS/EXTSOCIALPROTECTION/EXTSAFETYNETSANDTRANSFERS/0,,contentMDK:21835036~menuPK:5204353~pagePK:148956~piPK:216618~theSitePK:282761,00.html.

[300] See, *IMF Puts Bank Losses From Global Financial Crisis At $4.1 Trillion*, http://www.nytimes.com/2009/04/22/business/global/22fund.html. More recent estimates have lowered this estimate but still predict that the amount to $3.4 Trillion but could again rise. See, http://en.mercopress.com/2009/09/30/the-crisis-is-still-here-imf-warns-loan-losses-could-rise-forced-by-unemplo.

[301] As to what is a systemic risk and a systemic crisis, see Barth, p. 213.

[302] In happier times, loan losses at most banks are, in monetary terms, well below 1.00% and are often a fraction of a single percent.

[303] The concept of loans to a single borrower is one of percentages and is primarily in the United States. A bank, though any of its activities, cannot have credits issued and outstanding (or promised, such as the case with letters of credit) to a single related group of companies that exceeds a certain percentage of that bank's lendable capital. This way, one borrowing group could not cause an entire institution to fail. These laws were strengthened following the S&L Crisis of the 1980's and 1990's.

[304] Too Big To Fail is widely discussed. For example, see Lovett at p. 156.

[305] In fact, many argue that these mergers substantially weakened the resulting enterprise as many of the best people left for such 'synergies'.

[306] See, ABA, *Bank Mergers and Acquisitions Handbook* (2006)

[307] Major worldwide banks have once more increased share values by over 100% from the start of the bank crisis in 2008. Banks are driving the markets currently once more by investors banking on their renewed profitability.

[308] Capital is very expensive to acquire and this allowed an effortless way to do so.

[309] Bank mergers and acquisitions, commonly called Bank M&A, led most sectors in merger activity for the decade from early 1990's through early 2000's.

[310] This would be the sale of a smaller bank to a bigger bank, which sells to an even bigger bank—ultimately to compound share prices by multiples unimaginable with a single sale. Often called a flip or double dip as the acquiror soon becomes the acquiree.

[311] The cost savings on elimination of loan loss reserves is, itself, significant as this allows reserves to be lent rather than restricted as reserves.

[312] Many broker has now admitted that it was these fees paid for the generation of 'product' that led them to move lower and lower into the risky subprime mortgage market to find loans that could be placed in applicable pools. Literally, in some cases, the brokers were scraping the bottom of the barrel, or even worse, inventing the financial ability of borrowers to pay the loan at all through falsified financial and employment histories.

[313] Many rating services are now being sued by aggrieved investors for claimed negligence in offering such ratings in pools of loans that clearly were substandard.

[314] The regulation of ratings services is, itself, weak, and creates financial risks. As part of mending the financial safety net, it has been suggested that ratings services, themselves, require effective regulation. This has been actively discussed in Europe for almost a year. See, *ALDE Regulation of Rating Agencies: Getting It Right.* http://pr.euractiv.com/node/6854.

[315] See, for example, http://www.theaustralian.news.com.au/business/story/0,28124,24543810-20142,00.html.

[316] A complete discussion of so-called 'subprime' and 'predatory' lending by banks can be found at Carnell, pp. 370-395.

[317] This was a poor assumption as the risk was actually quite significant.

[318] Teaser rates are now coming under regulation. Although they appear to be offered for competitive reasons, they can be very misleading and buried in fine point, legalistic disclosures.

[319] It is felt that at least half of all currently defaulted subprime loans came from other mortgage products and the conversion occurred because the teaser or initial rate made the conversion attractive.

[320] This was rather dramatic and many reported listings of real estate for sale skyrocketing early in 2008. Prices are not expected to rebound until 2011 or even later in many parts of the world. See, http://www.nuwireinvestor.com/articles/economists-predict-uk-real-estate-decline-until-2011-53962.aspx.

[321] For an example of precisely this happening a year before it did, see articles such as this one from 2006: http://www.safehaven.com/article-6329.htm. If the commentators could see this occurring, it is only a guess why the prudential regulators did not act far sooner.

[322] 'Mark to Market' accounting has been around for decades. There is an argument that this form of accounting caused the financial crisis of 2008-2009. See, http://www.todaysfinancialnews.com/us-stocks-and-markets/mark-to-market-caused-the-subprime-crisis-1584.html.

[323] The 'Run On The Rock' Legislative Report issued by The Treasury Committee of the House of Commons on 26 January 2008 provides, in Chapter 6, analysis of the UK form of deposit insurance scheme and how it contributed to the events surrounding the failure of Northern Rock Bank.

[324] Filed for bankruptcy on September 15, 2008.

[325] Sold to JP Morgan Chase in May, 2008.

[326] This sparked interest in such funds (which are funds primarily owned by rich countries). However, the sovereign wealth fund fever has dissipated for now.

[327] AIG is one of the world's largest insurance concerns. It was not the general lines of insurance that caused huge losses and the dragging down of AIG; rather, some of the exotic securitization products that created massive financial risk caused extreme losses in the company.

[328] These twin programs required massive direct lending (TARP-type) intervention.

[329] See, http://en.wikipedia.org/wiki/American_International_Group.

[330] AIG suffered from a liquidity crisis when its credit ratings were downgraded below investment levels in September 2008. The Federal Reserve, on September 16, 2008, created an $85.0 billion credit facility to enable the company to meet increased collateral obligations consequent to the credit rating downgrade, in exchange for the issuance of a stock warrant to the Federal Reserve Bank for 79.9% of the equity (stock) of AIG. The Federal Reserve Bank and the United States Treasury by May 2009 had increased the potential financial support to AIG, with the support of an investment of as much as $70.0 billion, a $60.0 billion credit line and $52.5 billion to buy mortgage-based assets owned or guaranteed by AIG, increasing the total amount available to as much as $182.5 billion.

[331] http://edition.cnn.com/TRANSCRIPTS/0903/17/ltm.03.html.

[332] http://www.businessinsurance.com/article/20091028/NEWS/910289983,

[333] http://online.wsj.com/article/SB125451530375860305.html.

[334] http://www.cnbc.com/id/31661865.

[335] CIT, one of the world's largest lender to small business, is itself in serious financial trouble. http://online.wsj.com/article/BT-CO-20091028-716593.html.

[336] http://online.wsj.com/article/SB119690536188815285.html.

[337] http://www.reuters.com/article/hotStocksNews/idUSTRE52F75620090316.

[338] http://www.reuters.com/article/gc06/idUSTRE5580KQ20090609.

[339] During much of 2009, the FDIC has been visiting all licensed banks in America, for example, and undertaking a process called 'stress testing' institutions and, where needed, calling for increased capital. Stress testing is also starting up in Europe and the top 100 or so Euro banks are likely to be stress tested by the Summer of 2010.

[340] Banks have increased their early 2009 stock price by 100%, 200% or more during the late summer/early fall rally in financial markets during 2009. Several are at their 52 week high points going into October 2009.

[341] Despite positive trends, raising bank capital in the current environment is, at a minimum, very expensive. See, Ressinger Article; Richards Article; and, Schumacher Article.

[342] See, Chapter 2, above.

[343] This is automatic with the fall of the reserves below required percentage thresholds.

[344] Legislation is in the final stages of enactment giving the FDIC the increased authority.

[345] As ratings of an institution fall, the premium cost, ironically, of deposit insurance increases—further weakening the institution.

[346] This prepaid assessment is discussed in Chapter 4.

[347] See, web article, www.money.cnn.com , *Problem Bank List Tops 400* (08/27/09); also, see, web article, www.bloomberg.com, Vekshin, *FDIC Problem Bank List Surges Putting Fund At Risk* (08/27/09)

CHAPTER TWO

2. THE DESIGN, TYPES AND PURPOSES OF CURRENT WORLDWIDE DEPOSIT INSURANCE SYSTEMS

a. Introduction To The Recognized Design Types of Deposit Protection Systems

In the last Chapter we were introduced to deposit insurance and learned about its historical development and necessity following the Great Crash in America and around the world. It took a time of great tragedy for such a large program to be established. This Chapter focuses on the design of deposit insurance and the special problems that impact that design today. We look at deposit insurance design as it will tell us much about the approach and direction a country intends to utilize in protecting its savers.

There is no single or uniform deposit insurance system in the world today[1]. Unlike other financial systems with highly refined commonality, such as central bank systems theory or monetary policy, the implementation and design of deposit insurance programs have not been known for their general consistency, uniform design or being subject to a single set of common principles—at least until recently with some common principles and best practices surfacing[2].

As we shall see later in Chapter 6, the great variety of deposit insurance plans and schemes continue to evolve with option proposals, model provisions and core principles to rely upon. Several of the newer deposit protection plans feature a design that implements many of these best and brightest of deposit insurance practices[3]. For now, however, there are numerous systems and design criteria and they vary greatly as deposit insurance is customized to the country and personalized to the financial institutions of the region[4]. Even some of the basics vary. For example, coverage, which

should be far more uniform, can vary widely[5]. Even the approach the United States takes (which is one of setting maximum coverage levels) is precisely the opposite of the approach Europe takes (with the practice of setting minimum coverage levels). Many other design features are unpredictable until after the entire scheme is closely reviewed and funding and reserve issues are carefully examined. As we shall see later, various core principles and best practices are trying to encourage more consistency and fewer confidence lowering roadblocks[6].

In this Chapter 2, we will look at the major design elements impacting deposit insurance and the theoretical issues that arise from the planning and implementation of such a system. Later in Chapters 3, 4 and 5, we will see how the most significant systems actually operate in the United States, the European Union and in many other systems worldwide. Design is important as it frames the outline of any laws, rules and regulations regarding the implementation of a deposit insurance system and problems with those laws tend to have their origin in unusual or improvident design elements, complex formulae or other unusual features of deposit insurance planning.

Aside from the initial decision as to whether a deposit insurance scheme will be adopted on an explicit or implicit basis[7], which is an essential threshold question, there are many other major design issues that must be decided for an explicit plan or scheme to be adopted. Implicit schemes, being more in the nature of *ex post* plans, have few advance planning concerns as they are, essentially, *ad hoc*.

From the onset, a decision has to be made as to whether the plan will be voluntary or involuntary as to membership[8], how to amass a deposit fund (if the plan will

be *ex ante* funded)[9] or to elect not to do so (if the plan will not be pre-funded). Then, appropriate levels of protection, or coverage, must be considered; types of accounts to be covered must be reviewed[10]; exceptions to general rules regarding accounts worthy of special protection; and, of course, a comprehensive claims and administrative regime.

Further, the deposit insurer has to have the right to monitor its member institutions and, in many cases, to participate in decisions as to bank solvency, liquidity and whether an institution can be maintained or must be closed. Extensive rules, therefore, must then be created regarding the operations of the deposit insurer as a liquidator and receiver of bank assets; who it pays; in what order; what it does with deficit items and surplus; what agreements may be repudiated; civil and criminal penalties; and, many other questions often analogous to insolvency proceedings[11]. Finally, unless the plan is funded *ex post*, the deposit insurer will normally rely on a deposit insurance fund or will have further recourse to the full faith and credit of a government. The list of decision points for the design of a deposit insurance system is, therefore, lengthy and plans take time to design and implement.

One can quickly envisage the complexity of designing statutes, regulations or rules for a plan or scheme will depend on each of its unique design points. For example, a risk-rated differential-type bank deposit premium (such as in the American system) is far more complex to explain and present statutorily than a flat rate premium charged to banks in, for example, the current Japanese system. That does not make differential premiums, necessarily, a better method to fund a deposit insurance system with;

however, it does impose additional drafting requirements to state the complexity of a risk-rated system in proper statutory verbiage[12].

To assist in developing statutory regimes in deposit insurance areas, it will help, then, to examine the common types of regimes that now exist in the world.

b. *Types of Deposit Protection Plans, Schemes and Systems.*

There are, generally, three major categories of worldwide deposit protection plans, schemes or systems globally at this time. Each major type is described below and has the advantages and/or the disadvantages set forth in its respective category. Of course, within these major types, all the variations discussed elsewhere in this work can be found. Yet, in considering the different types of plans and schemes, it is also possible to arrive at several common points in almost any explicit deposit insurance plan design:

1) Most plans utilize a governmental agency of some type to administer the deposit insurance plan or scheme. However, and quite obviously, commercial and retail banks (who compete against each other) are also involved in this governmental system. This creates an interesting conflict between commercial competition and regulatory need for disclosure and information. The fact that governments are involved creates new and different requirements from data security to transparency and these issues may extend well beyond borders. Many countries align the deposit insurance administrative rules around similar rules for central banks of a nation. In essence, that deposit insurers (as with central banks) have certain public areas which can be freely discussed such as size of the DIF fund

or the assessment upon a specific bank and where competitive issues are not normally present; and, certain private or confidential functions which are beyond discussion publicly such as the solvency of a bank[13] or its management issues where competitive information could present problems and confidentiality is required. While in any plan design it is suggested this be an independent agency, many plans utilize a branch of the country's central banking authority for this purpose due to the expertise in banking that already exists.

2) The more extensive the coverage and funding assumptions[14] of a particular type of deposit protection plan (up to and including a fully guaranteed Blanket Coverage-type plan), the more costly the plan will be directly to its member banks as the plan is being funded. The more contributed by the financial institutions, the less costly it will likely be to its taxpayers (assuming the fund is exhausted) following a major bank failure episode. This creates a design crossroads problem. If *ex ante* funding is as to minimum levels of bank failure or as to a low level of insured account, the deposit premium will be low to an institution. If, however, a plan assumes larger levels of simultaneous bank failure closer to a systemic failure level and/or assumes a higher coverage level or broadens the covered accounts, the deposit insurance premium will understandably increase as these assumptions will cause the DIF to have to amass more funds to meet up with those assumptions. So coverage and funding design will cause the deposit insurance plan or scheme to rise or fall in overall cost rather dramatically.

3) The more a deposit protection plan is funded in advance (for example, the so-called high *ex ante* plans) the more likely that type of pre-funded plan, to the extent of its pre-funding, will have funds available to rapidly pay-out some or all of its insured liability. Reciprocally, the more plans are not funded in advance, and left to fund after an event or crisis (*ex post* or low *ex ante* plans), and even if governmentally guaranteed, the less likely they will promptly pay-out and the less confidence they may inspire due to delay.

i. *Type 1: Deposit Premium Funded; Government Guaranteed Plans (Ex Ante Funded Plans).*

This first form of plan has a governmental guarantee, often called a 'full faith and credit' governmental backing. This means that the government of that nation, even if the plan exhausts and fully runs through its reserves in a DIF, will cover all insured liability under its coverage provisions by, in essence, seeking additional appropriations from general governmental budgets. Up to the promised coverage, which may ever be unlimited Blanker Coverage, this obligation is unlimited and not fixed. Better put, the reserve fund is simply a first level of payment. If it is exhausted, the applicable government will back the promised guarantee of deposits up to insured levels no matter what the cost. Of course, government bank regulators know, at least roughly, what this liability is from reports issued by banks as to their aggregate deposit bases and complex modeling of the likelihood of defaults amongst banks. Actuarially, they assume a failure rate of a particular percent of all banks and a certain bank size.

However, there are problems at this point. The recent financial crisis is an example of situations where the assumed rate of failure may be below the actual rate of

failure[15]. In such case, the DIF is exhausted much more quickly than expected and the deposit insurance scheme seeks ways to stay solvent (such as recapitalization by the remaining healthy banks paying increased premium assessments or by borrowing from governments or central banks). However, at its extreme, and assuming full meltdown of any banking industry, maximum liability under a plan guaranteed by a government would likely be well beyond the capacity of most governments to pay in any short period of time.

This first type of plan is also intended to be *ex ante* funded; likely initially funded with governmental loans and thereafter funded by repetitive and periodic bank deposit premiums assessed to the member banks. However, as we have already seen, the extent of *ex ante* funding can vary based upon coverage and/or funding assumptions; and, reserves can quickly be depleted, and even swamped, by systemic failure as we have also seen in the latest crisis of 2008 and 2009.

While an *ex ante* funded plan is certainly better from a ready-to-insure standpoint than a plan entirely designed to be funded *ex post*, even a *ex ante* funded plan which assumes conservative failure rates (a so-called '*high ex ante*' rate of funding) is not assured of continuous solvency. Much depends on the funding assumptions that may range from the severely inadequate to highly conservative; and, of course, depletion rates caused by actual bank failures. In a circumstance where funding is at an unreasonably low *ex ante* level and depletion rates are at a fast pace, even many years of surplus funding will be fully depleted very rapidly. If a deposit insurance fund holds reserves that are funded at high *ex ante* levels and the rate of failure in that country is

low, a DIF may amass a considerable surplus and consider itself adequately funded and be able to withstand the failure of a number of banks.

In this type of plan, it is assumed that the government would have a monitoring mechanism to promptly recognize that the DIF has reached or has dropped below fully funded levels which would cause bank deposit premiums to stop, amend or continue and, if the rate of failure is strong, trigger a recapitalization or refinance mechanism to raise premiums if the plan was severely underfunded or starting to trend in that direction. Reciprocally, if the plan was over-funded (at least according to the assumptions provided), it is also assumed that there would be a similar mechanism in plan design to dividend back, reduce or even halt future premium deposit amounts so the plan did not amass unnecessary reserves that would likely never be used.

The following is a working example of this form of plan. In the event of loss, meaning bank failure, the DIF, as it contains previously *ex ante* funded reserves, would rapidly absorb the liability of the occasionally failed bank. If the liability or run rate for loss of the DIF was at a rate greater than that anticipated (due to the failure of more than the number of banks anticipated; or, if an insufficient period of recharge for any losses covered than the assumptions for funding allowed; or, loss per institution was at a higher loss rate than assumed), and if the DIF could not absorb the rate of loss by the normal addition of new premiums in due course, special premiums or supplemental governmental sums (or both) would be needed to recharge the DIF and the DIF would revert to an *ex post* condition (it would be out of its reserve funds) and seek to bridge the amounts needed in the interim by appropriation from the requisite governmental taxing base or borrowings. In essence, the government, through budgetary and revenue

means, would contribute or lend the shortfall to the DIF or, if necessary, honor the Guarantee directly. This Type 1 Plan is typical of the American FDIC system; and, the FDIC system, while *ex ante* funded, is currently and basically in an *ex post* funded condition with special deposit premium assessments and new proposals to prepay years of deposit premiums in advance as over 125 banks have failed in less than two years[16] and this has generally depleted the entire reserves of the FDIC fund. The Japanese deposit insurance fund is another example of this form of plan that has reverted to ex post condition through depletion.[17]

ii. *Type 2: Government Backed and Unfunded Mandates (Ex Post Funded Plans)*

This second form of deposit insurance plan has the same faith and credit of the government as stated in Type 1, but it is always in an unfunded *ex post* plan condition by design and from the start. In essence, it is a bare governmental promise to cover insured depositor loss (which is sometimes called an unfunded mandate or a limited standby Guarantee). These unfunded plans can be formal or they may be implicit plans. Implicit plans are where, after the fact, provision is made for bank failure on an *ad hoc* basis. An example of a Type 2 unfunded implicit plan is the system maintained in the State of Israel[18] and on the Chinese mainland (but not Hong Kong).

The following is a working example of this form of explicit plan. In the event of loss, and as there is no *ex ante* funded DIF, the government (through appropriations, taxation or other raising of revenue from banks or taxpayers or both) is requested to and would absorb the insured liability for depositors of the failed bank in either a formal coverage plan or, after-the-fact, in an informal or implicit plan. It would be anticipated

that unless some arrangements in larger governmental budgets had been made in advance to allow immediate access to general funds, that there would be a modest to serious delay in funding any such liability while sufficient revenues are approved and appropriated. For this reason, this Type 2 has a likely funding delay built into its system design and inspires less confidence as the guarantee is a bare promise not yet backed by any specific and actual funding and the delays in pay-out will directly impact the depositor as he or she is deprived of funds longer than in the first type. Laws in certain countries, such as the European Union, have tried to combat the delay inherent in such plans by imposing maximum pay-out periods and the application of this to the EU is considered in Chapter 3.

iii. *Type 3: Industry Shared; Private Insurance; or, 'Pooled Risk' Plans.*

This third form of plan is rare and does not normally rely upon governmental backing at all (although there is nothing precluding its combination with a governmental Guarantee as seen with credit unions in the United States with the combination of NCUA/NCUSIF funding and private insurance supplementary funding[19]). This form of design relies upon cross-commitments of constituent banks within a defined pool and/or private insurance commitments to cover initial, excess or other insured loss[20]. If pooled, it might be funded or it might be an unfunded arrangement. If insured privately, other insurance laws would require those reserves of the insuring carrier to back the policies of insurance as may be mandated by applicable law.

The following is a working example of this form of plan. In the event of loss, the pooled fund or private insurance, if either existed in an *ex ante* condition, would be

primarily liable to absorb the liability of one or more failed bank(s). If an insured plan, it is assumed the pay-out would be according to the policies of private insurance. In a pool, it is assumed that recourse would be to the other pool members. In essence, the failure of Bank 1 would be immediately covered by the several members of the pool remaining and future funding of the scheme by Banks 2, 3, 4, 5, etc. (if pooled) or by the insurer (if insured). If the pooled fund or insurance reserve was exhausted or did not exist in the first place (such as in an *ex post* funded pool), the balance of deposit liability would fall upon the remaining institutions within the pool in some sort of proportion, ratio or other order as agreed upon by the constituent entities who created the pool or may not be covered if the insurance fund was fully paid-out. An insolvent insurer would pose greater issues. It would be anticipated that unless sufficient *ex ante* pooled funds existed at the time of bank failure(s), there would be a modest or serious delay in funding or payment of any such liability. For this reason, this Type 3 inspires the least confidence of all.

iv. *Comparison Of Funding Methods For Various Types.*

Most deposit insurance programs that are formalized have adopted the Type 1 plan in either an *ex ante* or *ex post* form. It should come as little surprise that studies of deposit insurance confidence[21] show that bank depositor's value deposit insurance of this type over the other two types above. The funding method in a reasonably pre-funded Type 1 design inspires confidence for a number of reasons:

- It is a binding promise, formalized and already conclusively backed by the country creating the plan and with that nation's 'full faith and credit' guarantee.

- It provides a source of payment (if it is sufficiently pre-funded *ex ante* and remains so), or at least partially pre-funded, according to some credible and legitimate funding model.

- It provides a source of experience in addressing bank failures without the need to suddenly organize or activate that effort on a crisis basis after the fact.

- However, the design elements in drafting of statutory requirements for this form of pre-funded plan can be complex. In addition to the computation and collection of premiums, and the assumptions those premiums will be based upon, the law, statutory scheme or instrument must anticipate under-funded conditions, permissible investments of fund reserves, interim or bridge lending conditions required during peak periods of bank failure/depletion and much more.

An *ex post* plan of a Type 2 design is understandably, at least from a saver's viewpoint, and possibly a regulatory viewpoint, less desirable for the following reasons:

- It demonstrates a lack of fiscal discipline to fund the DIF in advance and a possible foreshadowing of the lack of Political Will to fund deposit insurance payments in advance.

- Bailing out of entire financial systems within a country at a single moment *ex post* can be enormously expensive and challenging.

- It imposes massive back-end and side-load burdens on banks and taxpayers as funding will, it is assumed, come at a particularly inopportune time when the nation's economy is at a low point or weakest, banks are failing, revenues are disrupted, and the like.

- It is hard to quantify excessive public exposure as it is assumed that much (if not all) of the risk will fall on the taxpayer in most cases all at once and entirely after the fact in an *ex post* funded plan. However, this type of deposit insurance plan would be desirable to a member bank as it is not pre-funded; however, this may be a short term gain for such a bank as healthy banks may wind up paying a greater share of bank failure costs in the long run by this method (as governments often recoup *ex post* costs from the remaining banks in the form of increased deposit premiums) than an equitably-allocated Type 1 *ex-ante* funded risk-based deposit premium.

- From a statutory drafting standpoint, such an *ex post* non-funded plan is less complex to draft than an *ex ante* funded plan as large swaths of regulation are not even addressed, such as computation of risk-based premiums, permissible investments, bridge lending and much more since no fund remains in existence for those regulations to apply to.

Of course, the weakest plan, in the eyes of consumers is the pooled risk or privately insured plan in subpart (iii) which is not even addressed in the BCBS-IADI Core Principles discussed in Chapter 6. Such a plan suffers from Moral Hazard,

transparency and potential insolvency issues of the provider of insured coverage as demonstrated by the numerous state-insured supplementary deposit insurance funds in the United States that have gone out of existence since the S&L Crisis for this very reason[22].

c. *The Concept of 'Moral Hazard'*[23].

The above types of plans and plan design now bring us to a major cross-roads and dilemma in deposit insurance design. That dilemma is one of a type of hazard, often called a *Moral Hazard*, that involves an odd and potentially counter-intuitive choice of making a plan either too weak as to coverage attributes (in essence rendering it nearly useless); or, the opposite concern, in making a deposit insurance plan far too desirable (in essence formulating a 'hazard' to the system all by itself by offering a perverse form of enticement)[24].

Of course, all can agree that very modestly designed deposit insurance programs are probably a nullity and worthless to stem panic or provide much confidence to savers. They are easily knocked over and are not imparting much in the way of real value to depositors; however, they do provide some political cover for a nation to be able to say they have adopted any plan—*albeit, a pretty awful and underpowered one*. This form of plan could take a number of insufficient forms: first, it could be a substandard plan due to excessively low coverage; or, second, it could have a requirement of large co-loss (loss sharing with the depositor); or, third, it could be unnecessarily complex and restrictive making its coverage difficult to qualify for; or, finally, it could require a lengthy claims process, amongst other poor design issues, all designed to forestall or even defeat substantial pay-out. However, most can agree that

such plans are quickly exposed as sad, window-dressing affairs in a major crisis and of no or little real protective value.

However, what of plans at the entire other extreme? For example, the high *ex ante* funded, full coverage plan of some countries that believe that not a cent of deposit should ever be lost by any bank saver? Those types of gold-plated plans, the top shelf of the Type 1 category, might logically appear quite paternal and protective but according to some, possibly many, actually pose another and potentially more serious risk. The risk a gold-plated plan imposes is that it purportedly encourages risk-taking behavior by a bank coupled with rewarding the full complacency of a saver who has, quite literally, nothing to lose wherever he or she banks and so he or she will choose the most aggressive (and potentially risk oriented) institution[25].

In essence, many argue, gold-plated plans encourage, even incentivize, risky behavior by banks to lure customers to their risk-taking bank because they can provide higher deposit rates or lowered lending standards. The depositor does not care if such a bank is the riskiest bank in the land so long as the bank pays high deposit rates and those accounts are fully insured for whatever the risk the bank is engaged in. If such an environment can be found, so the Moral Hazard concept states, depositors will flock to such a situation as it benefits them to do so. This rewards banks that venture into high risk areas by delivering depositors to their door who are promised higher returns and are seemingly unaffected by such risk and are actually rewarded for it. In essence, encouraging banks to push risk-profiles to entice depositors to bank with them—and all at the ultimate expense of deposit insurance schemes (and, therefore, that systems' taxpayers) if the bank fails in its business plan. If the bank wins in this situation, and

survives the risk, the taxpayers do not gain any of the risk-taking benefit. If the bank fails, either the DIF will suffer, or, even worse, the taxpayers will in the end pay for it. This is the final deadly outcome that Moral Hazard warns us of.

As we have seen, this is what the American President Roosevelt was quite concerned with in 1933 in America when the FDIC's formation was being discussed and before the FDIC enabling law was passed. He gave in to the creation of the FDIC despite such concern (not yet referred to as Moral Hazard) because the deposit insurance levels were low and this risk or hazard of gold-plating seemed to not be truly an issue or likely ever to be present—and, of course, due to popular support which he was not going to politically ignore.

However, the $2,500 low initial thresholds have given way to maximum coverage of at least 100 times that sum, or (U.S.) $250,000, in America (or even full Blanket Coverage for some account types through 2009) and if Moral Hazard is a concern this concept has not gone away and has actually followed deposit insurance design around for decades[26].

The concept of Moral Hazard (or moral risk as it is sometimes called) is an important concept to some—and a wholly imaginary problem to others. If it exists, it would appear to exist in more than just the banking deposit arena. There can be Moral Hazard in any area where the government, a private insurer or a third party seeks to protect one party against the folly of another and in doing so intentionally or inadvertently changes the inducements and encourages still more folly in some other unintended way. For example, inexpensive full cover accident insurance that might

encourage a foolish type to take dangerous actions that he or she knows are covered. The cost is low and the benefit significant. A deposit insurance plan where the bank pays the premium (thereby resulting in no direct cost to the depositor) and where the depositor gains a substantial benefit (for example, Blanket Coverage of deposits) may be too tempting to pass up whatever the risk proclivity of the bank so long as the rates are attractive and the burden to switch is not great.

Moral Hazard is certainly a concept that permeates financial services and is discussed constantly[27]. The focus of this discussion, however, will be on the Moral Hazard potentially created by the injection of deposit insurance into any country's banking system and whether deposit insurance design can be created to minimize Moral Hazard in a deposit insurance context without undermining the entire purpose for deposit insurance (such as maintaining an under-powered deposit insurer program that protects only the smallest accounts and is hardly worth the effort).

Moral Hazard dealing with deposit insurance actually can be split into two types. The first (and better known) type identifies the Moral Hazard created in the minds of bankers and/or depositors to take greater risk knowing that deposits will be fully or partially protected by deposit insurance[28]. The second type, as expressed by several noted authors, is the Moral Hazard created by the regulators of banking when deposit insurance is introduced—the so-called *regulatory* Moral Hazard[29]. These types of Moral Hazard will now be discussed in that order.

The reach of Moral Hazard purportedly grows very long when we induce conduct that a reasoned person would not normally take[30]. The reason he or she would not have

taken the action is because of the known adverse consequences that could result—in essence, the direct consequence of banking at a risky bank is the loss of one's risky deposit. If I know that consequence has not been removed and a risky bank has a higher chance of losing my deposits, assuming I am rational, I will avoid that institution as odds are I could lose much or all of my investment. Moral Hazard changes that equation to actually incentivize me to do that which I would normally not do[31].

However, there is one assumption in this argument that could prove to be an assumption that lacks foundation. It is recognized that Moral Hazard only creates this risk-shifting behavior when it is seen by those who once felt at *grave risk* to now feel they have substantially *no or slight risk.* The extreme change in position should be noted. For example, going from a substantial deposit investment in risky Bank Q with no deposit insurance on a Monday to a full Type 1 *ex ante* funded full coverage insurance plan on a Tuesday. The change, being extreme, would sway a depositor to change her impression of Bank Q and move her deposits to Bank Q on Tuesday when Monday's view of Bank Q stability looked rather shaky for that change to occur. Of course, Bank Q is the same shaky bank on both days. But her risk has changed because of the external guarantee.

However, if the fact pattern is changed from the same condition on Monday but Tuesday's revision only insures the accounts to a limit of €20,000 (but not entirely) than decisions may change. If the actual account balance is now over three times that amount at €75,000; and, if the investor can only receive one lifetime deposit insurance protection in her country due to the design of their laws; and, that one time limit is up to €100,000, then the investor may still feel uncomfortable (or certainly not motivated) with

many aspects of this plan as an inducement to move her accounts to shaky Bank Q. First, she may feel exposed to the extent of €55,000 that clearly remains underinsured. Second, she may not want to use most of her one-time protection for such a modest loss; or, third, the protective value may be too modest for her to be troubled to account switch at all. There is a 'tipping point' where the depositor is induced to take action. This tipping point is where deposit insurers constantly are in search of and seek to peg their insured cover if Moral Hazard is a factor in their decision—as occurred in the debates in the early 1990's in the European Union as to where to set minimal cover for the proposed 1994 Directive[32]. The tipping point balances the fact that one will receive adequate insured deposit protection, but it will not necessarily influence the depositor's decision to switch to a risky institution simply because the risk has been averted to a greater extent by overly generous external guarantees.

Still, despite the potential flaw of extreme versus modest inducement, many feel that gold-plated plans naturally favor riskier institutions in that, if they fail, they will not be around to have to pick-up the pieces; and, if they succeed, they will do so because an external governmental guarantee initially existed to protect the saver which enticed the saver into the arms of the riskier bank. This almost equates to a State Aid argument—the government assisting a private undertaking in taking risks and unnecessary chances. Such was the argument of the opponents when the country of Australia went from no insurance cover at all for deposits to total insurance cover for deposits in 2008[33]; or when counties like Korea moved back and forth between partial and blanket cover[34], as we will see in Chapter 5, below. However, even in the European Union, which allows its Member States to exceed the minimal cover of the 1994

Directive (as modified by the 2009 Directive), the decisions as to Moral Hazard are left to the Member State. Countries such as France, Italy and the United Kingdom have consistently set their 'tipping point' much higher than the Directives' minimums. The United States, with its current (U.S.) $250,000 maximum cover level, and opportunities for multiple account type cover, as we shall see in Chapter 4, appears to have set the tipping point not just higher but much higher. Some argue that competitive forces encourage richer, financially astute countries like the United States to push Moral Hazard aside and edge much closer to Blanket Coverage; and, for the poorer nations of the world fortunate enough to even have deposit insurance to stay as close to the low end of the tipping point as possible.

There has been no data shown to prove that countries with Blanket Coverage are incubators for riskier banks or there is a direct correlation[35]. However, offering far less than full protection of accounts does influence and direct larger depositors to take avoidance action and 'split' their deposit relationships and stay under the limits by accessing multiple institutions or finding other protections. However, many countries only have a limited number of institutions to bank deposits within reasonable geographic boundaries, and this need to fractionalize or split deposits to chase deposit insurance limits per institution (and acquire what will be termed *de facto* Blanket Coverage) almost seems to encourage deposits to be spread amongst available but fully unknown deposit-taking institutions when all other known bank depository options have been exhausted with deposit insurance cover. This, itself, is an issue rarely considered; it is illogical; and seems to encourage the very conduct that the concept of Moral Hazard

seeks to avoid (which is, of course, banking with an institution one would normally not bank with).[36]

Still, Moral Hazard, admittedly, remains important to many plans. The current belief is that plan design should balance low end plan coverage of little meaningful protective value against gold-plated full Blanket Coverage plans that flirt with Moral Hazard to avoid unnecessary bank risk and depositor complacency and somehow arrive at a tipping point to balance the two. When premium cost, competition and consumer protection is added into the equation, this is a deeper analysis and potentially bigger argument as to where that tipping point really lies than might first be apparent[37].

Despite great suspicion that the concept of Moral Hazard in the modern age is the equivalent of junk science brought into the world of deposit insurance, it does point to an important fairness issue. Depositors do not understand the fact that higher rates offered by an institution may signal a problem with that institution. Unless a bank is restricted as to the rates it can offer, a saver may never be able to begin to understand the risk profile of its banking institution with the current state of bank transparency and it is not entirely clear how Moral Hazard molds the behavior of the average saver to reach that level of understanding except by enticement through the payment of extraordinary rates of interest and brokered deposits of the type that alerted the regulators to the problems at Indy Mac Bank in California[38].

However, special promotional or teaser rates are not necessarily illegal and such rates abound in every bank market and a week does not go by when a perfectly healthy, solvent bank does not offer a bonus rate of interest that might be mistaken by

depositors (and regulators) as a last-ditch effort to save the institution and indicative of Moral Hazard. Therefore, high rates alone can never be an absolute indicator of shaky-bank conduct as there is no correlation. Or, if told to suspect a correlation, a depositor is left to wonder whether high rates are a 'too good to be true' indicator. It is an impossible burden to place on them.

Therefore, Moral Hazard is a confusing concept to the very depositor it seeks to protect and seems to point to the problem that we will always be influenced by the risk-taking actions of our banks in the form of the 'bounty' we are paid for placing our deposits in risky institutions and at higher rates. In some cases the bounty is perfectly acceptable; and, yet, in other cases it apparently should signal imminent failure and grave concern. This appears to be a difficult policy to implement.

It would appear that this would be better addressed as a problem of plan design by placing restraints, or collars, on the range of rates a bank of a particular type or risk-rating could pay if the competition and/or competition aspects could be ironed out[39]. For example, if a bank is a marginal bank and the spread of deposit rates for high performing banks in its service area is currently 2.50% to 3.50% for similar products, possibly the marginal bank should be restricted to a rate no higher than some point within the same range; or, if in the lending area, that concentrations or rates for the riskier banks cannot exceed a certain percent of concentrations of loans or rates in each category of risk that healthy banks maintain. It hardly seems like gold-plating of deposit insurance should be dismantled under the Moral Hazard concept simply because depositors (or borrowers) need to avoid a false inducement to account switch as it is almost impossible to tell when the inducement is really false in a highly competitive

bank marketplace which competition authorities continue to encourage[40]. In fact, the concept of Moral Hazard may be acting at cross purposes with encouraging bank competition[41].

In addition, the argument of Moral Hazard also seems to offer, at least at times, a thinly veiled cover for inept or ineffectual prudential supervision[42]. Banks are frequently examined more than ever for prudential operations; they are currently and repeatedly stress tested[43] in most countries for risk under various failure models; and prudential bank regulators have the clear ability to impose safety and soundness or insolvency protection requirements on banks to, in essence, save the taxpayers some or all of the above-referenced loss since the taxpayers under the deposit protection plan are left with the final loss and should be well protected by examination long before concepts of Moral Hazard comes into play[44]. One such protection a regulator could impose is to order the brokering deposits at high rates stopped[45]; another is to impose a regulatory agreement to act safely and soundly; or, another is to require rate comparisons to be posted just as many insurance departments require for insurance premium postings. A seasoned prudential examiner reviewing risky bank scenarios should, if qualified and competent, quickly turn up issues such as deposit rate or term volatility that would lead to bank-specific restrictions to prevent this risk from increasing. It seems that under the rubric of Moral Hazard concerns deposit coverage levels are simply tossed into the same basket, homogenized and marginalized because prudential supervision is less than sufficient to individualize this risk to specific institutions despite huge prudential efforts and expense to do just that.

Therefore, although gold-plated plan design could theoretically lead to Moral Hazard, it appears rather strained, self-serving and unlikely in this day and age (with strong competition, early surveillance and adequate prudential supervision) and that it should be nearly irrelevant as unrealistic rates or concentrations of loans would tend to promptly betray a bank with high risk levels giving away the bank's urgent need to attract deposits.

The concept of Moral Hazard, then, appears to be more of a theoretical concept than it appears to be a mandatory design imperative that molds behavior—because it is not clearly proven to do so in this modern time of a wide array of choice and efforts to educate depositors of risk. However, it is a near certainty, especially in light of Moral Hazard being featured so prominently in the Core Principles we shall see in Chapter 6, that every plan needs to consider the concept of Moral Hazard as a drafting element in any law they construct as it seems to be current belief that without it deposit insurance solvency is immediately at dire and serious risk. Moral Hazard remains an incomplete argument; but it is acknowledged to have clear and realistic impact.[46]

d. 'Too Big To Fail' and the Growing Problem of Mega-Banking and Risks Posed By Institutional Size and Systemic Risk[47]; The Bypass Strategy Of Direct Lending to Troubled Banks.

A further and equally serious plan design issue for deposit insurance that crosses over and raises relatively new and serious competition law and antitrust issues must now be considered[48]. That issue involves the consideration of when is a bank, usually a systemically large institution[49], 'TBTF', or too big to be managed, too big to fail, or simply too big to go insolvent (even if it is actually insolvent)? When is an institution labeled in this way simply too dangerous to a deposit insurance system to be left to

fail[50]? Related, is the question of whether we require special rules for such large institutions and do we need to regulate them differently[51]? The corollary being, is it fair to allow a select few banks to grow to become mega-banks and then place themselves at risk by their size and rate of growth amongst other banks that are more prudent and did not elect to do so?

This is the intersection of deposit insurance, bank regulatory laws, competition laws, company law and involves all sorts of other thorny issues[52]. It is a messy area of efficiency versus playing favorites and allowing some financial institutions to live on and others to be allowed to fail only because of size and not because of performance.

Thus, the world has seen cycles of dominance and cartel-like behavior (and laws enacted in response) where, in one decade, dominance brands a so-called industry leader, such as in banking, as a massive threat to competition; but, a decade later, our same 'champion' of that industry is revered as an undertaking that is capable of financing expansion and offering employment positions and is now a leader, captain or trendsetter of that same industry. From a bad Microsoft in Europe of the 1990s vilified by the Commission and the European Court of First Instance[53] to a good Microsoft in Europe of the 2000s, the law is fickle about the application of size with regard to competition laws in the modern age.[54] But the undertakings watch and wait as they did with the repeal of *Glass-Steagall* in the United States and they will become big, when able.

After the Great Crash, the development of large banking institutions, with oligopolistic or even monopolistic tendencies, were feared for decades and bigness was

normally considered as badness and dangerous as large financial institutions dominated an industry, raised prices and frustrated consumers[55]. However, during the economic boom around the globe in the late 1990s, and well before the current economic crisis of bust began, many countries deregulated their financial services area, including the deregulation of banks to actually incentivize and encourage growth[56]. In Europe, large undertakings were seen as those capable of creating a Single Market by spreading goods, services and capital[57]. In Europe, it was this formula that was intended to bring down of barriers and a Single Market plan[58]. In the United States, the incentives to grow banks into even larger institutions were often bi-partisan pursuits[59]. It was an effort couched in the need for interstate branching and to allow banks to compete with other growing international players in the financial services areas[60]. Our attitudes frequently changes about whether institutional size matters in banking. Opinions change based upon facts and the context presented.

So our policy on the issue of bank size and increasing risk posed by growth is inconsistent and lacks clear direction. The decision to allow the growth of banking in the 1990s through the mid-2000s was fueled by many decisions. First, bank merger activity was liberalized and this trend has allowed banks to become larger and more aggressive without serious concern about violation of competition laws as many decisions on these issues were made by bank regulators and not competition authorities[61]. Second, the monetary union and convergence of currencies under the euro in the early 2000s helped fuel consolidation in Europe, as well[62]. Third, the repeal of *Glass-Steagall* in the United States made the growth of banks accelerate and broaden[63]. The already large banks grew rapidly into massive, mega-banks in this environment. When the current

financial crisis occurred, many of those very banks reminded the prudential regulators and politicians that shutting down their banking operations would have real and serious consequences on competitiveness, employment, economies and the safety net[64]. In most cases, they have fully succeeded in fending off closure with their TBTF arguments.

However, are the banks correct that failure of a large institution purportedly TBTF would impact entire financial systems negatively? Actually, it likely would. Banks once measured in billions of Dollars, Euros and Pound Sterling would now, in several cases, exceed asset worth many times that number—maybe many hundreds of times that number. They employ tens of thousands of people. They have multiple relationships with their customers. Change would disrupt economies and impact productivity due to the large ripple effect of failure. The interconnections with other healthy, but smaller, banks through correspondent relationships (which are promises to render services for another bank) could drag other institutions into any insolvency with them and, quite possibly, also drag entire countries into their difficulties as the events in Iceland, Romania, Hungary and the United States have very recently demonstrated[65]. Therefore, banks being TBTF is not an imagined problem. As the United States Treasury reported late in 2008, without financial bailout, the failure of several banks TBTF in the United States could cause a cascading effect and lead to a series of resultant failures and create a financial effect of epic proportions[66].

Northern Rock was the first bank of this feared TBTF class to suddenly fail during the current financial crisis when it was subsequently nationalized by the UK government to avoid total failure[67]. The UK has since saved Lloyds TSG and HBOS, as well[68]. The United States has saved almost two dozen banks, the brand names of American

banking including Bank of America, Citibank, J P Morgan Chase and yet curiously left a few others to fail[69]. Of the 650 banks in the U.S. who took direct lending from the U.S. Government, referred to as TARP funds, most of the banks considered TBTF are on the list of banks that needed or wanted life support and got it[70]. Other such banks have been identified as TBTF in France[71] and Germany[72]. In Ireland, as we will see in Chapter 3, specific banks are actually included by name in Irish direct lending legislation as they are that important[73].

It is for these banks who are 'TBTF' that lender of last resort bailout programs like America's TARP were designed. A bank TBTF no longer needs to pass through the deposit insurance scheme only to overwhelm such a system with cost and workload issues; instead, it receives a bypass strategy and something much different is to be done with it[74]. Instead of liquidating it, it is infused with capital to keep it from failing and given a new life. This is where the taxpayers of a country, through direct lending, give new life to banks when no one else could or ever would dare take the chance simply because they are TBTF and pose a serious threat to their countries DIF.

It is no wonder that the concept of TBTF is unpopular with the public[75]. Taxpayers do not understand why bad banks are allowed to get as big as they have gotten and are not allowed to fail by governments[76]. The resistance to TBTF has been so significant and vocal in the United States that during the summer of 2009, and in hearings thereafter, the FDIC announced that that agency would no longer take the unpopular position that a bank could ever be 'TBTF' and that banks should not count on that policy continuing in the future[77].

Yet, to date, the largest banks to fail in the United States only include a surprisingly few banks in the TBTF class that exceed the level of banks with assets in the tens or hundreds of billions of dollars. Those that have failed and are in this TBTF class have been sold-off at surprising low loss amounts. Therefore, it seems that this announcement of the end and demise of the concept of TBTF may be more of a *policy aspiration*--but is not a *policy reality* around the world as the deposit insurance funds cannot handle the alternatives except through massive borrowing from the same sources that provide direct lending to troubled banks[78]. It appears disingenuous to declare that TBTF status no longer dictates policy as to mega banks and then, quite promptly, bypass the DIF and simply allow direct lending to undertakings in this mega class to avoid bank failure altogether.

Why is the concept of TBTF important to deposit insurance design? It exposes deposit insurance as a remedy for some survivable bank failures; but further points to the reality that deposit insurance is an incomplete remedy for other catastrophic bank failures. It demonstrates that deposit insurance, alone, cannot handle an approaching wall of systemic risk or the failure of multiple mega-bank institutions labeled TBTF and failing concurrently without immediately exhausting and overwhelming the DIF. It demonstrates that without direct lending, failing mega-banks would roll over most DIF's, force an ex post regime to take its place and in the process accomplish only the erosion of confidence in the deposit insurance scheme as a bulwark to halt financial ruin. Therefore, deposit insurance design is a bifurcated strategy--at least in American. For those banks deemed to be TBTF it is, in reality, targeting a bypass strategy through direct lending to prop up the lumbering but sickly giant bank; while as for the small, local

regional and community banks, bypass and direct lending are not the usual strategy and, instead, the usual rules of the deposit insurance fund will apply which will almost certainly result in closure, assumption or sell-off. This conclusion is obvious by scanning the list of bank failures in the United States from 2007 to date. They are predominately smaller to mid-sized institutions[79]. Mega banks need not wait in line for failure status. We cannot allow them to fail even if they tried hard to make that failure a reality.

Therefore, the mega bank class of banks that pays deposit premiums but for which no deposit insurance fund could ever begin to manage or repay their depositor loss is an emerging and important, even critical, exception to the normal deposit insurance rules. These mega banks are truly the outlier banks of our times; maybe even a new global brand of untouchable international rogue bank. Until the current financial crisis, the average depositor has been wholly unaware of these banks and such a revelation might be far more powerful than Moral Hazard to a saver's choice of institutions if she took the time to learn. This is because these mega-banks now appear to have a special deposit insurance escape option that community and regional banks do not have and the advantage of using lender of last resort direct lending bypass strategies and, in essence, full cover by recapitalization in a difficult financial environment is hard to miss. A bank TBTF seems to have an undeniable competitive and survival advantage as a result. These outlier banks may be the new and real Moral Hazard to our system as they may present a two tiered system to bypass and avoid the liquidating concerns of deposit insurance entirely.[80] Quite possibly, they can never be allowed to perish.

To be fair, there is a cost and repercussion to being infused with capital by a government acting as a lender of last resort whether your bank is big or small. The direct loan programs to troubled institutions, whether in the form of TARP in the U.S. or NAMI in Ireland or whatever program might actually be involved, allow for government ownership of the institution in the form of a partial nationalizing of banks in which they infuse emergency capital as a part of their design. However, they also offer (and encourage) liberal repurchase of the ownership interest so taken by the government and a release from that partly-nationalized status as quickly as possible. In essence, the lender of last resort governments provides a form of bridge capital much like a bank's rich uncle willing to bail-out the mega banks in trouble and, additionally, provides an easy pay-back alternative once the crisis abates. In the name of saving banking due to crisis, a crisis that banks likely brought on to themselves by risky lending and investment asset decisions, this process uses funds to aid a private undertaking and then buy its way back out the mess on terms and conditions a commercial bank could never offer. We will, however, see where the ECB has chosen not to brand this form of relief as impermissible State Aid despite its apparent touch and feel to be just that—impermissible aid.

Using direct lending programs before swamping underpowered deposit insurance schemes has obvious advantages to banks, bank regulator and its bank customers—but in the process reallocates risk to the taxpayer as direct lending programs by and large use governmental funds. 'TARP'-type loans are directly using tax monies to prop up private bank businesses that may never be repaid. In addition, the DIF may still suffer loss—a sort of double-whammy if all does not go well as the taxpayers will,

potentially pay once again for deposit guarantees if the bleeding of bank loss continues after the infusion of direct loans to troubled institutions. This risk is real and has been demonstrated by the need to recapitalize insurance giant AIG in America on more than one occasion due to serial near-failures and the flawed argument that an endless stream of new direct lending is urgently necessary to save the previous loans made and with each new loan granted that argument becomes more and more self-realizing[81].

However, the question remains as to how a deposit insurer can coherently design plan coverage, implementation and funding mechanisms when there is a huge back-door of direct lending and lender of last resort bypass available to some of its largest institutions and, yet, that bypass is denied to many of the others?

The decision to bypass the normal closure and receivership of a mega-bank appears to be necessitated by pragmatism as much as by a desire not to swamp the DIF. This is because a deposit insurer with, let's say, hundreds of branches of BNP in France, or Deutsche Bank in Germany, or Bank of America in the United States could not offer an effective closure response to such a large, systemically important institution without a huge allocation of workforce and maintenance of existing branch operations. Simply put, keeping the mega-banks TBTF afloat on life support through lender of last resort governmental programs may simply be the more realistic and practical option for the huge troubled bank over any other option as it keeps people working, branches open and banking operational[82]. Sometimes stopping a moving train may be a bigger crisis than allowing the train to simply slow and lose inertia while still moving down its normal tracks.

In America, this was compounded by the fact that at the start of 2008 it appeared that multiple mega-banks would fail at one time without direct lending. One can only imagine the workload that would have been imposed on the FDIC in America if Citibank, Bank of America, J P Morgan Chase and a dozen other troubled mega-banks ultimately receiving TARP funds had, instead, been allowed to simply fail together, hand-in-hand and over the cliff. Aside from the merciless, brutal assault on the DIF, which would have been wiped clean instantly, the manpower issues to control the liquidation of thousands of branches of dozens of failed mega-banks concurrently borders on the institutionally insane and is simply unimaginable and would have brought on its own terrible and chaotic panic—the absolute bane of deposit insurance.[83] Pragmatism therefore wins the argument as it is better to breathe new life in our very ill monster banks, and let her live as partially nationalized monster banks again with direct taxpayer dollars than to have to tote away the former mega-bank's big old dead carcass at great economic and confidence depleting cost, deploying everyone imaginable at the FDIC, along with thousands of its vendors and contractors, to operate these institutions into liquidation and well beyond. The thought of assuming such a role must have caused more than a flash of apocalyptic terror in at least a few senior FDIC officials. The conversation about closing and liquidating a Bank of America or a BNP is likely a very, very brief one even if it is clearly indicated.

Therefore, the pronouncements that TBTF may be changing appear to be a rather insincere, hollow claim at best. It is entirely unclear how deposit insurers could efficiently liquidate sickly monster banks in this modern age when those banks have a global reach and even one would impose impractical or impossible burdens and side

loads on home and host country regulators hither and yon and serially swamp DIF's near and far. Add several troubled mega banks to that equation and you have a full collapse potential. The answer may be that despite the claimed policy shift that banks TBTF must not be treated any differently, like *Frankenstein*, the monster has been given life and is lurching down the path and must be reckoned with somehow; that banks TBTF are here before us for as we allowed their birth and, possibly, they are here to stay in some form until we can get them under control; and, banks deemed TBTF will simply seek new cover in other forms of assistance such as TARP-like direct lending as the alternative is not capable of description. After all, direct lending and related guarantees are better than any 'Plan B' as to mega-banks as, well, there is likely no 'Plan B' to even offer.

In short, some mega-banks are now privileged to be ushered into the front door of our central banks to directly borrow under lender of last resort legislation and avoid failure and they are likely to remain immortal as they were first to make themselves large enough to be eligible for *immortality*. The remaining small to mid-sized institutions must play by very different rules, the rules of normal prudential supervision, adequate capital and liquidity and, if they fail, face liquidation and receivership[84]. Welcome to our current and bifurcated bank failure scenario. Practical? Well, quite practical, thanks. Coherent, rational and harmonized? Not at all. Possibly the FDIC should add as a motto for the TBTF issue the following: *"The bigger you are; the better our deal".*

e. *Consumer Rules and Awareness (Or Lack Thereof) Regarding Deposit Insurance Programs: Who Is This All For, Anyway?*

It would not be fair to leave a discussion of deposit insurance design without considering the consumer and their knowledge and expectations as to that design[85]. After all, deposit insurance has been stated to be an instrument of consumer protection against the adverse effects of financial fragility and crises that hit the banking system.[86]

i. *Consumers Are Not Always Considered In Designing Deposit Insurance.*

Deposit insurance in most countries contains an overriding provision that the depositor has pay-out priority and is first in line to receive that pay-out when any bank failure occurs[87]. For example, even trade creditors give way to depositors when considering the assets of a failed bank. However, while this appears appropriate in concept, in practice the consumer of bank services and products, our saver, actually can and does incur loss. However, this loss comes through the interpretation of coverage and other technical provisions[88].

It is important in this section to recall that for coverage purposes that there is a large distinction between statutory 'balance protection' and statutory 'account protection'. Most countries only offer balance protection in their deposit insurance programs and, often with claw-backs to that protection in the form of co-loss or other account-responsible offsets. Consumers often believe they have much broader account protection that would protect more than mere account balances but would also protect interest not yet received, rates of interest, account terms and other aspects of bank products and services. They are usually wrong and many of these attributes of their banking relationship are promptly, and legally, repudiated upon bank failure[89].

Consider the following example. Mr. Jones is a consumer of banking services. He has surplus funds and dutifully compares rates and fees in January of 2008 and carefully decides to choose a financial institution that offers the best rates for his deposit needs at the time and near his residence. He makes a suitable term commitment of many years in the favored institution and the bank, in turn, promises Mr. Jones the best rate of return he believes is obtainable over that term. Then, a year later, in 2009, Mr. Jones reads that his trusted institution has either failed, been nationalized or some other disposition that involves a deposit insurer. Mr. Jones is called in; is told that the statutory scheme for his deposit insurer allows for repudiation; and, he is presented with a check for his then account balance (if below insured levels for that nation, of course). Mr. Jones is relieved and likely feels this is a fair disposition of his account relationship. But Mr. Jones may be incorrect as he just lost the benefit of his bargain.

This settlement check does not protect the real worth and value of Mr. Jones account—it only protects the *balance* of Mr. Jones account as of an arbitrary day Mr. Jones bank happened to fail and only within deposit insurance insurable limits. Of course, Mr. Jones had no control over the failure of the institution or the precise date of its failure. It should all appear very arbitrary to Mr. Jones because it is. The failure date could be a day before the next interest payment is posted or a day after interest rates precipitously drop or the failure date may even be preplanned by the deposit insurer to minimize liability to savers.

But the consumer might even face a greater concern. The deposit insurer may, instead of encashment and payout as in the prior paragraph, sell Mr. Jones' account to another healthier bank in a so-called purchase and assumption, or P&A, acquisition.

Further, the acquiring bank may be allowed to reset the term, the interest rate or other account benefits for Mr. Jones account and still retain Jones account unless Mr. Jones acts to close the account within a designated period. While the depositor may have various rights to close his or her account in that situation, which is called claiming one's account, the depositor may be deprived of certain benefits by doing so which is mainly interest in arrears from the date of last payment due and it is his or her additional burden to undertake the claim. The need to take affirmative action typically favors the assuming bank and acts against the inattentive saver.

This is the use of the repudiation authority most deposit insurers have to maximize the amounts available to depositors. In this case, however, Mr. Jones will receive his account balance but will not receive his account benefit. So repudiation in this example actually works against his interests and simply delivers an account to the assuming bank to be modified as the assumptor bank may feel is in their interest. This hardly seems to place Mr. Jones at the front of the line of protected persons in a bank failure scenario. Rather, it seems to favor the assumptor bank over Mr. Jones and the hundreds just like him holding accounts in our failed institution.

The standard reason given for this approach is that the deposit insurer will likely be unable to find a assumptor bank willing to purchase the account assets of the failed institution at the higher deposit rates riskier banks are willing to pay before failure. Repudiation, it is said, simply restores the rates to those that are market competitive. Of course, the assumptor bank is normally free to offer their worst rates to the savers purchased from the failed institution, as well, and often do[90].

The better reason is that the assumptor bank will offer more for the failed bank deposits in a P&A assumption if the pricing of interest and the current term can be legally repudiated. However, this reallocates this risk of this occurrence to the depositor—a risk they had no idea they would bear as they are primarily focused on protection from principal loss. As with the perceived unfairness with co-loss recently abandoned by the EU[91], this is equally unfair and few, if any, consumer depositors fully appreciate and understand the difference between account protection and balance protection where it applies in many deposit insurer schemes; the questionable use of deposit insurer repudiation powers; and how such use seems to run against the grain of consumer protection.[92]

ii. *Reality Check: Consumer's Do Not Understand Deposit Insurance.*

This uncovers an important consumer weakness as savers do not understand the true workings of the aftermath of bank failure and deposit insurance. From analyzing the findings below, it is clear that American customers of banks, some of the most financially literate of all worldwide bank savers, do not understand the risks and requirements set forth in the FDIC scheme—and that scheme is one of the easiest to master as it is highly uniform with a nationwide maximum cover.

It is true that savers may understand simplistic issues regarding insurance and that it exists in some form; and the approximate amount of maximum cover (although that is not often known now with so many recent changes); and, on rare occasion, what account types may be covered. However, in America, as in most other countries, that knowledge level is superficial and there is no affirmative obligation to inform customers

of the specifics of deposit insurance; the claims procedure; the type of accounts covered; the exceptions to coverage; and, where to obtain more information until bank failure has already arrived. Of course, at the point of bank failure, this cascades into confusion, regret as to the manner of account structuring (if the system is not a full coverage system) and, at times, bank runs[93].

While harsh, the conclusion is that deposit insurer is not a consumer-driven concept despite the puffery it promotes; it often seeks to minimize pay-out and thereby guard and preserve its own reserves to live for another day and fund its ongoing administration; and, it leaves consumers to fend for themselves after bring turned out with, at best, bare coverage payments. Depositors may arrive expecting full coverage and depart the offices of their failed bank with something considerably less.

As stated in the recommendations in Chapter 7, and unequivocally, the lack of consumer awareness regarding deposit insurance demonstrates that as the concept is designed to protect the depositor, and the depositor's balances are intended to be paid first from a failed bank, that far more transparency in the operation and exceptions to deposit insurance is necessary for it to fully inform and the deposit insurer should be clear and candid in its coverage details and that effort should be direct and not solely involve reference to obscure websites or complex booklets which many will never see or read. Rather, if a deposit insurance system seeks to take advantage of bank failures to remake deposit bargains, impose co-loss coverage, net loans against deposits, or any other off-setting device, it should make those reductions or costs clear to the depositor at account opening so they understand the real worth of the deposit insurance coverage they are being offered. Sloganeering and blanket statements that insured balances are

covered, in light of far greater complexities in most plans and bare balance coverage, misses the mark, is misleading and hurts once more the already hurt depositor.

A survey of knowledge of FDIC insurance of selected households in the United States was conducted in April 2001 by the FDIC in conjunction with the well known Gallup Organization (Governmental Division)[94]. In addition, the FDIC conducted an additional survey of *Banks' Efforts To Serve The Unbanked and Underbanked* in February 2009 of this year[95]. Other groups, such as the IADI[96], have looked at this issue on a broader level[97]. These surveys, and others, show many interesting and, yet, troubling results that beckon deposit insurers to amend laws, rules and regulations to more clearly articulate the deposit insurance promises made:

From the FDIC's 2001 Household Survey:

- Over 8 out of 10 persons who had American bank accounts had heard of the American deposit insurer, the FDIC, and about the same percentage knew if their bank was insured or not. Of course, all banks in America are deposit insured and this should have been an easy question to respond to and yet *20% of all savers failed to answer the question correctly and did not know if their bank was insured.*

- Only half of bank savers identified the actual limits of deposit insurance in America and a third of the bank savers did not even have a guess as to the correct level. *50% to 60% percent of American savers did not know their deposit coverage limits.*

- Only a slight majority of Americans knew that certain transactions were not covered by the FDIC[98]. Over a quarter of all savers thought that the FDIC

covered all transactions. *This shows that 25% to 40% of bank savers misunderstood the scope of FDIC rules.*

- Over 60% of Americans thought that the FDIC covered annuities; over 50% thought that the FDIC protected mutual funds, stocks and bonds; and 75% thought the FDIC protected Treasury bills (which are, themselves, direct governmental obligations). *In addition to being tragically comical in their misunderstanding of deposit insurance, these assumptions either were entirely wrong or missed the underlying purpose and basic point of deposit insurance.*

- An astounding 75% of Americans did not understand the rules regarding joint accounts and that the FDIC insures separate types of accounts into various ownership categories for the amounts promised (in essence providing multiple coverage based upon account purpose).

- The survey determined that the public liked getting information from one's own bank rather than from the FDIC. *Inconsistently, many felt they received enough information about deposit insurance despite, quite obvious from the other responses, and in many cases, not knowing the rules at all.*

- Deposit insurance was cited as a significant reason and motivator by Americans to invest in a bank when household wealth is at issue. Therefore, American bank savers liked deposit insurance and considered it a reason to deposit money in an institution. *However, all institutions are insured in the United States if they take deposits and selecting one institution over another does not change these rules.*

- American bank customers want deposit insurance to keep pace with inflation (i.e. to increase with inflation); however, many were split as to whether the coverage limits should be raised or not. *These two results are contradictory.*

- Many admitted placing deposits into different banks to make sure they stayed within deposit insurance levels at each bank (the so called spreading or splitting of accounts) even though the nature of their accounts already fully insured them because of their various ownership types.

From the very recent 2009 *Unbanked and Underbanked Survey* more troubling results emerge as to the 'shadow banking' of American savers who are protected by little or no deposit insurance safety-net at all and the difficulty (or unwillingness) to reach them through traditional American banking:

- 73% of banks in the United States are aware of a significant number of persons who are *unbanked* or *underbanked* in their communities. However, under 20% of these banks intend to expand services to bank more of this unserved group. For example, to create products to encourage the unbanked or the underbanked to open accounts such as no frills lifeline accounts, etc.

- 63% of the banks in the United States try to educate the unbanked or underbanked individual. This means that about 4 out of 10 banks ignore this issue entirely.

- 37% of the banks in America try to educate this group through other organizations.

- 53% of the banks in America teach financial literacy courses to this group.
- 58% of the banks in America try to do off-site outreach to this group.
- 38% of the banks in America try to work with this group through business customers.
- 25% of American banks use targeted marketing to reach this group.

The first 'Awareness' survey shows, at least as of its date, that Americans are not well acquainted with deposit insurance. In fact, in many respects, their knowledge level is weak and American savers, themselves quite sophisticated worldwide financially, could not be bothered to know and do not care to be further educated about deposit insurance matters. This may explain the confusion that occurs when they hear their bank has failed and their surprise when rates, terms and other aspects of their deposits are suddenly repudiated and revised and they are sent insured deposits prematurely or their account is sold to another bank in a P&A transaction who promptly sets its own rates and terms for the same account long ago and seemingly fully negotiated with the now-failed bank.[99] The saver, then, pays a real price for the deposit insurer utilizing repudiation powers and seeking the highest value for the failed bank assets.

The second *'Unbanked'* survey demonstrates that there is a huge swath of unbanked or underbanked customers who make up a shadow banking community and currently have no deposits in a bank (and, hence, no deposit insurance at all). However, this sector of non-customers 'banks' in the shadow of America's financial system and is at risk for this conduct as the savings of those sums is in an insecure form (in the extreme, hidden under a mattress, buried in a yard or carried about with them, amongst

other examples) indicate they are a candidate for crime or theft and scam-related activity. This swath of non-banked customers is, quite literally, millions in numbers in America and likely similar millions exist in many other countries. If these funds could be added to insured deposits held in institutions, with premiums used to assist the DIF, it could result in greater protection for the depositor and greater fund reserves for the DIF.

However, as many in this large category of non-banked customers are illegal residents in one form or another, and lack supporting identification information of the type necessary to establish accounts, they are kept out of the banking system simply for their inability to be able to identify themselves sufficiently[100]. This seems like a curious penalty to those who may be in a country illegally. They are denied banking services, arbitrarily, but are provided with healthcare and educational services of much greater worth as a matter of right.[101]

So there are several issues in this consumer topic. Consumers have a poor grasp of deposit insurance; banks do a poor job of educating consumers about it; there are many areas where consumers are not told the full extent of what deposit insurance does cover (and does not cover) and this reallocates the risk of loss on to depositors; and, there are legions of the *unbanked* or *underbanked* that are not even under the umbrella of the deposit insurance system at all and have no deposit protection as they are denied the right to deposit in banks within certain countries due to various reasons, including identity issues[102].

f. *Responsibility and Accountability: Who Really Pays The Final Price For Bank Failure? We All Do.*

Our next design consideration for deposit insurance must decide if a deposit insurance plan will preempt other areas of the law or simply supplement those areas. For example, how is a deposit insurer to address the root causes of bank failure and any civil or criminal responsibility of a director, officer, employee or other person for that failure? Is this to be done through laws governing deposit insurance or, instead, through normal laws, statutes or codes governing proper commercial behavior?

Currently, many nations have laws in their banking regulatory regimes that make it a specific civil and/or criminal violation to operate a bank in an unsound or unsafe manner[103]. Other laws preclude lending by a banking institution in situations where laws would be broken or fraud is likely[104]. Some nations have the ability to promptly remove bank directors, officers and employees for violation of banking laws, rules and regulations in the nature of Nigeria's recent purge of those persons from many of its largest banks[105]. Finally, many countries have the ability to ban undesirable persons from being involved in the future operations, management or control of a financial institution for a period of time or for life if they have had a history of unsafe and unsound conduct[106].

Many countries, however, simply apply normal and general purpose commercial conduct statutes to banking. Crimes of embezzlement, theft and financial crime laws may be as easily applied to directors or officers of a bank who cause the failure of a financial institution as they may be applied to any other business activity; or, civil fraud, breach of trust, check statutes, violation of statute or other civil laws may be applied to the failure of an institution, as well.

However, it is rare for the former directorship or executive management of a failed bank to be directly assessed the cost of deposit insurance needed to cover loss or liquidation costs of an institution. Instead, it is generally understood that judgments and orders in the tens of millions or even billions of dollars, yen or euro that might be realized against such persons and make the public feel good but will not be repaid and that the cost to obtain the judgment or order and enforce it will likely far exceed any possible or actual recovery. Banking, in essence, is a commercial business pursuit where widespread harm can be delivered to thousands of depositors; huge losses delivered to the DIF and taxpayers; and, rarely, if ever, are managers or directors held to account.[107]

g. *Private Sector To The Rescue? The Possible Use Of Third Party Insurance To Guarantee Deposits.*

Finally, in our deposit insurance design strategies we are left with a final and important design feature for deposit insurance schemes: the possible use of private, pooled or excess deposit insurance (or reinsurance) as initial cover or as excess cover. There are existing examples of private insurance covering banks[108], credit unions[109] and other deposit gathering institutions. There is also extensive critical comment on the feasibility of replacing the governmental deposit insurance system with a privatized insurance-based system.[110]

The use of private insurance has been considered for some time.[111] Private insurance normally works on three common premises: Establishing cross-guarantees of some type; imposing discipline for risk-taking activities; and, incentives for early closure

of failing institutions so as to minimize policy loss[112]. Also, the system works best (as all insurance does) with premiums based on risk assessment.[113]

While private cover is generally not allowed as primary deposit insurance for banks in most countries[114], and excess cover is not common for banks as a deposit insurance alternative, there are exceptions. For example, excess cover is heavily marketed to credit unions in the United States and is sold on the basis that it often doubles the deposit insurance offered by the governmental NCUA/NCUSIF program. However the additional protections offered is backed solely by the reserves of the private insurance company and is not backed by the full faith and credit of any government deposit insurance agency. The concept of private insurance in a deposit insurance context generally follows the following pattern:

- For private insurance to be available, a bank or credit union must be licensed as a deposit-taking institution. This assures the private insurer that the institution is at least regulated and examined at certain basic levels.

- The prudential rating of the institution normally determines the premium for the risk-rated coverage and usually covers all depositors of the institution in roughly the same manner as governmentally-backed deposit insurance. The premium is usually paid by the bank or credit union but could be passed-through to the underlying customer. Policies sold directly to a customer are not normally available due to the real risk residing at the bank level and not at the customer level.

- Should a bank or credit union fail, normally the primary cover is through governmental deposit insurance and the primary claim is made to the governmental deposit scheme (unless a credit union which is entirely privately insured is involved, but that is rare). If there is a loss that remains and that loss exceeds the governmental deposit insurance plan limits, the excess loss is applied to the private insurance plan and paid to the limits of the private insurance policy.

The solvency of privately insured funds is being fully tested by the current financial crisis. For example, in September 2009, a Nevada credit union, Clearstar Financial Credit Union, and serving local school teachers[115] was closed with 16,000 members (savers). Clearstar held what is commonly referred to as excess private deposit (share) insurance, or EDI, issued by the private insurance undertaking American Share Insurance ("ASI") and in addition to primary governmental deposit insurance issued by NCUA. ASI had issued a policy to this failed credit union to increase deposit insurance coverage from (U.S.) $250,000 (the normal maximum coverage for credit unions in America for most deposit types) to (U.S.) $500,000 (in essence doubling the NCUA/NCUSIF governmental deposit insurance level for members of this credit union)[116].

It is unknown if Clearstar will incur any loss as there are normally complex loss-share agreements between regulators and the new institution upon liquidation and these arrangements are even more complex with credit unions. If there is excess loss, it may result in claims to ASI for the excess coverage. While ASI is bound and regulated by the American states it offers such excess depository account insurance

in, is it able to provide actual cover when swamped with claims? The answer depends on the availability and liquidity of its reserves which are often difficult to isolate to a particular risk and not readily known to the beneficiary of such a policy taken out by the now-failed institution.

What is important is that significant transparency issues remain in the use of private insurance and there also remains confusion as to the fact that it is not governmentally backed[117]. So customers coming into a Clearstar branch would come out with a minimum of (U.S.) $250,000 per insured account as promised by the NCUA fund; and, then, be required to make a claim for any sum above (U.S.) $250,000 up to (U.S.) $500,000 to entirely separate and private insurance entities.

A variant of this insurance in the bank area are more localized, state guaranteed plans[118] and 'industry-backed funds' such as those that have existed in the American State of Massachusetts for 75 years and some variations in Germany and at the Canton level in Switzerland[119]. Regarding the state guaranteed plans, the local governments provide excess cover (above normal coverage limitations) to fully insure accounts with some plans insuring right up to Blanket Coverage levels regardless of the saver's balance.[120] In essence, this form of private insurance increases the governmental Guarantee issued to something much higher than core coverage and possibly straight up to pure Blanket Coverage levels.

This excess insurance has faced numerous solvency issues and state guaranteed plans are often 'incentive-incompatible' schemes and these state plans have generally gone away[121]. It is noted that many state guarantee plans in

American states collapsed in the 1980s and 1990s with the S&L Crisis[122]. Again, the solvency of such a private insurance system or pooled risk fund remains a serious question as they are often unavailable when needed most during systemic failure.[123] Also, excess insurance from any source returns us to the Moral Hazard issue already discussed and for the same claimed and perverse incentivized to deposit in risky banks as a reason.[124]

In conclusion, a range of variations and design features of deposit insurance have been analyzed in this Chapter to demonstrate how complex the drafting of laws, statutes and regulations can become in implementing something as simple as insuring a bank account. There are a dizzying array of choices and options available to these designs and limitations of deposit insurance within the financial safety-net. In addition, alternatives such as privatized excess insurance or pooled risk systems may be insufficient because they can be opaque and lend little confidence when they collapse in the face of systemic risk because their basic loss assumptions were overly optimistic.. However, whatever the design features are, a deposit insurance system in any country must be translated into the complexity of that country's laws, rules and regulations and impacts the entire safety-net design. Therefore, the more complex a system of deposit insurance design elements and features are, the more complex the laws will need to be to implement those design elements and to explain those design features to depositors. This provides considerable caution in designing hyper-complex provisions as such provisions could work against a clear understanding of deposit insurance by the very savers for which the system is designed to offer protection and confidence.

In the next Chapter the prior design, current operation and recent changes to the European deposit insurance system will next be considered. Chapter 3 examines how the elements of deposit insurance design we have just reviewed in this Chapter 2 have come together into a Community-wide European framework Directive that has guided the Member States in the EU on this issue for the past 15 years; and, in an example of a specific Member State's implementation of this framework Directive, how the 1994 Directive has recently changed by urgent necessity and how one Member State, the Republic of Ireland, has expanded on this Directive to create its own deposit insurance laws, rules and regulations and utilize bypass methods, such as direct lending, to avoid collapsing its deposit insurance regime entirely.

ENDNOTES--CHAPTER 2

---

[1] Every explicit system is different. However, some systems, such as the American system, have wide-reaching impact and effects. See, ASBA, *Effective Deposit Insurance Schemes and Bank Resolution.*

[2] Deposit design can be very detailed and complex and factors can range from membership to corruption. For example, see Kunt, p. 3. Also, see Chapter 6 of this work. The IMF has taken the lead in design issue dating back to 2006. See, Hoelscher, The Design and Implementation of Deposit Insurance Systems.

[3] You will note that the newer countries who have adopted explicit plans, such as Korea and the Hong Kong schemes, integrate many of the more current best practices in deposit insurance areas.

[4] Campbell, p. 92. For other design options, see ASBA, Effective Deposit Insurance Schemes and Bank Resolution Practices. This book provides model provisions and concepts relating to statutes, powers, authority, structure, awareness and membership issues

[5] This may be why international depositors tend to favor the United States. See, Huizinga Article, *Deposit Insurance and International Bank Deposits* (2003).

[6] See Chapter 6, below.

[7] See, Penati, *The Effect of Implicit Deposit Insurance On Banks Portfolio Choices With An Application To International 'Overexposure'*.

[8] Campbell, p. 77.

[9] Campbell, p. 79.

[10] Campbell, p. 78.

[11] These can be complex decisions as a regime must either be created specifically for banks or the laws must integrate with other (existing) laws generally governing all companies.

[12] See, Pecchenino, *Risk Based Deposit Insurance: An Incentive Compatible Plan (1992).*

[13] There are various tests for bank solvency that can be applied. See, Heaton, *Solvency Tests* (2007)

[14] Funding is more expensive than might be realized. See, Morrison, *Is Deposit Insurance A Good Thing, And If So, Who Should Pay For It?* (2004).

[15] See, Arner Article.

[16] It is estimated that at least another 75 may fail before the crisis is over. See, web article, www.forbes.com, *Analyst: Up to 200 More Banks May Fail In Crisis* (08/24/09).

[17] This becomes a highly charged political decision as it normally requires large single year budgetary appropriations and those appropriations lead to tax increases. The taxpayers argue they should not have to bailout private sector banks *and where was the deposit insurance safety net of prudential regulation and reserves?*

[18] See, web article, www.israelinsurancelaw.com , *State-Insured Bank Deposits – Are Citizens Deposits Secure?*

[19] In other words, the first portion of a loss could be covered by a governmental plan; and the balance of all or part of the remaining loss could be covered by pooled coverage or private-party insurance.

[20] See, Beck, *Deposit Insurance As Private Club: The Case For Germany* (June 2000)

[21] See subpart 'e' of this Chapter 4, below.

[22] These plans are even more exposed to systemic failure than the FDIC as pooled funds or State-assisted funds lack the resources to weather major events of bank failure.

[23] See, Dubel, *Europe's Second Pillar: A European Deposit Insurance System, Complimenting Monetary Union, et al.* (2008). Dubel raises a very interesting argument that irrational fears of Moral Hazard could be creating a 'prisoner's dilemma' and contributing to a race to the bottom in Europe.

[24] There are many varied and interesting discussions on the Moral Hazard issue. For example, see ASBA, p. 14; Hoelscher, p. 26.

[25] It is argued that privately insured plans have a similar, if not greater, risk.

[26] There are countless articles on this issue. Some of the more useful are: McCoy, *The Moral Hazard Implications of Deposit Insurance: Theory and Evidence* (2006); Gropp, *ECB Working Paper Series, Deposit Insurance and Moral Hazard: Does The Counterfactual Matter?* (2001). For suggestions on reducing the Moral Hazard implications of deposit insurance, see Vaez-Zadeh, p. 7-10.

[27] There are, quite literally, over 25 articles specifically addressing, in one form or another, the issues of Moral Hazard and from many perspectives,

[28] This illogically assumes that a banker is willing to venture onto very thin ice for increased performance-based compensation and: (a) is willing to risk his employment from risky decisions; (b) is willing to risk disapproval from future employment for those decisions by prudential regulators; (c) is willing to risk violations of state and federal laws for those decisions; and, (d) is willing to risk loss of indemnification or third for his or her defense of actions for those decisions. Any tendency towards Moral Hazard seems far outweighed by those looming considerations.

[29] See, Ely, *Regulatory Moral Hazard: The Real Moral Hazard In Federal Deposit Insurance* (1999)

[30] See a comparison of Moral Hazard in a private insurance context in Carnell, p. 326-327.

[31] However, as deposit insurance is paid for by the banks (through deposit insurance premiums) and, at times, taxpayers) through bailout and recapitalization programs), it is particularly attractive to this argument as it has a fairly low individualized cost and a fairly high individualized benefit.

[32] The EU had a wide range of countries, cultures and economies to contend with

[33] As an example, note this 2003 study of the possibility of adding deposit insurance to Australia's financial safety net. It demonstrates how detailed and involved decisions, coverage or otherwise, are to make when instituting a deposit insurance scheme. http://fsgstudy.treasury.gov.au/content/Davis_Report/08_Chapter6.asp,

[34] Korea had a financial crisis in 1997 that compelled it to offer very high levels of coverage. It has since returned to partial coverage. A concern arises when deposit insurance 'chases' financial crises and then drops during periods of calm. See, http://www.iadi.org/profiles/korea.pdf.

[35] See, Gilmartin, Credit Crunch: *Hiding Behind Moral Hazard,* Business & Finance (14 March 2008)

[36] ASBA, p.14.

[37] This 'tipping point' is not always a decision that is logically based and involves more than Moral Hazard. For example, during crises, countries that raise coverage limits are acknowledging that their cover was set too low to avoid panic (but may, indeed, have been set appropriately for any concern for Moral Hazard). However, it does little good for confidence to avoid Moral Hazard and, yet, maintain an insufficient level of deposit insurance cover to avoid a lack of confidence and bank runs. It appears self-defeating and may have demonstrated why people lined up at Northern Rock (before the UK's increase in cover) and IndyMac Bank (before the FDIC's increase in cover in the United States). Therefore, if Moral Hazard is a real concern to a country, all factors (Moral Hazard, pay-out and funding) must all be balanced in setting coverage minimums or maximums and that is a far more difficult task than setting the target cover for Moral Hazard alone.

[38] The FDIC is well aware of this problem and in most regulatory agreements and orders, such as MOU's and C&D's, the FDIC will insert a specific paragraph restricting a troubled banks access to brokered deposits; or, in the alternative, set maximum rates of interest that can be paid on deposit, savings and time accounts if they can solicit volatile or out-of-the-area deposits.

[39] See Note 365.

[40] This does not seem to be the responsibility of a saver at all. Rather, the saver should assume that every authorized and operating institution within their county has the full capacity to bank that saver. If an institution is restricted in some form from full operations, once again, the institution should be responsible for adhering to those requirements of restriction. The saver is not and cannot be expected to understand prudential requirements imposed on a bank. However, by closing a bank and denying a saver the account bargain, and only paying the depositor the account balance, prudential regulation is indeed punishing the saver unfairly.

[41] Restricting deposit insurance due to Moral Hazard is no better than its opposite concept—unlimited Blanket Coverage. In the name of risk-taking, something prudential regulators should be able to spot well in advance and from a great time interval as banks do not move that quickly, it places artificial limits on deposit insurance. This is noncompetitive and anti-consumer. It seems, oddly, to punish savers for poor or inattentive bank supervision and makes little sense. A stronger case can be made that deposit insurance should be unlimited; banks should pay for that high level of protection through risk-rated premiums rewarding their proper management; and, banks should be subject to fully transparent disclosure and adequate supervision.

[42] The Basel Committee has also propounded Core Principles for Effective Banking Supervision, dated September 1997. These Core Principles address the proper authorization, supervision, capitalization and enforcement efforts as to banks. To avoid confusion, the Basel Committee has also propounded its 2009 Core Principles For Deposit Insurance which addresses that issue only.

[43] The following article explains how bank stress testing works: http://online.wsj.com/article/SB123557705225772665.html.

[44] Regulators already have these powers in most countries. The problem is not the fickle nature of depositors following risk around like a puppy dog, but the early recognition of impending loss. That requires competent regulatory review and admittedly high expenses; but with banks receiving record profits in the decade before 2008, and even if those profits were substantially reduced, the proper prudential regulation of banks (paid for by banks or the taxpayers) is less expensive than deposit insurers running through over $40,000,000,000.00 in one year due to bank failure as is the case in the United States in 2009.

[45] The order would restrict the rates paid to some percentage of rates paid by normal, healthy banks.

[46] It is obvious that Moral Hazard is so engrained in deposit insurance lore that there is little one can do to dismiss it as irrelevant or illogical. The best this work can hope to accomplish is to describe it as only one of a basket of many design considerations—*but not the primary one*.

[47] For a basic overview of the concept of systemic risk, see Carnell, pp. 732-737.

[48] The issue is, of course, whether banks TBTF should be broken up as dominant undertakings, cartels or monopolistic groups. For example, in many European Member States and several American states, fewer than five 'champions' of the banking industry vastly dominate bank activity in that country. While there may be numerous other very small undertakings, they have very little to do with market power or saturation of branch systems. In the 1950's and 1960's, as the computer industry was growing, a concern surfaced that entities like IBM in America and many of the telephone companies were growing too dominant and too large and they were broken-up. A decision-point has now been reached as to whether a BNP in France; a Bank of America in America; or a Lloyds TSG Group in the UK are simply too large to regulate and, for the public's protection, must be broken up. In October of 2009, possibly in recognition of this analysis occurring in the future (and certainly to get by various State Aid issues), the giant banking concern of the Dutch ING Group announced that it would be breaking itself up into banking companies and "other" companies. This may be a trend to watch—the reversal of the prior trend and the dismantling of mega-banking by the mega-banks themselves. See, *ING Splits Business To Satisfy EU Over State Aid*, http://online.wsj.com/article/BT-CO-20091026-708660.html.

[49] Cranston, p. 66.

[50] Campbell, p. 92. Additional texts and articles that contributed to this section are: *Too Big To Fail: The Hazards of Bank Bailouts*, Brookings Institute Press (2004); The Federal Reserve Bank (Minneapolis), Policy Studies: *Too Big To Fail*; The Federal Reserve Bank (Minneapolis), *Addressing The Too Big To Fail Problem*; The Federal Reverse Bank (Minneapolis), *Better Late Than Never: Addressing Too Big To Fail*; Also, see: *Statement of Shiela C. Bair, Chairman, FDIC on 'Too Big To Fail' Before The U.S. Senate* (May 6, 2009), which may be found at www.fdic.gov/news/news/speeches/chairman/spmay0609.html.

[51] Mishkin, p.97

[52] See, Kuttner, Kenneth, The *Federal Reserve as Lender of Last Resort During The Panic of 2008* (December 30, 2008)

[53] The European Commission issued a finding against Microsoft in 2004 and in 2007 the European Court of First Instance affirmed that Commission finding along with a huge fine.

[54] See, http://ec.europa.eu/competition/index_en.html. It is noted that DG Competition has been relatively quiet in bringing new enforcement actions since the *Microsoft* case. The banking sector is especially quiet right now. Member State competition authorities in the EU have been complaining about the anti-competitive nature of banking for years. For example, in Ireland, the Competition Authority in 2005 issued a critical report regarding banking and the lack of competition that may be found here: http://www.tca.ie/PromotingCompetition/MarketStudies/Banking/Banking.aspx.

[55] The report mentioned in Note 378 confirmed that many of the large undertaking practices in non-bank industries were being utilized in banking, as well.

[56] Many were told by the banking industry that larger undertakings and companies were needed to compete in the worldwide financial marketplace.

[57] The spread of Capital is set forth in Article 56 (ex Article 73b) with effect from 1 January 1994.

[58] See, Gual, Working Paper, *The Integration of EU Banking Markets* (2003)

[59] Gramm-Leach-Bliley, which repealed the Glass-Steagall Act, was approved on a bipartisan basis and signed into law by President Clinton in 1999. The democrats continue to bemoan that support. See, http://www.democraticunderground.com/discuss/duboard.php?az=view_all&address=389x4057993.

[60] As America is a dual banking system, the state banks wanted similar powers as the national banks; and the national banks wanted to easily penetrate states they were not yet branch banking in as yet. Both prevailed on their respective regulators to give them many of the rights, privileges and benefits of the other through certain 'wild card' rights and preemptions.

[61] In many countries it is the prudential bank regulators that primarily act on bank mergers and acquisitions and not the antitrust or competition authority.

[62] The common currency has been cited as a reason some mergers were made more practical during the height of bank merger mania. See, http://www.bankdirector.com/issues/articles.pl?article_id=10729.

[63] The repeal was effected by the Gramm-Leach-Bliley Act (GLBA), also known as the Financial Services Modernization Act of 1999, (Pub.L. 106-102, 113 Stat. 1338, Enacted November 12, 1999)

[64] Basically, the regulators were told in meetings with the large financial institutions in the Summer and Fall of 2008 that should the government not directly lend to them, their failure will wipe out the deposit insurance system (as no one will remain able to purchase such large banks) and they could thrust the American economy into a Japan-styled deflationary cycle that could take decades to climb out of. For many, the sad part is that the regulators buckled and gave in to most of the demands and only punished a relatively few large institutions for their poor decisions.

[65] See, Barth, p. 246; also, see: web article www.realdeal.hu, Hungarian Government Makes Quick Move To Insure All Bank Deposits (10/08/08); Letter of Intent by and between the IMF and the Government of Romania dated April 24, 2009 (available at the IMF website).

[66] Fox, *Without Bailout What Will The Cost Be?* Which may be found at: http://www.time.com/time/nation/article/0,8599,1845609,00.html.

[67] Despite being nationalized, it continues to lose money. See, http://news.bbc.co.uk/2/hi/business/8182751.stm.

[68] Included in the banks saved are HBOS, or the holding company for Bank of Scotland.

[69] Lehman Brothers continues to pose a mystery as to why it was allowed to fail and other investment banks allowed to continue. There are also legal actions pending regarding the takeover of Washington Mutual claiming that action was clearly premature. See, http://www.law.com/jsp/article.jsp?id=1202434948271&Washington_Mutual_Sues_to_Get_Billions_Back_From_FDIC.

[70] For example, Bank of America, Citibank and Wells Fargo.

[71] Banque Nationale de Paris (BNF) and Societe General are examples of French banks TBTF.

[72] HRE and Dresdner are partially nationalized. Deutsche Bank remains in the TBTF category. See, *The German's Are Toxic Too*, http://www.newsweek.com/id/201749.

[73] As an example, Allied Irish Bank (AIB) and Bank of Ireland, amongst others.

[74] O'Hara, p. 1587.

[75] See, http://www.brookings.edu/testimony/2009/0506_too_big_to_fail_baily_litan.aspx.

[76] See, Baum, *Too Big To Fail With Steroids*, http://www.bloomberg.com/apps/news?pid=20601039&sid=a05rHorIdIzg.

[77]See, *Bair Says Don't Count On Too Big To Fail*, http://www.ababj.com/briefing/bair-calls-for-end-to-too-big-to-fail.html

[78] It seems unlikely the TBTF doctrine can be done away with the massive liability deposit insurers face in today's complex credit markets.

[79] The list, which may be found here http://money.cnn.com/news/storysupplement/economy/bank_failures/list , is very enlightening. Note that this list provides information regarding FDIC loss. Of the approximate 100 institutions that have failed thus far in 2009 in the United States, the vast majority of the institutions have caused a loss of less than (U.S.) $250.0 million per institution to the FDIC DIF; and about 40% are even smaller than with a loss at less than (U.S.) $100.0 million per institution to the FDIC DIF. Only four institutions have been allowed to fail in 2009 that exceed (U.S.) $1 billion in loss per institution to the FDIC DIF.

[80] This bypass strategy seems to weaken and not strengthen deposit insurance as all players do not play by the same rules.

[81] See, http://online.wsj.com/article/SB122156561931242905.html.

[82] See, Kahn, *Allocating Bank Regulatory Powers: Lender of Last Resort, Deposit Insurance and Supervision* (2005)

[83] This is precisely what the United States was trying to counteract after the *Great Crash.*

[84] This just does not appear to be fair and equitable approach, let alone proper, rational, deposit insurance design.

[85] Late in the finalization of this work, the U.S. Congress proposed a new agency to protect consumers in financial transactions in the United States. An overview regarding the proposed CFPA, or Consumer Financial Protection Agency, can be found at http://www.latimes.com/classified/realestate/news/la-fi-harney2-2009aug02,0,7083818.story.

[86] Masciandaro, p. 273.

[87] The priority of a depositor is codified and can be found in the Federal Deposit Act at this location: http://www.fdic.gov/regulations/laws/rules/1000-1240.html#fdic1000sec.11f

[88] Therefore, while a depositor may have priority, it is as to what aggregate sum that depositor realizes priority.

[89] The FDIC right of legal repudiation is found here: http://www.fdic.gov/regulations/laws/rules/1000-1240.html#fdic1000sec.11e.

[90] A regional bank in the United States by the name of Irwin Union Bank that operated in several Midwest and southwest states in America was assumed in a P&A transaction by another institution when it failed in September 2009. It promptly noticed the revision (repudiation) of terms from up to 5 years to terms as short as one year or less; and interest rates were revised (repudiated) and declined from in excess of 5.00% per annum to rates well below 2.00% per annum (a 60% drop). For a balance of $100,000, this could result in a significant loss of over $10,000 over the remaining five year life of the intended deposit. The repayment of the principal, in this case $100,000, still leaves a real loss to the saver unless they can claim the account and acquire the same interest rate elsewhere.

[91] The co-loss provision was abandoned through the 2009 Directive, which is discussed in Chapter 3.

[92] It seems like a difficult and inopportune time to be discussing such an important concept at the bank after it has failed.

[93] Carnell, p. 46-47; Of course, bank runs have a real and serious cost. See, Carisano, *Deposit Insurance: Theory, Policy and Evidence* (1992), p. 9; See, also, Diamond, *Bank Runs, Deposit Insurance and Liquidity* (2000).

[94] www.fdic.gov/deposit/insurance/initiative/household/index.html

[95] This Survey is available at www.fdic.org.

[96] The International Association of Deposit Insurers.

[97] See, IADI, Public Awareness of Deposit Insurance Systems (Guidance Paper) (6 May 2009)

[98] There are easy to understand websites on this very issue—the problem is American savers will not read technical data online like this and another way to create transparency must be found. See, *Insured or Not Insured?*, found at www.fdic.gov/consumers/sonsumer/information/fdiciorn.html.

[99] Very few savers understand the nature of the repudiation authority held by a deposit insurer.

[100] This is a serious problem in countries where illegal immigration is a problem, such as the American Southwest or certain parts of Eastern Europe.

[101] For example, emergency healthcare, police, fire and many other services.

[102] This creates a huge shadow economy where funds are withheld from banks or banked through others at some risk to the *de facto* depositor.

[103] For example, it is illegal in most American states for a bank Board of Directors to pay a dividend if the Bank is financially insolvent.

[104] For example, lending to a bank executive or bank director requires, in the United States, compliance with Regulation O of the Regulations of the Federal Reserve. Failure to comply with 'Regulation O' could lead to criminal or civil liability.

[105] *See,* http://www.businessdayonline.com/index.php?option=com_content&view=article&id=5436:imf-says-nigerian-banking-reform-on-target&catid=1:latest-news&Itemid=18

[106] For example, the FDIC has this right of disapproval of any executive bank officer or bank director.

[107] It is often cited as being a waste of DIF monies to pursue wayward bank officers and directors beyond debarment orders.

[108] Although insured status for banks is rare, it exists in some countries.

[109] Insurance to 'top up' credit union insurance is actually common in the United States.

[110] See, Hane, *Deposit Insurance Reform: State of the Debate*, pp. 14-18.

[111] The FDIC did a study on the use of self-insurance in Konstas, *FDIC Working Paper 2005-04, Reforming FDIC Insurance With FDIC-Sponsored Deposit Self-Insurance*; See, also, Wallison, *Back From The Brink: A Practical Plan For Privatizing Deposit Insurance and Strengthening Our Banks and Thrifts* published almost 20 years ago and following the S&L Crisis.

[112] Wallison, p. 9.

[113] Wallison, p. 13.

[114] See, England Article; Chari Article.

[115] http://www.kolotv.com/home/headlines/61607022.html.

[116] For a complete analysis of NCUA-type deposit insurance, see 'NCUA Share Draft And You: Maximizing Your Insurance Coverage. This guide is at:
http://www.ncua.gov/NewsPublications/Publications/PDF/brochures/insured_funds/funds.pdf

[117] The confusion often comes from the mixing of private, state and governmental deposit insurance programs.

[118] See, Barth, p. 21. For a history of the state-related deposit insurance plans, see Calomiris, *Deposit Insurance: Lessons From The Record.*

[119] See, Beck Article; Binder Article.

[120] In essence, the state 'topped up' coverage to a Blanket Guarantee.

[121] Kunt, p. 201-204.

[122] Most were inadequately funded; some were poorly managed.

[123] These funds are much harder to test for solvency or to keep transparent.

[124] Carnell, p. 327.

CHAPTER THREE

3. THE EUROPEAN DEPOSIT INSURANCE SCHEME: AN ANTIQUATED DIRECTIVE UNDER MOUNTING PRESSURE FOR RAPID MODERNIZATION

a. Overview Of The European Deposit Insurance Scheme[1].

In the last Chapter the various forms of deposit insurance were introduced and the complexity of deposit insurance became more apparent. In this Chapter, the specific deposit insurance regime will be examined. That regime is the European Union's scheme for addressing account protection for European savers.

The European Union's method of handling deposit insurance is by way of a framework 1994 Directive[2] (modified in 2009[3] and currently under consultation[4]) and by transposition of both directives by each of the Member States[5]. The approach of the 1994 Directive is direct. First, the Member States[6] are asked to set out the minimum or base level coverage requirements (as many so-called framework directives do in financial areas) and certain basic design attributes in their adopting statutory legislation. Being Directives, this can be accomplished by a Member State in a way best suited to their own unique laws. The 1994 Directive then allows each Member State to comply with the framework Directive's general mandates and minimum standards[7] in any manner reasonable to accomplish the goals the Directive has set and, if the Member State likes, to even exceed the framework basic requirements. Finally, a procedure for claiming deposit insurance must be implemented with certain maximum time periods for the various decision points such as declaring an institution insolvent, making pay-outs and other key issues.

However, implementing dozens of deposit insurance schemes amongst a banking industry where branches could be in any or all of the Member States makes such a system complex[8] and generally inefficient[9] to a banking industry that tries to create a standardized method for delivery of banking services. It is for this reason, as we shall see later in this Chapter 3, that changes are occurring quickly in this area after 15 years of being under the current broad-brush regime and the European deposit insurance system remains in need of more focused revision and improvement and this is recognized by the recent Directive itself as review must occur every five years through the automatic consultation built into the Directive.

Europe has a generally more conservative brand of banking than does America. In the period of the 19th and early 20th Centuries in Europe, little effort was made to insure deposits on a pan-European basis although there are spotty deposit insurance regimes in the then independent countries of Europe[10]. Rather, protecting markets with protectionist barriers and supporting currency exchange rates between the then fully rival countries was the more immediate goal of European monetary and banking policies in the late 1800s and throughout much of the first half of the 1900s[11].

With the Community's founding in the 1950s[12], and finally culminating after a twisted and tortured 50 year obstacle course to monetary union and currency convergence by the year 2000[13], great changes in attitude have occurred and movement has accelerated towards a Single Market in so many of the financial services areas of banking, securities, insurance, pensions, and investments under the Treaty's requirement that capital circulate freely about the European Union[14].

To many surprised observers, the culmination of decades of work in this area, the Maastricht Treaty[15] agreements on currency issues, opened the door to a new and more fully integrated European Union from an economic, financial, monetary and banking point of view[16]. Of course, stability is still being mastered; yet, the creation of the Eurozone and the European System of Central Banks (ESCB) is a bold step towards a Single Market[17]. Only with the rejected European Constitution did this door start to close again, at least in part[18]. However, with Ireland's very recent approval by referendum of the Lisbon Treaty, and the pushing aside of final resistance by Poland and Czechoslovakia, has the door once more seemingly reopened to full Single Market integration of financial services.[19]. Therefore, we start with the premise that Europe's push to integrate financial services is now irreversible and inevitable.

What potentially is a consequence of the introduction of the euro which did not exist when deposit insurance was launched in the EU is that the spread of the euro in the 16 countries in the Eurozone[20] has facilitated the homogenization of deposit insurance. As more countries adopt a common currency with monetary union and convergence, it becomes harder and harder to justify differences in deposit protection.[21]

With that overview, let us step back. As the United States was implementing the Federal Deposit Insurance Corporation in the early 1930s, and thereafter, Europe's attention was, quite understandably focused, instead, upon combating *Great Depression* issues and the growing aggression of the Axis Powers and the looming and dire fate of a Europe starting to once again lose its way by drifting into a second major world conflict[22]. The finances of those nations that actually operated independently in Europe as the Second World War unleashed itself, including repeat belligerents like

Germany, had a war footing and markets did not operate normally[23]. The war years, of course, disrupted most banking activities altogether[24].

After the war, Europe was heavily dependent on aide and reconstruction programs such as the Marshall Plan and Truman Doctrine[25] and little could be done in the immediate post-war period to stabilize deposit risk in a uniform manner as banking was volatile and unstable as it emerged from the Second World War and protection of deposits was not an immediate or serious priority[26]. Rather, recapitalizing beleaguered banks and normalizing the banking systems of various European countries and rates of exchange between them was the immediate and main goal[27].

As countries sifted through the remnants of European banking, none of the initial countries that were to become the first Member States of the European Community, and later to become the European Union, had deeply engrained deposit protection schemes[28]. For the decade and one-half between 1945 and 1960, and following the end of the Second World War, rebuilding and survival would be Europe's most basic concern and retiring war debts and moving economies forward would be its primary goal. It was not until three decades later, in the 1990's, and after various experiences with Mutual Recognition[29] and similar concepts along with many other Single Market Directives were well established and behind her that Europe was confident enough to seek out an agreement amongst the then rapidly expanding Member States as to the issue of coordinated deposit protection[30]. Much of this coincided with the evolutionary changes in moving to the European Union concept and a lengthy run-up to a planned monetary union and euro introduction in 2000 and the major leap in membership with ten new accession countries that was planned for 2004 and which nearly doubled the

Member States and brought Europe to the borders of Russian influence on the Eastern flank of the European continent.

With this background in mind, we now turn to a detailed look at this European deposit insurance scheme (referred to herein as the "EU DIS"), administered by the European Union (the "EU") and it's Commission; transposed by its various Member States through Directive, and now operating within the 27 Member State EU (the "EU-27"). At times we will refer to the pre-accession EU Member States as the "EU-15" and the post-accession EU Member States (in 2004 and before the latest additional three additional accession members) as the "EU-25". All 27 Member States have adopted the Community-level scheme on deposit insurance; however, not all of these 27 Member State countries are in the Eurozone and some of the charts listed below are expressed in their local currency as a result.

Before assessing the 1994 Directive's development and bringing its evolution forward to the 2009 Directive and the present day, it is important to note that the 1994 Directive has recently been changed as to insured amounts and certain other issues and it is best to get these changes before us at the very start of this discussion to eliminate confusion later.

In October 2008, and because of the worsening economic crisis then emerging and now in full bloom, and with great speed and almost no consultation, the EU more than doubled its minimum deposit insurance scheme upward for all Member States (at least those who do not hold any current abrogation or did not already exceed minimal coverage levels) and will, once more, redouble that amount next year if the current

consultation finds that increase would not create financial hardship[31]. This change and increase was, of course, to address the sagging confidence of depositors resulting from the current financial crisis that was spilling over from America into Europe. We shall see these changes in greater detail below; however, as a preview of the changes the following is a summary of the four major points the changes address:

- Dramatic Increase In The Minimum Level Of Deposit Insurance Allowed For Each Member State.

EU minimum protection has moved from €20,000 to €50,000 currently; a further increase to €100,000 will occur by the end of 2010 if an impact assessment does not conclude that such an increase would create financial hardship or competition issues for the Member States. The full increase is likely to become permanent[32].

- Maximum Period For Payment After The Scheme Is Deemed To Apply.

Payout periods, often a source of frustration under the 1994 Directive, have decreased from an elongated period of up to 9 months (with various extensions possible) to a far speedier 20 days and in some cases even more quickly[33].

- Co-Loss Provisions.

Competent authorities in the EU (in essence, each Member State's deposit insurer) have been allowed to withhold from the depositor with up to 10.00% of account loss as Co-Insurance or Co-Loss on impacted account(s). In essence, this makes the saver partially at risk for up to 10.00% of his or her account loss. This has always been seen as a negative issue and as eroding

saver confidence in the deposit insurance scheme. Any Co-Loss liability of a depositor in an EU institution will now be eliminated on the insured portion giving full protection for the insured portion of a deposit and boosting, by up to 10.00%, the saver's recovery on the account loss until the specific coverage limitations of a particular Member State are reached[34].

- Greater Protection Allowed; However, No Abrogation Below Floor Levels. Any Member State may continue to exceed, but may not attempt to unilaterally abrogate, the revisions to deposit protection. This creates competition issues, as explained further below.

With these newest changes now in mind, and even with their implementation, the EU-DIS remains a weaker form of deposit insurance when compared with the more generous and liberalized systems typified by the American's FDIC system we will next see in Chapter 4. This does not mean that a saver realizes more deposit risk in Europe, however. For example, if it could be shown that European institutions were more carefully regulated from a prudential standpoint, and fewer banks failed, then the recovery by each impacted depositor might be the same or even better than systems where deposit insurance was more generous but banks were more poorly regulated or suffered from high risk profiles or volatility concerns.

There are a number of reasons why the American system is considered more gold-plated than the European system. First, we will see that the amount insured as a base level in Europe continues to remain, at best, average in cover and reflects Europe's greater concern with the concept of Moral Hazard we have discussed previously[35]. The United States is considerably less preoccupied with Moral Hazard

than is Europe. Second, we will see that the 1994 Directive, already in play for the past 15 years in Europe, allows a Member State to, in essence, to customize the design of their Member State's deposit insurance plan to their financial landscape with numerous exceptions that carve away from what could be described as full range coverage[36]. Third, we will see technicalities allowed by the 1994 Directive in claiming insured benefits that might delay prompt recovery and are not user-friendly or contribute to easy to understand coverage.[37]. Finally, we will see the use and even manipulation of deposit insurance by certain Member States in Europe in order to obtain competitive advantage as certain countries have long been criticized for[38]. None of these particular deficiencies exist in the lock-step and uniform American cover for deposit insurance.

An example of the disparity between FDIC coverage and the EU level under the Directive can quickly be shown under the systems and laws that exist in each scheme at the time this work was being finalized[39]. The FDIC system currently provides (U.S.) $250,000 in maximum account protection per account (and separate protection for each type of different forms of accounts, as well, and as to each beneficiary of a trust when special rules are adhered to). In Europe, current coverage equals about (U.S.) $72,000 at the €50,000 recently revised level[40] and (U.S.) $145,000 at the proposed €100,000 level to be adopted by the end of 2010 if that increase is implemented[41]. At current levels and amounts, European cover is only about 40% of the American FDIC (U.S.) $250,000 single account sum; and, likely a tiny fraction when the multiple ownership account rules of the FDIC are applied. At the planned increased cover amount to be implemented in 2010, the European minimum is approximately 60.00% of the single account maximum sum in America; and, of course, also far less in practical cover when

the American multiple account rules are employed. Also, several types of American accounts currently have the benefit of Blanket Protection such as non-interest bearing commercial accounts and lawyer trust accounts[42]. Therefore, one can say with confidence that the amount or level of cover is substantially less before these changes, now and in the immediate future in Europe when comparing deposit scheme to scheme and currency equivalent to currency equivalent. Of course, this is a pure monetary comparison and does not imply the American system is any safer than the European system and the recent financial crisis demonstrates it may not, indeed, be so. Also, this comparison assumes that the EU-27 all utilize the base level of insurance and all 27 Member States clearly do not as several Member States already meet or substantially exceed the planned increase for 2010.[43]

Next, the FDIC normally pays out under its scheme on the date of bank closure or very shortly thereafter and at least makes substantial funds instantly available in useful amounts upon a bank's insolvency through cash withdrawals at automated teller machines. The European current maximum wait of 20 days under the 2009 Directive could still impose real and serious hardship to a saver.

Third, the Americans insure a wider variety of accounts within an institution with fewer exceptions. For example, many of the exceptions for cover of accounts held by directors or executive managers, other currencies, other banks and governments do not exist in the American deposit insurance scheme. In contrast, many of these categories of savers are fully precluded in the EU from receiving deposit insurance pay-outs[44].

Except for the FDIC's notable reluctance to make the final leap and grant Blanket Coverage to any and all accounts, which a saver may indeed have through the 'back door' of insuring multiple account types in the same bank or using special programs to spread accounts amongst brother-sister banks in the United States under the CDARS system that is well understood in American banking[45], FDIC-type insurance overshadows its European Directive minimums and is, indeed, the gold-plated plan of deposit insurance that the doctrine of Moral Hazard seems to warn deposit insurers to avoid as imposing too much risk or inducement to save in the most risky of financial institutions.[46] It is one reason that American banking has been seen as a refuge and flight from risk and a safe haven even in light of the closure of hundreds of U.S. banks since 2007[47].

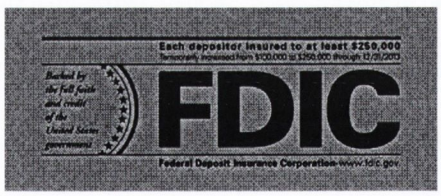
Still, at least as to the elevated minimum cover that occurred in 2009, and along with the elimination of confidence-lowering Co-Loss, Europe has substantially improved its coverage and remains at least at a respectable midpoint in its deposit insurance design than the nearly token minimal cover that existed up to 2008. Europe may be attempting to reset its coverage to and reach a more appropriate tipping-point balance we discussed above that balances confidence against Moral Hazard. However, Europe is certainly not at the lofty levels of New Zealand (about four times the EU current cover) or the total blanket cover of countries such as Australia or Turkey as will soon be seen in Chapter 6. Instead, Europe continues to require, at its minimum 2009 Directive coverage amount, a basic deposit insurance benefit. In addition to concern with Moral Hazard this reduces a Member State's overall exposure to loss while keeping costs to financial institutions for payment of deposit premiums fairly modest[48].

As we will see later in this Chapter, because the original 1994 Directive serves as only a base level minimum coverage requirement, and allows additional design elements to each Member State after applying its base requirements, the various plans and schemes continue to differ widely throughout the European Union. The EU DIS is, therefore, not yet an EU-wide consistent or unified deposit insurance scheme that can be explained as easily in troubled Ireland as it can be explained in very troubled Greece[49]. This diversity, even under the 1994 and 2009 Directives, creates difficulties amongst banks that cross Member State borders as there may be two (or many more) competing deposit insurance regimes to address the operations of the same institution. In fact, the same bank may theoretically be subject to up to 27 different deposit insurance schemes in Europe and an equal and dizzying range of equalizing or topping-up arrangements. This makes the concept of a Single Market and the spread of financial services harder to achieve and generally inefficient and various options, to create a Single Market consensus, including a so-called 28th Regime option, have been repeatedly considered[50].

As just mentioned, these differences often must be reconciled and differing schemes can be equalized by top-up participation and other methods. However, a customer in Poland may find that his scheme is a deposit insurance system based out of Ireland and confusion can set in. For example, the deposit insurance program of Allied Irish Bank (AIB) in Ireland must be compared to that of its sister bank, Bank Zachodni, in Poland and may either be exported to its Polish bank and its branches (as AIB is authorized in Ireland) or the local Polish scheme may be adopted and topped-up, if required. Polish banks in Spain may have a similar choice and the variations continue

with each bank and branch in every new Member State. This creates a degree of unnecessary customer confusion and unwillingness to deposit in a bank subject to another Member State's deposit insurance and top-up scheme. We will discuss which bank deposit laws control and if 'topping up' is required, below.

However, such complexity is not a feature of the FDIC program in America which is virtually the same program in all regions of America, its territories and possessions ranging from the banks on the Islands of American Samoa or Guam to the banks of the United States on the opposite Eastern seaboard—a spread of nearly third of the Earth's time zones[51]. As a more specific example, a bank saver moving her account from Banco Popular in San Juan, Puerto Rico (a territory of the United States) to the equally tropical Bank of Hawaii, American Samoa Branch in Pago Pago, American Samoa (another territory of the United States over 5000 miles away) would immediately recognize the following FDIC logo on the door of both branches despite the fact that they are over a third of the globe and eight time zones apart:



By comparison, a bank saver moving modestly from Belfast, Northern Ireland to Dublin, Republic of Ireland in a morning's leisurely drive (a distance of only a few hours by highway and all in the same time zone and all certainly within the European Union), would have no similar coordination as the United Kingdom's FSA plan covering Northern Ireland differs materially from the Republic of Ireland's deposit insurance

scheme set out by Irish legislation transposing the 1994 and 2009 Directives and even the currencies are different.[52] This is a major weakness of the European Union's deposit insurance system, Confidence and transparency inevitably suffer as a result.

While changes occur frequently, the following is a summary of the 27 deposit insurance schemes currently implemented by each Member State in the European Union (including the three candidate countries) as of the submission of this work. There is no longer a Co-Loss opportunity for Member States and all cover is now deemed to be 100% insured by the EU-DIF up to the coverage levels noted. The scheme that existed in each Member State before the 2009 Directive amendments to the 1994 Directive is noted in parentheses, including any prior Co-Loss that is now eliminated. Countries with an asterisk (*) have not yet converged into the Eurozone and converted to the euro and their benefit is expressed in local currency values. Note that some of these amounts are temporary increases that will expire in 2009, or in some cases 2010, unless further extended:

- Austria (Osterreich): Blanket Cover through 2009, Then €50,000 if not extended (€20,000)[53]
- France: €70,000 (Unchanged)
- Germany (Deutschland): Blanket Cover On Some Accounts; Otherwise, €50,000 (€20,000/10% Co-Loss)[54]
- United Kingdom: £50,000 (£31,700/10% Co-Loss)*
- Ireland (Eire): Full Coverage Through 2010; Otherwise €50,000 (€20,000/10% Co-Loss)
- Spain (Espana): €50,000 (€20,000)
- Italy (Italia): €103,291 (Unchanged)
- Greece: €100,000 (€20,000)

- Belgium (Belgique): €50,000 (€20,000)
- Bulgaria: BGN 39,200*[55]
- Cyprus: € 50,000 (€20,000) (Cyprus Adopted The Euro In 2008)
- Czech Republic (Ceska): €50,000 (€25,000/10% Co-Loss)[56]
- Denmark (Danmark): DKK (Kroner) 300,000*
- Estonia (Eesti): €50,000 (€20,000/10% Co-Loss)
- Finland (Suomi): €50,000 (€25,000)
- Hungary: HUF 13,000,000 (HUF 6,000,000)*
- Latvia (Latvija): €50,000 (€20,000)
- Lithuania (Lietuva): €50,000 (€20,000/10% Co-Loss)
- Luxembourg: €50,000 (€20,000/ 10% Co-Loss)
- Netherlands (Nederland): €50,000 (€20,000/10% Co-Loss)
- Malta: €50,000 (MTL 20,000) (Malta adopted the euro in 2008)
- Poland (Polska): €50,000 (€22,350/10% Co-Loss)
- Portugal: €50,000 (€25,000/10% Co-Loss)
- Romania: Equivalent of €50,000*
- Slovak Republic (Slovakia): €50,000 (SKK 727,400)[57]
- Slovenia: €50,000 (SIT 5,100,000)
- Sweden (Sverige): SEK 500,000 (SEK 250,000)*
- Croatia (EU Candidate): HRK 100,000*
- Macedonia (EU Candidate): MKD 1,223,558*
- Turkey (EU Candidate): Blanket Cover*

One would likely need a guidebook to navigate around all these differences and they are only as to the single issue of the level of coverage. One can only imagine the other variations based upon account type, claims procedures and the like. *Why are*

these differences so pronounced in Europe and why is Europe unable to achieve the same degree of uniformity as to basic deposit insurance structure as the FDIC? It will be seen that there are many reasons along the way which include:

- The cost of increased or more comprehensive coverage is not easily absorbed by smaller Member States and their banking systems already face economic struggle and are often subsidized by other, more wealthy, EU countries, the IMF or the World Bank.[58]
- Letters of Intent or Stability Agreements may preclude higher levels of cover.[59]
- A European business or cultural perception that some bank products are unworthy of protection or protecting them encourages a form of Moral Hazard or rewards misconduct.[60]
- Related, a European business or cultural perception that some bank customers are either unworthy of protection or can absorb loss.[61]
- Countries outside the Eurozone continue to find it difficult to meet convergence criteria; let, alone, additional deposit insurance criteria.
- Pure Euro cultural differences or low socioeconomic status.[62]
- The lack of political will of a Member State to create a vibrant deposit insurance regime.[63]

- Hidden agendas of certain Member States, including efforts to replace overt protectionism in banking in other latent ways to create a more competitive advantage by 'gold-plating' deposit insurance coverage.[64]

As the funding issue is normally one of the greatest of the financial cost of a deposit insurance system, certainly the EU DIS is a relatively inexpensive system to fund at an average current Member State cost of €50,000 and a narrowed definition of eligible accounts when juxtaposed against the FDIC system which is funding at a heightened level of $250,000 per account with far more liberal interpretations of multiple eligible account ownership[65]. Funding the basic 1994 Directive, as modified in 2009, and at the current required coverage level of €50,000 and full coverage (and later at the €100,000 level by the end of 2010 if a current consultation does not conclude that this increased level would create financial and competition issues as discussed below), and with all the many carve-out exceptions and conditions offered, is not as expensive a scheme from a programmatic standpoint as the high *ex ante* cover of the American system with its 8,195 insured bank institutions, and, in addition, approximately 8,000 credit unions insured by the NCUA/NCUSIF all covered at the higher base level for the U.S. savers.

Perception is somewhat different, as well. Americans are told to have great confidence in the fact that no one has lost any money in an insured account up to the existing insured limits of (U.S.) $250,000 per account type[66]. This is engrained in American thinking; is shown by the wide recognition of some form of deposit insurance existing as shown in Chapter 2 in the FDIC's 2001 Household Survey, and purportedly motivates bank account selection[67]. Europeans are not as preoccupied with deposit

protection schemes; they are told they have a conservative banking system and a more practical and lower cost of deposit insurance that does not encourage Moral Hazard; that their surveillance and monitoring of banks is good to very good and is considered better than the Americans; and they are told by their European counterparts that they should feel fortunate they earn higher rates of interest, on average, than Americans on similar deposits as a result of lower deposit premium costs[68].

Funding varies between the two systems, as well. The American system attempts to fund its entire premium scheme in advance (*ex ante*) although it is, admittedly, in current deficit[69]. The American system uses a differential or risk-rated deposit premium rate[70]. Until 2007, it was thought to be in a strong surplus condition[71]. Very recently, the FDIC has stated it will accelerate funding to replace a staggering depletion rate for run-off of its DIF and require all insured banks to fund the next three years of anticipated premiums all at once and immediately to replenish FDIC reserves—something well beyond even high *ex ante* funding levels.[72]

The European system features a variety of *ex ante*, *ex post* and hybrid systems of funding, including some unique private funding methods in Austria, Germany and elsewhere[73]. In addition, some premiums are fixed and some are differential in the EU potpourri of schemes although the EU is actively studying this very issue at present and encouraging a rethink on fixed premiums in favor of differential premiums[74]. However, and in truth, even with risk-rated premiums the FDIC's DIF is substantially depleted at this time and although recapitalization, special assessments and accelerated funding programs are now in place, it is hardly the best practices model and 'poster child' for a fully funded, solvent, *ex ante* program.[75].

At the end of this section we will examine the specific two-pronged effort of one EU Member State, Ireland, to lead the increase of its deposit insurance levels to the €100,000 targeted EU level; and, to create a virtual Blanket Cover on all deposits and liabilities of specified institutions until at least 2010[76].

b. *The Underpinnings of the EU's Deposit Insurance System (1994 to 2008).*

Since the inception of the Community, the spread of capital and financial services across Europe has been a clear and unmistakable Treaty and European Commission goal[77]. This is an area that the Commission felt would bind Europe together philosophically, economically and cause all to consider themselves as 'Europeans', However, this is also an area of Europe that divided it with artificial barriers, high prices and repressed competition (and many studies bore out the lack of competition in banking)[78]. Therefore, it has been the mantra of the EU for years to reduce barriers and to encourage pan-European integration of financial services—in essence, to strive for the elusive Single Market[79] Banking was seen as taking the lead in this regard with its many branches and the ease in which banking translates into various languages and cultures. It also would also help to lessen the dominance that Germany had traditionally held over banking in Europe.

The development of the EU DIS has progressed in tandem with the development of the overall prudential regulation of banking in the European Union. For example, the First, Second and Consolidated Banking Directives from the 1970s, 1980s and 1990s decades encouraged the spread of banking services across Europe by use of Mutual Recognition and a Home-Host regulatory system. Along with banking itself, it made

sense to also provide more consistency in the area of the law which would guarantee deposit accounts[80].

However, the so-called 'passporting' of Member State banking services from the Home Member State of a bank to various Host Member States created issues for deposit insurance as the system was inherently non-uniform as to those Member States that had some version of it before the 1994 Directive[81]. At the same time, capital adequacy also came under scrutiny with revisions to the Capital Requirements Directives (mainly with the help of the Basel Committee on Bank Supervision) and led to minimum levels of bank capitalization to shore up weaker banks; the creation of international standards for bank capitalization; and, created an improved first line of defense to minimize depositor risk and loss[82].

As banking and deposit-gathering activities of credit institutions became more standardized under the core Banking and Capital Adequacy Directives, these two key bank areas were regulated more consistently at the Community level, the area of deposit insurance came under more intense scrutiny to complete the circle of prudential regulation of banks and fill in the financial services safety-net 'gap' and to insure that deposit insurance would not be used in a manner to undermine the efforts of other key Community directives, such as in the areas of competition or precluded State Aid[83].

Work on the Directive began, in earnest, as a result of a recommendation by the EU Commission in December 1986—nearly a decade before its implementation[84]. The Commission felt that prior efforts to harmonize the area of bank account guarantees had not succeeded as being too ambitious[85] and that continuing negative effects of not

having consistency was actually prejudicial to the smooth functioning of a single, internal market[86]. There was also a growing confidence that uniform regulation of this area could finally be accomplished as more and more positive developments occurred in the common currency convergence discussion. The Second Banking Directive, created during this pre-1994 Directive period in 1989, expanded the passporting possibilities of a branch of a Member State and provided further impetus for the need to coordinate authorization practices with the safety net of deposit insurance as the two are somewhat linked because expansion of branching throughout Europe brings with it new bank failure challenges and having varying deposit insurance schemes only adds to that complexity[87].

The further development of the 1994 Directive first recognized that deposit insurance is one of many tools that regulators of banking may use to harmonize and protect credit institutions[88]. It was the intention of the 1994 Directive to make deposit insurance an integral part of the 'safety-net' protecting banks; but not the only safety-net tool to be used.[89] Therefore, any final directive had to integrate deposit insurance into a broader safety net of protections and make it consistent with operations of other agencies (such as the competent regulator of banks, the central bank of each Member State, etc.). As we saw in Chapter 2, these included prudential regulation, enforcement, direct-lending and other tools to complete our broad safety net of troubled bank resources.

A large part of the debate regarding the creation of the 1994 Directive was the now familiar task of balancing trivial or insufficiently low protection with the concerns of creating 'gold plated' protection so high so as to encourage the unsound management

of credit institutions and infuse Moral Hazard[90]. In 1994, as the Directive was being finalized, the EU Commission felt the appropriate tipping-point level we previously discussed for Europe was the equivalent of €20,000 (the euro had not yet, however, been introduced and this sum was in equivalent former Member State currencies) and this was an adequate compromise between the two extremes of cover and this minimum threshold was implemented and remained as a base level for deposit insurance in Europe for 15 years[91]. While the level set was not trivial, it certainly was not generous. Underpowered and, yet, affordable are the best way to describe this base level of cover.

This level of protection of €20,000, or the current (U.S.) $30,000 equivalent[92], was about 30.00% of the 1994 FDIC's ceiling of (U.S.) $100,000 at the time of its initial introduction. In addition, several Member States received abrogation of the amount to an even lower sum for an initial period of time[93]. The reason for this compromise level of protection is a compromise of average deposit, cultural factors and avoidance of high funding levels. Many of the accession countries, already candidates for EU admission a decade later in 2004, needed to have ascertainable levels of deposit insurance that would be acceptable to their banking institutions and affordable from a deposit premium perspective.[94].

Apart from coverage, decisions could not be arrived at quickly regarding a single funding method. As funding methods were still not fully understood in Europe in 1994, it was suggested that the 1994 Directive defer a permanent or mandated funding method for the fledgling insurance scheme and allow funding methods to be implemented on a trial basis at the discretion of the Member State. Although the 1994 Directive states that

whatever the funding method of the deposit insurance scheme utilized is within the Member State's reasonable discretion, it was also clear that the cost and funding should be paid for by the credit institutions in each Member State.

The following are the key provisions of Directive 94/19/EC that have remained, basically, unchanged over an approximate 15 year period from 1994 through 2009:

- The term deposit under the Directive is defined as any credit balance and which a bank must pay under any legal or contractual conditions. This includes most building society share deposits. Certain deposits may be excluded from this definition such as a bank's own funds, any funds arising from money laundering activities, or deposits made by other banks.

- A deposit is deemed 'unavailable', so as to trigger deposit insurance for pay-out through the insurance scheme, if a bank is unable to pay a deposit when it is legally due. This determination must be made within 20 days of that event and, more preferred, within 10 working days.

- The Directive makes clear that the term 'deposits' includes the concept of netting of any balances in accounts at an institution after repayment of any liabilities (such as loans) owed to the institution. In Plain English terms, loans and other obligations owed to a bank may be accelerated and then deducted from deposits owed by the bank to the same customer or customer group under the scheme; or the deposit may be held until the liability is fully repaid. We discussed the fairness or unfairness of netting deposits against loans when a bank fails in Chapter 2, above.

- The Directive makes deposit insurance mandatory at the minimum levels in the EU. Institutions that take deposits must participate in an approved deposit insurance scheme or its equivalent (and any equivalent system must be approved by the Commission). Therefore, a deposit-taking institution that does not comply with this requirement will ultimately have its deposit-taking authorization revoked.

- A bank may apply its Home Country deposit scheme to its branches in other Host Countries (but for the first 5 years it could not offer more favorable coverage than the Host Country's deposit insurance scheme). If the Host County's scheme is better than the Home Country's scheme, the bank may voluntarily top-up the Home Country's scheme with supplementary participation in the Host Country's more favorable arrangement. In essence, the branch may join the Host Member State's scheme in that situation. Failure to properly adhere to these requirements may require notice to the customers of the branch of the inadequate insurance cover under the Member State regime for the branch[95].

- A withdrawal of authorization of an institution will not cancel the deposit protection of its accounts (at the current levels of coverage levels mandated). This makes sense, as most pay-outs occur after a bank fails and its authorization is likely already revoked or in revocation proceedings.

- Similar rules apply to branches of banks primarily located outside of the European Union (for example, an American bank authorized to operate branches within the United Kingdom).

- Coverage must be as to deposits not less than €20,000, or its (U.S.) $30,000 equivalent (and there was an initial and interim provision for €15,000 that expired many years ago).

- A Co-Loss may be allocated to a saver which allowed a Member State to cover less than 100% but at least 90% of deposits (and up to the coverage level) The remaining 10% or less would be covered by the depositor. Not all Member States actually adopted this Co-Loss provision. The Co-Loss, if applicable was applied to the base coverage for each Member State's scheme. For example, if a Member State allowed for a insured cover level of €20,000 and a 10.00% Co-Loss provision, the depositor would not collect the full cover of €20,000. In fact, it was not until almost €22,000 was lost that full cover could occur. If the account balance was €25,000, and the country had a €20,000 minimum cover scheme, under the 1994 Directive the customer would receive the full cover of €20,000 from the deposit insurance scheme and would incur an uncovered €5,000 loss for the uninsured portion. Only if the account balance was under €22,000 would the saver receive less than full cover if the Co-Loss was applicable in that Member State. Of course, an acquiring bank taking over the obligations of a failed bank could elect, as part of its assumption of the failed bank, to cover all account balances; provided, however, if it did so it became the liability of the acquiring bank that protected uninsured portions of accounts and was not the liability of the applicable deposit insurance fund. As stated above, and under the provisions of the 2009 Directive, the concept of Co-Loss has been eliminated entirely in the European deposit insurance scheme.

- The Commission was charged with periodic review of coverage limits and Co-Loss provisions at least every 5 years (and they are currently doing so in the 2009 Directive and related consultation more fully discussed below).

- Special rules apply to certain account types (individual, joint and business accounts).

- Generally, the coverage limits may be applied in the aggregate to the credit institution; deposits in various branches are combined for coverage; and, it does not matter where the branch is located or what the currency of the branch is for this aggregation to occur.

- Depositors are to be informed of the deposit insurance scheme applicable to the specific institution and branch they are served by; however, this is normally by way of a nondescript brochure available at branches of that institution.

- To preserve confidence in the deposit insurance system, Member States may restrict the information flow regarding the deposit guarantee or deposit system to basic, factual information in order to avoid rumors leading to the dreaded run on banks. This is a form of banking 'gag rule' that precludes a person simply guessing about the financial viability of a deposit insurance fund in Europe and then publishing his or her uninformed opinion that a deposit system is in decline, in trouble or insolvent if they cannot prove it with factual information. It is the also the reason that discussion of deposit insurance in Europe is often conducted in hushed voices and with less than cutting edge claims (this work possibly being an exception to that trend).

- Duly verified claims for reimbursement under the scheme must be paid within 3 months after determination that pay-out is actually due. Extensions of time may be sought under exceptional circumstances that could extend this pay-out period for up to 9 months. Along with the initial periods to determine that the bank cannot pay accounts when legally due, this is a very long period. The 2009 Directive has provided for far more rapid payment of deposit insurance benefits to savers by cutting this long period established by the 1994 Directive to a mere fraction of that time period. In this regard, it has moved far closer to the immediate pay-out provisions maintained by the FDIC in America.

- The deposit insurer can seek sums owed to the insured depositors from those responsible for the loss (the legal right of subrogation as found in many insurance contexts). This means, quite simply, that the deposit insurers in Europe can pursue any bad actors that caused the failure of the institution. Whether they can prove that these purported bad actors *actually caused* the loss is another matter entirely.

- A Member State can always offer a deposit insurance scheme that exceeds these requirements; but, a Member State without abrogation can never provide less.

c. *Revised Minimum Coverage; European Directive 2009/14/EC*

On October 15, 2008[96], pushed by Member States with troubled banking systems such as Ireland, Spain and Greece, and as the financial crisis dramatically escalated, EU Finance Ministers agreed, for an initial period of at least one year, and until more

detailed consultations could be considered, to provide enhanced deposit guarantees for individuals at more than double the 1994 Directive minimums. This raised the cover under the 1994 Directive to at least €50,000 (or the equivalent currencies for those Member States not in the Eurozone). The proposal also implemented a preset second stage additional increase to at least €100,000 or its monetary equivalent in 2010 which, in essence, doubled once more the level of protection and so long as the 2009 Directive's ongoing consultation did not find financial hardship in doing so.

Assuming these provisions are fully implemented in the coming year, protection will have gone from a minimum cover of €20,000 in 2008 to a minimum cover of €100,000 in 2010—*a staggering fivefold increase*. This demonstrates the concern over rapidly eroding loss of depositor confidence and the aging and antiquated nature of the EU's 1994 Directive. In essence, the dramatic increase in cover indicated the EU's concession that the 1994 Directive was far out of step; the tipping point for cover had moved substantially higher than €20,000; and, the financial crisis gave the Commission sufficient reason and adequate political cover to raise the base coverage dramatically.

The Commission made it clear that individual Member States may choose to exceed even the much greatly increased minimum threshold of coverage and as of now at least four Member States have chosen to do so[97]. On 13 March 2009, the European Parliament and the Council approved of the proposal in the form of Directive 2009/14/EC which directly amends the 1994 Directive[98].

The following are the key provisions of the 2009 Directive. It is noted that due to the financial crisis the 2009 Directive required unusually prompt transposition by 30

June 2009, a date that has now been passed, and all Member States have complied by adopting conforming legislation.

- The purpose of the 2009 Directive is stated to restore confidence and proper functioning of the EU's financial sector in light of the current and severe financial turmoil and crisis.

- The Commission recognized that the existing 1994 Directive provided minimum coverage and the Member States have always been able to provide additional coverage above those levels (as explained above). However, it was further determined that the new Directive was needed as this low minimum threshold of €20,000 was clearly not an adequate arrangement for deposit insurance under any situation and the Member States had no choice but to raise cover under the scheme. Therefore, the minimal level of cover needed to be more than doubled and raised to €50,000 immediately and to be further raised in a stage two reset to €100,000 by the end of 2010 (so long as consultations did not show the further increase to €100,000 to be a unique financial hardship to the Member States). The option not to raise the level further to €100,000 would be based upon an impact assessment (a consultation under the 2009 Directive) which would need to demonstrate that such an increased level would not be financially viable for some Member States, or would improperly distort competition. As this consultation is currently ongoing, it is not clear what the final increase will be, if any, in 2010 and thereafter; however, the second stage increase appears likely.

- The Council also expressed an intention to implement an inflation-adjusting minimal level of deposit insurance cover in the future based upon the index of consumer prices, also known as the Consumer Price Index.

- The Council called for comprehensive reports on the design aspects of the EU deposit insurance scheme running a broad spectrum from contribution methods (funding) through the scope of coverage and including cooperation between schemes as well as emergency pay-out systems to speed up payments. This foreshadows a complete revision and rethink of the 1994 Directive scheme and not just a revision of the minimum contribution levels set out in the 2009 Directive.

- As for countries with troubled banks, such as Greece and Ireland, who currently offer, in essence, Blanket Coverage at this time for stability reasons, the Commission is directed by the 2009 Directive to determine how those schemes are functioning and if they should be maintained or even introduced to all Member States on a community-wide basis.

- Related to coverage levels, the Council determined that requiring co-insurance ('Co-Loss') by a depositor undermined confidence in the European Union deposit insurance scheme and elected to fully discontinue the Co-Loss provision. This means that the entire first €50,000 of deposit loss, or its equivalent for Member States not in the Eurozone, will be covered without any off-set for Co-Loss. If the

amount of minimum cover is increased to €100,000, this sum will also be covered without any Co-Loss off-set. Although the FDIC's (U.S.) $250,000 is a different, maximum coverage concept, the EU appears to be following the FDIC's lead in offering the base coverage amount of deposit insurance is provided to a saver without confidence-degrading off-setting.

- The Directive states that pay-outs and processing must be made much faster. The Council stated the period to assess claims should be reduced to 20 working days from many months which had been the practice under the 1994 Directive. It was stated that this period should be further reduced to 10 working days, or less, in many cases.

The EU Finance Ministers agreed in supporting this Directive that in so doing that it was a priority of the European Union to restore confidence and the proper functioning of the financial sector in the short term and in light of the current crisis and there was sufficient time in the future to arrive at a final set of design changes for the next generation of deposit insurance laws in Europe and on a longer term basis after the current consultation concludes. The changes made by the 2009 Directive, then, were interim steps to address crisis events. However, the 1994 Directive needed a complete revision and further effort at coordination and consistency was clearly needed at the European level so that "competitive distortions between banks can also be avoided" and, hence, the need to adopt the 2009 Directive amendments, without prior consultation, was just the initial step.[99]

The Commission, for its part, stated that the intermediate increase to €50,000 was an important improvement and was intended to be a strong interim step to combat loss of confidence in banking and the current financial crisis in Europe. It would insure robust coverage of 23.00% more of European bank deposits[100] than were covered by the prior coverage level under the old, antiquated €20,000 minimum base coverage level of the 1994 Directive. An estimated 80.00% of all European accounts would be covered under a €50,000 minimum coverage amount. If the further increase in base coverage to a minimum cover of €100,000 occurs (as planned in 2010), this would raise that percentage of covered European accounts from 80.00% to 90.00% which would be an impressive cover of nearly all of Europe's bank accounts on a full coverage basis. Of course, the United States, as we have seen already seen, covers most (if not all) of many different types of deposits up to (U.S.) $250,000 for each type and, in some cases, well beyond that amount. Therefore, the European decision to increase cover and provide for the vast majority of accounts to realize full cover is of little surprise as the United States has already reached these lofty coverage levels and Europe does not wish to incentivize the disintermediation of accounts from Europe to the States[101].

The EU DIS Scheme will now be required to reimburse depositors within twenty days (and often sooner under the 10 business day aspirational standard) of events causing a Member State's competent deposit insurer authority to find that the deposits of an authorized credit institution are not available and thus triggering pay-out under the revised EU DIS. This is a major departure from the slow, frustrating period that a deposit insurer in a Member State was given previously to address its savers, without even considering possible extensions, to start the deposit insurance claims process. To

bring pay-out from many months down to 20 days or less, while not as instantaneous as the American system, is a significant improvement in timing.

d. *Variations Amongst Member States Above Base Levels; Topping Up Arrangements; and, Concerns About Double Recovery*

Topping up arrangements, which enable participants to handle discrepancies between Home State banking operations (where a credit institution is authorized) and Host State (where some or much of the branch operations of that credit institution may be occurring) exist in the 1994 Directive and have been implemented for many years. Without such supplementary or topping up arrangements, the deposit insurance throughout the EU could be even more problematic as it would create a patch-work of uncoordinated deposit insurance schemes based upon Member State's differing levels of cover.

Therefore certain equalizing or topping-up provisions are found in the 2004 Directive and these provisions were not changed in the 2009 Directive process. The 'topping up' arrangement set forth in the 1994 Directive states that if the Host State's deposit insurance scheme is less generous than the Home State's scheme, rather than allow banks (and their depositors) to take advantage of the more generous Home State scenario, the 1994 Directive provides that the Host State's scheme is the maximum a depositor is entitled to in the Home State. This is what many call a 'leveling down' or the 'export prohibition' provision.[102] The Host State, in essence, determines the maximum cover for the domestic Home State customers.

If the Host State's scheme is *more generous* than the Home State, the Host State must ensure that those firms outside the Host State can 'top up' their lower Home

State cover through the Host State's deposit insurance plan. This is a so-called 'supplementary guarantee' provision. The reason the Host State provides this top up is that it is not in as good of a position as the Home State to assess a banks' prudential risks and to minimize them[103]. It is more likely that the current consultation will realize a uniform coverage level and dispense with the leveling down and topping-up formula going forward as it can be a real source of confusion and frustration for a bank, let alone the normal saver, to be able to follow and keep current with these intricate leveling rules.

Currently in the European Union, certain protections exist against doubling one's recovery under both a European deposit insurance scheme of the many Member States and any scheme that might exist for a branch of foreign bank operating in the EU. For example, an American bank, such as Bank of America, may have a branch of that institution in Ireland. In that event, a depositor would be precluded from realizing two deposit insurance recoveries from the same lost deposit—one under the American system and one under the Irish scheme. Such a doubling-up of deposit insurance benefits would only constitute an unfair windfall to a saver.

e. *Involvement of the European Central Bank In Deposit Insurance and Direct Payments To Troubled Banks (Bailout and Recapitalization)*

Unbeknownst to many, the European Central Bank ('ECB') is involved in decisions regarding the deposit insurance schemes of the various Member States. The ECB maintains an opinion process to determine (in advance) the propriety and risk to deposit insurance and other Community laws when deposit insurance schemes are amended or direct lending to banks is proposed because the ECB, as part of its remit, is

the central bank to the Member States central banks and bears risk when financial systems become weak or when deposit insurance systems are impacted[104]. These ECB opinions are, in their nature, advisory and issued to fully avoid enforcement actions and to aid the competent authorities in each Member State in staying within general Community law frameworks regarding safety net protections and to assist banks in handling economic crises and recapitalizing financial institutions without violating other laws concerning competition, state aid, and others[105].

With the recent financial crisis, there have been an unusually high number of advisory opinions being issued by the ECB with regard to deposit insurance and related direct lending issues. However, such a high number of opinions demonstrate community-wide trends and are helpful in illuminating the approach of the EU as they show the specific concerns and direction the ECB would like the Member States and their central banks to proceed with as to deposit insurance schemes and direct lending programs to troubled banks within a Community framework.

The ECB is a Treaty-based Community institution[106]. The ECB's remit, as set forth in the Treaty, includes the competence to give advisory opinions on whether a proposed law offered by a Member State will be in accord with central bank governing laws and Treaty obligations[107].

The following eight recent advisory decisions of the ECB offered during the financial crisis during 2008 and 2009 demonstrate the Community's and ECB's impact on deposit insurance programs and/or the direct lending and recapitalization programs (i.e. bailout) of banks within the Member States. These advisory opinions lend insight

into Community positions on these issues and are the counterbalance to simply allowing Member States to take unilateral action to stem financial crisis within their borders:

i. *ECB OPINION CON/2008/44 (3 October 2008) (Ireland):*

The proposed Irish law addressed in this ECB opinion would require that the Irish Minister of Finance provide financial support to certain credit institutions (banks) and allow the purchase of shares in the credit institution in return for that support. It is intended that the financial support would be repaid. The support would not extend beyond 29 September 2010. Also, company law provisions would be exempted for the purchase of these shares in essence creating an abrogation for these transactions as they are being held by the Irish Government. Also, the Minister of Finance of the Republic of Ireland requested the right to approve mergers or acquisitions of banks even if the Commission or Irish Competition Authority might otherwise object to same and even if competition may be substantially lessened and so long as the financial stability of Ireland required it.

The ECB advisory opinion recognized the full Blanket Coverage guarantee provisions put in place the month prior to this request with six Irish-authorized institutions and that will expire on 28 September 2010. However, the ECB seemed cautionary in stating that Ireland has acted by way of an individual response to the current economic crisis without consulting with its EU Member State partners and expressed regret that they did not seek a more coordinated response to the financial crisis on a pan-European basis.

The ECB next expressed concern that the proposed law remained quite general and was intended to be filled in with significant secondary legislation not yet even specified. The concern of the ECB is that this secondary legislation not act in such a way so as to violate other Community laws, such as offering impermissible State Aid or other requirements to banks. Of special concern was the obvious preferential treatment of the six named Irish-authorized banks. The ECB also stated its belief that the Commission must also offer its opinion on the compatibility of the proposed law on such Treaty and State Aid issues (and it is noted it later did so on a revised version). The ECB additionally expressed concerns that such a large anticipated infusion of capital will have a profound effect on Ireland's internal governmental budgets and will expose Ireland to considerable guarantee obligations, although all are currently contingent. As the Irish economy is noticeably deteriorating already, the ECB expressed considerable cause for concern with this widespread contingent commitment.

The ECB suggested changes in the propose law to insure that nothing in it would: change the obligations under central bank legislation; would act as a waiver of any Treaty or European System of Central Bank (ESCB) statute; or, would constitute prohibited financing under specific Treaty provisions. In essence, recapitalizing banks under these proposals would change none of the obligations of Ireland to the ECB, the Eurosystem or the ESCB; and, of course, would not act as an implicit waiver of any Treaty obligations.

Finally, the ECB did not feel that waiver of company law adequately protected the Eurosystem (due to the fact that this may result in a failure to disclose important issues, such as floating charges) and strongly recommended revisions to this provision. The

ECB stated that they felt there was an inherent conflict with the Irish Government acting both as a 'Financial Regulator' in approving bank mergers and acting as a 'Competition Authority' monitoring such mergers[108]. The ECB felt that this was an unwise conflict and the Irish Competition Authority can aptly consider the exceptional nature of the need to approve certain proposals that might not normally be approved on stability grounds and, it is assumed, would be reasonably sensitive to such needs. It would not be prudent to allow one governmental entity to decide both issues and preempt all others.

ii. *ECB OPINION CON/2008/46 (8 October 2008) (Belgium):*

In this ECB opinion, Member State Belgium sought to approve a draft law to stem the financial crisis. Belgium had realized serious bank stress as of this submission and the likely further failure of several institutions and sought advisory approval from the ECB for its draft legislation. The legislation allowed the Belgium Government to take any urgent measures necessary to stabilize the financial markets in Belgium in the event of a sudden financial crisis or a serious systemic threat. Further, the draft law would allow for a guarantee by Belgium to its central bank as to any credit the central bank, in turn, guarantees for its underlying regulated and authorized credit institutions. The law would be retroactive by several weeks.

Once more the ECB stressed the need to coordinate activities between Member States and Community-wide institutions and for Belgium to not proceed on its protections and reforms unilaterally. The ECB recognized the Belgium central banks' lender of last resort role and that it is very much in the range of responsibilities for a

central bank, such as that in Belgium, to provide liquidity assistance in emergency situations by appropriate means (direct lending, guarantees, etc.)

However, the ECB felt that the draft law should make it clear that the central bank must have full independence to decide these issues if this law is to be implemented. The ECB was fearful of interference from the Belgium Government in monetary matters and which institutions would receive direct aid. Regarding the guarantee to the central bank by the Belgium State, the ECB felt that this guarantee should also respect the independence of the central bank and be at the sole direction of that authority (and not political influence); be as short term as possible; and, that there be no doubt that the guarantee is enforceable by the central bank under Belgium law and that proper provisions have been made to insure it is economically adequate.

iii. *ECB OPINION CON/2008/48 (15 October 2008) (Ireland):*

Ireland returned to the ECB with a revised draft law to attempt to correct the issues contained in CON/2008/44. The matter was submitted on an urgent basis before being finally approved by the *Oireachtas*, or Irish Parliament. It is noted that between this opinion and the prior submission, an Ecofin meeting (a meeting of Member States Finance Ministers) had occurred on 7 October 2008 where additional framework requirements were worked out for legislation of this type. Also, on 12 October 2008 a concerted European action plan had been worked out for those countries in the Eurozone (of which Ireland is a member) where, amongst other guidelines, they resolved to work together as the ECB had suggested.

With this opinion, the ECB issued a longer opinion as the revised proposed Irish scheme was more detailed in this resubmission from the events of the prior week and matters were evolving quickly. This revised legislation required a guarantee acceptance deed; basically, a Guarantee of certain covered liabilities of covered institutions. Rather than targeting only a select number of covered bank undertakings, the scheme also expanded its cover to include the six Irish-authorized credit institutions and would also include five other banking subsidiaries of non-Irish authorized institutions in Ireland "with a significant and broad-based footprint in the Irish economy". In essence, these newly and additionally covered entities are banking subsidiaries who are considered hosted undertakings in Ireland and are authorized in other Member States but profoundly impact banking in Ireland. In the words of the Minister of Finance, those that are systemically important are included in this revised scheme.

It its advisory opinion, the ECB recognized that the expansion of undertakings to include others not originally proposed was a sincere effort by Ireland to avoid competition and State Aid issues resulting from the prior legislation version, and to insure there is no unfair advantage provided to selected institutions which could distort market conditions and lead to new problems. Once more, the ECB urged safeguards to insure these distortions did not occur. The ECB confirmed that the Commission has cleared the revised scheme from such State Aid concerns[109]. Still, State Aid was very much a concern of the ECB and in Ireland's quest to solve its financial problems the ECB stated its need to insure that Ireland did not violate other Treaty requirements.

The ECB also remained concerned with uncoordinated efforts in the area of guarantees. This has special relevance for deposit insurance and ties into

recommendations made in Chapter 7 of this work, below. The ECB stated that Member States, in the area of guarantees, must act in a coordinated manner to avoid significant differences in national implementation that could have a counter-productive effect, create distortions in global banking markets, and that guarantees must be consistently applied by the Member States. Against this backdrop, the ECB next noted that uncoordinated decisions to guarantee interbank deposits in some Member States (and, it is assumed, not to do so at those same levels in others) should be carefully avoided as those uncoordinated efforts may fragment euro area markets and, it is assumed, work against the efforts to harmonize such guarantees. In essence, any guarantees that distort and undermine a Single Market monetary policy in the European Union are unwelcome and may violate Treaty and/or Eurosystem imperatives.

The ECB was also concerned with the specific nature of the direct guarantee program. In essence, *what covered liabilities are being directly guaranteed by Ireland as to these undertakings?* was the focus of this concern. The ECB stated a preference for the deposit insurance scheme being used in the 1994 Directive to guarantee deposits rather than this use of new, direct guarantee obligations of the Irish Government covering certain liabilities of certain systemically important covered institutions. The ECB calls for more clarity as to the relationship between direct guarantees and the normal deposit insurance guarantees of the 1994 Directive (and as of this time in 2008, the 2009 revised Directive had not yet been enacted but soon would be).

Finally, the ECB stated it was concerned with the extensive powers provided to the Minister of Finance in Ireland and the Irish Financial Regulator under this revised scheme. While recognizing safeguards, and the further inclusion of the Central Bank

Governor in the scheme, the ECB remained concerned with the 'operational independence of banking supervisors' which are to pursue supervisory objectives free of political pressure and asked that the balance be reconsidered in the final legislation so as to assign the tasks of gauging bank condition to the Financial Regulator or the Irish Central Bank and not to a person subject to the many political pressures of Ireland such as the Minister of Finance. A more coherent delineation of the powers of the respective supervisory authorities should be introduced.

iv. *ECB OPINION CON/2008/69 (17 November 2008) (Ireland):*

About one month later, Ireland was once more before the ECB. This time, having reviewed the ECB's concern about coordinating direct lending under 'TARP'-type programs with approaches the ECB felt were more favorable under the 1994 Directive regarding deposit insurance schemes, Ireland was seeking an advisory opinion on its efforts to amend its Member State deposit insurance scheme.

The ECB acknowledged that Ireland was attempting to accomplish several things with its draft and proposed Financial Services (Deposit Guarantee Scheme) Bill 2008. First, it was seeking to elevate many of its 1995 Regulations implementing the 1994 Directive from Statutory Instrument (S.I.) status to full bill status (and, thus, giving it a higher legislative status). Second, Ireland, under this Bill would raise its deposit insurance base level from €20,000 directly to €100,000 and would thus eliminate the current 10.00% Co-Loss payment by its depositors. Third, that Ireland would make clear that credit union savers would be covered by the revised Irish deposit insurance

scheme. Finally, that responsibility for the DIF for the Irish system would move from the Irish Financial Regulator to the Irish Central Bank.

The ECB had few concerns with the raising of base level coverage or removal of the Co-Loss payment and this change tracked the known and referenced similar change that was already being discussed in the proposed 2009 Directive to the 1994 Directive and requiring all of the Community to raise the base level deposit insurance coverage to at least €50,000, immediately, and eliminate the same Co-Loss coverage[110]. However, the ECB again stressed the need for strong Community-wide coordination and harmonization in these efforts.

Of course, Ireland also had proposed to fully and directly guarantee the deposits of certain covered institutions that have systemic importance to Ireland as noted in the prior ECB decision ECB CON/2008/44 that predated this one. The direct guarantee of deposits of those institutions is handled under a different approach. Also, those guarantees lapse in September of 2010 and when they did lapse this would leave the deposit insurance scheme, at these increased levels, and without a Co-Loss provision, within the framework of the 2009 Directive modifying the 1994 Directive. Once more the ECB makes it clear that adjusting base levels of coverage under deposit guarantee schemes is considered more desirable than direct lending under 'TARP'-like governmental guarantee programs and that the existing deposit insurance mechanism should be used to the fullest extent possible. Finally, the ECB felt the movement of deposit insurance obligations from the Irish Financial Regulator to the Irish Central Bank was beneficial and was a better fit for the remit of the scheme and the ability of the Irish

Central Bank to provide short-term cover for any pay-out needed was easier handled when they also controlled the deposit insurance fund.

v. *ECB OPINION CON/2009/16 (25 February 2009) (Ireland):*

Ireland made its next request to the ECB a few months later. The ECB reviewed the proposal of the Irish Government to give two leading Irish banks (Allied Irish Bank and Bank of Ireland) €3.5 billion in capital in return for preferred or preference shares to be issued back to the Irish Government in the same banks. This proposal was modeled after the TARP program in the United States which was commenced a few months before this decision and was widely publicized. The dividend on the preferred shares would be 8.00%. The two banks impacted would be allowed and encouraged to repurchase the preference shares from the Irish Government when financial health returned at 125.00% of their face value (giving the Irish Government a profit in such event) and within the first five years of their issue. There would be other incidence of ownership, such as appointment of 25% of all the bank directors of these institutions. The Government was also allowed, if they wished to, convert the preference shares into common stock at a pre-agreed exchange price and a prearranged point if they were not redeemed. Ireland sought approval of this scheme. Of course, we now recognize this program as one element of the broader safety-net of programs in many countries and this one is within the traditional 'lender of last resort' category—but with the added aspect of interim equity ownership by a government in a private undertaking.

The ECB recognized that the Irish Government did not seek to take actual control over these institutions and the equity ownership was an accommodation and acted as

security for the loan and to assist the government in directing the operations of these mega-banks. Also, about half of the necessary funds would come from existing resources of the Irish Government or the Irish Central Bank and half would have to be raised and budgeted.

Coordination is once more stressed by the ECB with other EU partners and the common principles that developed at the Ecofin meeting of 7 October 2008 and the 12 October 2008 Declaration regarding a concerted action plan by the Heads of the Member States and the common principles agreed to between them. The ECB stressed that this 'acting together' avoids counter-effects and distortions in global banking markets and uncoordinated decisions lead to fragmentation of the euro area money market.

The ECB felt that such direct lending is possibly but only fundamentally sound institutions should be considered for such programs and common agreement must be reached as to what conditions will apply and how the recapitalization should be priced. Regarding institutions deemed fundamentally sound, the ECB stressed that it has published extensive separate recommendations on this topic and they should be consulted before acting. In essence, a Member State's direct capital support for its banks should be as short as possible and should not result in an excessive increase in the general cost of capital. Also, the expiry of the recapitalizations across the EU should be harmonized. So as to not run afoul of State Aid requirements, and European and Member State competition laws, a Member State's role in the support schemes must be limited in time. Finally, any arrangements should work to insure an equitable return for the use of funds to the taxpayers.

vi. *ECB OPINION CON/2009/20 (10 March 2009) (Cyprus):*

A request was provided to the ECB to approve draft regulations regarding the Cypriot deposit insurance scheme. The regulations created two separate schemes for the benefit of the customers of Cypriot banks and, as to both schemes, the base level of protection would be increased to €100,000; the payment delay will be reduced to 20 days; and the 10% Co-Loss provision will be eliminated. In addition to the above, coverage will be broadened and expanded to include deposits denominated in other currencies; and reserves for the Cypriot DIF would be increased to reinforce the increase in the base levels of deposit insurance by appropriate premium increase.

As these changes closely track the 2009 Directive amending the 1994 Directive, the ECB had few concerns with these changes. Of course, the ECB stated that it remains to be seen if the base level in the EU is actually raised to € 100,000, however, as it is subject to ongoing consultation. However, as with Ireland's approach, even if the EU base level remains at €50,000, the Cypriot level rising to €100,000 will still be a supportable decision as Member States can introduce schemes that exceed the minimum coverage base-level mandated requirements of the 1994 Directive as amended by the 2009 Amendment.

vii. *ECB OPINION CON/2009/31 (26 March 2009) (Latvia):*

A request was made by Member State Latvia to introduce a draft law to change the Latvian Deposit Guarantee Fund in the following ways: first, to broaden the scope of the DIF with regard to branches in Latvia of banks not registered in the EU; second, to clarify who may be excluded from the deposit insurance scheme; third, to introduce risk-

based premiums to be paid by Latvian banks to fund the deposit insurance scheme (as opposed to flat or fixed based payments); fourth, to allow pay-outs from the DIF to be made from a single, pre-selected commercial bank.

The ECB expressed concern with the legality of handling branches of foreign banks differently than branches of EU-authorized banks whose Home Member State of authorization is another Member State. In the case of a EU-authorized bank, its branches need only top-up to the Host Member State's deposit insurance scheme. Latvia proposed that a branch of a foreign bank, not otherwise authorized in the EU, cannot just top-up but must, potentially, duplicate coverage elsewhere. There would be a sanctions regime that backstops this requirement. The ECB expressed concern with this disparity.

While the ECB supports the concept of risk-based premiums, it is aware that this issue is also under study with various 'models' offered by the EU (and discussed in Chapter 6 of this work) and suggests that any adoption of this concept be monitored so as to remain consistent with Community pronouncements on this issue following completion of the current and ongoing consultation regarding the 1994 and 2009 Directives.

Finally, regarding the concept of using a single commercial bank to make deposit insurance payments, the ECB stated that the concept, in and of itself, is not necessary improper. However, how that entity will be selected is of real concern to the ECB as well as the nature of its precise tasks. It is primarily the responsibility of the deposit insurer, not a selected agent bank, to assess and validate claims for deposit insurance and such

work cannot be assigned to a single institution without considerable thought as to that institution's assisting role. Use of a single commercial bank could also create issues of distortion, favoritism or even Moral Hazard if the commercial bank was designated in advance (as the selected bank may be seen as immune from closure). Therefore, such temporary outsourcing methods are likely to be discouraged. Instead, the ECB suggests that the deposit insurer in Latvia should focus upon strengthening its own technical capacities and resources.

ix. *ECB OPINION CON/2009/51 (5 July 2009) (Romania)*:

A request is provided to the ECB to approve Romania's emergency ordinance regarding setting up and operating a deposit insurance guarantee fund. It is noted that Romania acceded to the EU in January of 2007. Specifically, the request tracks the 2009 Directive changes (increase in base level, elimination of Co-Loss, etc.). However, it has some unique features, such as: informing depositors to the extent their deposits are not insured; strengthening the DIF's ability to pay-out claims; and, other aspects. Specifically, the DIF is being authorized to borrow from the Romanian Government when the resources in the deposit fund are insufficient to pay claims as there are, obviously, insufficient reserves to handle the current crisis as the DIF has not been existence for a lengthy period.

Recognizing Romania's severe financial crisis[111], the ECB felt these provisions were consistent and pragmatic. In addition, the ECB stated that it is not appropriate for Member States to put their central banks in a position to have insufficient resources to carry out all their obligations and this pointed in the direction of approving these

changes and additional authorities.

These ECB decisions, therefore, provide very recent examples of how the European Central Bank views its role as independent guardian of the EU's financial system and monitors Member States actions with regard to the direct lending and deposit insurance areas[112]. The ECB is helpful in reminding the Member States that their deposit insurance schemes, drafted in accordance with the 1994 Directive and as amended by the 2009 Directive, must also remain part of a larger financial safety-net and with full partnering with other EU Member States and institutions. They are further reminded that a financial crisis is not at all a reason to allow a Member State to fail to honor other core Treaty provisions, such as decades-long preclusions on impermissible State Aid and failure to scrutinize competition issues.[113]

f. *How Well Are The European Deposit Insurance Schemes Funded Currently?*

The brief answer is, generally, the funds house inadequate reserves for the systemic risks bank face in modern times. Of course, unlike other systems, such as the American system, the deposit insurance reserves for Member State schemes in the EU are held in 27 different deposit funds associated with each Member State's central bank. However, unlike the American FDIC system, there is a surprisingly diverse set of funding mechanisms between the different EU DIS schemes spread amongst the EU-27 Member States and several additional candidate states. Generally, some of the funds attempt to fund deposit insurance premiums at a low *ex ante* level; and several do not fund any premiums and are *ex post* currently.

A majority of the schemes take one of two forms. Most are some form of the Type 1 scheme we investigated in Chapter 2 which is *ex ante* funded; some are a mixture of *ex-ante* and *ex post* schemes; and several are, in essence, pure Type 2 or *ex post* funding schemes. Because of insufficient funding and/or reserves, direct lending programs such as are found in Belgium, Ireland and Romania are necessary for systemic risk bank failures as insufficient reserves exist to cover such bank failures. Without direct lending of the TARP-type, the DIF in these countries could be swamped by the failure of large undertakings as with the American FDIC system, currently.

The following are the various funding models for the EU's DIS:

- *High Ex Ante Funding.* This is the funding model frequently adopted by Nordic European countries, including some of the new Member States of that region. The common feature of this form of funding is the high level of available funds in reserve, which reaches coverage ratios of 2.00% or more. In countries adopting this highly prudent form of contribution and reserve level, the DIF should be able to withstand and meet most important crisis and loss situations.

- *Medium Ex Ante Funding.* This funding model allows for a contribution rate of 1.00% or more of covered deposits (approximately half of the *High Ex Ante* Funding Model). It would allow for coverage during severe disruptions but could be quickly tested for failure during widespread and systemic banking events.

- *Low Ex Ante Funding.* This funding model is representative of certain countries such as Ireland and a significant number of other EU Member States. The

scheme in countries adopting this *Low Ex Ante* funding model have weak contribution and reserve levels resulting in a poorly funded DIF and this could lead to a DIF that would quickly collapse after a deposit insurance scheme was forced to address several medium or multiple small simultaneous bank failures. Each failure would significantly weaken the DIF for such a Member State.

- *Ex Post Funding.* Obviously, this model relies upon after-the-fact funding. It is a promise to pay for the cost of bank failure and could, in essence, force the entire deposit insurance scheme upon governmental funding sources. It is, in essence, a promise without assured funding in advance.

The Commission has previously advised that almost 80.00% of depositors in the EU are covered by low *ex ante* or *ex post* unfunded schemes and this poses significant risks to the EU deposit insurance system[114]. Another risk imposed by the EU system is that it is not generally funded based on the actual risk of an institution—a so-called risk-based or differential system; but, rather, some Member States use a fixed rate deposit premium system. A majority of the Member States (18 Member States out of the current EU-27) have not, as yet, introduced risk-based premiums to fund their schemes[115]. The remaining countries use some sort of indicator(s) to assess their risk. For example, France uses a four risk indicators of solvency, risk diversification, operating profitability and liquidity that we will see again in Chapter 6 with the Risk-Based models recently proposed by the EU. However, other Member States who use a differential premium may rely on other risk factors and the risk-based analysis is not coordinated between the Member States.

g. *How Solvent Are Member State's Deposit Insurance Reserves?*

In a candid announcement of the revised EU DIS in October 2008, the Commission offered this Q & A regarding EU DIS preparedness for pay-out:

> Q. *Do Deposit Guarantees in the EU have enough money to pay out if needed?*
>
> A. While Member States have committed to "take all necessary measures to enhance the soundness and stability of our banking system and to protect the deposits of individual savers", recent research undertaken by the Commission's Joint Research Centre suggests that *almost all schemes* are robust enough to face a *medium-sized bank failure*. In addition to funds already available in the schemes, other funding options include credit facilities or additional contributions from member banks. The Commission will follow up this proposal with a review of funding mechanisms by the end of 2009. (*emphasis added*)

This is hardly a ringing endorsement for full financial viability of the 27 Member State deposit funds and this response occurred even before the deepening nature of the current economic crisis.

Further, European banks have seemingly not as yet faced the full force of a full blown financial calamity, according to many, and if these institutions are stressed much beyond the current serious levels of lending and other loss, it is thought many more Euro institutions would be in much more severe and dire straits without obtaining additional and immediate capital to preserve eroding liquidity. Many experts have, therefore, called for immediate stress testing of Euro banks as urgently needed to determine the true health of banking in Europe and such testing is likely to soon take place later in 2009 and into 2010. The problem is whether such testing will be a weak attempt by member states and/or the ECB to cover for troubled banks; or, a realistic and rigorous examination of systemic risks. Of special concern, is the true state of banking solvency in Ireland, Greece, Spain, the UK and the 2004 EU accession countries.

A more detailed answer of fund solvency depends on the Member State. In the EU's *Scenario Analysis Estimating the Effects of Changing The Funding Mechanism of EU Deposit Guarantee Schemes* promulgated in February 2007, the Commission found that seven of the EU's Member States are either not funding deposit insurance premiums *ex ante* or the deposit insurance premiums being funded are deficient. Eight other Member States are funding at low levels less than 1.00% of all deposits It is believed that the current consultation will conclude that funding and reserves for Member States deposit insurance funds must be increased to at least High *Ex Ante* status in all Member States and the current rag-tag funding levels are not conducive to a fully functioning deposit insurance scheme[116].

h. *The Curent EU Consultation On Deposit Insurance.*

The Commission, through its DG Internal Markets, has been engaged in a rethink and review of the 1994 Directive, as amended by the 2009 Directive. The 1994 Directive requires a five year periodic review but the current financial crisis has greatly accelerated that slow pace of review of this antiquated Directive out of necessity and caused the interim stage of the 2009 Directive to be implemented before that review can be concluded. Other EU institutions have also been studying this issue, such as the ECB[117] and the European Forum of Deposit Insurers[118].

As part of the ongoing Consultation, the Commission is required to prepare a report by the end of this current year (2009) on a variety of issues in addition to the desirability of the proposed increase to €100,000 of the base limits of coverage, such as the harmonization of funding mechanisms, operational issues (claims process and payout delay), and the feasibility of a pan-European (single deposit protection system)

in the likeness of the FDIC system in the United States, and to submit legislative proposals, if appropriate.

Specifically, the report must address the following issues:

- Harmonization of the funding mechanism of deposit-guarantee schemes and the benefits and costs of such harmonization.
- Possible models for introducing risk-based contributions on a pan-European basis.
- Benefits and costs of a possible introduction of a Community (Single Market) deposit-Guarantee scheme.
- The appropriateness of and modalities for providing a full coverage for certain account balances.
- Effectiveness and delays of the payout procedures assessing whether further reduction could be implemented.
- The link between deposit guarantee schemes and alternative means for reimbursing depositors, such as emergency pay-out mechanisms.
- The harmonization of the scope of products and depositors covered, including the specific needs of SMEs (small and medium enterprises) and local authorities.
- The impact of diverging legislations as regards set-off, where a depositor's credit is balanced against its debts, on the efficiency of the system and possible distortions, taking into account cross-border winding-up.

- Transparency and information available to depositors (i.e. their awareness about the functioning and the features of existing schemes).
- The effectiveness of cross-border cooperation between deposit guarantee schemes.

The Commission has accelerated their efforts in this area. At an informal roundtable of experts (the "Roundtable") sponsored by the Commission's Internal Markets DG in Brussels on 31 March 2009[119], several discussion points, challenges and issues were identified for the Commission's 2009 year-end response and recommendations, as follows:

- The Roundtable felt that questions of not retaining a fixed coverage level may look simple but becomes rather complicated when looking at issues such as alternative (and voluntary) guarantee systems, temporarily high balances, pension deposits, other exemptions etc. or raising the level e.g. in times of a crisis.
- With regard to the upcoming increase of the EU DIS to €100,000, many experts at the Roundtable were of the opinion that the limit could be effective and be set substantially lower (or targeted more precisely to different deposit levels); however, the experts also acknowledged that this was a significant psychological and political level that might lend additional confidence and put depositors 'entirely at rest' as regards protection of the vast majority of their deposits and as a proactive response to the current crisis situation.

- Concerning the fixing of the coverage level, the Roundtable participants pointed out the existence of competitive concerns related to coverage uniformity when the aim was to create a Single Market in financial products. Experience with the former export ban has shown that different levels of coverage for different Member States, in principle, does not pose greater concern (i.e. in normal times, depositors do not necessarily only put their money where the level is highest). On the other hand, in the event of a crisis the unilateral increase of certain Member States raising coverage had recognizable effects in other Member States. Having a single coverage amount could allow a level playing field and complicated topping-up programs could be dropped.

- The Roundtable experts recognized the strain of the ongoing financial crisis on *ex-post* financed schemes; and, the increased need to more candidly discuss *ex-ante* financed systems. *Ex a nte* systems would also minimize cyclical effects. They warned however, to prescribe a fixed level of *ex-ante* financing could prove difficult and suggested target levels linked to deposits covered which should be reached after a sufficient amount of years. Experts made it clear that in crisis times, especially at systemic levels, governments would still have to step in to provide *ex-post* funding or direct lending (this is the bypass argument discussed above for large institutions near failure). Arguing against *ex ante* funding, some experts warned that there was risks associated with *ex ante* funding, such as potential 'political' deviation of such funds in case they are not needed for a couple of years, the

matter of stability of funds in terms of devaluation and investment risks and negative effects of *ex-ante* contributions to the liquidity situation of institutions; and, that ex-post financing of deposit insurance could actually lead to more market discipline and inter-bank monitoring than *ex ante* systems.

- A majority of the participants at the Roundtable believed that it was much more important that depositors really get their money back rather than to ensure an unrealistically short pay-out period and little delay. Some warned that vetting the eligibility criteria takes time and one should not promise what one could not deliver in the end with rapid payment systems. Some participants were in favor of a general and interim emergency payout procedure (i.e. short-term payment of a pre-set limited amount) or arrangements on individual basis to be arranged between depositors and the scheme in order to prevent hardship cases.

- Regarding set-off (i.e. the netting of deposits and depositors' liabilities against the bank), the Roundtable d iscussed the concept and different views were expressed. It was concluded that what is important is to adopt a harmonized approach with or without set-off. Some considered it an unnecessary burden for depositors who might in an extreme case not receive anything when needing cash, while others saw the need to amend national insolvency laws in order to avoid schemes being deprived of certain rights without netting (since schemes subrogated into depositors' claims against the bank, the bank's insolvency practitioner could later set off a depositor's liability against the claim of the scheme against the insolvent bank,

depriving the scheme of refinancing itself and being an unjustified enrichment for the depositor who would get rid of his or her debt). Some acknowledged that set-off was, without any doubt, delaying pay-out and may be counter-productive.

- A uniform (pan-EU) deposit insurance scheme was considered to be useful in different ways: first, making up for deficiencies in Member State DIF's, in the form of a type of reinsurance system; and, second, preventing failures in a cross-border banking group. Some suggested a similar approach for mutual guarantee schemes, which are currently exempt from the Directive under certain conditions. In a reinsurance capacity, Member States could join a pooled EU deposit guarantee scheme while not being forced to give up their own national mutual guarantee schemes.

- It was agreed that it was important to be clear on which problem a pan-EU scheme should target and address and that any measures introduced needed to be pragmatic. As a practical example, in the case of Iceland, it was agreed that it might have been useful for the Icelandic scheme to be able to borrow from other schemes, in a pre-agreed and coordinated way (including repayment terms) in order to fulfill its responsibilities to depositors in other Member States. In essence, if the Icelandic Government could not act as a 'lender of last resort' to the banks of Iceland who were failing, possibly a pan-EU deposit insurance scheme should.

- Some participants were of the opinion that any pan-EU scheme would increase Moral Hazard since some schemes would have to pay for the mistakes other countries had made. Local banks only needed local solutions and the existing scattered system (there are 40 schemes in 27 Member States) could be overcome by first imposing one scheme for each Member State before thinking about conversion to a single pan-EU solution.

- There was some sympathy for a '28th regime', i.e. a scheme complementing the existing national schemes. It was suggested to gradually introduce any such changes in order to test its usefulness. The idea to create a mixed scheme (a new pan-European operating along with the national schemes), whereby the pan-EU scheme would cover a percentage (for example, 25%) and the national scheme the remainder (for example, 75%), was mentioned. This might make full harmonization of national schemes less urgent and allow a phased and more gradual introduction (by, over time, increasing the percentage of the pan-EU-scheme on a gradual and structured basis).

Even amongst deposit insurance professionals, these diverse opinions, even during urgent economic crisis, demonstrate the nature of the challenges in obtaining consensus to harmonize European deposit insurance laws, regulations and rules on a pan-European basis.

i. *An EU Member State Case Study: The Irish Deposit Insurance Scheme; It's Changes; and, Evolution During This Financial Crisis.*

i. Development of the Irish Deposit Insurance Scheme, 1995 to 2008

As Europe continues in its use of framework directives, it is helpful to isolate one Member State and determine how it has implemented the 1994 Directive and the more recent 2009 Directive amendments. Ireland, having been a leader in the current economic crisis, is the Member State of our focus.

The European Communities (Deposit Guarantee Schemes) Regulations, 1995, which implemented the 1994 Directive (European Council Directive 94/19/EC), and which was subsequently amended by the Central Bank Act, 1997; the European Communities (Deposit Guarantee Schemes Regulations, 1999; the European Communities (Deposit Guarantee Schemes) Regulations, 2002; and, the European Communities (Deposit Guarantee Schemes) Regulations, 2003 previously implemented the deposit protection scheme in the Country of Ireland before the current economic crisis.

The Irish deposit protection scheme[120], which we will refer to as the Irish Scheme, is funded by financial institutions which, in Ireland, are defined as credit institutions authorized by the Central Bank and Financial Services Authority of Ireland. In reality, the Central Bank's functions are split into two parts. The Irish Central Bank is the representative country's central bank to the European Central Bank and would be responsible for any direct lending to banks and (following recent changes), the deposit insurance remit of the 1994 and 2009 Directives. Its sister agency, the Irish Financial Regulator, is the competent authority for bank regulation and prudential supervision and is therefore responsible for the day-to-day prudential regulation of financial institutions whose Home Member State country of authorization is Ireland. Ireland has approximately 40 authorized banking institutions; over 200 branches of hosted banking

institutions; 3 building societies; and over 300 credit union institutions that fund the Irish Scheme[121].

Up until 2008, the level of contribution required from each credit institution was 0.20% of the aggregate deposits held by an institution. This would refer to current accounts; share accounts (in the case of credit unions); and, building society accounts. This is considered a Low *Ex Ante* level of funding. In Ireland, certain time accounts, such as negotiable certificates of deposits are excluded from inclusion in determination of the premium to be paid. A minimum annual deposit insurance premium payment of €25,400 is required from all authorized banks. The premiums each institution is responsible for are paid into a DIF, entitled the *Deposit Protection Account,* which is housed at the Central Bank of Ireland.

Ireland, in the period that predated the current market crisis, had technical coverage rules on deposits eligible for cover under the Irish Scheme. For example, the following deposits were *not covered at all*:

- Interbank deposits.
- Certificates of Deposit.
- Items which make up an institutions own funds or represents its own capital accounts.
- Any deposit for which money laundering offences had been committed.
- Any company affiliated or connected with a failed institution.
- Any person, such as a director, who was responsible for or contributed to the failure of a failed institution or profited from its failure.
- Deposits made by bank directors, certain senior officers and their families.
- Deposits made by other financial institutions or insurance companies.

- Deposits made by certain governmental authorities.
- Deposits made by collective investment schemes.
- Deposits made by pension and retirement funds.
- Deposits in the form of debt securities.
- Deposits by large companies.

It is useful to note that under the comparative FDIC scheme in the United States, categorically, none of these exclusions would apply and all these categories would realize full cover. Of course, the U.S. deposit insurer (the FDIC) could seek to recover bank loss from a responsible party through separate statute or laws or subrogate to losses the failed bank incurred. This might include depositors who received their insured deposits from the institutions.

In addition to the numerous carve-outs listed above, the Irish Scheme had, until late in 2008, both a maximum recoverable ceiling and a percentage Co-Loss component. Prior to 2009, the minimum coverage an Irish institution would pay for deposit insurance liability was €20,000 (the minimum threshold set forth in the 1994 Directive). Ireland, prior to 2009, did not elect to exceed the minimum coverage required by the 1994 Directive by raising the €20,000 to a higher amount[122]. Additionally, prior to 2009, the Irish Scheme applied the full 10.00% Co-Loss percentage to any saver's deposit loss. In the event the loss was less than €22,222, only 90.00% of the otherwise eligible account's value would be paid.

Ireland is also less generous than other countries on the aggregation of accounts. In Ireland, under the Irish Scheme, all balances held in the depositor's name,

including balances held in a joint account, together with any interest due, will be aggregated for the purpose of calculating covered amounts due in an institution. However, joint account balances are apportioned equally between each account holder named in a joint account. As an example, if Depositor A had an individual account with €15,000 and a joint account with his wife, Depositor B, with €10,000, he will be deemed to have €20,000 in the institution (assuming no other accounts). For deposit insurance purposes under the Irish Scheme, his wife will be deemed to have €5,000 in that institution (again, assuming no other accounts). Total protection, after application of the 90.00% Co-Loss, would be €18,000 for Depositor A and €4,500 for Depositor B, or a total of €22,500, leaving €2500 uninsured or self-insured.

Regarding trusts, Ireland does not use the same 'pass-through' rules we will see in the American system in Chapter 4. Instead, coverage depends on complex regulations determining if the beneficiary or beneficiaries are entitled to all or part of the balance and whether they are the sole beneficiary or share jointly with others.[123]

Regarding netting and off-sets for debts owed to the institution by the depositor, and excluding situations where accounts are properly being held as cash-security collateral for loans, in Ireland the banks can deduct from the aggregate deposit balance used to compute coverage dollar-for-dollar sums owed to the bank by any depositor owed monies under the Irish Scheme or withhold deposits until the liability is finally repaid. In essence, there is full netting of amounts.[124]

ii. *Irish Bank Failure and the Current Deposit Protection Scheme In Ireland: Ireland Adopts An Elevated €100,000 Threshold; and, Unlimited Account and Bank Guarantee Scheme Until 2010.*

Starting late in 2008[125], Ireland began to see the rapid failure of several of its institutions begin to unfold and there were great concerns about the stability of the Irish economy and its collapse potential. In addition to the worldwide decline in financial services, the Irish economy faced property market erosion; the increase in unemployment; and, the Irish Government faced serious budget difficulties. Institutions impacted included Ireland's largest such as Anglo Irish Bank[126], Allied Irish Bank[127], and Bank of Ireland.[128] Anglo Irish failed due to a number of reasons.[129] Containment[130] was immediately necessary to preserve confidence.[131]

Many calls were made for the Irish Government to provide a full Blanket Guarantee cover to bank deposits[132]. In September and October, 2008, the Irish Government proposed, on an emergency basis[133], a number of proposals to combat the rapid deterioration in Irish banking and stock exchange systems by a two-prong approach. After some revisions the scheme was cleared by the EU Commission for State Aid purposes[134] and was implemented, as follows:

- The Irish Government proposed to increase the Irish deposit guarantee coverage to a level of €100,000 and this level would continue on a permanent basis[135].

- The Irish Government proposed an unlimited guarantee of all deposits and inter-bank debts until 2010 only for six selected authorized institutions and branches of five other institutions that have systemic importance to Ireland[136]. This program would not be pursuant to a temporary increase in deposit insurance but, instead, would be in the form of 'lender of last resort' a direct guarantee. See the subpart, above, regarding the ECB and their review of this Legislation. This scheme is

termed the 'CIFS' Scheme, referring to the Credit Institutions (Financial Support) Scheme 2008 which enabled it[137].

The success of the bank bailout has been mixed and some feel it has not been fully successful[138]. The above proposals prompted the United Kingdom to adjust their coverage and promptly caused the Irish Stock Market to surge after Irish banks had lost as much as 67% of their value on the exchange.

More recent proposals to breathe new life into Irish banks include proposals for a National Asset Management Agency ('NAMA') to deal with distressed assets of banks in need of assistance or already nationalized. However, such compulsory purchases (to assist banks and move them along to the recapitalization phase as 'Clean Banks) has raised concerns about the government (and taxpayers) paying too much for the toxic assets being purchased[139]. However, critical to everything else, guarantee of bank deposits and liabilities is no substitute for recapitalization of banks who, under any circumstances, will be capital deficient as they come out of the turbulent environment of the last two years.[140]

Just prior to submission of this work, a revision of the second bulleted point above was presented in the form of a draft Credit Institutions (Eligible Liabilities Guarantee) Scheme 2009[141]. This termed 'ELG' Scheme will determine what occurs with Ireland's guarantees after the September 2010 expiry of the scheme noted above. It remains under discussion; however, the following are the highlights of the proposal still in draft form:

- Only systemically important institutions may join the ELG Scheme.

- As to covered institutions, all deposits and senior unsecured certificates of deposits, unsecured commercial paper, and other unsecured bonds and notes will be covered by the unconditional guarantee.
- Eligible liabilities may not exceed 5 years in maturity and will terminate at that time unless extended.
- The ECB pricing guidelines (see ECB discussion above) will apply to liabilities guaranteed under the ELG Scheme.
- Unlike the CIFS Scheme, the ELG Scheme is proposed to not cover all forms of Lower Tier 2 Subordinated Debt.
- Otherwise, the CFIS and ELG Schemes remain very similar.

Chapter 3 has reviewed the European Union's approach to deposit insurance and its evolution during two decades between the early 1990's, through the economic development of the Single Market and into the current economic crisis. We have examined the design of the 1994 Directive; its minimal coverage; and the funding and solvency of its deposit insurance reserves. We have seen changes to the 1994 Directive through the 2009 Directive rapidly adopted without delay. We have also seen the influence and advice of the European Central Bank (as to deposit insurance and direct lending issues) and of the European Commission (with regard to issues of competition and State Aid). We concluded with an examination of how one Member State, Ireland, has implemented the 1994 Directive; led the way in encouraging the adoption of the 2009 Directive; and that Ireland was an early leader in its adoption of direct lending and guarantee programs for systemically critical banks during the current financial crisis

modeled after America's TARP Program. In Chapter 4, we will examine what the FDIC has done under similar circumstances and how the FDIC has sought to combat the present economic crisis under a far more widespread and systemic failure pattern that the United States is currently deeply impacted by.

CHAPTER 3—ENDNOTES

---

[1] A pre-crisis article written about the 'one size fits all' 1994 Directive can be found at Kunt, p. 253-279, 281-313. The authors of both articles make it clear that the EU Directive is unique as it imposes minimum standards of deposit insurance on countries—many of which never had a history of deposit insurance before accession to the EU. However, as it leaves the design of the systems open to Member State interpretation, the countries within the EU tend to compete on design elements and not coverage ones. However, forcing the poorer Eastern-block accession countries to insure at a minimum of €20,000, states the author, could lead to increased Moral Hazard.

[2] Directive 94/19/EC (30 May 1994), Official Journal L 135, 31/05/1994; Hemetsberger, p. 31; Cotter, Section 1.7; Cranston, p. 78.

[3] Directive 2009/14/EC (11 March 2009), Official Journal L 68. 13/3/2009

[4] See Consultation Document, *Review of Directive 94/19/EC on Deposit Guarantee Schemes (DGS)* (listing 40 questions for consultation). The last consultation was conducted in July of 2005 (see DGS 001/2005). Also, see: *Report From The Commission To The Counsel and the European Parliament On The Application Of The Export Prohibition Clause, Art 4(1) Of The Directive On Deposit Guarantee Schemes (94/19/EC)*; *Communication From The Commission To The European Parliament and the Council Concerning the Review of Directive 94/19/EC On Deposit Guarantee Schemes* COM (2006) 729 final (27.11.2006); *Report On The Minimum Guarantee Level Of Deposit Guarantee Schemes Directive 94/19/EC Of The European Commission; Scenario Analysis:* European Commission, *Estimating The Effects Of Changing The Funding Mechanisms Of EU Deposit Guarantee Schemes (February, 2007).*

[5] See Legislation In Force At the EU's Internal Market and Service DG For State In Play As Of 25/08/2009.

[6] The listing and attributes of each Member State can be found at www.en.wikipedia.org under the topic of 'Member State of the European Union'. A discussion of the EU Home-Host Regulatory Bank System can be found at Mayes, p. 233.

[7] See, di Noia, p. 8; Ellinger, p. 59.

[8] See, Dubel Article

[9] It is very expensive to maintain different policies and procedures in each state of operation. Deposit insurance involves more than bank liquidation. Customer inquiries regarding coverage occur frequently and banks tend to utilize common call center technology to field operational questions. To have multiple schemes for the same banking institution can lead to complexity and incorrect advice.

[10] At best, these were localized and small schemes of modest proportions.

[11] Europe was well known for this. Barriers were erected to preclude competition from other European states.

[12] Battilossi, p. 36, p. 74.

[13] The euro was formally introduced shortly thereafter.

[14] See EC Treaty Articles 56 through 60. Also, see, http://ec.europa.eu/internal_market/capital/framework/treaty_en.htm

[15] Temperton, p. 7.

[16] Temperton, p. 51.

[17] Temperton, p. 145.

[18] Ireland rejected the Lisbon Treaty in early 2008 and approved a modified version of it in 2009.

[19] See, http://www.telegraph.co.uk/finance/economics/6258132/Lisbon-Treaty-approval-could-save-Ireland-200m-a-year-in-debt-costs.html.

[20] The Eurozone is a term that describes the countries utilizing the euro and consists of France, Germany, Italy, Spain, Ireland, Netherlands, Greece, Austria, Portugal, Belgium, Cyprus, Finland, Luxembourg, Malta, Slovenia and Slovakia.

[21] Temperton, p. 217. The euro certainly facilitated a significant leap forward.

[22] It is understandable that deposit insurance would not rank high on the list of important issues.

[23] All of the economies of that period were unstable in Europe and the banks realized much volatility and disruption in their bank activities.

[24] In essence, banking failed to operate normally during the War Years. For example, the banking regulators in the United States basically suspended capital adequacy requirements for banks. Tarullo, *Banking On Basel* (Peterson Institute, 2008)

[25] A detailed explanation of the Marshall Plan and the Truman Doctrine can be found here: http://en.wikipedia.org/wiki/Marshall_Plan

[26] The average balance was also modest. It is very difficult to price deposit insurance in a war-time environment with risk and volatility are clearly in full play.

[27] In addition to the Marshall Plan, Europe acted quickly to institute various rebuilding programs and to arrange economic loans for development. Related to this effort was the 'Truman Doctrine" which was the U.S. support of Greece and Turkey in their resistance to Soviet-sponsored conflict in those countries and based upon the announced departure of the United Kingdom in support of opposition to communist efforts in the region. In addition, the World Bank was involved in redevelopment of Europe. Between these various efforts, billions of dollars of aid and capital flowed into Europe and the banks realized a restart to the economic activity suspended during the war. In essence, the reconstruction of Europe was aided by European banks being funded as to capital by the United States and other Allied countries, including the World Bank and other specialized reconstruction banks. This realized a sufficient flow of capital to rebuild traditional banking structures.

[28] The European Economic Community (EEC) (also referred to as simply the European Community or the Common Market in the English-speaking world) was an international organization that existed between 1958 and 1993 and which was created to bring about economic integration (including a Single Market) between Belgium, France, Germany, Italy, Luxembourg and the Netherlands. Although several basic deposit insurance schemes in the form of financial guarantee programs did exist before the 1994 Directive in Europe, until the 1994 Directive none of these original EEC countries had a fully integrated and Community-wide program to insure deposits.

[29] Mutual recognition is the concept of one Member State's recognition of another Member State's authorization of banks. The idea is elegant but simple. If Germany authorizes a bank and that bank wishes to open a branch in Italy, unless the Italian Financial Regulator has some unique reason for refusing that authority, Italy must allow the branch to open. An Italian authorized bank has the same right to open a branch in Greece as does an Irish bank in France. This has been called the right to passport services from one Member State to another and is designed to tear down protectionist systems favoring intrastate banks over other banks. Regulating credit institutions is a series of four evolutional banking directives culminating in the latest Recast Banking Directive 2006/48/EC. The spread of consistently applied deposit insurance schemes is in coordination and is consistent with these general mutual recognition efforts.

[30] See, di Noia, *Structuring Deposit Insurance In Europe: Some Considerations and a Regulatory Game.*

[31] The current consultation asks whether an increase to €100,000 would cause this level of hardship. See, http://ec.europa.eu/internal_market/consultations/2009/deposit_guarantee_schemes_en.htm. The consultation resulted in 104 responses and is now closed. The Commission issued an interesting summary of the responses which may be accessed at the following web address:
http://ec.europa.eu/internal_market/consultations/docs/2009/deposit_guarantee_schemes/summary_en.pdf

[32] The consultation noted in Note 31 revealed that over 50.0% of the responding parties believed the level of coverage should be higher than €50,000 and several respondents believed that an unlimited (Blanket Coverage) level was the appropriate level of cover.

[33] It is noted that fast pay-out places the greatest pressure on the deposit insurer and costs of the deposit insurer will be raised as a result of quicker payment. However, if the disfavored netting of loans against deposits is eliminated as a deposit insurance concept, such as in the United States, faster pay-outs are possible without extraordinary additional expense.

[34] This seems to assist small savers below the minimum cover for deposit insurance. By eliminating the 10.00% Co-Loss, full recovery by small savers is possible for any insured loss as to their account balance.

[35] Since 1994, Europe has demonstrated the tentative nature of their deposit insurance cover by insuring a minimum amount rather than a uniform maximum coverage sum (as with the FDIC in the United States). The latest

consultation, now completed, has indicated a need for more uniformity as 80.00% of the respondents wish for there to be a level playing field as to cover for all participants in Europe (which would tend to argue against a mandatory minimum and, instead, opt for a mandatory maximum cover, instead). See: http://ec.europa.eu/internal_market/consultations/docs/2009/deposit_guarantee_schemes/summary_en.pdf.

[36] However, this flexibility is narrowing with decisions to eliminate Co-Loss, reduce pay-out times and other decisions made through the 2009 Directive as well as responses to the recent Consultation referred to in Note 31.

[37] A simple review of the 1994 Directive makes clear that many design decisions regarding deposit insurance is left to the Member State. This is changing with the 2009 Directive and is likely to change further with any recast directive arising from the recent Consultation set forth in Note 31.

[38] One is the Member State of Italy which has been cited a number of time by the Commission for its conduct as to banking matters. For example, Italy has been cited for opaque bank fees with regard to accounts (http://europa.eu/rapid/pressReleasesAction.do?reference=IP/09/1341&format=HTML&aged=0&language=EN&guiLanguage=en); For the award of banking relationships with the University of Parma (IP/09/159, 29 January 2009); and, discriminating against other banks as to tax credits (IP/99/1999, 30 June 1999).

[39] October 1, 2009.

[40] See, the 2009 Directive.

[41] See, the 2009 Directive.

[42] See, Chapter 4, below.

[43] Ireland , Greece, UK (£50,000), Italy. Austria and France currently exceed the minimum coverage of the 2009 Directive (€50,000 level). Some of these levels will decrease in 2010 (Ireland and Austria are two scheduled decreasing country levels). The UK, France and Italy consistently exceed the minimum cover required by the EU Directives.

[44] Other banks, governments, certain time certificates, any funds to be netted against loans, any funds of a suspected money launderer and several other categories are frequently excluded from pay-out.

[45] CDARS is an acronym for Certificate of Deposit Account registry Service. Rather than a customer having to 'spread' accounts to receive, in essence, *de facto* Blanket Coverage, this service handles that task for the depositor for a set fee and single interest rate. See, http://www.cdars.com/index.php.

[46] Between the various ways outlined to obtain *de facto* Blanket Coverage from FDIC-insured accounts, it seems that anyone who actually loses funds in an insured institution in the United States is, either: (a) unable to understand the deposit insurance rules; or (b) has fallen into a trap for the unwary. It would seem to eliminate any confusion to offer Blanket Coverage straightaway as under the current system only those with knowledge and plenty of time to open up multiple account relationship are assured of *de facto* Blanket Coverage..

[47] The U.S. as a refuge from risk and safe haven is changing. While the United States will likely never depart, countries have been diversifying currency holdings and seeking alternative reduced risk investment alternatives that do not always involve the United States and its best days as a refuge may be in the past. See, Hutchinson, *Where is the Safe Haven?* Which may be found at http://www.atimes.com/atimes/Global_Economy/KA21Dj06.html.

[48] It has not yet been established that the slight increase in deposit rates in Europe over the United States are preferable to the fuller protection allowed for American accounts under the FDIC regime.

[49] While it is appropriate to assume that another Member State is offering at least €50,000 in protection, and with the 2009 Directive may no longer require a 10.00% Co-Loss, beyond that not much can be known without reviewing the actual deposit scheme for a particular Member State.

[50] A 28th Regime is normally a single optional plan that may be adopted by all or any of the Member States.

[51] This also demonstrates that deposit insurance is likely not that dependent on culture as the cultural differences between Spanish speaking Puerto Rico and the Pacific Islanders of Pago, Pago are as diverse as cultures can get.

[52] At the time of the announcement of the Irish Blanket Coverage, there was fear in the United Kingdom that a wave of UK deposits would flow into the Republic. Also, see the UK Parliament's April 2009 critique of the problems with Irish banking found here: http://www.parliament.uk/commons/lib/research/briefings/snbt-05005.pdf

[53] See, Herbst, *Austria: Legislation To Stabilize Financial Markets In Times Of Market Crisis*, Corporate Counsel

[54] More information on the German system can be found in Haan, The History of the Bundesbank; see, also, Battilossi, p. 177

[55] See, BPK, International Conference PowerPoint® Presentation, 11-12 November 2004.

[56] See, Polucek, p. 41-43.

[57] See, Oravec, D*eposit Protection In The Slovak Republic and the Countries of the European Union.*

[58] In fact, this is one of the primarily purposes of the World Bank. See, http://web.worldbank.org/WBSITE/EXTERNAL/NEWS/0,,contentMDK:22335223~pagePK:64257043~piPK:437376~theSitePK:4607,00.html.

[59] One of the reasons that Member States remain at the low end of framework directives is that they have entered into other stability or standby agreements with the EU, the IMF or the World Bank to control budgets and reduce liabilities.

[60] This concern is likely fading. As many of the accession countries who joined the EU in 2004 had histories of centrally planned economies and little exposure to concepts such as deposit insurance take time to assimilate and consider adopted into the framework of the financial systems.

[61] This is why certain funds held in a bank by large companies, other banks or governments may be uninsured entirely.

[62] For example, the disparity between average savings between a Member State of Romania and a Member State of the UK can be great.

[63] The issue of political will is usually tied to the resources of a country.

[64] This is a matter left to competition law.

[65] This makes the European system much less expensive to fund as the combination of lower cover; more stringent account inclusion; and, slower pay-out all realize savings over the American system. As each of those elements change, if they do change, and as we saw in Chapter 2 regarding design aspects of deposit insurance, the cost of the scheme will increase as will its complexity.

[66] Although Americans want deposit insurance and have learned to expect it, they do not fully understand it as discussed above in Chapter 2.

[67] It appears that in America the FDIC walks a thin line between serving depositor loss through insured accounts and preserving the FDIC DIF to insure they remain a viable deposit insurer.

[68] Generally, Europeans earn a higher rate of interest, before any applicable taxes, than American savers do. Partly, this is due to the more expensive nature of American deposit insurance which must be considered by American banks in setting their rates. As the deposit insurance premiums rise, American savers are receiving record low deposit interest rates. European savers also save a greater percentage of their income than Americans do. See, Lawrence, *Barriers To European Growth* (Brookings Institute, 1987), p.392.

[69] Or such is the intent. Even during the current crisis, American banks have paid their deposit premiums to the FDIC on the normal, scheduled basis. However, the outflow of over 125 banks failing in two years has, of course, drained the DIF.

[70] See Chapter 4.

[71] Current law allows for a dividend or refunding of a portion of premiums paid if the FDIC DIF is in a surplus condition. Of course, that issue was eliminated by the recent failure of U.S. banks as the FDIC DIF has gone from near surplus to severely undercapitalized and will likely remain in that condition for many years.

[72] This is estimated to be a full quarter of all U.S. banks profits for this year and 2010. See, web article, www.americanbankingnews.com, *FDIC's Deposit Fund May Need 25% Of U.S. Banking Profit In 2010* (08/23/09).

[73] These are the countries where it is most likely industry based pooled plans will be found.

[74] See Chapter 6 and the presentation of the EU's Possible Models for adoption of a risk-based premium system. Generally, the experience of countries like the United States (who converted over to such a risk-based premium system in the 1990s) has been favorable.

[75] It is especially embarrassing for the FDIC to offer admissions of their declining solvency.

[76] Ireland had specific reasons for having to take this bold step; however, it was impressive to the rest of the world and certainly did not go unnoticed by the EU. It likely hastened the adoption of the 2009 Directive and cooperation at meetings, such as Ecofin, about the same time.

[77] So important is this goal that the EU has devoted an entire website to it. See, http://ec.europa.eu/internal_market/top_layer/index_1_en.htm.

[78] The Commission has dedicated a specific page to financial services and creating a Single Market in them. See, http://ec.europa.eu/internal_market/top_layer/index_24_en.htm.

[79] Financial markets are crucial to the functioning of modern economies. The more integrated they are, the more efficient the allocation of capital and long-run economic performance will be. Completing the Single Market in financial services is thus a crucial part of the European Commission's overriding objective of achieving more and better jobs in a more dynamic, innovative and attractive Europe.

[80] Simple efficiency would lead the EU to this decision and it is consistent with all the other banking directives.

[81] The schemes, at best, were fragmentary.

[82] See, the Commission's Regulatory Capital website located here: http://ec.europa.eu/internal_market/bank/regcapital/index_en.htm,

[83] See, State Aid: *Overview of National Rescue Measures and Deposit Insurance Schemes*, MEMO/08/614 (10 October 2008)

[84] This work was conducted in conjunction with other activity in the Community banking area and the entire period was not spent solely on a discussion of the design of deposit insurance in the European Union.

[85] The efforts to implement a uniform deposit insurance regime before the 1994 Directive was, unsuccessful. Many of the reasons why economic union and a single currency were controversial appeared to spill over to a discussion of deposit insurance.

[86] It was thought that uniformity in banking might give Europeans more choice in financial services as companies from other Member States spread their products and services freely in the new 'borderless' environment.

[87] This had the opposite effect of spreading banking services. It created a real disincentive to leave the well-understood confines of one's own Member State.

[88] See, Brewer Article.

[89] The 1994 Directive, in its introductory provisions, recognizes it is just one tool of many in the financial safety net.

[90] The concerns regarding creating acceptable deposit insurance in the 'New Europe' are discussed in Masciandaro, p. 321.

[91] Even for its adoption period, this was a very modest sum for highly developed Westernized countries that made up the EU of that period.

[92] All the cited exchange rates are as of September-October 2009.

[93] Some of the newer EU countries, unfamiliar with deposit insurance, were given an abrogation and elongated time period to comply with the 1994 Directive. Those periods have generally now expired.

[94] The accession countries were deemed to pose special risk to the deposit insurance system. See, Masciandaro, p. 87, 181. Also, see Poloucek, *Reforming The Financial Sector In Central European Countries*, which is a work dedicated to specific financial sector problems in the accession countries as of the time of their accession in 2004 (with special emphasis on Czech, Polish and Slovakia banking).

[95] See, Schobel, *Home Country or Recipient Country? Confining the Extraterritorial Reach of Domestic Banking Law*.

[96] Commission Sets Out Proposal To Increase Minimum Protection For Bank Deposits To €100,000, IP/08/1508, Memo/08/622 (15 October 2008)

[97] Ireland, UK, Greece and Italy.

[98] It is anticipated that the current consultation will result in an entirely recast directive sometime in 2010.

[99] It is rare in the EU to take such action without consultation. However, the current financial crisis made consultation impractical.

[100] This is, of course, a significant increase in coverage.

[101] As stated elsewhere, the American system, with its ability to obtain *de facto* Blanket Coverage through account ownership, high cover and multiple bank relationships is as close to gold-plated as a system can get in its practical workings.

[102] Ellinger, p. 59.

[103] Ellinger, p. 60.

[104] Kuppens, p. 59.

[105] The European Central Bank's remit is covered in great detail in Scheller, The European Central Bank: History, Role and Functions. See, also, Haan, pp. 124 and 143.

[106] Scheller, p.41; See, also, Amicorum, p. 93-114.

[107] Masciandaro, p.457

[108] There appears to be the possibility for competition between the two. See, Binder, *Regulatory Competition Between The Deposit Insurer and a Single Financial Regulator—The Case Of Germany*.

[109] European Commission State Aid NN 48/2008- Ireland (13.10.2008)

[110] The Co-Loss provision appears to be some sort of misguided effort to reduce loss to the deposit insurer; however, if it can be acknowledged that the depositor had nothing to do with the failure of a bank, it makes little sense why that same depositor should have to share the initial portion of his or her loss.

[111] Romania has entered into an agreement with the IMF for additional financing; however, and unfortunately, the government of Romania has collapsed leaving the agreement in principle in doubt. http://www.imf.org/External/NP/LOI/2009/rou/042409.pdf.

[112] Howarth, p. 117.

[113] The areas of Competition and State Aid have been difficult areas for the Commission where significant legislation already exists. The Commission is unwilling to move backwards in these area. For information regarding Competition and State Aid Legislation, refer to the Commission's website located here: http://ec.europa.eu/competition/state_aid/legislation/compilation/index_en.html.

[114] http://ec.europa.eu/internal_market/bank/docs/guarantee/final_report_en.pdf.

[115] http://ec.europa.eu/internal_market/bank/docs/guarantee/risk-based-report_en.pdf.

[116] http://ec.europa.eu/internal_market/bank/docs/guarantee/dgs_proposal_en.pdf.

[117] See, The Eurosystem's Stance On The Commission's Consultation Document On The Review Of Directive 94/19/EC On Deposit-Guarantee Schemes (August 2009); for a contrary view on central banks, see Cooper, p. 21.

[118] European Forum Of Deposit Insurers, EU Committee; Response To European Commission Consultation Document (17 July 2009)

[119] European Commission, Internal Markets and Services DG, Financial Institutions; Draft Minutes For Informal Experts Roundtable On Deposit Guarantee Schemes (DGS) on 31 March 2009 In Brussels.

[120] For a dated detailed explanation of the Irish system, before the changes of the recent financial crisis, see Masciandaro, p. 355.

[121] See, Credit Institutions Register; Register of Credit Unions, available at www.financialregulator.ie. These registers lists financial institutions pursuant to Section 9 of the Central Bank Act, 1971; the Building Societies Act, 1989; and, the Credit Union Act, 1997.

[122] Cotter, p. 10.

[123] The Pass-Thru rules for the FDIC are found in FDIC 93-7 (1993) and can be accessed here: http://www.fdic.gov/regulations/laws/rules/4000-7960.html.

[124] This can create unfairness by wither denying insured deposit pay-out or by accelerating loan repayment.

[125] The Irish Government released a governmental release on 20 September 2008 entitled Government Increases Deposit Guarantee Limit To €100,000 Per Depositor.

[126] The Irish Government fully nationalized Anglo Irish Bank in 2009.
http://www.independent.co.uk/news/business/news/anglo-irish-bank-nationalised-1380495.html.

[127] Allied Irish Bank (AIB) is part of the direct lending program of the Irish Government. See, http://www.bloomberg.com/apps/news?pid=20601087&sid=aKlOOPvAypOg&refer=home

[128] Bank of Ireland is also part of the direct lending and guarantee program of the Irish Government.

[129] Primarily a loan scandal in the range of €87 million which contributed to a severe liquidity crisis.

[130] See, Honohan, *Irish Banking Policy During and After The Crisis*. Honohan states that a blanket guarantee was necessary for containment of the sliding Irish bank economy and there was little doubt that an extensive guarantee was necessary due to the severe solvency issues at banks like Anglo Irish Bank. However, containment was likely not possible without the additional liquidity support of the ECB. However, containment to maintain confidence should not be obsessive—but it is central.

[131] See, Honohan, *Policy Paper, Resolving Ireland's Banking Crisis;* Honohan, *What Went Wrong In Ireland?*. Honohan states that Ireland was relatively poorly positioned heading into the global recession for three distinct but unrelated domestic reasons: a home-grown banking crisis; a trend loss in wage competitiveness that had been underway since 2000; and, a tax structure whose yield was far too heavily dependent on a continuation of the boom. What is interesting is that many of these same factors contributed to the United States' S&L Crisis in the late-1980's.

[132] Strange, Paddy, *Government Must Ensure Our Money Is Safe In Banks*, Irish Independent, July 27, 2008; however, for an opposite view, see Blinder, Alan, *Blanket Deposit Insurance Is A Bad Idea*, Wall Street Journal, October 15, 2008. Blinder feels that Blanket Coverage plans create an odd sort of 'Beggar Thy Neighbor' game and the small sounds of deposits being sucked into smaller countries like Ireland with Blanket Guarantee cover would be the very loud sounds of sucking if a major country was to institute such Blanket Guarantee cover.

[133] See, website article, www.msnbc.msn.com, Ireland OKs World-Leading Bank Guarantee

[134] See, *State Aid: Commission Welcomes Revised Irish Scheme*, MEMO/08/615 (13/10/2008)

[135] The Irish Government was allowed to set the new level pursuant to Financial Services (Deposit Guarantee Scheme) Act 2009, Section 2.

[136] Details of the Irish Guarantee Scheme are set forth in Statutory Instrument No. 411 of 2008, Credit Institutions (Financial Support) Scheme 2008. In September of 2009, it was believes that the Irish State's exposure to the guarantee scheme was €346 billion (from a high of €427 billion). See, web article, www.irishexaminer.com. Also, see: web article, independent.ie 1; web article, independent.ie 2.

[137] There are extensive Q&A's on CIFS issued by the Irish Department of Finance on 16 December 2008. See, also, web article, www.tax-news.com, Pilgrim, *Irish Deposit Guarantee Scheme Bill Published.* The CIFS was announced on September 20, 2008 and was followed-up by the Financial Services (Deposit Guarantee Scheme) Bill 2009 which is discussed earlier in this Chapter.

[138] See, Kelly, *Bailout Inept and Potentially Dangerous*, Irish Times, October 2, 2008.

[139] See, Honohan, *Banking Debate Has Been Reduced To False Dichotomy*, Irish Times, May 21, 2009.

[140] See, Honohan, *Policy Paper, Resolving Ireland's Banking Crisis*, p. 222

[141] See, http://www.finance.gov.ie/documents/speeches2009/sfbl034guarantee.pdf. The key points of the proposed ELF are set forth in this speech.

CHAPTER FOUR

4. THE FEDERAL DEPOSIT INSURANCE ACT DEPOSIT INSURANCE SCHEME; THE U.S. TAKES THE LEAD IN DEPOSIT PROTECTION REGULATION AND, SEVENTY FIVE YEARS LATER, FACES SERIOUS CHALLENGES WITH SYSTEMIC RISK AND BANKS ADJUDGED TOO BIG TO FAIL

In the last chapter, the European Union's deposit insurance scheme was reviewed for design purposes and how it approached the issues of coverage, payment and funding. We also saw where the EU and its deposit insurance approach is undergoing significant revision under a pending Consultation. In this Chapter 4, possibly the most significant worldwide deposit scheme will be examined. That scheme, or system of deposit insurance, is the U.S. system operated by the Federal Deposit Insurance Corporation since the 1930's.

a. Overview of the FDI Act and the FDIC Deposit Protection System

i. One Deposit Insurance Regulator To Rule Them All (Well Almost); Coverage Development From FDIC's 1933 Inception to 2008

Although the United States is a country of many financial regulators, both national and state, and literally thousands upon thousands of financial institutions of all sizes and types, since 1933 it is a country of only one governmental deposit insurer for deposit-gathering financial institutions and that regulator is the legendary FDIC. Currently, the only exception to that rule is for NCUA/NCUSIF-regulated credit unions discussed below and so-called 'deposits' taken by securities brokers and purportedly 'protected' by the SIPC[1]. This means that whether a financial institution accepting deposits is a retail bank, a commercial bank, a Federal Savings Bank or a thrift

institution, in the United States, by law, it has as its deposit regulator the FDIC and only that entity[2].

The structure of the FDIC is composed of a Board of Directors that includes two FDIC officers; one appointed member; one member from the Comptroller of the Currency, or the OCC (the regulator of national banks); and, one member of the Office of Thrift Supervision (the regulator of thrift institutions and where many of the surviving S&L institutions landed after the S&L Crisis). In addition to its Washington main office, the FDIC has six area offices and one regional center for bank receiverships.

In addition to being a deposit insurer, the FDIC has primary responsibility for liquidating failed banks.[3] In most cases, it is the national or state bank prudential regulator who first closes a bank in the United States after consultation with the FDIC. That prudential regulator then coordinates the closure and delegates to the FDIC responsibility for liquidation of the failed bank[4].

The FDIC, itself, is bound by a dizzying patchwork of laws, regulations, rules and opinions that follow (and most of the operative statutory law is found in Title 12 of the United States Code of Federal Regulations, or "CFR's"):

- **Banking Act of 1933** (P.L. 73-66, 48 STAT. 162). Also known as the Glass-Steagall Act. This Act established the FDIC as a temporary agency and separated commercial banking from investment banking, establishing them as separate lines of commerce.

- **Banking Act of 1935** (P.L. 74-305, 49 STAT. 684). Established the FDIC as a permanent agency of the U.S. Government.

- **Federal Deposit Insurance Act of 1950** (P.L. 81-797, 64 STAT. 873). Revised and consolidated earlier FDIC legislation into a single Act. Embodied the basic authority for the operation of the FDIC.

- **Bank Holding Company Act of 1956** (P.L. 84-511, 70 STAT. 133). Required Federal Reserve Board approval for the establishment of a bank holding company. Prohibited bank holding companies headquartered in one state from acquiring a bank in another state[5].

- **International Banking Act of 1978** (P.L. 95-369, 92 STAT. 607). Brought foreign banks within the federal regulatory framework. Required deposit insurance for branches of foreign banks engaged in retail deposit taking in the U.S.

- **Financial Institutions Regulatory and Interest Rate Control Act of 1978** (P.L. 95-630, 92 STAT. 3641). This law is also known as FIRIRCA. Created the Federal Financial Institutions Examination Council. Established limits and reporting requirements for bank insider transactions. Created major statutory provisions regarding electronic fund transfers.

- **Depository Institutions Deregulation and Monetary Control Act of 1980** (P.L. 96-221, 94 STAT. 132). This law is also known as DIDMCA. Established "NOW Accounts." Began the phase-out of interest rate ceilings on deposits. Established the Depository Institutions Deregulation Committee. Granted new powers to thrift institutions. Raised the deposit insurance ceiling to $100,000.

- **Depository Institutions Act of 1982** (P.L. 97-320, 96 STAT. 1469). Also known as Garn-St Germaine. Expanded FDIC powers to assist troubled banks. Established the Net Worth Certificate program. Expanded the powers of thrift institutions.

- **Competitive Equality Banking Act of 1987** (P.L. 100-86, 101 STAT. 552). Also known as CEBA. Established new standards for expedited funds availability. Recapitalized the Federal Savings & Loan Insurance Company (FSLIC). Expanded FDIC authority for open bank assistance

transactions, including the use of so-called bridge banks.

- **Financial Institutions Reform, Recovery, and Enforcement Act of 1989** (P.L. 101-73, 103 STAT. 183). This law is also known as FIRREA. FIRREA's purpose was to restore the public's confidence in the savings and loan industry. FIRREA abolished the Federal Savings & Loan Insurance Corporation (FSLIC), and the FDIC was given the responsibility of insuring the deposits of thrift institutions in its place. The FDIC insurance fund created to cover thrifts was named the Savings Association Insurance Fund (SAIF), while the fund covering banks was called the Bank Insurance Fund (BIF). FIRREA also abolished the Federal Home Loan Bank Board. Two new agencies, the Federal Housing Finance Board (FHFB) and the Office of Thrift Supervision (OTS), were created to replace it. Finally, FIRREA created the Resolution Trust Corporation (RTC) as a temporary agency of the government. The RTC was given the responsibility of managing and disposing of the assets of failed institutions. An Oversight Board was created to provide supervisory authority over the policies of the RTC, and the Resolution Funding Corporation (RFC) was created to provide funding for RTC operations.

- **Crime Control Act of 1990** (P.L. 101-647, 104 STAT. 4789). Title XXV of the Crime Control Act, known as the Comprehensive Thrift and Bank Fraud Prosecution and Taxpayer Recovery Act of 1990, greatly expanded the authority of Federal regulators to combat financial fraud. This Act prohibited undercapitalized banks from making golden parachute and other indemnification payments to institution-affiliated parties. It also increased penalties and prison time for those convicted of bank crimes, increased the powers and authority of the FDIC to take enforcement actions against institutions operating in an unsafe or unsound manner, and gave regulators new procedural powers to recover assets improperly diverted from financial institutions.

- **Federal Deposit Insurance Corporation Improvement Act of 1991** (P.L. 102-242, 105 STAT. 2236). This law is also known as FDICIA. FDICIA greatly increased the powers and authority of the FDIC. Major provisions recapitalized the Bank Insurance Fund and allowed the FDIC to

strengthen the fund by borrowing from the Treasury. The Act mandated a least-cost resolution method and prompt resolution approach to problem and failing banks and ordered the creation of a risk-based deposit insurance assessment scheme. Brokered deposits and the solicitation of deposits were restricted, as were the non-bank activities of insured state banks. FDICIA created new supervisory and regulatory examination standards and put forth new capital requirements for banks. It also expanded prohibitions against insider activities and created new Truth in Savings provisions.

- **Housing and Community Development Act of 1992** (P.L. 102-550, 106 STAT. 3672). Established regulatory structure for government-sponsored enterprises (GSEs), combated money laundering, and provided regulatory relief to financial institutions.

- **RTC Completion Act** (P.L. 103-204, 107 STAT. 2369). Requires the Resolution Trust Corporation (RTC) to adopt a series of management reforms and to implement provisions designed to improve the agency's record in providing business opportunities to minorities and women when issuing RTC contracts or selling assets. Expands the existing affordable housing programs of the RTC and the FDIC by broadening the potential affordable housing stock of the two agencies. Increases the statute of limitations on RTC civil lawsuits from three years to five, or to the period provided in state law, whichever is longer. In cases in which the statute of limitations has expired, claims can be revived for fraud and intentional misconduct resulting in unjust enrichment or substantial loss to the thrift. Provides final funding for the RTC and establishes a transition plan for transfer of RTC resources to the FDIC. The RTC's sunset date is set at Dec. 31, 1995, at which time the FDIC will assume its conservatorship and receivership functions.
- **Riegle Community Development and Regulatory Improvement Act of 1994** (P.L. 103-325, 108 STAT. 2160). Established a Community Development Financial Institutions Fund, a wholly owned government corporation that would provide financial and technical assistance to CDFIs. Contains several provisions aimed at curbing the practice of "reverse redlining" in which non-bank lenders target low and moderate income homeowners, minorities and the elderly for home equity

loans on abusive terms. Relaxes capital requirements and other regulations to encourage the private sector secondary market for small business loans. Contains more than 50 provisions to reduce bank regulatory burden and paperwork requirements. Requires the Treasury Dept. to develop ways to substantially reduce the number of currency transactions filed by financial institutions. Contains provisions aimed at shoring up the National Flood Insurance Program.

- **Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994** (P.L. 103-328, 108 STAT. 2338). Permits adequately capitalized and managed bank holding companies to acquire banks in any state one year after enactment. Concentration limits apply and CRA evaluations by the Federal Reserve are required before acquisitions are approved. Beginning June 1, 1997, allows interstate mergers between adequately capitalized and managed banks, subject to concentration limits, state laws and CRA evaluations. Extends the statute of limitations to permit the FDIC and RTC to revive lawsuits that had expired under state statutes of limitations.

- **Economic Growth and Regulatory Paperwork Reduction Act of 1996** (P.L. 104-208, 110 STAT. 3009). Modified financial institution regulations, including regulations impeding the flow of credit from lending institutions to businesses and consumers. Amended the Truth in Lending Act and the Real Estate Settlement Procedures Act of 1974 to streamline the mortgage lending process. Amended the FDIA to eliminate or revise various application, notice, and recordkeeping requirements to reduce regulatory burden and the cost of credit. Amended the Fair Credit Reporting Act to strengthen consumer protections relating to credit reporting agency practices. Established consumer protections for potential clients of consumer repair services. Clarified lender liability and federal agency liability issues under the CERCLA. Directed FDIC to impose a special assessment on depository institutions to recapitalize the SAIF, aligned SAIF assessment rates.

- **Gramm-Leach-Bliley Act of 1999** (P.L. 106-102, 113 STAT 1338). Repeals the last vestiges of the Glass Steagall Act of 1933. Modifies portions of the Bank Holding Company Act to allow affiliations between banks and insurance underwriters. While preserving authority of states to

regulate insurance, the act prohibits state actions that have the effect of preventing bank-affiliated firms from selling insurance on an equal basis with other insurance agents. Law creates a new financial holding company under section 4 of the BHCA, authorized to engage in: underwriting and selling insurance and securities, conducting both commercial and merchant banking, investing in and developing real estate and other "complimentary activities." There are limits on the kinds of non-financial activities these new entities may engage in. Allows national banks to underwrite municipal bonds. Restricts the disclosure of nonpublic customer information by financial institutions. All financial institutions must provide customers the opportunity to "opt-out" of the sharing of the customers' nonpublic information with unaffiliated third parties. The Act imposes criminal penalties on anyone who obtains customer information from a financial institution under false pretenses. Amends the Community Reinvestment Act to require that financial holding companies cannot be formed before their insured depository institutions receive and maintain a satisfactory CRA rating. Also requires public disclosure of bank-community CRA-related agreements. Grants some regulatory relief to small institutions in the shape of reducing the frequency of their CRA examinations if they have received outstanding or satisfactory ratings. Prohibits affiliations and acquisitions between commercial firms and unitary thrift institutions. Makes significant changes in the operation of the Federal Home Loan Bank System, easing membership requirements and loosening restrictions on the use of FHLB funds.[6]

- **International Money Laundering Abatement and Financial Anti-Terrorism Act of 2001** (P.L. 107-56). Legislation designed to prevent terrorists and others from using the U.S. financial system anonymously to move funds obtained from or destined for illegal activity. It authorizes and requires additional record keeping and reporting by financial institutions and greater scrutiny of accounts held for foreign banks and of private banking conducted for foreign persons. The law requires financial institutions to establish anti-money laundering programs and imposes various standards on money-transmitting businesses. It amends criminal anti-money laundering statutes and procedures for forfeitures in money laundering cases and requires further cooperation between financial institutions and government agencies in fighting money laundering.

- **Sarbanes-Oxley Act of 2002** (P.L. 107-204). Sarbanes-Oxley establishes the Public Company Oversight Board to regulate public accounting firms that audit publicly traded companies. It prohibits such firms from providing other services to such companies along with the audit. It requires that CEOs and CFOs certify the annual and quarterly reports of publicly traded companies. The Act authorizes, and in some cases requires, that the Securities and Exchange Commission (SEC) issue rules governing audits. The law requires that insiders may no longer trade their company's securities during pension fund blackout periods. It mandates various studies including a study of the involvement of investment banks and financial advisors in the scandals preceding the legislation. Also included are whistle blower protections, new federal criminal laws, including a ban on alteration of documents.

- **Fair and Accurate Credit Transactions Act of 2003*** (P.L. 108-159). The Fair and Accurate Credit Transactions (FACT) Act contains extensive amendments to the Fair Credit Reporting Act and is designed to improve the accuracy and transparency of the national credit reporting system and preventing identity theft and assisting victims. It contains provisions enhancing consumer rights in situations involving alleged identity theft, credit scoring, and claims of inaccurate information. It requires use of consumer reports to provide certain information to consumers who are offered credit on terms that are materially less favorable than the offers that the creditor makes to a substantial portion of its consumers. Companies that share consumer information among affiliated companies, must provide consumers notice and an opt-out for sharing of such information if the information will be used for marketing purposes.

- **Federal Deposit Reform Act of 2005 and the Federal Deposit Reform Act Conforming Amendments Act of 2005.** Merging the Bank Insurance Fund (BIF) and the Savings Association Insurance Fund (SAIF) into a new fund, the Deposit Insurance Fund (DIF). This change was made effective March 31, 2006. Increasing the coverage limit for retirement accounts to $250,000 and indexing the coverage limit for retirement accounts to inflation as with the general deposit insurance coverage limit. This change was made effective April 1, 2006. Establishing a range of

1.15 percent to 1.50 percent within which the FDIC Board of Directors may set the Designated Reserve Ratio (DRR). Eliminating the restrictions on premium rates based on the DRR and granting the FDIC Board the discretion to price deposit insurance according to risk for all insured institutions regardless of the level of the reserve ratio. Granting a one-time initial assessment credit (of approximately $4.7 billion) to recognize institutions' past contributions to the fund.

- **Emergency Economic Stabilization Act of 2008.** This Act, also referred to as 'EESA', temporarily raises the basic limit on federal deposit insurance coverage from $100,000 to $250,000 per depositor. The temporary increase in deposit insurance coverage became effective immediately upon the President's signature. The legislation provides that the basic deposit insurance limit will return to $100,000 after December 31, 2009 (but not as to retirement savings as that is not a temporary increase and will remain at $250,000).

- **Helping Families Save Their Homes Act of 2009.** This Act *extends* the temporary increase in the standard maximum deposit insurance amount (SMDIA) to $250,000 per depositor through December 31, 2013. This extension of the temporary $250,000 coverage limit became effective immediately upon the President's signature. The legislation provides that the SMDIA will return to $100,000 on January 1, 2014 (but not as to retirement savings as that is not a temporary increase and will remain at $250,000).

ii. American Coverage[7].

Unlike the European focus on minimal levels of coverage (and which allows any Member State to increase minimal or base level coverage to a higher level up to and including Blanket Coverage), the United States, through the FDIC, takes a different approach[8]. The FDIC sets a maximum coverage amount that is uniform for the entire United States, its territories and possessions and there is no deviation. In the U.S.,

there is no localized option to change coverage—*up or down*[9]. The maximum coverage of insured deposits in United States financial institutions has progressed, as follows:

Years Of Applicability (Year At Level):	Coverage Maximum (U.S.) $	% Increase Over Prior
Initial Starting Level (1934):	$ 2,500.00	------
1934 to 1949 (15 Years)	$ 5,000.00	100.00%
1950 to 1965 (15 Years)	$ 10,000.00	100.00%
1966 to 1968 (3 Years)	$ 15,000.00	50.00%
1969 to 1973 (5 Years)	$ 20,000.00	33.33%
1974 to 1979 (5 Years)	$ 40,000.00	100.00%
1980 to 2008 (28 Years)	$ 100,000.00	150.00%
After October, 2009	$ 250,000.00*	150.00%

*The standard insurance amount of (U.S.) $250,000 per depositor is in effect through December 31, 2013. Unless made permanent, which is likely in 2010 with pending financial modernization, on January 1, 2014, the standard insurance amount will return to (U.S.) $100,000 per depositor for all account categories except IRAs and other certain retirement accounts, which will remain at (U.S.) $250,000 per depositor. However, restoring the old and lower limit would be politically unpopular and there is likely no going back on the increase in the United States in light of the continuing failure of banks and ongoing lending defaults.

Coincidentally, the current FDIC maximum coverage rate (per account type) of (U.S.) $250,000 is *100 times* the starting maximum coverage rate of (U.S.) $2,500 which commenced coverage by the FDIC over 75 years ago. *There has never been a decline in the maximum coverage rates in the United States since the founding of the FDIC.*

The FDIC deposit insurance system is relatively simplistic. Still, unexpected interpretation issues makes deposit insurance design critical even for a plan of this clear

nature. For example, in 1986 the United States Supreme Court was called upon to decide what is a 'deposit' subject to deposit insurance in the United States. In *Federal Deposit Insurance Corporation v. Philadelphia Gear Corporation*[10], the high court was presented with a standby letter of credit issued before Penn Square Bank went insolvent to a business undertaking by the name of Philadelphia Gear for (U.S.) $145,200. After Penn Square Bank failed and was placed into bank receivership, Philadelphia Gear applied to the FDIC (as receiver) for payment of the Standby Letter of Credit and the request was denied. Philadelphia Gear filed suit stating that the Letter of Credit, being a substitute for cash at this Bank, and an irrevocable obligation of the institution, was a form of insured deposit and Philadelphia Gear should realize at least the then-existing maximum deposit insurance cover amount of (U.S.) $100,000. The FDIC stated that letters of credit are not deposits but, instead, are contingent promissory obligations of the institution and the FDIC had never treated such contingent notes as insured deposits in its history. The Supreme Court agreed that a letter of credit was not a deposit for deposit insurance purposes after examining the enabling statutes.[11]

The FDIC has generally taken the position over its 75 years of operation that the coverage level set as the deposit insurance maximum ceiling is a political decision more than an FDIC calculated decision as it involves taxpayer cost and could invoke claims of Moral Hazard if set inappropriately high or may be useless as to protection if set unreasonably low. Therefore, the FDIC, while offering ongoing expertise and counsel in this area to the American Congress through the legislative hearing process, has been generally *reactive* to deposit insurance coverage levels set rather than *proactive* in

pursuing changes to the maximum American deposit insurance coverage levels. This explains the most recent 28 year static period where no change occurred at all in the maximum coverage for deposit insurance in the United States despite the fact that (U.S.) $100,000 in protection in 1980 would require (U.S.) $261,290 in deposit protection when inflation adjusted just prior to the 2008 increase[12]. However, if one examines the series of enacted legislation, above, that was underway during the 28 years the FDIC maximum coverage level remained static and unchanged, it will soon be clear that the FDIC was very busy with solidifying their role in the broader safety-net and tackling many other issues from money laundering to regulatory reform and raising coverage levels following the disastrous S&L Crisis was not supported by the Bush Administration and was, therefore, not a political priority of that Republican Administration.

The FDIC then, as to coverage, applies the levels set by Congress and determines the necessary reserves required and prices its bank deposit insurance premiums in accordance with its calculations of likely loss and the DIF reserve requirements. On February 27, 2009, the FDIC adopted a final rule modifying the risk-based assessment system and setting initial base assessment rates beginning April 1, 2009 at 12 to 45 basis points; and due to extraordinary circumstances, extending the time within which the reserve ratio must be returned to 1.15 percent from five to seven years. This means poorly rated banks under these criteria would pay higher deposit premiums and the period for the increase in risk-rated premiums to attempt to replenish the depleted deposit insurance fund would extend for many additional years. The following are the current risk-rated assessments for banks in the United States:

Total Base Assessment Rates*

	Risk Category I	Risk Category II	Risk Category III	Risk Category IV
Initial Base Assessment Rate	12 – 16	22	32	45
Unsecured Debt Adjustment (added)	-5 to 0	-5 to 0	-5 to 0	-5 to 0
Secured Liability Adjustment (added)	0 to 8	0 to 11	0 to 16	0 to 22.5
Brokered Deposit Adjustment (added)	N/A	0 to 10	0 to 10	0 to 10
Total Base Assessment Rate	7 to 24.0	17 to 43.0	27 to 58.0	40 to 77.5

*All amounts for all risk categories are in basis points annually. There are 100 basis points in each 1.00% of interest. Therefore, as an example, 25 basis points is equal to one quarter of one percent of interest.

Therefore, without considering special or emergency assessments, or prepayment of deposit insurance premiums, banks in the United States can range from premium cost as low as 7 basis points to over 77 basis points for their premium assessments—*a major tenfold difference*—and all based on assigned risk to the institution by the FDIC and other prudential regulators based upon the investments and loan assets held by the particular financial institution.

As coverage ceilings are raised by the American Congress, the funding assumptions must increase (or, if coverage is reduced, be decreased) and deposit insurance premiums tend to be subject to revised formula and change to meet up with the periodic resetting of the maximum coverage protections. Until 2009, major resetting had not occurred for 28 years and there is no recent history of the effect of a reset under non-crisis conditions in the United States until the 2009 dramatic increase in deposit insurance cover and will provide that outcome information in due time. In 2013,

the first ever downward reset may occur if the current levels are not made permanent (except as to retirement funds as the 2006 increase to (U.S.) $250,000 as to accounts housing IRA's and similar plans are permanent).

Funding, however, is more than just an actuarial computation based these various risk assumptions. It is part of a broader formula of deposit insurance design we have already seen. In happier times, the assumptions used to set the deposit premiums would be adjusted by refunds (rebates) if the assumptions proved too conservative and when fewer than expected banks fail or the banks that do fail are smaller failures than expected.

For example, at all times the FDIC must maintain, by law, a reserve fund that includes 1.15% of all bank insured deposits. If the fund reaches a level of 1.35%, the highly rated (low risk) member institutions benefit from a 50.00% refund on their deposit premiums. If the fund reaches 1.50%, the highly rated (low risk) member institutions are to receive a 100.00% refund on their deposit premiums. So, funding can change based upon the reserves in the DIF and the rebate system devised by the FDIC.

However, and in times such as we now face, the funding can also be *below* expectation and this leads to unstable solvency of the insuring agency (here the FDIC)[13]. Current economic conditions can reflect unanticipated or unexpected depletion of reserves; more intensive rates of bank failure; and, the expected rate of failure may be as to banks larger than first assumed. Such an unanticipated situation can quickly drain the reserves of a deposit fund. This is precisely what has occurred in America.

As bank failure is cyclical and bank solvency has volatility ups and downs, this can pose real reset challenges. There are certain periods when high rates of bank failure occur and the DIF is rapidly depleted; and, other periods when that failure is extremely low and the DIF grows rapidly. The cycles run from *Boom to Bust*; and the depletion of reserves in the DIF track these cycles. Therefore, an initial question is posed: *Should a deposit insurance fund be chasing cyclical bank cycles (the so-called Boom or Bust Cycle), or should the DIF fund maximum coverage levels at a standard rate and allow the applicable government to lend during any shortfall and receive a repayment of any bridging-type loans during any surplus years so taxpayers are repaid?* Decisions vary amongst countries. In the United States, the FDIC clearly is a reactive entity and generally chases these Boom and Bust Cycles and often borrows from the government (in this case, the Treasury) in the Bust Cycle phase of the progression.

For example, the United States DIF realized the 'down cycle' and the outflow of reserves during the 1980's and 1990's during the Savings & Loan crisis[14]. The DIF was rapidly depleted as the FDIC and/or the SAIF, after liquidating banks through the Resolution Trust Corporation (RTC), and along with reserves, realized fewer assets of failed banks upon liquidation and the recharge rate of newly funded deposit premiums was collectively less than the amount the FDIC and/or the FSLIC was required to pay to depositors for coverage liability and money flowed outward to cover depositor loss. To effectively recapitalize that fund, and in addition to appropriations made to shore up the faltering system by the United States Government, bank deposit premiums had to increase to the remaining institutions. This is an example of the outflow of an *ex ante*

funded deposit system during a 'Bust' period and how governments lend or appropriate funds to fill the shortfall or gap.

However, as the last bank during that cycle was liquidated by the FDIC and the Resolution Trust Corporation, the RTC was disbanded and a period of relative calm and profitability then descended on the remaining institutions and they once again became very profitable. This was the start of a period of the 'up' or 'Boom' cycle and the accumulation of reserves for the FDIC (as the FSLIC had been disbanded and the SAIF had been absorbed by the FDIC). As banks entered this a period of profitability which lasted approximately 12 years and would continue from 1995 until 2007, the DIF reversed from outflow, repaid its borrowings and started to once again amass significant inflow surplus funds as the bank deposit premiums continuously were received by the DIF and yet few new bank failures were realized or the average loss for those that did occur was small. This is an example of the inflow of an *ex ante* funded deposit system during a 'Boom' cycle period.

This growth in reserves in the 1990's and the first half of 2000s created a DIF with a significant reserve of assets and the above referenced refund levels of 1.35% and 1.50% appeared to be well in sight as late as 2007 and many highly rated (low risk) banks eligible anticipated the start of the referenced rebates at 50.00%, or even 100.00%, and there was an additional, modest credit given to banks in the reform legislation of 2005.

Of course, the rapid failure of 125 banks in the period of 2008 to 2009 changed that discussion dramatically and now, instead of the long sought surplus rates of 1.35%

to 1.50% or greater being reached and rebates flowing back to highly-rated banks, the DIF of the FDIC has once more reversed, the DIF is in a 'Bust' cycle once more and has been rapidly depleted and, without TARP and related borrowing, would have been fully depleted by the time this work was concluded and is nearly so. Even with TARP funding, the FDIC's DIF is, in essence, currently in an extreme under-funded condition and they are back to chasing the Bust premium deficits with proposals to recapitalize the DIF[15]. While the FDIC has a (U.S.) $100 billion borrowing line with the U.S. Treasury (which is proposed to rise to (U.S.) $500 billion), the FDIC is reluctant to borrow to maintain DIF solvency for historic and political reasons. Instead, the FDIC has proposed, first, an emergency assessment;[16]; then, borrowing from its member banks[17]; and now, the latest proposal is a prepayment of three years of deposit insurance premiums.[18]

iii. *The FDIC's Reluctance To Offer Blanket Coverage; The Fallacy Of Spreading Deposits—A Serious Trap For The Unwary? Obtaining De Facto Blanket Coverage Anyway By Account Type.*

With significant maximum coverage levels now maintained, and currently the vast majority of accounts covered, why doesn't the United States simply offer Blanket Coverage as a permanent plan design element? Certainly, the (U.S.) $250,000 current standard is well in excess of the tipping point under Moral Hazard standards. Ignoring account types which may give Blanket Coverage within a single institution, why does the FDIC continue to force depositors to bifurcate (split) their deposits amongst many institutions if the FDIC openly sanctions, in essence, *de facto* Blanket Coverage?

The FDIC intent to not offer Blanket Coverage is claimed to encourage the spread of accounts to various insured banks in a service area so that a depositor's

exposure at any one bank was never above the current (U.S.) $250,000 insured limit per account type and this would, quite possibly, avoid high dollar-denominated claims at a handful of troubled banks. However, this assumption is weak and assumes 'the handful of troubled institution' element and no systemic risk and that, on average, most of the banks in a region, community or locale will always remain solvent and only a few will ever be weak or insolvent. The financial crisis of 2008 and 2009 has demonstrated that this can be an assumption that is very much not supported by reality.

While in normal times not having maximum coverage levels could act as an incentive to move large deposit base accounts from well-capitalized banks paying standard rates of return to failing banks who often attempt to stave off liquidation due to illiquidity by enticing deposits at unusually high rates of return (and these are called brokered deposits and they are considered transitory and volatile deposits[19]), the recent financial crisis has demonstrated that if a wide swath of institutions in a region are all in various stages of financial distress and/or troubled status, the forced spreading and splitting of deposit accounts in America between multiple institutions to gain *de facto* Blanket Coverage continues to make little sense. Rather, the risk sought to be controlled by not allowing Blanket Coverage seems far better contained by proper prudential supervision, restrictions on rates and brokered deposits, and the like than to force a depositor to dredge-up other institutions willing to house the balance of a deposit simply to support *de facto* Blanket Coverage. It's almost like the FDIC is creating a disincentive for consumers to protect deposits that exceed coverage limits.

The much-publicized failure of Southern California's Indy-Mac Bank during the recent financial crisis is instructive. This bank failure caused a loss estimated at (U.S.)

$10.7 billion to the FDIC's DIF. The loss was greatly compounded for a number of reasons. First, IndyMac was a bank that held many toxic assets and sub-prime loans and this was the main cause for the bank's failure as its asset and investment base rapidly eroded and literally drove the bank into insolvency. However, while the bank regulators were working with this institution to attempt to control that serious loan loss risk to the asset side of its balance sheet, the bank brokered deposits to maintain its liquidity as the value of its loan assets literally dropped with the eroding property market. It was generally known that IndyMac was failing and, yet, the bank was allowed to offer through various intermediate entities (such as securities brokers) bonus rates that were substantially above deposit rates offered by healthier banks for its savings and certificate of deposit products and money poured into this failing institution because the investors, being primarily rate sensitive and believing that FDIC deposit insurance fully insured each account (at that time) to (U.S.) $100,000, the failure of the institution was of only minimal, passing concern. The argument for spreading of accounts by coverage limits states that had the coverage maximum not existed, the loss could have been much larger.

However, was the larger loss actually averted in a market that was systemic in its failure as the current crisis is? It is unlikely it was. The policy of the forced spread or splitting of large deposits to obtain *de facto* Blanket Coverage would have pushed deposits into banks generally unknown to depositors to maintain, in essence, their *de facto* Blanket Coverage. A depositor in the same Southern California regional market area with large balances was forced to chose the next highest priced localized option(s) of, possibly, Downey Savings, Washington Mutual Bank or First Heritage Bank to avoid

having uninsured deposits at IndyMac Bank. At the time, these were some of the next highest rates offered for similar accounts. The problem is that all of those three banks, as well as many other localized options like Mirae Bank, Metro Pacific Bank, Security Pacific Bank, Affinity Bank, First Federal Savings and First Centennial Bank, all failed soon thereafter as well, and the diligent depositor wishing to receive *de facto* Blanket Coverage was rewarded for his or her diligence by being forced to address multiple bank failures and the FDIC gained nothing. This seems counter-intuitive, hopelessly inefficient and ignores the fact that such splitting only works when very localized bank failures occur and only a very few of them at that.

Therefore, when a market is subject to systemic risk (as the current financial crisis has shown to be), a DIF with a coverage cap forces deposits to be spread about *willy-nilly* and likely straight to the remaining riskiest banks as they are the most likely candidate for the split as they are most likely paying the highest bonus rates. Little is gained by the FDIC to buffer the risk of additional loss, as a result, and claiming that the system has fully controlled the purported additional risk of large loss by forcing deposits to other institutions (as it quite clearly has not) is both unscientific and unproven. Even worse, this becomes a trap for the unwary for least informed about deposit insurance: the elderly, the uninformed or the lazy as those categories of savers are most likely to fail to spread and split deposits under the FDIC *de facto* Blanket Coverage system as it now exists and, as a result, realize a potential loss; while those who are diligent and open multiple accounts at any number of unknown and shaky banks lose nothing. This policy, if it can be called a policy, is obviously flawed unless it can be demonstrated that the FDIC, on a net basis, realizes a pay-out of less than what would have occurred had

the depositor not been forced to bifurcate or split their accounts; and, if such realized savings is moral and a proper policy decision.

Deposit insurance should not be a game of account opening, spreading and splitting of accounts and this plan design effort appears misplaced as not serving the protection of depository accounts; rather, it is essentially turning deposit insurance into a calculated maze (or mess) with difficult rules and tragic consequences for some; and, a different result for the diligent and fortunate who are willing to understand the maze; do the extra paperwork; and, realize substantial benefits. Yet, the depositor is the focus of deposit insurance; he is designed to have priority over all others; and such a strategy intending to catch the unaware or unguarded depositor seems to benefit preservation of reserve funds held by those far more able to bear a loss and/or the DIF and all at the expense of the average saver. This is hardly a system designed and dedicated to depositor protection. Yet, that principle is and should always be at its core.

As account openings are time consuming in American with various "Know Your Customer", money laundering, identity theft and Bank Secrecy Act requirements, this forced 'split and spread' of deposits to remain fully insured on a *de facto* basis is arcane; has proven to be one of the most unpopular plan design element with the American public; and needs significant rethinking and revision. The American public generally considers it less than a sign of sound supervision to force them to split and spread their demand deposit accounts and/or savings simply to gain *de facto* Blanket Coverage and for the FDIC to avoid excessive claims for deposit insurance. Instead, those that are knowledgeable about this issue believe this is what prudential regulation

exists to regulate and this should be a matter of safety and soundness and not of matter of clever depositor action to stay one step ahead of evolving coverage limits.

iv. *FDIC Increases Coverage To $250,000 For Some Accounts; Then All Accounts.*

In 2005 (and effective in April 2006), as part of the Federal Deposit Reform Act of 2005 and Conforming Amendments, the (U.S.) $100,000 maximum coverage level per insured account was increased to (U.S.) $250,000 for accounts designed as retirement plans (and America has many diverse types of retirement plans)[20]. For example, an account designated as an IRA, self-directed KEOGH or similar retirement plans could be insured for as much as (U.S.) $250,000 in a single institution.

In October 2008, the (U.S.) $250,000 level of maximum coverage was increased for all accounts and not just retirement accounts[21]. In addition, some accounts, such as those accounts under the Temporary Guarantee Liquidity Program, or TGLP, and under the Interest On Law Office Trust Account Program, or IOLTA, as noted below, receive Blanket Coverage if the institution is eligible and elects to participate.

The reason for the 150% increase in maximum coverage from (U.S.) $100,000 to (U.S.) $250,000 (or more) was, of course, the serious loss of confidence American's had in the United States banking system caused by the economic crisis, rising governmental expenditures, erosion in confidence in the U.S. currency and many other factors. This increase was initially deemed to be temporary and was first due to expire at the end of 2009; however, it has since been extended to the end of 2013 although, somewhat implausibly, it still is labeled by the FDIC as temporary[22]. Should it not be made permanent, the maximum coverage level will return to its prior amount of (U.S.)

$100,000 for all accounts increased to (U.S.) $250,000 except retirement accounts (and as to retirement accounts, the change was permanent since April, 2006). If the accounts do fall back to an insured cover of (U.S.) $100,000 from the current temporary cover of (U.S.) $250,000 it will be the first time ever the FDIC would realize a decline in maximum coverage. Most predict this would be politically unpopular and will not happen and that with pending U.S. financial reform this increase will become permanent in 2010, or soon thereafter.[23]

v. *Use Of Account Types For Separate Insured Account Status: Another De Facto Blanket Coverage Device?*

However, there is a second way that savers in the United States can obtain *de facto* Blanket Coverage status besides splitting or spreading accounts between multiple banks. American's often do not have to go to multiple banks in many cases to obtain *de facto* Blanket Coverage protection for their accounts. Instead, they can utilize the rules regarding ownership account types to maximize coverage at a single institution. In essence, to open up different account types at the same bank.

This is because the FDIC has a unique and broad interpretation of who is a 'depositor' for insured status by referring to different forms or types of ownership of an account as a wholly different ownership category for deposit insurance purposes. One can be the same person in America and wear many different depositor 'hats' or hold different account types while still being the same person. Every different 'hat' worn or type of account earns the same person a duplicate (U.S.) $250,000 in deposit protection (or better) in current maximum amounts at the same bank because the purpose or type of each account is deemed to be distinct and different. In American deposit protection

areas, to continue our analogy, 'hats' are most plentiful. *Is this not Blanket Coverage incognito?*

Certain account types currently have express (but temporary) Blanket Coverage. Included in this category are the TGLP-type non-interest-bearing transaction accounts and NOW accounts earning 0.5% or less (through June, 2010) and IOLTA accounts (discussed below). IOLTA accounts are short term trust account held by attorneys in the United States for the benefit of their clients for which interest is paid to a bar association or law society or other law-related group eligible.

Aside from those special types, the following are the common account types (or 'ownership hats") one can have at a single banking institution in the U.S. and for which multiple insured accounts at the maximum coverage level of $250,000 each can be maintained[24]:

FDIC Deposit Insurance Coverage Limits (Through December 31, 2013)	
Single Accounts (owned by one person)	$250,000 per owner
Joint Accounts (two or more persons)	$250,000 per co-owner
Certain Retirement Accounts (includes IRAs)	$250,000 per owner
Revocable Trust Accounts	$250,000 per owner per beneficiary up to 5 beneficiaries (more coverage is available with 6 or more beneficiaries subject to specific limitations and requirements)[25]
Corporation, Partnership and Unincorporated Association Accounts	$250,000 per corporation, partnership or unincorporated association
Irrevocable Trust Accounts	$250,000 for the non-contingent, ascertainable interest of each beneficiary
Employee Benefit Plan Accounts	$250,000 for the non-contingent, ascertainable interest of each plan participant
Government Accounts	$250,000 per official custodian

The above chart demonstrates that even if one had more than $250,000 in multiple accounts of different ownership categories at a single bank in the United States, it may be possible to recover 100% of all monies deposited if the monies can be separated into the various and different types of accounts listed above or amongst many beneficiaries of a revocable trust. Unlike other countries, as we will see in later sections, the FDIC is most generous in how it designates and defines the various ownership types of accounts it deems as distinct, separate and apart from one another (and, therefore, each being considered its own 'depositor' and each earning a duplicate $250,000 or better insurance protection level at the same institution).

For example, let's look at an American bank Customer, Mrs. B. She has 5 accounts all housed at Bank X located in the American State of Nevada. One account is her 'mad money' individual account with inheritance she received from her late parents and with (U.S.) $50,000 in it. Another is an account she maintains for her child's private education (in her child's name with Mrs. B as signer) from a previous marriage with (U.S.) $100,000 in it. Another is a joint account she maintains with her second husband to pay household bills with (U.S.) $50,000 in it. Another is her Individual Retirement Account (a so-called 'IRA') from her 20 years of private occupational pension savings with (U.S.) $250,000 in it. Another is her husband's rolled over 401(k) savings, another form of retirement savings, with (U.S.) $250,000 in it. Another is an estate-type revocable trust account for her family, with the trust instrument duly identifying the beneficiaries by name and with 10 beneficiaries (children and grandchildren) clearly designated and with (U.S.) $1,000,000 in it. Altogether, this is an insured sum of (U.S.) $1.70 million.

What, then, is the insurance protection at American Bank X for Mrs. B? Does she aggregate all accounts and is she (and her husband) insured for $250,000 for all of their holdings in Bank X and uninsured for the balance of (U.S.) $1.45 million? Or is she (and her husband) insured for all of their holdings at Bank X up to $1.70 million? *Or, something in between?* The answer is that both her and her husband are insured for all of these accounts in America...*and all at one bank.* She, in essence, has Blanket Coverage through the back door of account ownership types. This is easily possible with an American system so very generous in defining who is a 'depositor' of a failed bank and who deems each type of deposit account as a different type of depositor that is entitled to a separate $250,000 in deposit protection.

American banks, anxious to have a full relationship with customers and retain as much of their wealth as possible, but knowing that deposit protection is important, advertise this ability to increase FDIC deposit insurance well beyond $250,000 by defining separate account types as a marketing tool. For middle class families, rarely is resort to multiple banks ever needed as a result. This is a far cry from the EU DIS where minimal coverage allotments are often made for aggregated accounts of all types in the same bank.

In fact, FDIC deposit protection, despite its (U.S.) $250,000 cap per depositor, is by far the gold-plated standard of deposit protection and may be closer to Blanket Coverage through back door account type separation than many of the Blanket Coverage countries who appear more generous on levels of protection but who exclude certain forms of accounts from deposit protection entirely or who aggregate accounts. Once more, this is a trap for the unwary and seems to overcomplicate the reality that

most accounts at American banks realize de *facto* Blanket Coverage and the relatively small proportion of accounts that do not, out of fairness, should. With Blanket Coverage, it would make the applicable laws, rules and regulations governing deposit insurance, as well as the funding assumptions, simplistic and make it far easier to trust the FDIC to have depositor interests more firmly in mind and, if coupled with the suggested enhancements on insuring account value and just not account balances, would remove the depositor from an adversarial relationship with their institution and the FDIC entirely.

vi. *Immediate and Prompt Assumption or Pay-Out Are the Hallmark of FDIC Deposit Protection.*

Another important aspect of the FDIC system is its proven ability to pay-out deposit insurance coverage amounts at lightning speed[26]. This concept of prompt payment is very important to maintaining deposit insurance confidence[27]. Later in our world-wide examination of other deposit protection systems in Chapter 5, we will see this is not always the case in other systems and is a common source of frustration.

When an American bank fails, the FDIC has two options that it typically utilizes. The first is to pay depositors within just a few days after an institution closes or is acquired by U.S. Treasury check. Or, the FDIC utilizes a P&A transaction and sells the accounts (and possibly some or all of the loans) of the failed institution, and likely the branch location and staff, to a purchasing and assuming bank[28].

The closing of the account is certainly easy to imagine but also is coupled with the often seriously unfair cancellation of that accounts' rate and terms we earlier discussed in Chapter 2. The alternative, being the P&A transaction, is usually conducted in private auction proceedings while bank closure efforts are being readied

by the FDIC and the prudential regulator. In essence, the assumptor bank is aware of the future status of a bank's closure even before the executives of the closed banks are informed of the closure as the assuming bank needs to be prepared to act immediately upon seizure and closure to take over the institution and all its operations and branches.

In a P&A transaction, the new institution (our assumptor) agrees to provide immediate access to funds under the new bank's name subject to certain FDIC agreements and the customer simply is considered a customer of the new bank without any effort on their part except for some simplistic 'claim' forms. However, a P&A transaction also allows certain repudiation rights as to rate and term and the customer is often given a difficult choice to either claim their account at the reduced rate or less advantageous terms; or, close the account and have to locate an entirely new bank relationship. This favors the assumptor bank's retention of accounts at less favorable rates. To date, only 10.00% of the failed banks have not been sold to another institution. This pre-closing P&A transaction system is unlike many other systems, including those found in the EU[29].

b. *The Alphabet Soup of Troubled Bank Bailout: TARP and TAGP.*

i. *The Troubled Assets Relief Program (TARP).*

TARP allows the United States Department of the Treasury to purchase or insure up to $700 billion of "troubled" bank assets. This allows the Treasury to purchase illiquid, difficult-to-value assets from banks and other financial institutions. TARP is intended to improve the liquidity of these assets by purchasing them using secondary market mechanisms, thus allowing participating institutions to stabilize their balance

sheets and avoid further losses, or to lend against them. TARP does not allow banks to recoup losses already incurred on troubled assets, but officials hope that once the liquidity of these assets returns, their prices will stabilize and ultimately increase in value, resulting in gains to both participating banks and the Treasury itself. The Act requires financial institutions selling assets to TARP, or securing assets for bridge loans, to issue equity (usually of a preferred class), warrants (a type of security that entitles its holder to purchase shares in the company issuing the security for a specific price), or senior debt securities (for non-publicly listed companies) to the Treasury. In essence, the government trades lent funds for a preferred ownership stake.

Hundreds of U.S. banks participated in the TARP Program. The TARP program has had both success and failure. Thirty-three TARP recipients missed a scheduled preferred stock dividend payment to taxpayers in late summer of 2009, according to the Treasury Department, including 18 banks that missed a dividend payment for the first time. It's a powerful indication of severe financial crisis that the U.S. banking system remains troubled despite the liquidity provided by TARP. The following are the banks that have not honored their TARP repayment promises as of the submission of this work:

TARP RECIPIENTS MISSING PAYMENTS

Companies that have missed their latest dividend payments

Institution	Total Assets ($mln)	Amount TARP Received ($mln)	NPAs/Total Assets (%)	Leverage Ratio
CIT Group Inc.	$71,019.2	$2,330.0	3.5%	4.2%
First BanCorp.	$20,012.9	$400.0	6.5%	4.4%
UCBH Holdings, Inc.	$12,823.6	$298.7	6.7%	1.5%
Sterling Financial Corporation	$12,414.0	$303.0	6.1%	4.5%
First Banks, Inc.	$10,382.5	$295.4	6.3%	0.6%
Pacific Capital Bancorp	$7,312.8	$180.6	4.7%	3.2%
Dickinson Financial Corporation II	$5,608.9	$146.1	11.6%	7.4%
Central Pacific Financial Corp.	$5,525.3	$135.0	4.7%	5.6%
Anchor BanCorp Wisconsin Inc.	$5,292.7	$110.0	7.1%	2.3%
Midwest Banc Holdings, Inc.	$3,569.2	$84.8	3.5%	0.2%
Seacoast Banking Corporation of Florida	$2,136.7	$50.0	7.7%	4.7%
Royal Bancshares of Pennsylvania, Inc.	$1,320.6	$30.4	10.2%	5.8%
Centrue Financial Corporation	$1,312.5	$32.7	6.2%	6.0%
Total for 20 other banks	$5,847.0	$138.6	n/a	n/a

Notes: Leverage ratio is tangible common equity / tangible assets. NPAs = Non-performing assets
Sources: SNL Financial and the U.S. Treasury Department

Reuters graphic/Stephen Culp

080109

ii. *The Temporary Liquidity Guarantee Program (TAGP).*

The Transaction Account Guarantee Program (TAGP)[30] is another program designed to combat concerns about bank solvency and is part of the FDIC's Temporary Liquidity Guarantee Program (TLGP). The program was created October 14, 2008. The FDIC approved a final rule for the program on November 21, 2008. The program was created to strengthen confidence and encourage liquidity in the banking system. The TAGP is the portion of the program that establishes rules for the temporary and unlimited guarantee by the FDIC of certain types of non-interest bearing transaction accounts. The temporary guarantee is given to participating FDIC-insured institutions and will remain in place through December 31, 2009 at participating FDIC-insured institutions

The following accounts are covered by this TAGP Program:

- Non-interest bearing checking accounts, personal and business;
- Interest On Lawyer's Trust Accounts (IOLTA's), regardless of the interest rate;

- Interest bearing checking accounts with interest rates at or below 0.50%

This program has approximately 7100 banks now participating (it is an opt-in/opt-out program) and, as a result, about $700 billion in additional U.S. deposits currently receive a blanket guarantee as to deposit protection despite the (U.S.) $250,000 account limitation.

TAGP is undergoing revision. A bank could agree to allow the TAGP to expire as to their institution at the end of 2009 and the guarantee would revert to the standard (U.S.) $250,000 protection levels noted above. Or, they could continue with the TAGP for a new and higher premium. If they elected to opt-out, customers would have to be alerted as to the changing coverage. Or, for a new and higher premium rate, a bank could agree to extend its participation in TAGP for another six months (until June 30, 2010) which would, of course, continue the blanket guarantee. The additional charge would increase deposit premiums to 25 basis points instead of a normal 10 basis points rate (the standard rate of coverage).

c. *Other Coverage Exceptions and Special Deposit Insurance Situations.*

i. *'Sweep' or Zero Balance Accounts.*

Starting in July of 2009, the FDIC initiated special rules for insuring so-called 'sweep' accounts. An account is considered a 'sweep account' if the funds are taken from an otherwise insured bank account and moved to another uninsured investment vehicle. This is often done during periods the funds are not needed, as the rate of interest from the non-insured investment vehicle may exceed the return promised by an insured bank on the insured account (as the insured account is priced with the deposit

premium in mind); and, even after fees and costs associated with the 'sweep', this movement of funds nets the accountholder more of a return than if the funds were not swept in and out of the insured account at all. These accounts are often called zero-balance arrangements or reserve sweeps[31].

The problem with such arrangements are that a customer could get caught within the cycle of sweeping funds back and forth to the uninsured investment vehicle by the non-insured vehicle failing or, reciprocally, by the bank failing. In such a situation are the funds in transit or in hiatus insured under an FDIC deposit protection scheme or not?

For example, Bank A may allow the funds in Customer B's account to be swept to Fund C. If Fund C faces insolvency and fails to sweep the funds back to Bank A for the benefit of Customer B at the designated time, is the FDIC liable for deposit insurance on the loss? Also, reciprocally, what if Bank A fails and Fund C is unable to restore the funds to Customer B's account even though it is prepared and fully able to do so?

The FDIC has proposed a Final Rule in this situation. A distinction is made between internal sweeps (those sweeps from a brother bank to a sister fund firm and where both entities are owed by the same parent) and those sweeps in and out of a wholly unrelated entity such as a sweep from Bank A to Fund B where Fund B is not owned by Bank A or a common parent. 'Internal Sweeps' are generally treated as if the funds remained on deposit at the bank at all times during the in and out cycle; and, are generally insured at normal levels.

Customers who maintain external sweep arrangements, however, are treated much differently. The customers of external sweeps must be notified when the account is insured and when it remains uninsured. If a bank fails during the cycle of an external sweep, all external sweeps are frozen in place and are not further honored. This could convert a fully insured account on a Monday to a fully uninsured account on a Monday night if the bank or the fund fails overnight. Of course, the fund may be covered by SIPC insurance (as we will soon see below). Also, applicable private insurance may cover some of this loss. Still, this is a fine distinction and a trap for the unwary.

The new disclosures must prominently disclose whether the funds swept in and/or out of a normally insured bank deposit account will be treated as an internal sweep (insured) or external sweeps (uninsured). The disclosure must make this issue clear and must state what happens to the funds if the institution fails during any sweep cycle.

It is likely that the above-referenced distinction between internal and external sweeps will favor banks using affiliates for sweep arrangements as the likelihood of preserving deposit insurance protection is greatly increased if they do. This appears to create a competitive advantage for the internal sweeps of large banks with sister funds at the expense of the DIF. Alternatively, companies must be cautious in using external companies for their sweeps in circumstances where their own bank or the investment vehicle is at risk financially. This will disfavor sweeps outside of a common family of companies. Once more, this seems counter-intuitive.

ii. *'IOLTA' Coverage For Interest On Law Office Accounts.*

Whomever said that those who understand the law can benefit from it are probably well ahead of the truth. Lawyers in America, who are well positioned to understand the deposit insurance laws, quickly sought in this financial crisis an unlimited blanket guarantee for any funds held in law office trust accounts. One reason is that the lawyer could be held professionally responsible to account for the loss of client funds if a bank fails and the funds lost exceeded the insured coverage limits.

Law office trust accounts are those accounts housing short term client funds and for which the interest, which is often paid at a bonus rate, reverts to the benefit of worthy causes and local legally-oriented aid and charitable organizations (and not to their client). These forms of accounts have acquired a nationwide acronym in the U.S. of 'Interest On Law Office Trust Accounts', or 'IOLTA' accounts.

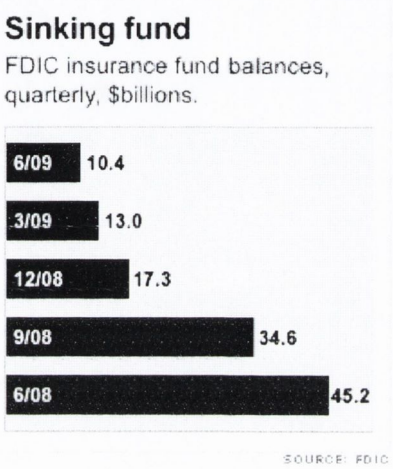
Therefore, funds held by lawyers for clients in IOLTA accounts are not subject to the (U.S.) $250,000 cap in maximum payment. Instead, they benefit from an unlimited blanket guarantee. Such an industry-specific exception has a clearly questionable justification when measured against trust accounts of other professions and monies held for the benefit of others where the same protections may not exist. It is uncertain why IOLTA accounts deserve such special protection as trust accounts of all professions (real estate, deposits, etc.) could argue the same policy considerations for a blanket guarantee.

d. *American Deposit Insurance Solvency: Ex Ante In Name; Ex Post In Operation?*[32]

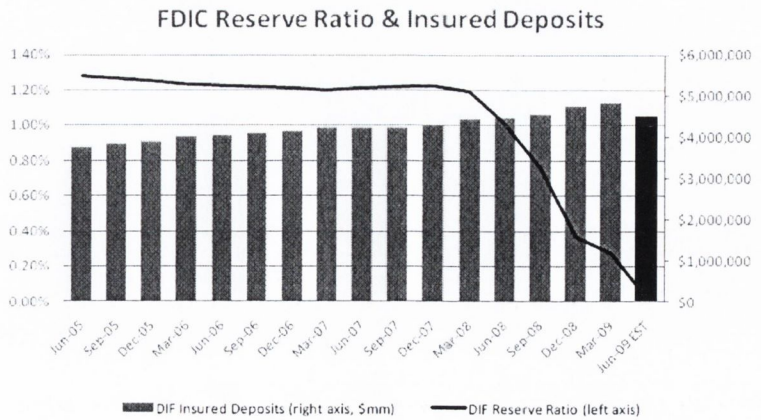
How adequate, then, are the FDIC's reserves and ability to handle bank failure? Well, to be very candid, not adequate at all. The charts that follow demonstrate the

current and declining solvency issues with the FDIC's DIF; its rising costs; and, it is disturbing that the fall from surplus has been so swift.

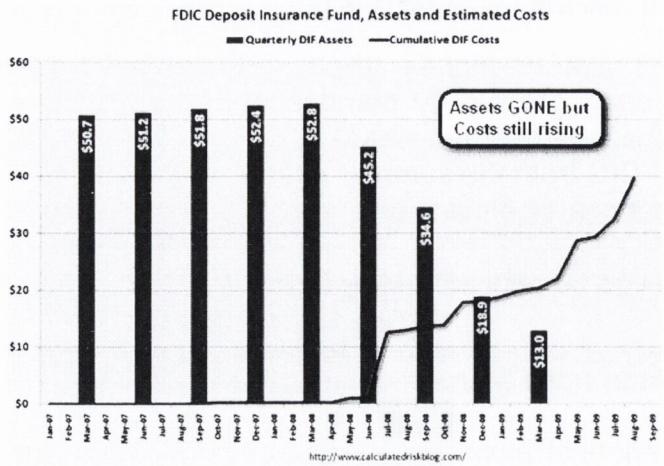
The first chart graphically demonstrates the dramatic 75% decline in the DIF balances of the FDIC from the summer of 2008 to the summer of 2009:



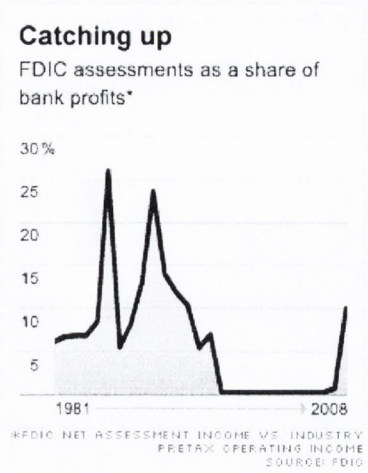
The next graph is equally dramatic. Expressed as a percentage of insured deposits (left axis) as and against insured deposits (right axis), the solvency of the FDIC DIF is alarmingly clear (it has no solvency at present) as the ratio sharply descents well below the minimum floor and down to a fully depleted status:



Although the FDIC DIF is depleted, or nearly so, its costs are dramatically rising:



The next chart demonstrates that during various financial crises that deposit premiums assessed by the FDIC as to banks take a large bite out of banks profits as banks are only marginally profitable (or not profitable at all) during economic periods of financial stress and rising risk-rated deposit insurance make them even less so. Reciprocally, during profitable periods, FDIC assessments (even when rising) hardly have any impact on bank profits at all. Therefore, to increase premium deposits during difficult financial periods for surviving banks in order to cover outflows from the DIF results in a heavy current impact on the ability of marginal banks to remain profitable.

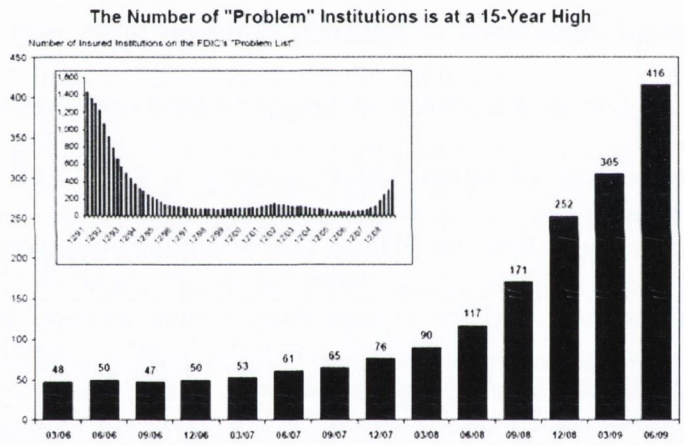


Despite the clear wealth of Americans, the current state of the American FDIC DIF is bleak, at best. This is due to actual or reserved outflows of (U.S.) $38.8 billion to date for the 125 failed institutions in America between 2008 and 2009[33]. Some have referred to the FDIC's DIF as a bankrupt or beggar's fund and it certainly would certainly appear so without the use of direct TARP lending in 2008 and 2009 as a bypass. However, it is critical to note that the FDIC's DIF is actually composed of two funds: the DIF and a related reserve fund for known risky banks already established. Only by looking at both fund elements can a clearer picture of FDIC solvency be arrived at.

On August 27, 2009, FDIC Chairman Sheila Bair announced the latest status of the DIF that is known in relation to the submission of this work. First, the FDIC Chairman announced that insured American banks had posted a collective (U.S.) $3.7 billion net loss in the Second Quarter of 2009[34]—indicating that American banks were particularly unprofitable during that period of reporting. However, her latest effort and plan was to assess three years of deposit premiums (about a quarter of a bank's normal annual profit) to each institution now and not over the usual three year cycle. According

to the chart above, this is a particularly poor time to be increasing deposit premiums or asking for prepayments at an accelerated 300.00% of normal payment rate.

This could increase the rate of bank deterioration. The following FDIC chart shows a dramatic tenfold increase upward trend in problem banks since the 'Bank Problem List' was at its historic low in 2006 and when bank profits were at their record highs. Although the number of institutions on the 'Bank Problem List' continues to rapidly increase, it remains well below the levels seen during the *S&L Crisis* of the 1980's in numbers (but note, not in asset size).



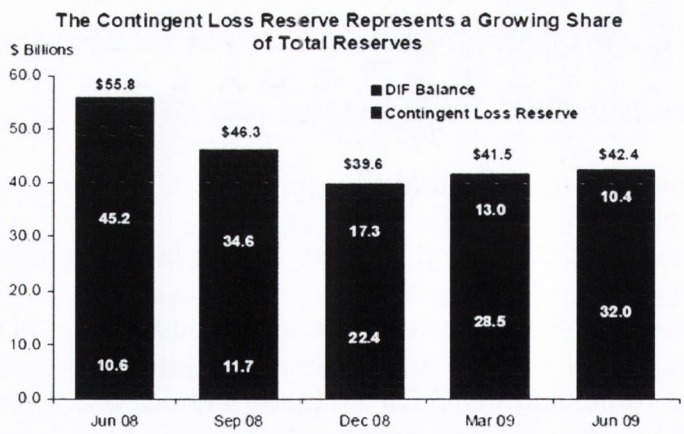
The FDIC has already anticipated that certain banks will likely fail and has transferred funds from the primary DIF into a DIF set-aside or reserve fund to await the likely failure of those specific failing banks in the amount estimated. This is a sort of '*Doomsday Fund*'. In essence, the FDIC budgets for the closure of banks likely to fail and thereby can maintain the remaining DIF funds targeting future unknown bank failures and can give Congress a better picture of the true capacity to fend off future failures. Together, these items constitute the total DIF.

So when a known failing bank actually fails, and to the extent that the FDIC has already reserved for that event, the loss normally comes out of the set-aside reserve account already created for that event (if adequate) and not the general FDIC DIF which has already suffered that loss. For example, when the major bank failure for Colonial Bank failed just before this work was submitted in August 2009, we have since learned that there was no reduction in the DIF because the estimated loss for Colonial Bank's failure had already been fully reserved for and held in a reserve account for some time. The loss will still be borne by the taxpayers of the U.S. until any bridge lending has been repaid; however, remaining capacity of the FDIC's DIF can be better monitored with such a contingent loss reserve system.

The FDIC reviews the adequacy of the contingent loss reserve every quarter and makes adjustments, as needed. As illustrated in the following FDIC chart, the FDIC has been shifting large sums from the DIF and into the contingent loss reserve for specific bank failures as its failure projections have grown and specific banks can be pegged for loss. The good news is that the contingent loss reserve for failing banks is (U.S.) $32.0 billion. However, the bad news is that the general DIF dropped to a very lean (U.S.) $10.4 billion as a result. As of the end of June, 2009 it is likely further depleted. Just one or two of the largest bank liquidations already conducted in 2008 and 2009 would promptly cripple the remaining FDIC DIF balance without U.S. Treasury borrowing. So, as to banks in the regional or larger class of bank size and for which there is no adequate reserve already held in the contingent loss reserve, the DIF as of its reserves today is clearly inadequate and may be entirely broke. This means that until

replenished, the losses now in place in the FDIC DIF are the responsibility of the taxpayers.

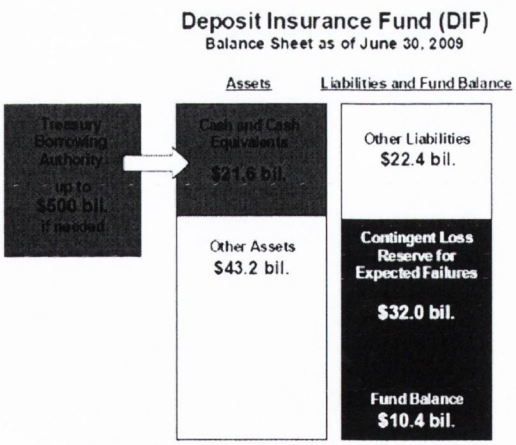
The FDIC's DIF, just a few years ago, was poised to offer 50% to 100% refunds to highly rated/low risk banks, has now turned from an *ex ante* funded DIF into an *ex post* funded DIF at this time. This is the first time this has occurred since the S&L Crisis and collapse of the 1980's. It is placing the United States in the same posture as Japan (discussed below) when its DIF turned from significant surplus to a deficit fund and required substantial borrowing from the Japanese Government to recapitalize the DIF and regain its solvency. The trend is certainly of major concern since the U.S. economy continues to run at a major deficit and U.S. debt is estimated to be amassing at record levels measured by trillions of dollars by 2010 (where the deficit is thought to be increasing to one trillion, 500 billion dollars by the end of 2010):



The FDIC has the current ability to borrow up to (U.S.) $100 billion, and soon (U.S.) $500 billion from the United States Treasury. This has dramatically increased from a previous ceiling of (U.S.) $30.0 billion in previous borrowing ability. However, the

FDIC may be reluctant to access such borrowing in order to maintain its appearance of solvency. The concern with borrowing from a government to fund a deficit DIF is easy to imagine: (a) it, in essence, converts the DIF on a long term basis to an *ex post* fund fully reliant upon governmental appropriation; and, (b) this creates long-term debt in the DIF. The second concern is historically a significant problem as shown by the fact that Japan, who also had to governmentally borrow to keep their Fund afloat, is still repaying that debt a decade after it was incurred and the current poor economy has slowed their rate or repayment.

The following, then, is the FDIC's summary of the FDIC Fund, including reserves. Please especially note that the smallest share, in the darkest shade, is the DIF Fund Balance equal to (U.S.) $10.4 billion. As of the summer of 2009, the following is what remains of bank premiums paid into the DIF for years before the current financial crisis:



Indeed, what a difference two years can make! In May of 2007, the Director of the FDIC's Research area provided an outlook that anticipated deposit *growth* of 5.00% in the DIF and that the DIF would reach the first level surplus 1.25% mark (triggering a rebate for qualified low risk banks) during 2009[35]. In March of 2009, the same year this

was expected to occur, the Chairman of the Board of the FDIC, Sheila Bair, had a much revised view and stated that the FDIC DIF was at real risk of 'drying up' amidst a surge of bank failures[36]. All one can say is that this is a dramatic, maybe even shocking, shift. As 2009 has now seen 100 bank failures alone in one year to date[37], and with many months of the current economic crisis still undoubtedly remaining, the situation may grow considerably worse before the inflow of surplus deposit premiums will once more exceed the strong outflow of existing reserves[38]. As noted below, the FDIC has been forced to increase bank assessments[39] and, additionally, impose an emergency assessment; and, of late, seek a three year advance funding of deposit insurance premiums and has commenced a full restoration plan for the DIF in light of its depleted status[40].

Regarding the latest plan of the FDIC to recapitalize the DIF by assessing three years of deposit premiums to banks all at once, many banks are opposed to this plan as it comes at unprofitable times for banks and will simply wipe out any hope of marginal institutions becoming profitable over the next several years. Without profitability, raising additional capital at a fair cost becomes difficult and bank failures will rise amongst the troubled banks as they run short of capital and/or become illiquid.

The following are the current hard realities of the FDIC solvency issue:

- The DIF was approximately (U.S.) $50 Billion before 2008[41] and is approaching full depletion[42]. While a considerable sum has been diverted to specific reserves for targeted banks[43], it is unclear how many of the 416 banks are reserved for at this time, if any, as this is confidential[44]. Further,

billions of new premium deposits apparently cannot stem further erosion of the Fund[45]. The DIF utilized an astounding (U.S.) $35.1 Billion in Fund assets in 2008 alone. To a certain extent, the FDIC's DIF is in free fall.[46] Yet, the FDIC is reluctant to use its borrowing lines at the United States Treasury and would rather place the majority of the burden on the banks in prefunded ways and, therefore, further stress the weakest of them.

- The additional (U.S.) $500.0 billion Treasury borrowing line facility is certainly more adequate than the former (U.S.) $30.0 billion borrowing line but the FDIC is apparently reluctant to access it. Still, if utilized, it creates a Japanese-style 'debtor DIF' that has to partially erode confidence as it certainly is a long way off from the former surplus condition *ex ante* DIF of the period before 2007.

- The rate of bank failure is increasing and more banks than ever remain on the troubled bank lists in America despite the closure of more than 125 to date during this crisis. Nearly four times more American banks have failed in 2009 (98 institutions) than in 2008 (25 institutions) and 2009 still has several months remaining as this dissertation was being finalized. While bank failure may, indeed, be a lagging indicator, we do not appear to be nearly at any end of the cycle of American bank failure and it is uncertain how the FDIC can claim to be recapitalizing the American DIF with the outflows and borrowing now underway. Rather, outflows appear certain well into 2010 and possibly beyond. The American DIF was far too lean to handle this crisis and it was now clearly optimistic to think otherwise.

- The DIF has seen the average rate of premiums rise about 14.00% in a single year and a special assessment and, now, prepaid assessments being added to that difficult increase, in addition[47]. The special assessment appears to be giving way to three years of advance payment of premiums[48]. This rate is approaching a breaking point for marginal banks as the pricing on deposit products reflects the cost of deposit insurance and rates have dipped into the 2.00% or less per annum deposit rates to reflect these increasing costs[49]. Yet, riskier banks, continue to have to attract deposits by paying higher rates for brokered deposits. These volatile or 'hot' deposits are turning troubled banks decidedly unprofitable.

- Increased deposit insurance hurts a class of savers least able to absorb the change[50]. The increased insurance premiums are frequently passed through in multiple forms to savers in ways not always obvious: (a) by decreasing interest rates paid (which explains the very low rates currently offered in America)[51]; (b) by decreasing reciprocal earnings credit to business customers on analyzed accounts; and, (c) as an extra fee or as a direct pass-thru to savers, where allowed. This further weakens all savers but especially harms fixed earners (often the elderly and retired) and others who find it hard to survive on investments paying such very low rates of interest or to absorb new costs in the current difficult economic times.

An example of the arguments against increasing premiums for deposit insurance is attached as Appendix "B". This Appendix is a letter written by this author on behalf of two large U.S. banking groups (the banking groups of the American States of Nevada and Arizona) to the FDIC asking that the emergency special assessments be delayed or curtailed and can be found amongst hundreds of similar comments at the FDIC's website[52]. Such appeals have had marginal impact.

The sorry current state of the FDIC's DIF helps to explain the FDIC's prior discussed *'Too Big To Fail'* policy for American institutions such as Citibank and Bank of America as well as the massive assistance given to the nineteen largest mega-banks in the United States. Those efforts were a practical realization that failure was not a viable option as the collapse of any of the large money-centered institutions would have immediately swamped and savaged the remaining FDIC's DIF or, more likely, resulted in massive borrowings from Treasury to fund the immediate deficits in the FDIC's DIF. It was, so the logic goes, far better to directly prop-up and directly lend to the largest banks in America sufficient monies to stabilize them under the TARP Program and related programs with the expectation of gradual recovery and repayment rather than to fund an equally (or even larger sum) into the FDIC's already ravaged DIF following a major bank failure and collapse. Along with the direct lending comes increasing oversight and control of issues such as governance and executive compensation. The Treasury saw this alternative as providing a double benefit while avoiding the confidence-lowering issues of overnight creating a bankrupt or 'Beggar' DIF. In addition, the FDIC is ill-equipped with sufficient trained internal staff to duplicate the legions of employees that major banks employ even in a wind-down mode; or, to manage those

staffs with the high rate of attrition such situations usually realize for bank staff and therefore liquidation of banks the size of Citibank or Bank of America would cause immediate and serious, even massive, disruption and high costs to the FDIC. Compound that failure by several major banks failing at once and you would have an absolute American governmental crisis. These banks are, then, classic banks TBTF and that is what makes them dangerous to the financial health of the United States.

Of course, along with lending of TARP funds comes hopeful pay-back, additional control, ownership and, more recently, proposals for the Federal Reserve to more actively regulate banks of such a 'systemic risk' orientation. To be fair, over 30 of the largest banks have already repaid their borrowed funds (mainly to be free of the burdensome extra compensation conditions) but many others have not, including Citicorp and Bank of America, two of America's largest banks on the TBTF list. So the plan to avoid pushing this problem on to the FDIC and, instead, deal with it by direct lending appears to have been the best choice.

This demonstrates the rough underside of deposit insurance—the ultimate liability of taxpayers in a governmentally guaranteed plan or scheme. Ultimate liability for such plans falls upon society at large in the country at issue in any governmentally guaranteed plan and up to the benefits promised (at least until the lent funds can be repaid). For example, the FDIC DIF under the U.S. laws never really can go truly insolvent as the FDIC insurance guarantee is backed entirely by the unlimited Full Faith and Credit[53] of the United States Government and thereby renders FDIC Insurance an unavoidable obligation of the American taxpayer as being the party with full recourse (up to the benefits promised) at the end of the line of liquidation of bank assets and

coverage by the FDIC's DIF. This is why countries are reluctant to offer unlimited blanket guarantees for deposits as they fear swamping their taxpayer base with liability following a major bank crisis or catastrophic bank failure.

Still, the FDIC's DIF was never intended to be primarily governmentally funded (it was the first *ex ante* bank-funded program in the world). Yet, it is anything but *ex ante* funded in any major economic crisis or at the moment. Rather, it is facing depletion and losses of a rapid and extreme nature which has unavoidably shifted the costs and losses of bank failure from the banking industry (funding premiums *ex ante,* as a whole) to the taxpayers of the United States or any other country in a similar condition funding huge bank losses *ex post* and in arrears. Just ask Japan about the conversion of a deposit insurance fund from an *ex ante* condition to an *ex post* condition and how difficult digging out of that hole can be in a sluggish economy. We are already well down the same road.

Despite the positive spin placed on the DIF and its future by the FDIC, the DIF in America is on life support and this is reality aside from the pretty words and the optimistic talk. Despite its high protective levels, liberal interpretation of account types, fast turnaround for deposit insurance pay-outs, if a DIF like that maintained by the FDIC is rapidly going broke apart without massive *ex post* borrowing from lines of governmental credit that will make it a debtor fund for years ahead, is such a system sustainable? Or is the 'funding lite' approach previously taken in a period of bank prosperity really the *Achilles' Heel* of any deposit insurance system?

The DIF in America, while intended to be a pay-as-you-go and an *ex ante* funded plan, has not delivered that level of funding in this crisis. Rather, the funding of this *Bust* round of financial crisis appears to be taxpayer-driven and very much *ex post* in orientation. This is evidence of a serious deposit insurance design problem. The DIF in America was never intended to be an *ex post* plan or a taxpayer-driven system for bailout; rather, it was to be funded by bank premiums. The many healthy banks protecting against the few bank failures.

This is why the American public remains livid about the current round of bank bailout. The system, during major failures, and due to underfunding, is quickly turned on its head and the net cost, after the DIF is predictably wiped out, is imposed (at least on an interim basis) on American's through easy access to governmental funds. Yet, the banks continue to generate significant profits and earnings, and pay objectionable compensation to senior staff, and this often continues through the entire crisis.

The decline of the FDIC's fund, and the need for TARP funds, has obviously resulted in renewed, fresh debate on how the safety-net system should be overhauled. Aside from deposit insurance, the proposals in the United States include the need for a systemic regulator, the adoption of a consumer financial protection agency and stronger regulation or the elimination of banks TBTF.

e. *Comparison to Competing Non-Bank Depositories in the U.S.: The NCUA (Credit Union) and the SPIC (Brokerage Money Market) Fund Form of Investment 'Insurance'.*[54]

i. *Credit Unions and An Unfair Playing Field? The NCUA Fund*[55].

As we have seen, FDIC insurance applies to bank deposits and institutions which are part of the regulated banking system in America. For many years it did not apply to S&L's but that issue was remedied by the S&L Crisis when the SAIF was merged into the FDIC fund after-the-fact and the FSLIC was abolished. Credit unions in America remain the lone exception to FDIC deposit insurance cover and are insured by the NCUA. There has been discussion that their fate should be the same as the SAIF in the mid-1990's—that being a merger of the credit union fund into the FDIC's DIF.

NCUA deposit insurance works to insure its members in similar ways as to FDIC coverage. After all, credit unions are competing directly with banks as to deposits and it would be unwise and unfair to offer lesser or greater coverage as it would create competition and even playing field issues. However, due to the nature of credit unions and their share draft system, some additional factors come into play.

The first factor is that while credit unions pay deposit insurance premiums in America, due to an federal exemption they do not pay the full range of income-related taxes on their income as that income is purportedly distributed to its share draft members. Banks, of course, pay taxes on their net profits even if they also distribute those net profits to shareholders in the form of dividends. This already creates an unequal playing field.

Next, NCUA solvency and stabilization is a major issue as this work was being finalized[56]. Recall that there are thousands of retail credit unions in the United States now operating. Currently, the fund insuring credit union deposits is maintained by the NCUA and it is undergoing 'stabilization' which, it is assumed, is similar to the

recapitalization of the FDIC's DIF. At the same time the NCUA's NCUSIF is facing strong loss exposure from several large 'corporate' credit unions with billions of dollars of at risk liability to the NCUSIF for their 'back room' operations in mortgage lending, auto loans, credit card lending and even commercial loans. Some have referred to the NCUA fund in practical terms as currently insolvent and a liability few have come to fully appreciate.

In May 2009, Congress enacted legislation that created a temporary corporate credit union stabilization fund with authority to assess special premiums over 7 years as to all credit unions; extend through 2013 the same (U.S.) $250,000 level of protection as exists with banks and the FDIC; provide the NCUSIF the right to stabilize and rebuild the credit union insurance fund if it drops below 1.20% in the reserves to covered deposits ratio calculation; increase NCUA's borrowing authority to (U.S.) $6.0 billion with the Treasury and with an additional emergency right to borrow (U.S.) $30.0 billion more. This need for legislation hardly indicates a fully *ex ante* funded arrangement; it appears that the NCUSIF is at the same or worse position as the FDIC's DIF with regard for the need for governmental borrowed funds to survive the current crisis while still paying claims; and, it appears the NCUSIF will require many years of replenishment to be deemed to have a reasonably funded deposit insurance program and until that time it will be, in essence, remain *ex post* funded.

ii. *The American SIPC (Investor Protection) Fund: Account Insurance For Securities or Simply Protection Against Securities Loss or Theft?*

The remaining major source of competition with banks for depository or quasi-depository products is the creation in the 1970's of deposit like mutual funds of

securities brokers that are designed to be safe and have extremely low volatility as they invest in low risk assets such as governmental obligations. Many brokerage companies create or sell these deposit-like products where excess funds can be placed in money market mutual funds or governmental funds and where the risk (while certainly not at zero) is fairly low to very low and the rate of return (which is more in the nature of a yield on the investment rather than interest) could exceed a similar deposit rate at a bank. These products compete for deposits; often have check-like access rights; and, to an uninformed person look like an FDIC-insured account. However, they have no FDIC insurance and since the early 1990's have required warnings to that effect in documents establishing such accounts. So, then, how are these deposit-like brokerage products protected by deposit insurance?

The brokerage industry does maintain a protective fund that sounds much like deposit insurance (which may be intentionally phrased) and which is aptly named the *Securities Investor Protection Corporation*, or SIPC[57]. Compare this to the *Federal Deposit Insurance Corporation* and note the word "Insurance" is missing and is replaced by a new word "Protection". Is not the 'Protection' portion of the SIPC's name also indicative of account insurance?

The answer is that this is not insurance of an account balance as with FDIC cover; rather, under the SIPC regime this is protection against loss or misuse of instruments and cash. Therefore, it is helpful to compare and contrast FDIC 'insurance' with SIPC investor 'protection' to find out the differences.

Think of the SIPC as a security company that guards your securities and cash 24/7 against the theft or misappropriation by your own brokerage firm and its employees as to those assets. In essence, if it's missing from your account you will get it back. The concept is one of replacement of lost or misused securities and cash (within coverage limits) and not the concept of guarantying an account balance. Although not every investor is protected by the SIPC system, most securities investors are and will regain (within coverage limits) their investments back from SIPC if they turn up lost or misused and if their brokerage firm goes insolvent and cannot restore the account.

So, in the competition between banks and securities brokers for 'deposits', the money market or governmental fund that the securities brokerage firm is using to 'deposit' its customers money into generates units or shares of ownership. If these units or shares never make it to an investor's account, or are improperly removed or diverted, the SIPC will protect our investor from this loss and restore the units or shares within SIPC maximum coverage limits.

From its creation by Congress in 1970 through December 2007, almost 40 years of coverage, SIPC advanced (U.S.) $508.0 million in order to make possible the recovery of (U.S.) $15.7 billion in assets for an estimated 625,000 investors. In essence, the SIPC gave back securities and cash to all those investors and there was a shortfall of (U.S.) $15.7 billion in what they received from the failed securities brokerage firms versus what they were required to pay out in claims as brokerage firm receiver (and we assume this was the element of the property that was mishandled by the failed brokerage firm due to one reason or another).

When a brokerage firm is closed in the U.S. due to irregularity in trading, improper record keeping, fraud, bankruptcy or other financial difficulties and customer assets turn up missing, SIPC's mandate is to seek to return customers' cash, stock and other securities and, in tandem with pay-out, seek restoration and recovery from the firm and its managers for any abuses their engaged in. Without the SIPC, investors at financially troubled brokerage firms might lose their securities or money entirely if a brokerage went insolvent or closed. However, because not everyone, and not every loss, is protected by SIPC, there are limits of protection. This makes SIPC less predictable than bank FDIC cover (especially if one is dealing with any entity other than the direct SIPC broker member as affiliates may not benefit from SIPC coverage).

So SIPC is not the same as FDIC deposit insurance at all. The Securities Investor Protection Corporation does not offer to investors a blanket protection that the Federal Deposit Insurance Corporation provides to bank depositors as explained above to insure account balances to the current maximum levels of coverage. SIPC insurance also does not insure separate account types. For example, when a member bank fails, the FDIC insures all depositors at that institution against loss up to a certain dollar limit, which is generally (U.S.) $250,000 per insured account at present. As we have stated before, there can be many insured account types in the same bank or financial institution. There is much more limited account differentiation under the SIPC rules and requirements.

SIPC protection also functions much differently. It aggregates and protects one's brokerage account to the coverage limits. It does not protect the decline in that

aggregated account and the account continues to be subject to market forces during any claims period. It only promises to redeliver those securities and cash allowed pursuant to the coverage rules in the same form. So a share of stock worth $100 on January 1; found lost on March 1; and returned at $85 per share on May 1, is all that is promised and the $15 difference is not protected. Of course, the stock might be returned at an appreciated value, as well, and that stock appreciation on our hypothetical share would inure to the stock owner and not the SIPC.

This is why SIPC does not 'bail out' investors when the value of their stocks, bonds and other investments fall for any reason. They are not an insurer of that form (or any form) of risk of volatility or of the initial sum paid to their broker. They protect assets in accounts by replacing missing cash, stocks and other securities (where it is possible to do so) or the SIPC pays the equivalent value for them if they cannot be recovered. Taken to extremes, the SIPC will pay nothing for stolen worthless stock even if large sums were paid to buy it initially. The SIPC is not insuring the purchase price; they are insuring the return of the security (here, worth nothing).

There are some ineligible categories of assets and cash not covered by the SIPC at all. They are primarily commodity futures contracts, investment contracts, certain partnerships and other securities not registered with the SEC. In essence, aside from limited amounts of cash, the securities or other assets must be in registered or bearer form so ownership can be proven.

Often a trustee on behalf of the SIPC takes many months (and possibly years) to determine ownership issues, take control of remaining brokerage firm assets and value

claims. Therefore, unlike FDIC insurance, this is a slow process described by the SIPC itself as generally taking one to three months, at the minimum, and far longer if records are not accurate or if the principals of the firm were involved in fraudulent behavior (both likely to occur as recently seen in the *Bernard Madoff* Scandal which has been pending for over a year). Some of the accounts may be transferred to other brokerage firms in something similar to the purchase and assumption transaction we have already seen in the banking area and which may speed up the process somewhat.

Critical to the comparison between the FDIC and the SIPC is maximum liability. SIPC liability for its form of 'protection' is limited to (U.S.) $500,000, which is clearly a higher cover than FDIC cover; however this sum is per customer (not per account type) and *cash losses* may not exceed (U.S.) $100,000 (which is substantially lower than FDIC cover per account type which currently stands at $250,000). This makes SIPC protection as to cash losses, such as cash deposits not yet invested in money market or governmental funds, clearly less favorable than FDIC coverage unless, upon liquidation, the brokerage firm has available assets which will cover more of the investor's claim. With SIPC cover, the financial worth of a customer's account is calculated as of a 'filing date.' The FDIC values accounts as of the bank closure date. These could be two very divergent dates and could realize much different numbers in changing economies.

Wherever possible, the actual stocks and other securities owned by a customer are returned to him or her (which means that market forces continue to apply even to the investment although the customer has no right to sell these securities during the valuation and pay-out period). Again, this interim loss of control is far less favorable

than the FDIC prompt pay-out periods where the customer has the account balance in hand almost immediately even if they lost the account benefit of rate and terms. Also, there are more involved proof issues for SIPC cover and significant time-limits for paying claims that do not exist in deposit insurance areas in the United States.

SIPC coverage can be best be described as tedious, time-consuming and resulting in a final payout in securities and cash that may look much different in worth when finally made due to the interim loss of control and the passage of time. Few American's could even begin to explain these differences in cover and procedure and the differences appear to greatly favor FDIC cover over the SIPC and the SIPC regime can hardly be described as a robust 'confidence builder'.

There are also exclusions to SIPC protection that must be considered. Some of the most important exclusions include:

1. A general partner, officer, or director of the firm.
2. The beneficial owner of five percent or more of any class of equity security of the firm (other than certain nonconvertible preferred stocks).
3. A limited partner with a participation of five percent or more in the net assets or net profits of the firm.
4. Someone with the power to exercise a controlling influence over the management or policies of the firm.
5. A broker or dealer or bank acting for itself rather than for its own customer or customers.

However, SIPC has no authority to examine or investigate member firms. Rather, those functions are left to FINRA and the United States Securities and Exchange Commission (SEC). This is very much different with the FDIC as to banks. The FDIC actually regulates banks in addition to constituting a banks' deposit insurer and has a full range of regulatory actions available to it for misconduct.

As with the FDIC and NCUA, SIPC solvency is of great concern in these troubled financial times. In sworn testimony in January of 2009, the CEO of the SIPC acknowledged that the entire current available balance for SIPC cover was then at only a paltry (U.S.) $1.6 billion. The SIPC also has access to a (U.S.) $1.0 billion line of credit with the United States Treasury which is also available. However, the *Madoff* scandal, alone, could reach (U.S.) $50.0 billion or more in potential exposure to the SIPC. The Lehman Brothers, Bear Sterns and Merrill Lynch closures could impose still greater liability on SIPC (although those closures may involve the acquiring entities or surviving parties). There have been dozens of regional brokerage closures and there are reportedly dozens of large broker-based *'Ponzi Scheme'* investigations being conducted by the SEC that could impose hundreds of millions of dollars more in exposure to SIPC. The protection fund at the SIPC appears, at least as of this writing, to be substantially under-funded and of relative low confidence value to investors who understand its current levels of solvency.

SIPC coverage, while certainly welcome over no cover at all and serving a distinct purpose, is certainly no rival to FDIC deposit insurance when all these elements are brought together. However, many investors see SIPC protection as the securities industry's equivalent to FDIC insurance and believe they are in a similar,

or even better, competing environment with the same risk orientation. This is almost certainly untrue and borders on fantasy with the current levels of solvency of the SIPC and the trillions of dollars of securities held by brokerage firms and at risk.

Further, SIPC protected assets are subject to the full range of market forces during the process, the SIPC has no power to examine, and the periods to restore missing securities or cash is far too complex and long. This is hardly the functional equivalent to FDIC insurance. It would appear that more transparency must be given to this issue or those shopping rates of return and relative risk for depository or quasi-depository accounts could be seriously misled in comparing the safety of an FDIC insured bank account with the complexity and solvency of the protection scheme offered pursuant to the SIPC system.

CHAPTER 4 – ENDNOTES

---

[1] As described below, SIPC is more loss protection than it is FDIC-type deposit insurance.
[2] American deposit insurance is extensively covered in literature. The following are examples: Williams, p. 35;
[3] Gibson, 1-29.
[4] The following is a typical statute and is found in the American State of Nevada that authorizes the use of the FDIC to liquidate a Nevada state-chartered institution after the Nevada Financial Institutions Division has closed a Nevada bank:

> ***NRS 667.035*** *Federal Deposit Insurance Corporation may act as receiver or liquidator of closed bank having insured deposits; no bond required.*
>
> 1. *After July 1, 1971, the Federal Deposit Insurance Corporation created by the Federal Deposit Insurance Act, 12 U.S.C. § 1811, may act without bond as receiver or liquidator of any state bank which has been closed because of inability to meet the demands of its depositors.*
>
> 2. *The appropriate state authority having the right to appoint a receiver or liquidator of a state bank may, upon such closing, tender to the Federal Deposit Insurance Corporation the appointment as receiver or liquidator of such bank. If the Federal Deposit Insurance Corporation accepts the appointment, it shall have and possess all the powers and privileges provided by the laws of this state with respect to a receiver or liquidator, respectively, of a state bank, its depositors and other creditors, and shall be subject to all the duties of such receiver or liquidator, except insofar as such powers, privileges or duties are in conflict with the provisions of the Federal Deposit Insurance Act.*

[5] Bank holding companies are explained at Carnell, pp. 437-451. The Bank Holding Company Act may be found at 12 USC §1841.
[6] Carnell, p. 27.

[7] For general background, see FDIC, Your Insured Deposits: FDIC's Guide To Deposit Insurance Coverage. This Guide has numerous examples of ownership types that can be used to maximize FDIC coverage.
[8] Malloy, pp. 53, 178.
[9] So the United States has a more uniform maximum coverage system than the European Union system that only sets a minimum threshold.
[10] 476 U.S. 426 (1986)
[11] Pollard, pp. 20-22 to 20-27.
[12] See, www.bls.gov/CPI and using the inflation adjusting calculator found at: http://www.bls.gov/data/inflation_calculator.htm.
[13] See, Kaufman , p. 303.
[14] Williams, p. 79. For a discussion of the progression from institutions in default through to closure and receivership, see Malloy, p. 294.
[15] The FDIC refuses to borrow from the U.S. Treasury at the current time. The latest proposal involves the prefunding of three years of bank insurance premiums. See the FAQ regarding the proposed prepaid assessment program here: http://www.fdic.gov/deposit/insurance/prepay/index.html.
[16] See Appendix B, attached hereto, which explains and opposes this special assessment.
[17] In essence, the remaining healthy banks would lend the FDIC the funds necessary to recapitalize the DIF. This seems rather ironic.
[18] See Note 590.
[19] See, FDIC Working Paper 2002-01, Should Bank Liability Structure Influence Deposit Insurance Pricing (January 2002).
[20] In additional to Traditional and so-called ROTH Individual Retirement Plans, certain other plans, such as self-directed KEOGH plans and certain roll-over plans may be covered by this provision. Funds held in banks through 401(k) or other qualified plans may receive 'Pass Thru' insurance for each identified participant.
[21] ABA, The International Lawyer, 2008 Legal Developments (Financial Products and Services), p. 654.
[22] It will be in effect for at least five years and is anything but temporary.
[23] To reduce coverage from potentially unlimited coverage (or certainly $250,000 per insured account type) back down to $100,000 would be politically unpopular and would be the first decrease in FDIC insurance maximum cover in its 75 year history.
[24] For even more detailed examples of using ownership types to maximize insurance in the United States, See Farrell, p. 206.
[25] The FDIC relaxed the rules on revocable trust accounts. These accounts can either be formal, such as a living or family trust, or informal, such as a POD (payable on death) account. In either case, the beneficiaries should be apparent from the bank's records for each beneficiary to receive the $250,000 cover under current law. There use to be a second requirement, that the beneficiary be 'qualifying', but the FDIC did away with that requirement. However, the beneficiary must be an individual, a charity or another nonprofit organization. See, FDIC FIL-99-2008 (Revised 10/08/08). See, ABA Bank Compliance, *How Are You Handling FDIC Insurance Changes?* (January/February, 2009).
[26] Malloy, p. 309.
[27] Campbell, p. 17.
[28] The FDIC has rules for doing this. See Chapter 4, pp. 41-46 of the FDIC Manual (entitled Deposit Payoffs). The FDIC refers to cash-outs as deposit payoffs; and it may refer to a P&A transaction as an IDT, or an Insured Deposit Transfer.
[29] The FDIC has great experience in P&A transactions and the various guarantees that accompany various forms of P&A transactions.
[30] ABA Compliance Article 1.
[31] ABA Advisory Article.
[32] See, web article, www.nolanchart.com, Towne, *The Banksters: The FDIC Is Bankrupt* (08/17/09)
[33] The FDIC appears to be getting increasing bleak in its self-assessment of fund solvency.
[34] See, FDIC Press Release, August 27, 2009, PR-153-2009; Also, see: *Statement by FDIC Chairman Bair At The Quarterly Banking Profile Press Conference* (August 27, 2009), which can be found at: www.fdic.gov/news/news/press/2009/pr09_qbp.html .
[35] FDIC Outlook dated May 7, 2007 Issued By Arthur J. Murton, Director, Division of Insurance and Research.
[36] See, web article, money.cnn.cnn.com, *Bank Failures.*
[37] The number is expected to be approximately 125 just in 2009.

[38] It is believed the current rapid outflow will decline by the end of 2010 and reverse in 2011 or 2012.
[39] See, Epstein, Lita, *Banks May Lend Money To FDIC*; Paletta, Damian, *FDIC Prepayment Likely For Banks*; Vekshin, Alison, *FDIC Proposes Banks Prepay Deposit Fees Through 2010*; Barr, Colin, *FDIC Asks Banks For Help*; McGlasson, Linda, *FDIC Asks Banks To Prepay $45 Billion.*
[40] See, FDIC Press Release Dated September 29, 2009, located here: http://www.fdic.gov/news/news/press/2009/pr09178.html.
[41] See, http://www.npr.org/templates/story/story.php?storyId=112304551
[42] http://www2.fdic.gov/qbp/2009jun/qbpdep.html
[43] http://www2.fdic.gov/qbp/2009jun/qbpdep.html
[44] http://www2.fdic.gov/qbp/2009jun/qbpdep.html
[45] This is because the outflow exceeds the inflow at the present time.
[46] However, the FDIC feels this characterization is quite unfair. See, *FDIC Frustrated With Perception Of Bank Failures* http://www.google.com/hostednews/ap/article/ALeqM5jC6RXlb6aGXcxwxnDyh9_UVyZ0wD9BIVDM01
[47] The Special Assessment in discussed in Appendix B, attached hereto.
[48] http://www.fdic.gov/deposit/insurance/prepay/index.html
[49] The rates cannot go any lower. They are at the theoretical bottom of the market.
[50] Those who are most dependent on interest income, the fixed income earner, have realized some of the harshest consequences of the current financial crisis.
[51] Most banks in the United States take into consideration deposit insurance premiums when determining deposit rates of interest.
[52] The Special Assessments are explained in web article, www.bloomberg.com, Vekshin, *FDIC May Add To Special fees As Mounting Failures Drain Reserve* (08/20/09); also, see, USA Today, *FDIC Seeks More Fees From Banks To Insure Consumer Deposits* (10/08/08). See, also, http://www.fdic.gov/news/news/financial/2009/fil09024.html.
[53] http://www.fdic.gov/consumers/banking/confidence/symbol.html#Full.
[54] See, NCUA, *Share Insurance and You: Maximize Your Insurance Coverage*; NCUA, *How Your Accounts Are Federal Insured*; all of which may be found in current versions at www.ncua.gov.
[55] See, Hannifin, *Deposit Insurance and Credit Unions: An International Perspective*, Journal of Financial Regulation and Compliance, vol. 15, Issue 1, pp. 42-62 (2007)
[56] NCUA Letter No. 09-CU-14 (June 2009) From The National Credit Union Administration
[57] See, www.sipc.org, *What SIPC Covers..What It Does Not.*

CHAPTER FIVE

5. OTHER WORLDWIDE DEPOSIT INSURANCE SCHEMES COMPARED AND CONTRASTED

a. *Introduction To General Worldwide Deposit Insurance Protection and Trends*[1]

After examining the European system in Chapter 3, and the American system in Chapter 4, the contours of deposit insurance design and development are much clearer. The differences, and the similarities, of deposit insurance design are now more apparent. Also, the aftermath of the design decisions in the area of deposit insurance have been revealed. It is clear we are building a case towards improving the design of deposit insurance by understanding it; however, our discussion (in order to not be arrogant) requires one additional ingredient to be totally inclusive. We need to look at what the rest of the world thinks and does as to deposit insurance and how our perfect design may be once more influenced by region, culture or religion. In this Chapter 5 that will be our objective.

The United States and the European Union are certainly a major part of worldwide banking, and they form a sort of twin rudder for many of its operations. They are not, however, the totality of worldwide banking[2] and both of these highly evolved and economically advanced countries' deposit insurance schemes have emerged from the current financial crisis more than a little tarnished and with greater concern as to their ability to fully understand their own complex banking markets. Also, with regard to deposit insurance, the American and European systems are but two of over one hundred worldwide deposit insurance programs and schemes now being used to insure

deposits; and that list continues to grow[3]. For Europeans and Americans to properly and fully understand world banking, they must understand world deposit insurance and how it may work differently in developing and underdeveloped countries[4]. The most current list of nations of the world offering explicit deposit insurance plans is appended as Appendix "A" hereto[5]. This will give the reader insight into the broad economic status of the world's deposit insurers. They range from countries with low standards of living to the great and dominate financial countries of our time. Deposit insurance is not—and *need not*—be the province of the rich first world nations like the United States and the Member States of the EU. Banks that fail in under-developed nations hurt their savers, at least proportionately, just as much as those institutions that fail in America or Germany. Bank failure brings down all savers of all classes and degrees of wealth.

No dissertation leading to best practices recommendations, as this one will in the following Chapters 6 and 7, would be complete without moving well beyond Europe and the United States and viewing what many of the continents and countries of the world do as to explicit deposit insurance and why certain countries have only so-called 'implicit' schemes and other countries have no protection at all. From Canada to Korea; New Zealand to Mexico; and, Brazil to China, studying the application of deposit insurance as it relates to other peoples, economies and stages of economic development can be instructive as to arriving at common standards that all banks can adhere to moving forward. Along the way we will hope to see the inter-relationships between cultures, religions and deposit insurance—such as the relationship of Islamic culture and religion to banking in the Middle East; what is considered to be an insurable account in different lands; whether foreign accounts or persons will be covered under a

domestic program; and, many other issues. As with other issues throughout the world, some countries do not agree entirely on the American-EU approach to these deposit insurance questions and address problems differently for cultural, religious, economic or political reasons. It is important we know this before defining best practices for them.

Therefore, in the following worldwide tour of deposit protection we can gain significant insight into different approaches and make sure that we understand meaningful differences from a geographical, socio-economical and cultural standpoint before attempting to arrive at global recommendations in our final two chapters. It is also noted in my discussion, and to assist in the bridging of these differences, where additional information about each country's plan can be found so this comparative and harmonizing work can continue as it continues to gain momentum in this current financial crisis and needs to progress.

It is important to start back again with a slight bit of history. Before the current financial crisis of the last two years, the world countries who maintained deposit insurance programs had remained fairly flat and numbered about 70 nations for many years. That has certainly changed with the current global crisis and the fact that the current number of countries with explicit systems now significantly exceeds 100. This is a major, definitive surge of adopters of plans and schemes worldwide.

If anything, the use of deposit insurance is on the upswing for various reasons. First, several countries have been in the adoption process for some time and this is simply the best adoption climate from a needs standpoint (but a poor time from an economic standpoint) to proceed to create a deposit insurance system (China, with its

Hong Kong experiment, being an example). Others see the need for deposit insurance as a confidence-boosting measure due to the outflow of business and activity from their country caused by the current crisis (South Africa[6] being one such example). Others need to adopt stronger provisions because the weak provisions they maintained as a safety-net have utterly failed (Nigeria being an example). Some are looking for an interim confidence-building fix and may not continue with deposit insurance when the crisis blows over (Australia and New Zealand being examples). So motives differ widely as to why the list of adopters of deposit insurance is growing very rapidly.

Also, the list of recent adopters of deposit insurance is somewhat eye-opening from a resistance-to-adoption basis in the past. As recently as a year or two ago, it would have been unheard of for certain countries to adopt deposit insurance. Countries like Australia, New Zealand and certain African countries, for example, would decidedly have not have been members of this club had it not been for the current financial crisis. However, adopt a deposit insurance plan in various forms they now certainly have.

With motive and resistance exposed, then, the concern is whether these efforts are truly protective of investors over the long haul in the American or EU style; or, is the effort *window dressing* and simply designed to calm commercial markets over the short term; or, give political cover to governments that they are 'doing something'; or some or all of these reasons. Keeping in mind that the depositors are the reason for deposit insurance (as opposed to other programs, such as TARP, that may focus more on commercial interests), are the recent adopters sincere in realizing the desired effect from the creation of a deposit insurance systems? The results are not yet available to decide this question fully. Therefore, motive should always be kept firmly in mind.

Next, we will see that plans outside the EU and America often differ widely. We need to ask why there is such a lack of uniformity in the adoption of systems and schemes around the world. Of course, there are variations in savings rates, standards of living and acceptance of banks worldwide and all those reasons contribute to differences. There are also creative approaches to the thorny issues of implementation of deposit insurance, including funding concerns, borrowing to 'catch up' on fully funded status, setting of deposit premiums (and whether they will be risk-based or not) and, of course, the often expressed Moral Hazard concern. Finally, there are cultural, religious and sociological reasons for adopting a design for a deposit insurance system. Uniformity, then, can be a challenge in this area.

While the devastating financial crisis of 2008-09 has changed many a mind on the issue of implementation of deposit insurance, and coming in the midst of this work has caused relative havoc in this writing to keep up, the world continues to produce deposit insurance systems in every shape and size. Even beyond amount or levels of coverage, there is no standard formula or 'one size fits all' approach to the protection of deposits. While many believe that this diversity is inevitable, and possibly even a good idea, this is not always the case. Rather, it seems to belie the fact that money is one of the easiest to transfer of global commodities; almost every person in today's world is part of some larger Diaspora and heritage that causes them to deal with many of the world's banking systems almost by necessity; and, why money is treated in a widely disparate manner from county-to-country is not entirely clear beyond local political pressures, a reaction to cost or how well a localized economy is doing.

As each of the following representative country deposit insurance plans are discussed, it may be enlightening to ask if this countries deposit insurance plan has been solid for decades; or, is it in the class of recent adopters who have jumped on to the idea and concept of deposit insurance for one of the above less-than-perfect reasons and in a sudden reaction to our ongoing economic declines. Will the adopted plan be a permanent fixture of that country's financial services landscape and serve as an integrated safety-net participant long into the future? Or, will it be a temporary effort to calm markets that will quietly 'sunset' (end) at some preset date a few years from now? Likely, cost, and the strength of the banking industry in any country will make that determination. The continuation of such programs will be an interesting test of the political will of certain countries without a deposit protection history as economic conditions improve and complacency undoubtedly returns.

b. DEPOSIT INSURANCE ON THE CONTINENT OF ASIA[7]:

i. County of China, Including Hong Kong[8]

The Chinese banking system has been in rapid evolution over the past several decades and is actually more than a single system as China has multiple markets for foreign and domestic consumption purposes.

China, as one of the leading producers of goods for export to world markets, and as a rapidly emerging financial superpower, has seen a maturing of its unusual governmental cocktail of former Maoist Socialism with old-styled Western Capitalism stand-up and become a truly global player. To be blunt, through high productivity and relatively low wages, and while an average Chinese worker is by no means rich by Western standards, the County of China has grown to be a global financial juggernaut

and, if measured by nothing more than their fancy for new automobiles, its citizens have realized something closer to a middle-class standard of living in wider swaths of the country than ever before.

However, the recent financial crisis has mildly set back this effort, closed factories and for the first time ever China is facing a loss of something they have come to welcome—savings. Still, even with these declines and set-backs, savings is by no means rare even in these harder times or even discouraged in the modern China of this millennium. Therefore, the saver has come into tighter focus in China as this new breed of Chinese saver is regarded with respect in the Chinese culture.

China is actually a vast country of many provincial areas. Some areas, such as Taiwan, Mongolia and Tibet remain, as yet, not entirely integrated or independent of the central governmental apparatus. The Hong Kong area, a former Westernized (British) financial center for China ceded back to China, and also where the major financial resources of banking and stock market activity arises from, has taken the lead in China as to the adoption of deposit protection while other provincial areas of China are still trailing and in the study phase.

In September 2006, through a Hong Kong Ordinance known as the Deposit Protection Scheme Ordinance (Chapter 581), Hong Kong started providing deposit protection through its Deposit Protection Scheme (the "HK DPS")[9]. This Hong Kong Scheme initially started protecting up to 1,000,000 Hong Kong ("HK Dollar") dollars per depositor or the equivalent of about (U.S.) $130,000 and €88,000. It also created the Hong Kong Deposit Protection Board ("HK DPB").

Eligible deposits for the HK DPS include Hong Kong Dollar or foreign currency savings deposits, time deposits and deposits in current accounts. Note the inclusion of foreign dollar deposits in the HK DPS as many countries preclude this. With the deteriorating world markets, and starting in October 2008, the 2006-2008 ceiling of (HK Dollar) 1,000,000 was increased further to become a full (Blanket Coverage) guarantee for all bank deposits for two years (until October 2010) and for accounts domiciled within authorized HK institutions. This was done in order to quickly stabilize shaky institutions and increase depositor confidence. However, not every form of account is covered by full coverage[10]. This Unlimited (Blanket Coverage) Guarantee will end next year unless extended. Its renewal remains uncertain as of the end of this work but likely will continue in some form.

An interesting aspect to the Hong Kong DPS is that the HK DPB issued detailed guidelines (soon after the blanket increase to unlimited protection) in December 2008 requesting that domestic HK banks actually take the initiative to inform each of their depositors holding unprotected deposits by the end of May 2009 and explain which deposits held by these depositors are *not* protected under the HK DPS and to the extent measures can be taken to avoid loss such as splitting deposits. This positive disclosure regarding deposit insurance is rare and is an innovation[11].

The HK DPB has taken these new laws seriously and has announced that most domestic banks are already compliant with applicable deadlines regarding assessing the impact of coverage on each customer. Explaining the positive and negative aspects of deposit insurance to a huge saver base not generally familiar with the concepts of deposit insurance is a great undertaking and a considerable step forward and provides

increased transparency to the deposit protection system in the HK and leaves few surprises upon subsequent bank failure. In comparison, even the United States and Europe do not require such positive and specific deposit insurance coverage explanations and allow for generalized, media-centered disclosures often missed entirely or misunderstood by the average saver[12].

This positive obligation to inform is significant as confusion can abound in the area of DPS. For example, under the HK DPS many HK bank customers may not be aware (without the forced written explanation obligation) that under the HK Scheme, deposit protection compensation in HK is paid to a saver on a *net basis*. This means that the normally protected and separate deposits of a borrower lodged in a HK bank will suddenly be withheld from pay-out under the HK DPS Scheme and diverted to repay any loan or other financial obligation that he, she or it owes the failed bank in the first instance. This might even accelerate due dates and balances and, in essence, wipe out cash balances long before sums were due (such as rapidly reducing loans). This can cause havoc with a business planning or personal budgets. As with the FDIC system in America that allows repudiation, this unfairly changes the lending terms only due to the failure of the borrower's banks and, in the HK, could also result in the loss of compensating balances in deposit accounts. This is important information in the choice of banking relationships and lending terms and a customer should be aware of his, her or its options well ahead of any bank insolvency or failure[13]. Instead, it may help a depositor to separate their deposit relationship from their lending relationship in countries, such as the HK, where deposit balances are netted against obligations. Depending upon a country's scheme, there are many other areas where this

transparency can assist a bank customer to strategize and plan for a possible bank failure.

There are other areas where China has paid attention to prior implementation issues for other countries. The Hong Kong bank regulators have shown focused attention to and have closely monitored the manner of implementation of the recently upgraded HK DPS program. They have coordinated prudential supervision along with the roll-out of deposit insurance and this creates increased oversight, early intervention and transparency for the Hong Kong HK DPS and forms one of the many best practices recommendations noted later below.

The HK DPB also was not content to adopt simply a Chinese-based system without reference to international standards. The HK DPS went through a self-assessment under the BCBS-IADI recommended Core Principles guidelines introduced earlier this year, and discussed below in Chapter 6. In essence, China, at least as to its HK DPS, has tried to mold its deposit insurance scheme into the broader international framework suggested by the Basel Committee (and see below for more information on the critique of the Core Principles the Basel Committee has recommended).

However, the news is not entirely positive when it comes to deposit protection in China. Up until 2007, the remaining and broader China was without any well defined and express deposit protection program and was, at best, an informal, implicit system outside of the core business area of Hong Kong. Therefore, as to deposit insurance, we have a two-sided China -- a business China with deposit protections; and, we have a

mainland China with a much weaker and informal safety-net. China certainly has yet to adhere to the breadth of the explicit HK Scheme on a pan-China basis.

However, the broader Chinese depositor does have certain rights under the informal or implicit bank deposit protection system. The problem with informal systems, however, is that under such a system the Chinese Central Bank and provincial Chinese governments must be financially prepared to pay-off depository obligations and other debts when financial institutions fail because of management and operational faults. But such a promise is bare and clearly *ad hoc* and discretionary (in essence, *ex post* at best); it imposes a sudden and heavy burden on local governments; and, it generally undermines the Chinese Central Bank's monetary policy by having no established laws, rules and regulations and coordinated effort as the financial burden will likely fall on the central bank system as opposed to the local government. It is an undisciplined system and lacks the certainly to instill bank customer confidence that a formal *ex ante* and fully bank funded DIS would provide. Implicit systems run counter to the Core Principles we will see in Chapter 6 and China needs to make a more decisive leap in introducing meaningful deposit insurance throughout its vast nation and just not have one toe in the water with its tentative efforts in Hong Kong.

To counteract this shortcoming, in 2007 and at the start of the worldwide financial crisis, the national Chinese government announced that it was studying the broader implementation of a formal (explicit) DPS system for all provincial areas in China and just not Hong Kong. Such a '*Chinese Deposit Insurance Corporation*' would involve setting up deposit-insurance institutions in the spirit of the FDIC, and with the

established aims to protect depositors against financial losses caused by the bankruptcy of financial institutions through a 'risk-compensation mechanism'.

> The State [Chinese] Council's Development Research Center explained that such a system "...*will help prevent depositors from making mass withdrawals from a bank, which can have a negative impact on other financial institutions, even healthy ones. A mass withdrawal is usually highly contagious in a financial market, which is fragile and unstable by nature.*"[14]

As of the date of finality of this work, it cannot yet be confirmed that a broader national Chinese DPS will be, in fact, adopted in place of the current mainland implicit system outside of Hong Kong; but, it is believed that the success of the HK DPS Scheme will lead to its likely broader adoption in the near future.

ii *The Country of Japan*[15]

The Japanese system has, surprisingly, been in existence for only thirty years despite Japan's maturity as a financial power since the end of World War II (over 60 years ago)[16]. This left Japan with a period of thirty years without any express program of deposit insurance.

Japan realized great financial success in the post-war period of the 1950's through the 1980's through manufacturing. It was considered one of the world's financial success stories and the standard of living for Japanese workers rose consistently during this mid-Century period. Japan also has developed a 'savings' culture that encourages savings and thriftiness.

In the 1990's, this period of rapid ascension and success came to an end. In the middle part of the 1990's, Japan faced one of the worst economic emergencies in modern times. In essence, Japan found their financial institutions had collapsed as they

were undercapitalized and had engaged in risky behavior in lending and operations; and, as regulators began to become concerned and enforced various 'safety and soundness' laws, Japanese banking rapidly descended into the dark and dreaded world of deflation which saw over 120 undercapitalized Japanese banks fail in a compressed period of just a few years[17]. Unlike America with its thousands of banks, 120 banks in Japan is a very significant part of the banking industry. This froze credit and contributed to a decade of lost Japanese economic progress which had only started to improve as the global economic crisis of 2008-09 got underway. Therefore, for much of its existence, the Japanese 'DIC' has been a debtor or so-called beggar fund.

To be able to fund its deposit insurance obligations following its financial emergency in the 1990's, the Japanese revamped their financial safety[18] and the Japanese DIF was required to borrow heavily directly from the Japanese government and the loans to finance that activity were gradually being repaid as the global financial crisis of 2008 first appeared. The current brutal economic downturn is rendering the Japanese repayment schedule more problematic and challenging just as it appeared that Japan would finally return to a degree of normalcy.

The DIF in Japan, which currently insures about 600 financial institutions, remains in a deficit funding condition (meaning it relies upon government funding and has not fully repaid loans it owes to its government). This renders the system, essentially, and subject to Japanese budgetary concerns, tied to the national finances; less than independent; and funded, essentially, *ex post*. This is certainly not the ideal situation under the Core Principles as we shall later in the next Chapter.

Utilizing information from the Japanese deposit system, the following is a graphical explanation of the Japanese method of deposit protection. As the Japanese system can be complex, and has varied widely over time, the following chart-based presentation is the most practical way to explain it in greater detail:

a. *Insured Banks.*

The following chart depicts the classifications of the 610 financial institutions insured by the Japanese system. Note that the Japanese City Banks and the Japanese Regional banks comprise more than half of all Japanese banks currently insured:

(End of March 2008)			
Insured Financial Institutions		**Number**	**Insured Deposits (¥ billion)**
Banks	**City Banks**	6	227,933 (31.5%)
	Regional Banks	64	185,428 (25.6%)
	Regional Banks II	45	54,060 (7.5%)
	Trust Banks	22	36,935 (5.1%)
	Others	12	76,044 (10.5%)
	Sub-Total	**149**	**580,399 (80.2%)**
Shinkin Banks		281	111,514 (15.4%)
Credit Cooperatives		164	16,171 (2.2%)
Labor Banks		13	14,860 (2.1%)
Federations		3	1,004 (0.1%)
Total		**610**	**723,948 (100.0%)** **140% of GDP**

b. Insured Deposits.

The following is a list of the types of accounts insured (and those not insured as well) under the Japanese System:

Insured Deposits In Japan Include:
Deposits
Installment savings
Installment contributions
Money in trusts with guarantee of principal (including loan trusts)
Bank debenture (custody products)
Accumulating or asset-forming products based upon deposits, etc., in a. to e. above
Deposits related to investments in fixed-contribution pension reserves, etc.

Uninsured Deposits (Not Included In The Japanese Protection Scheme) Include:
Foreign currency deposits

Negotiable certificates of deposits (NCD)

Deposits in special international financial transaction accounts (Japan off-shore market accounts)

Deposits, etc., from the Bank of Japan (excluding treasury funds)

Deposits, etc., from insured financial institutions (excluding those related to the investment of fixed contribution pension reserves)

Deposits, etc., from the DICJ

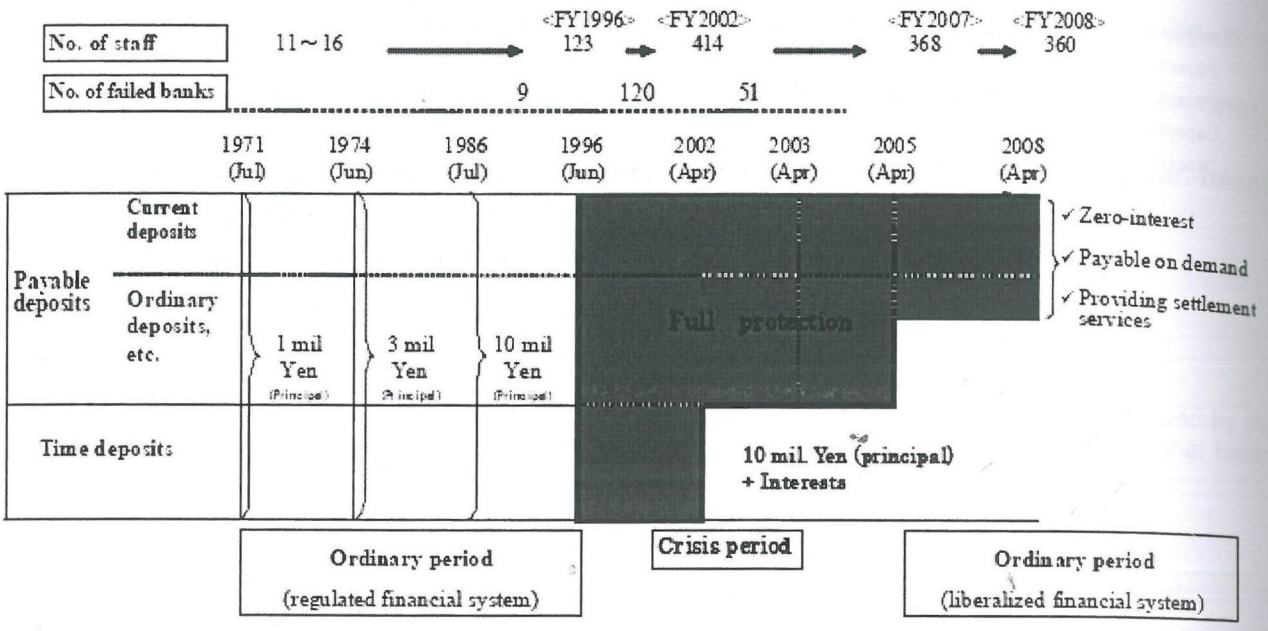
c. *Japanese and American Systems Compared.*

The following chart demonstrates the current similarities and differences between the Japanese Scheme and the American FDIC System:

	Japan	USA
Deposits	**Yes** Deposits which meet the following three conditions are fully insured: 1) non-interest 2) payable on demand 3) providing settlement services	**Yes** All accounts insured to $250,000. Non-interest-bearing transaction deposit account are fully guaranteed. Many of these limits only valid until 2013.
Time deposits	**Yes**	**Yes**
Foreign currency deposits	**No**	**Yes**
Deposits from individuals	**Yes**	**Yes**
Deposits from corporations	**Yes**	**Yes**
Deposits from financial institutions	**No**	**Yes**

d. *Changing Coverage Amounts.*

The deposit insurance limit was first raised in 1986 to JPY (Japanese Yen) 10,000,000 and this level continued until the Japanese economic crisis in the 1990's. From 1996-2005, the deposit protection limit was again raised to a full Blanket Guarantee.



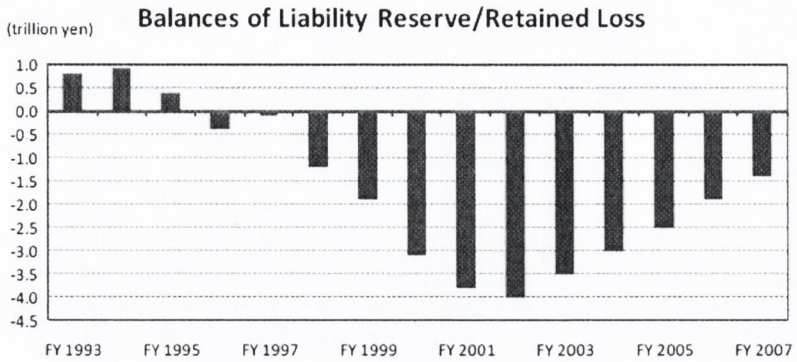
e. *Funding Methods.*

The following is the funding methods for the Japanese Scheme:

- Partial funding through premiums paid from insured banks. *Ex Ante* Funded (however, *Ex Post* funding continues as the DIF remains in arrears.) A flat premium system is used (differential or risk-rated premiums could be adopted under the current legal framework).
- Remainder of funding through external financing (Japanese governmental bonds ranging in terms from 2 to 7 years). Also, short-term borrowing from Bank of Japan and private financial institutions.

f. *Reserves In The Japanese Deposit Insurance Fund.*

The following are the reserves held in the Japanese Scheme. Note reserves actually fall below the zero level. In essence, there are no reserves and the scheme is, in essence, *ex post*. The General Account for the Japanese Scheme has been in arrears (deficit) since the previous Japanese economic crisis of the mid-1990's, but this General Account is expected to turn to surplus relatively soon after the effects of the 2008-09 economic crisis lifts:



g. *Insurance Premiums Paid By Financial Institutions.*

The following are the flat premium rates paid by Japanese financial institutions for their portion of deposit insurance funding. Premium rates were raised during the 1990's crisis and have been kept at 0.084% on a weighted average basis since that time:

	Premium rate		Effective rate
From 1971 on (when system began)	0.006%		0.006%
From FY1982 on	0.008%		0.008%
From FY1986 on	0.012%		0.012%
From FY1996 on	0.048%		0.084% Note ; including special premium (Special premium ‹0.036%› was imposed between FY 1996 and FY2001.)
FY2001	Specific deposits	Other deposits, etc.	
	0.048%	0.048%	
FY2002	0.094%	0.080%	
From FY2003 on	Deposits for payment and settlement purposes	General deposits, etc.	
	0.090%	0.080%	
FY2005	0.115%	0.083%	
From FY2006 on	0.110%	0.080%	
FY2008	0.108%	0.081%	

h. *Premium Rate Trends.*

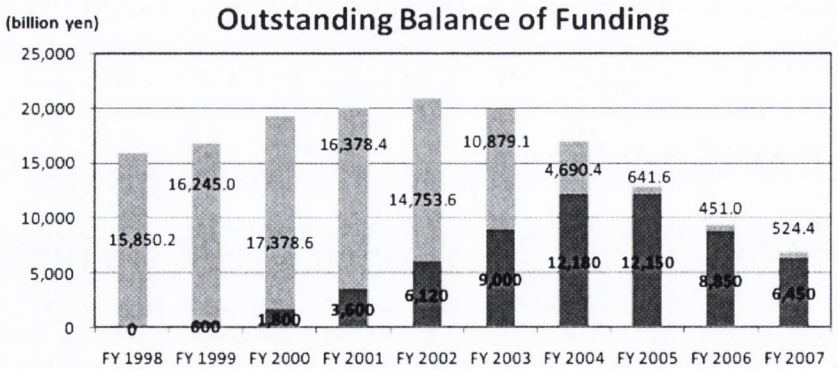
As of April 1, 2009, the following chart demonstrates trends in the rates of premiums charged to its Japanese member institutions at ordinary and special rates (and note that no special rates have been assessed since FY2001):

	Ordinary Premium Rate(1)		Special Premium Rate (2)	
1971- (on launch of the system)	0.006%			
FY1982-	0.008%		-	
FY1986-	0.012%			Total(1)+(2)
FY1996-	0.048%		0.036%	0.084%
FY2001	Specific Deposits	Other Deposits	0.036%	0.084%
	0.048%	0.048%		
FY2002	0.094%	0.080%		
FY2003-	Payment& Settlement Deposits	General Deposits		
	0.090%	0.080%	-	
FY2005	0.115%	0.083%		
FY2006	0.110%	0.080%		
FY2007	0.110%	0.080%		
FY2008	0.108%	0.081%		
FY2009	0.107%	0.081%		

* Applicable between FY1996 and FY2001 only pursuant to Paragraph 1, Article 19 of the Supplementary Provisions of the Deposit Insurance Law and Paragraph 2, Article 3 of the Supplementary Provisions of Order for Enforcement of the Deposit Insurance Law.

i. Borrowing To Maintain Solvency Of Fund.

To honor its deposit insurance guarantees while the General Account is in deficit, the Japanese Scheme relies on long-term financing from the Japanese Government. Note that in FY2002, this was the high-water mark for such governmental funding (in total amount) and in the last year available, FY2007, the long-term financing of the DIF has dropped to about one-third of the high-water mark.



j. Comparison Funding.

The following chart compares the funding mechanism of the Japanese Scheme with the funding mechanism of the United States' FDIC Scheme:

	Japan	USA
Pre-funding / Post-funding	Pre-funding [HOWEVER FUND IS IN DEFICIT CONDITION]	Pre-funding [HOWEVER FUND IS APPROACHING OR IS NEARLY AT DEFICIT CONDITION]
Flat / Differential	Flat rate	Differential rate
Rate of premium	0.108% (deposits for payment and settlement purposed, FY2008) 0.081%(general deposits, etc. FY2008)	0.05%~0.43% (2008) 0.07%~0.77% (2009)
Borrowing	DICJ can borrow funds in the following ways on a government guaranteed basis: • Issue of DICJ bonds • Borrowing from BOJ • Borrowing from private financial institutions	FDIC can borrow funds in the following ways. • Borrowing from the Government (Currently a $500 Billion Treasury Line of Credit) • Borrowing from the Federal Financing Bank (for working capital)
Targeted Reserve Ratio (= Accumulated fund / Total insured deposits)	-	1.25% (2008) *FDIC reviews the target ratio between 1.15% and 1.50% on an annual basis.
Current accumulated funds	Deficit (General Account) (JPY) 1,377.7 billion (March 2008)	$34.6 billion (Sep. 2008) (Less Late In 2009) *Reserve Ratio: 0.76%

iii. The Country of (Republic Of) Korea[19]

This DIF of Korea is an example of a very recent and accelerated country's entry into global deposit insurance systems. The applicable Korean law is the Depositor Protection Act ("DPA") which was enacted in December 1995 and the competent authority is the Korea Deposit Insurance Corporation ("KDIC") which was established in June 1996 to formally protect depositors of insured financial institutions and to maintain public confidence in the Korean financial and banking system.

Initially, the KDIC embarked upon the task of deposit insurance protection of domestic banks in January 1997 (only 12 years ago) while separate funding for non-bank financial institutions remained in place. The DPA was revised and expanded at the end of 1997; and, accordingly, the various and separate deposit insurance funds were consolidated under the single management of the KDIC in April 1998.

Although Korea's deposit insurance system has only been in operation for a little more than a decade, it has shown real progress and remarkable growth through active introduction of various devices demonstrated by other countries to be effective and implementation of best practices policies designed to further advance and enhance the Korean system. As a result, the KDIC has quickly become a central player in Korea's financial stability and safety-net and in the current restructuring process by way of effectively intervening and supporting the resolution of failed Korean financial institutions.

When the KDIC was first established very late in 1995, the insurance coverage limit was (KRW) 20 million (the won being the Korean monetary unit) per depositor, which is approximately (U.S.) $17,100 and €11,600. Due to the market instability resulting from the Korean financial crisis of 1997, however, full (Blanket Coverage) Protection coverage was introduced through an amendment to the Enforcement Decree of Depositor Protection Act in December of 1997.

After the Korean financial crisis had run its course, and the market gradually stabilized due to significant bank restructuring, concern returned as to the possibility of increased Moral Hazard if the full Blanket Protection remained in place. In light of the perceived Moral Hazard concerns, the Enforcement Decree mentioned above was further amended six months later in July 1998 in order to decrease the Blanket Coverage to partial coverage so that for deposits (or paid-in premiums) with principal not exceeding (won) 20 million, or approximately (U.S.) $17,100 and €11,600, would be guaranteed as to principal and designated interest and for those accounts with more than 20 million won in the account, *only the principal would be covered.*

As financial market stability become more apparent, a further refined partial protection system was reinstated with the limit raised to (KRW) 50 million, approximately (U.S.) $43,000 or €29,100 through further amendment of the Enforcement Decree in October 2000.

Consequently, beginning from January 1, 2001, deposits in banks, securities companies, merchant banks and mutual savings banks have been protected up to (KRW) 50 million which includes both principal and designated interest. For insurance companies there are unique and special rules. For example, they are insured at the lesser of either the sum of the paid-in premiums plus designated interest; or, the sum of the cancellation refund received; or, insurance payments on maturity plus other related obligations up to (KRW) 50 million are covered. It is uncertain why insurance companies are given unique protection in Korea (and this is an industry specific protection that is criticized below). Generally, protection is now considered to be lower midrange under the Korean deposit insurance program.

iv. *The Country of India*[20]

Deposit insurance in India was introduced 47 years ago. India was only the second country in the world to introduce such a formal scheme at the time (the first, of course, being the United States with the creation of the FDIC in 1933).

The Indian system evolved from the integration of several prior systems and the various systems are now collectively regulated by a single entity, the Deposit Insurance and Credit Guarantee Corporation, or DICGC.

India's DICGC insures two types of financial institutions[21]: First, it insures commercial banks including branches of foreign banks functioning in India, local area banks and regional rural banks. Second, it insures India's many cooperative banks. All state, central and primary cooperative banks, also called urban cooperative banks, functioning in the Indian states/union territories, are generally covered under the India Deposit Insurance System. At present all co-operative banks other than those from the States of Meghalaya, and the Union Territories of Chandigarh, Lakshadweep and Dadra and Nagar Haveli are covered under the deposit insurance system of DICGC.

In the event of a bank failure, DICGC only protects those bank deposits that are payable in India. The DICGC specifically insures deposits such as savings, fixed, current, recurring, etc. *except* the following types of deposits which are *not* protected at all by deposit insurance:

- Deposits of foreign governments;
- Deposits of central/state governments;
- Inter-bank deposits;
- Deposits of the State Land Development Banks with the State co-operative bank;
- Any amount due on account of any deposit received outside India
- Any amount, which has been specifically exempted by the corporation with the previous approval of Reserve Bank of India.

With regard to maximum levels of protection, each depositor in an Indian bank is insured up to a maximum of (Rupees or Rs.) 1,00000 (One Lakh) (Estimate (U.S.) $2,250 or €1,500) for both principal and interest amount held by him in the same

capacity and in the same right on the date of liquidation/cancellation of bank's license or the date on which the scheme of amalgamation/merger/reconstruction comes into force. This level of protection is considered at the low to very low end range by Western deposit protection criteria and standards.

For clarity sake, then, the DICGC insures principal and interest up to a maximum amount of (Rs.) One Lakh. For example, if an individual had an account with a principal amount of (Rs.) 95,000 plus accrued interest of (Rs.) 4,000, the total amount insured by the DICGC would be (Rs.) 99,000 and all of the account would be fully protected (as it falls below Rs. 1,00000 or One Lakh). If, however, the principal amount in that account was Rs. One Lakh (1,00000) or greater, the accrued interest would not be insured (not because it was designated as interest but because that it was in an amount over the maximum insurance limit)[22].

All funds held in the same type of ownership at the same domestic Indian bank are aggregated (added together) before deposit insurance is determined and then the insurance maximum caps are applied. However, India (as with the United States) recognizes the limited possibility of holding different categories or types of ownership of accounts in the same institution that may be provided with separate insurance protection. If the funds are in different types of account ownership they could realize separate coverage if the account types matched those types recognized by Indian banking regulations.

Deposits held in different capacities (note these sums are in Rupees):

	Savings A/C	Current A/C	FD A/C	Total Deposits	Deposits Insured
Shri S. K. Pandit (Individual)	**17,200**	**22,000**	**80,000**	**1,19,200**	**1,00,000**
Shri S. K. Pandit (Partner of ABC & Co.)		**75,000**	**50,000**	**1,25,000**	**1,00,000**
Shri S. K. Pandit (Guardian for Master Ajit)	**7,800**		**80,000**	**87,800**	**87,800**
Shri S. K. Pandit (Director, J.K. Udyog Ltd.)		**2,30,000**	**45,000**	**2,75,000**	**1,00,000**
Shri S. K. Pandit Jointly with Smt. K. A. Pandit	**7,500**	**1,50,000**	**50,000**	**2,07,500**	**1,00,000**

This is similar to the FDIC 'type of account' differentiation discussed above. Of course, if one has deposits with more than one bank, deposit insurance coverage limit is multiplied and applied separately to the maximum deposits in each bank.

With the financial sector reforms undertaken in the 1990s, credit guarantees have been gradually phased out in India and the focus of the DICGC is now on its core function of bank account deposit insurance with the traditional objective of averting panics, reducing systemic risk, and ensuring financial stability.

v. The Country of Russia (The Russian Federation)[23].

The Russian Federation, which for decades languished under a centrally-planned Soviet-styled banking system which was fully governmentally planned and centrally controlled (and, it is added, was generally not transparent as a banking system), has recently created a Western-styled deposit protection plan for its more liberalized financial industry currently emerging in the country[24]. In many respects, the Russian

system adopts some of the best international practices in the design and implementation of the system and has many of the features of the BCBS-IADI Core Principles. Additional information regarding the Russian system can be found at www.asv.org.ru[25].

The (Russian) Deposit Insurance Agency, or DIA, was established in January 2004 on the basis of the Federal law entitled *"On the Insurance of Household Deposits in Banks of the Russian Federation"* Federal Law No. 177-FZ dated December 12, 2003. Very recently, in October of 2008, the Russian State Duma [(Государственная дума (Gosudarstvennaya Duma)] passed additional legislation in the form of follow-on Federal Law No. 175-FZ[26] to stabilize its banking system and prevent bank-related bankruptcies (and thereby strengthen the fledgling deposit insurance system). The DIA was given considerable oversight and enhanced powers dealing with failing banks in Russia as a result of the expanded 2008 legislation.

The level of protection started out modest at (Rubles or RUB) 100,000 of full coverage and was raised in September 2008 to double that sum or (Rubles/RUB) 200,000, or about (U.S.) $6800 or €4500 (the Ruble is the current Russian currency) reflecting the financial crisis. A maximum of (Ruble/RUB) 700,000 is insured, or about (U.S.) $23,000 and €16,000. This is at the low to very low range of coverage. The scheme covers the net liability of the institution with the depositor (in other words, netting the outstanding loans and other obligations of the depositor against the deposits with the failed bank). Foreign currency deposits are covered in the same amount but are

payable in Russian Rubles and then converted to the foreign currency at the normal state-approved exchange rates.

With regard to funding, and in addition to bank-generated premiums as is traditional in deposit insurance schemes, the Finance Ministry of the Russian Federation is directed to appropriate from the Russian Federations' Federal Budget sufficient funds necessary to ensure deposit insurance system financial stability. Therefore, the scheme is, at its core, governmentally backed. However, the current solvency of the DIA and funding rate methods are unclear.

To ensure proper operation of deposit insurance system, the DIA is directed to pay-out deposit compensation amounts to savers in case of a recognized insurance event; maintain registers of banks-participants in the scheme; monitor the funding of the deposit insurance fund, including insurance premiums of banks; and, of course, manage the resources of the deposit insurance Fund.

Concurrent execution by the Agency of two functions — the maintenance of a deposit insurance system and the liquidation of insolvent banks — is a necessary dual component of the Russian system and is similar to the FDIC. Organizational combination of functions reduces loss to the DIS; quickly and efficiently reimburses savers from the bankrupt bank's estate to the mandatory deposit insurance fund resources and pays out to depositors; and, ensures transparency and completeness of settlements with all creditors. This dual combination of functions helps form a single center of responsibility that increases the confidence in the banking system as the DIA

is part of the 'safety-net' of players on both the bank liquidation side and the deposit insurance side of the equation.

The DIA is a non-commercial organization, which acts in the common form of a Russian State Corporation. The Supreme Body of the Agency is the Board of Directors, which consists of seven representatives of the Government of the Russian Federation, five representatives of the (central bank) Bank of Russia and General Director of the DIA.

The Russian Government originally funded the DIA with (Rubles or RUB) 5.2 billion, or about (U.S.) $175 million. In 2006, it was believed the DIF had grown to (Rubles or RUB) 28 billion, or about (U.S.) $946 million[27].

vi. The Country of Malaysia[28].

PIDM
Perbadanan Insurans Deposit Malaysia
Malaysia Deposit Insurance Corporation

The Country of Malaysia is another relative newcomer to the area of deposit protection and has, as an added issue, the fact that this is a nation with a large Islamic population and it is a country with substantial Islamic banking issues that overlay the usual deposit protection implementation and payment issues. Indonesia, Egypt and even Israel face similar issues with large Islamic populations[29].

The deposit insurance system in Malaysia was launched in September 2005 pursuant to Act 642 which is also known as the Malaysian Deposit Insurance

Corporation Act 2005. The scheme is managed by *Perbadanan Insurans Deposit Malaysia* ("PIDM"). PIDM is a Government agency established under the Akta Perbadanan Insurans Deposit Malaysia 2005 legal acts.

With the implementation for the Government Deposit Guarantee on 16 October 2008, PIDM offers Blanket Coverage and fully protects all ringgit (the official Malaysian currency) and foreign currency deposits with commercial, Islamic and investment banks, international Islamic banks and deposit-taking development financial institutions regulated by Bank Negara Malaysia.

The Government Deposit Guarantee provides for additional depositor protection over and above that provided by PIDM which will remain in place until 31 December 2010. These enhancements insures that all types of depositors – whether owned by businesses or individuals holding conventional or Islamic deposits – are fully protected on their eligible deposits. However, as noted below, there are certain account types that are not covered.

Types of deposits and instruments protected in Malaysia are:

- Fixed deposits, current accounts, saving accounts, joint accounts and trust accounts;
- Islamic banking deposits;
- Principal guaranteed conventional structured deposits;
- Foreign currency deposits; and,
- Negotiable instruments of deposits held by non-banks

Types of deposits and instruments NOT protected in Malaysia are;

- Conventional structured products that are not principal guaranteed;
- Deposits payable outside Malaysia;

• Inter-bank money market placements;
• Negotiable instruments of deposits held by banks; and,
• Repurchase agreements

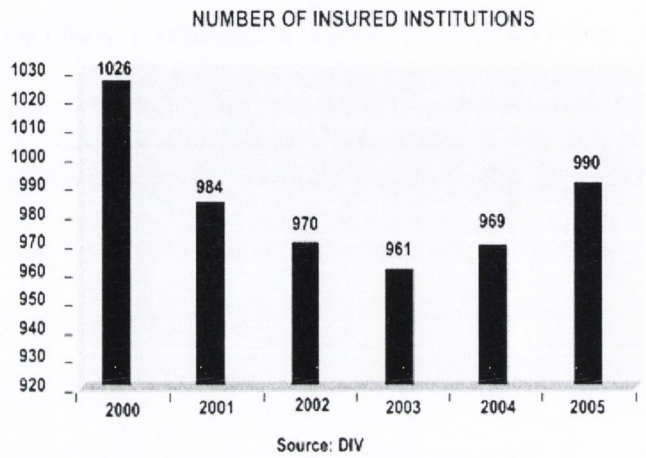
PIDM has a current fund size of about (RM) 280 million, or (U.S.) $82 million which is very modest. In Malaysia, the deposit insurer is a government agency and, like the U.S., also has the authority to borrow from the Government and/or issue debt to maintain fund solvency. PIDM surplus funds may be invested only in Malaysian government securities, based on the objective of capital preservation.

vii. *The Country of Vietnam*[30].

Activities of the deposit insurer, the Deposit Insurance of Vietnam (DIV), are regulated by Vietnamese Decree 109/2005/ND-CP and Decree 89/1999/ND-CP. Insured deposits are accounts owned by individuals, households, cooperatives, private businesses and associates, funds deposited at organizations, all of which participate in DIV. Accounts that are not insured include deposits of shareholders owning over 10.00% of chartered bank capital or 10.00% of the voting-rights stake of DIV participants, deposits of members of managing boards, general directors (directors) of DIV participants and others.

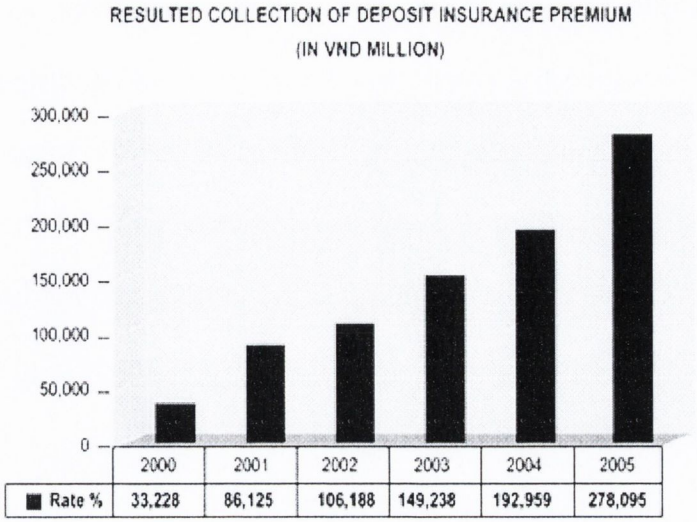
Under current Vietnamese law, the maximum insurance amount paid for all deposits including principal and interest amount of a depositor at a DIV participant is

(dong) 50 million (the dong is the official currency of Vietnam). This is about (U.S.) $2,620 and is at the low or very low end of cover. The deposit insurance premiums, collected from deposit recipients are used to set up a provisioning fund, which pays insurance and supports finance for deposit recipients.



According to DIV, it currently supervises 76 commercial banks, 10 non-banking credit organizations, 992 People's Credit Funds and the Central People's Credit Fund. The DIV engages in a risk-analysis strategy and has put forward timely warnings for DIV participants that report weak activities, increasing non-performing loans, violate safety regulations and so on. The DIV, itself, has been critical of delays in fully implementing deposit insurance in Vietnam although it has made considerable progress in rolling out such a program in a nation with little history of deposit protection and a former centrally planned economy under authoritative regimes.

The following chart demonstrates the progress of Vietnam's deposit insurance premium collection as it approaches (U.S.) $15 million in total worth:



c. *DEPOSIT INSURANCE IN THE PACIFIC REGION*

i. *The Country of Australia*

APRA

Years ago, Australia adopted a single prudential regulator as a result of a Commission's finding that this would, in fact, avoid the need for deposit insurance and the Moral Hazard argument engendered in its adoption. This Commission, called the *Wallis Commission,*[31] felt this single regulatory system would maintain Australian financial stability through strong prudential supervision and avoid the need for the added cost and complexity of deposit insurance and it indeed appeared to have merit for many years as the system functioned without deposit insurance[32]. In 2008-09, however, and with the start of the worldwide financial meltdown, Australia weakened its resolve on this issue[33].

As the worldwide financial crisis deepened in 2008, the Australian government became rapidly concerned that Australian banking would be dragged down along with U.S. and European declining economies[34]. Australia initially braced their local financial economies for the worst and then the worst began to arrive at their shores. Additional bracing of the financial system was implemented and part of this bracing was the active consideration of the implementation of a deposit insurance scheme for Australia to maintain confidence in Australian banks[35].

Despite grave concerns about added cost of deposit insurance to depositors and the ever-present Moral Hazard that banks would go unpunished for bad behavior and the Australian taxpayers would be left with the cost of poor bank decision-making, in 2008 the Country of Australia went, quite literally, from having no deposit protection at all to full Blanket Protection and unlimited deposit coverage. A dramatic shift for any nation; however, a radical shift for Australia who has no experience maintaining a deposit protection scheme. The system is, therefore, new and the solvency of the DIF is still in its infancy period.

The government has stated that this protection may, however, sunset in three years when it is anticipated that the wave of financial trouble has fully passed (assuming no extension of crisis or the deposit protection scheme). It is unclear what will be done with the three-year *ex ante* funded DIF in that case if it remains unused[36]. However, there is belief that deposit insurance has finally arrived in Australia in some permanent form (even if not destined to remain at *high ex ante* Blanket Coverage levels) and it will be harder to end the introduction of DIF than to finally start one.

As mentioned, Australian went far beyond what might have been expected for their initial introduction into deposit protection plans. With its Blanket Coverage, the DIF in Australia insures, unlimitedly, all retail and corporate deposits—as well as wholesale funding. Virtually, Australia has a total Blanket Coverage guarantee at this time. In fact, there is concern that Australia went considerably beyond what was needed with this depth of protection[37]. Such a sweeping, broad and unlimited guarantee could raise questions of Moral Hazard for a country like Australia with little or no experience with deposit guarantees at all[38].

ii. *The Country of New Zealand*[39]

For many years, along with its close economic partner and geographic neighbor Australia, New Zealand was frequently-cited as a leading example of a country that felt it would not benefit from and did *not* need deposit insurance protection and it was far better off without such a system as its banks were seen as solvent and actively managed by experienced and watchful banking regulators[40]. New Zealand was determined to stand clear of deposit insurance for a variety of reasons, including cost, competition and the ever-present Moral Hazard threat[41]. However, as with Australia, that was before the worst financial crisis in 50 years took place and shook the core of all banking throughout the world—impacting New Zealand banking and financial markets, certainly. The fact that Australia had decided to make the leap into deposit insurance greatly influenced and pressured New Zealand to follow as they are tied so closely economically and culturally to their Australian neighbor[42]. This is similar to the pressure placed on Great Britain when the Republic of Ireland elevated their deposit insurance

level to Blanket Coverage in late 2008 because of their close commercial and geographic relationships[43].

After considerable speculation and debate, in 2008 the Treasury of New Zealand ended New Zealand's long-held decision to fully avoid deposit protection and to the great surprise of many announced twin schemes to protect deposits:

- first, a 'retail' deposit guarantee scheme;
- and, a few weeks later a 'wholesale' funding guarantee facility.

The government's Retail Deposit Guarantee Scheme was announced on 12 October 2008 and will run at least until October 2010 as part of interim measures to ensure continuing depositor confidence in New Zealand (given current international financial market turbulence). Unlike Australia, however, the New Zealand scheme is not in the nature of Blanket Coverage and is more limited. The New Zealand Scheme provides 100.0% coverage of eligible deposits *up to (NZ) $1.0 million per depositor* per covered institution. While not a full Blanket Protection plan, this generous allotment equates to approximately (U.S.) $662,000 and €465,000 and places New Zealand at the highest end of deposit insurance protection schemes as far as ceilings and caps.

This means that in the event an eligible deposit taking banking entity is unable to meet claims against it, the NZ DGS will provide its own payout to eligible depositors up to the maximum sums noted above. This scheme does not differentiate between types of accounts (basically it only covers one allotment per bank, however) and therefore is more restrictive than an American plan, for example, in that regard.

Eligible depositors will receive the principal sum deposited, along with interest accruing in accordance with the terms of the deposit (of course, up to NZ $1.0 million per depositor) and per institution inclusive of any interest payable. Anything over this amount will have to be recovered in the liquidation of the entity (which, it is noted, is generally unsuccessful).

The Treasury of New Zealand has committed to pay-out guaranteed deposits as soon as is practicably possible; however, unlike many systems there is no fixed period for repayment this is an uncertain standard and injects uncertainty into the system when compared with the immediate pay-out by the Americans or the similarly prompt three day pay-out period mandated under the EU Directive, as revised in 2009.

There is also some red-tape and bureaucracy in the newly-implemented NZ scheme. Before the government can pay-out under the terms of the guarantee there are a number of threshold requirements the NZ Treasury must attend to. These include: establishing that an event of default has occurred for the purposes of the guarantee; the NZ Treasury must receive a fully completed notice of claim form (in the prescribed form with full supporting information); establish that a depositor is eligible for payout under the terms of the guarantee; and, establish that the amount of the claim is correct. All these added conditions and requirements slow ultimate pay-back to a depositor and could erode confidence in the scheme.

d. *DEPOSIT INSURANCE IN THE AMERICAS (Other Than The United States)*

i. *The Country of Canada*[44]

The Canada Deposit Insurance Corporation ("CDIC") is a Federal Canadian Crown (governmental) Corporation specially created by the Canadian Parliament to insure certain Canadian bank deposits[45].



It is important to note that only members of the CDIC are considered insured banks (and only insured banks can offer CDIC deposit insurance to their customers). CDIC insures eligible deposits at each CDIC member institution up to a maximum of (CAN) $100,000 (principal and interest combined) per depositor (or, in the case of joint deposits, per each set of joint owners), for each of the following:

- savings held in one name,
- savings held in trust for another person,
- savings held in Registered Retirement Savings Plans (RRSPs),
- savings held in Registered Retirement Income Funds (RRIFs),
- savings held for paying realty taxes on mortgaged property, and
- joint deposits (savings held in more than one name).

The (CAN) $100,000 sum equates to approximately (U.S.) $93,000 and €65,000. In this regard, it is similar to the FDIC maximum insured sum that existed before the

2008 increase to $250,000 (and an unlimited sum in certain cases) and which will continue until 2013. It is considered to be at the mid-level of overall deposit protection.

To be eligible for deposit insurance, deposits must be payable in Canada, and in Canadian currency. As a general rule, a deposit is considered to be 'payable in Canada' if it is held at a branch or office of a CDIC member institution in Canada. Eligible deposits include savings accounts, checking accounts, GICs (basically, Canadian forms of certificates of deposits) or other term deposits with an original term to maturity of 5 years or less, money orders, certified checks, and bank drafts issued by CDIC members, and debentures issued by loan companies that are CDIC members.

The following products *are insured* at the above limits by the CDIC:

- savings accounts and checking accounts
- GICs or other term deposits with an original term to maturity of 5 years or less
- money orders, certified checks, travelers' checks and bank drafts issued by CDIC members
- accounts that hold realty taxes on mortgaged properties

Once again, it is important to note that a*ccounts and products above must be held in Canadian dollars at a CDIC member institution.*

The following products *are not insured* by the CDIC at all:

- Mutual funds and stocks
- GICs and other term deposits with a date to maturity of more than 5 years
- Bonds
- Treasury bills
- Any accounts or products in U.S. dollars or other foreign currency.

- Any accounts or products held in banks or other institutions that are NOT CDIC members.
- Credit Unions (they are usually insured at a provincial level).

The Canadian system, therefore, has its complexities that could impact depositor confidence and rapid pay-out.

ii. *The Country of Brazil*[46]

The Fundo Garantidor de Creditos ("FGC") is the Brazilian governmental agency responsible for protecting bank deposits in the Country of Brazil.

As determined by [Brazilian] Resolution 3251, National Monetary Council (CMN) of December 16, 2004, members-institutions of the FGC are multiple banks, commercial banks, investment banks and development banks, the Federal Savings Banks (the Caixa Econômica Federal), credit, financing and investment companies, real estate credit companies and savings and loan associations, operating in the country, that:

- Receive demand deposits, deposits in current accounts for investments, saving accounts deposits and time deposits;
- Accept bills of exchange;
- Raise funds by issuing and placing real estate bills, mortgage bills, and real estate credit bills.

The following credits *are duly covered* by the 'guarantee' granted by the FGC:

- Demand deposits or deposits drawn on prior notice;
- Deposits in current account of deposits for investments;
- Savings account deposits;
- Time deposits, with or without the issuance of certificates;

- Deposits in accounts not draw able by means of checks and which are used for the registration and control of flows of funds for the purpose of paying salaries, wages, retirement payments, pension payments and other similar obligations;
- Bills of exchange;
- Real estate bills;
- Mortgage bills;
- Real Estate Credit bills.

The following category items *are not covered* by the FGC 'guarantee' in Brazil
:

- Deposits, loans or any other resources collected or raised abroad;
- Operations related to programs of government interest instituted by law;
- Judicial deposits;
- Time deposits authorized to compose Level II of the Reference Equity (PR) as set forth under Resolution 2,837, dated May 30, 2001.

Total credit held by each person against one single member-institution or against all member-institutions of the same financial conglomerate (brother-sister banks), will be covered up to (R) 60,000.00 (sixty thousand reais), or about (U.S.) $ 30,000.00 or €24,000.

For the purpose of determining the coverage value of credit for each person, the following criteria is used:

- The credit holder will be the person in whose name the credit is posted with the member-institution or any other person nominated in a security issued or accepted by the member-institution; and,

- Credit amounts of each person identified by his respective Individual Tax Payer Number (CPF)/National Corporation Tax Number (CNPJ) against all member-institutions belonging to the same financial conglomerate should be added up.

- Spouses are considered to be insured *separately* regardless of their legal marital status and the guaranteed value of the credit will be paid out individually. Each spouse will receive up to (R) 60,000.00 (sixty thousand reais), taking into consideration the actual amount of the outstanding balance.

- Credit amounts in the name of dependents of credit holds should be computed separately, only when the dependence relationship can be attested by the submission of a copy of the latest Brazilian income tax return.

- Credit amounts held by associations, condominiums, cooperatives, groups or consortium managers, private supplementary pension entities, insurance companies, capitalization entities, other non-corporate entity or association and similar entities, will be guaranteed up to the maximum value of (R) 60,000.00 (sixty thousand reais) of their total assets against the same member-institution.

- In joint accounts, not held by spouses and dependents, the guaranteed value is limited to (R) 60,000.00 (sixty thousand reais) or to the actual outstanding balance under the account if this is lower than the limit above, divided by the number of holders and credited individually.

The above are potentially complex and detailed requirements that could impact depositor confidence and understanding of the Brazilian scheme. Generally, protection of accounts in the Country of Brazil is considered by Western standards to be at the modest to low levels.

iii. *The Country of Mexico*[47].



The Institute for the Protection of Banking Savings ("IPAB") is the Mexican Agency responsible for protecting bank deposits in the Country of Mexico.

Mexico's Banking Act of 1897 established the legal possibility of the failure of a credit institution and set-up various early mechanisms in the banking law itself to prevent bank failures; however, the Act of 1897 did not itself create a formal deposit insurance scheme and note that this Act was created 36 years before the FDIC mandated the first comprehensive deposit insurance system[48]. In 1981, nearly a century later, the General Law of Credit Institutions and Auxiliary Organizations of Mexico finally provided for the creation of a Mexican deposit insurance fund to protect credit obligations assumed by banks and the IPAB. This makes Mexico a very early adopter of laws to combat bank failure and an equally late adopter of laws creating a deposit insurance system[49].

One of IPAB's primary functions is to protect savers' deposits in full service banks. On January 1, 2005, the permanent coverage regime for up to (UDI) 400,000 per natural or legal person and per bank took effect and is the current limit. A UDI is a conversion mechanism for the peso and stands for *Unidad de Inversion*. (UDI) 400,000 equates to approximately (U.S.) $93,000 and €62,000 in current protection.

When a full service bank enters a state of liquidation or insolvency (bankruptcy), IPAB will proceed to pay the guaranteed obligations assumed by that full service bank, subject to the many detailed limits and conditions established in the Law of Banking Savings Protection (Spanish acronym "LPAB"), except those that have been the object of a transfer of assets and liabilities.

The procedure for payment of guaranteed obligations is not precisely specified and will be published after-the-fact in the Official Gazette of the Federation, in two daily newspapers with nationwide circulation, and using other means of communication that IPAB considers appropriate. IPAB will publish said payment procedure within five business days after assuming the position of liquidator or receiver, as the case may be.

The Mexican system has other difficult and technical aspects associated with an insured claim. For example, only persons that file a payment request, to which they must attach copies of contracts, account statements, or other documents evidencing the guaranteed obligations in the full service bank in the process of dissolution and liquidation, may exercise the right to receive payment for guaranteed obligations.

The request to which the preceding paragraph refers must be filed within the terms, hours, and places mentioned in the procedure for payment of guaranteed obligations published by IPAB as part of its general rules. Persons that have not filed the above request within the aforementioned term will retain all their rights in relation to the full service bank in question, which they may exercise through the appropriate judicial channels or liquidation proceedings. However, resort to the insured fund appears at risk if a saver is not aware of these requirements. No judicial action whatsoever may be exercised against resolutions issued by IPAB regarding payment of guaranteed obligations unless the relevant request has filed within the terms and conditions mentioned above.

From the date of publication of the payment procedure, IPAB then has ninety days to make the corresponding payment of obligations to insured savers. This seems like an inordinately long period for payment of an insured obligation.

As stated above, IPAB will pay the balance of principal and accessories on guaranteed obligations, for up to a maximum of (UDI) 400,000 per natural or legal person. The amount payable is determined in UDIs on the day IPAB publishes the resolution regarding the liquidation of the full service bank, independently of the currency in which the guaranteed obligations are denominated or the interest rates stipulated. Payment of guaranteed obligations is made in Mexican currency, and therefore the amount denominated in UDIs will be converted using the present value of the UDI on the day IPAB makes the payment.

Guaranteed obligations are understood to include the deposits, loans, and credit mentioned in Article 46, Items I and II, of the Law of Credit Institutions. For example:

- Sight deposits, such as checking accounts
- Savings accounts.
- Savings accounts.
- Term deposits or deposits that may be withdrawn on prior notice, such as certificates of deposit.
- Deposits which may be withdrawn on predefined days.
- Current account deposits associated with debit cards.

Under the LPAB, bank obligations payable to the following persons are *excluded* from the Mexican coverage regime:

- Corporations that form part of the same financial group as the bank.
- Financial entities.
- Shareholders, board members, and officers at the two highest levels in the bank's organization and attorneys-in-fact.
- Operations that have not observed the applicable legal, regulatory, and administrative provisions.
- Bank obligations that deviate from sound banking practices and methods.
- Liabilities documented in negotiable instruments, as well as bearer instruments.
- IPAB also does not protect investments in investment firms, insurers, savings funds, savings and loan companies, brokerage firms, or development banks, even if such investments are offered or promoted in bank branch offices.

The Mexican DIS is, therefore, a complex process and replete with conditions. Depositor confidence in such a system could be eroded by the effort, cost, legal challenge and delay caused by such a system. Protection levels are moderate.

iv. The Country of Jamaica.

In the Country of Jamaica, the Jamaica Deposit Insurance Corporation ("JDIC") insures deposits in commercial banks, merchant banks, trust companies and building societies up to (J) $300,000 (U.S.) $3,500 and €2,300). All of these institutions are required to participate in the deposit insurance system. Depositors are directly reimbursed by the JDIC when an insured institution fails. This is considered a very low level of coverage.

v. The Country of Argentina[50].

In the Country of Argentina, the Seguro de Depósitos S.A. ("SEDESA") insures deposits to (Argentine Peso) 30,000 (U.S.) $8,000 and €5,300). The Argentine insurance scheme was established by legislation, but is privately administered by the Argentine Central Bank. Upon a bank's failure, the Argentine Central Bank uses various methods to reimburse depositors, including straight pay-outs or transfer of the deposits to another bank.

vi. *The Country of Peru*.

In the Country of Peru, the Fondo de Seguro de Deposito ("FSD") insures deposits in all financial institutions that accept deposits from the public up to Peruvian (Neuvo Sol) 68,474 (US $24,000 and €16,400). Participation in the insurance scheme is mandatory and coverage limits are adjusted quarterly based on inflation.

vii. *Other Caribbean Countries*.

As of 2008, all countries in South America and the Caribbean maintained explicit deposit insurance programs of various types *except* for the Countries of Belize, Costa Rica, Cuba, Grenada, Guyana, Haiti, Panama, St. Lucia, and Suriname.

e. EUROPE (*Other Than The European Union*)

i. The Country of Iceland[51]

The Country of Iceland is not currently part of the EU, although it is an EEC country. In the summer of 2009, Iceland approved of submission of an EU application for hopeful entry into the European Union as an accession country (although in more recent days public support for admission is turning decidedly cold). This would require adoption of the EU deposit protection scheme already discussed above in Chapter 3.

Times in Iceland should, therefore, be happy and with great anticipation in likely accession to the EU. Unfortunately, this is not the case as Iceland has turned into a severely troubled nation economically. The Icelandic banking system is in one of the worst victims of the recent financial crisis and currently is in utter shambles and has just suffered a near complete collapse in its banking system[52].

The financial crisis has had serious consequences for the Icelandic economy: the national currency has fallen sharply in value, foreign currency transactions were virtually suspended for weeks, and the market capitalization of the Icelandic stock exchange has dropped by more than 90%. As a result of the crisis, Iceland is currently undergoing a severe economic recession; the nation's gross domestic product decreased by 5.5% in real terms in the first six months of 2009. The full cost of the crisis cannot yet be

determined, but already it exceeds 75% of the country's 2007 GDP. Outside of Iceland, more than half a million depositors (far more than the entire population of Iceland) found their bank accounts in Iceland frozen amid a diplomatic argument over deposit insurance.

ii. *The Country of Switzerland*

Switzerland has a privately operated deposit insurance system called the *Deposit Protection of Swiss Banks and Securities Dealers*. Membership in this system is compulsory for all banks and securities dealers who are regulated by the Swiss Financial Market Supervisory Authority.

The current limit of the Swiss deposit scheme is of CHF (Swiss Francs) 100'000 per account holder (equivalent to U.S. $90,000 or EUR 68,000 or £63,000). It also protects non-Swiss residents who have accounts in Switzerland and further covers deposits on foreign currencies, up to the equivalent of the same CHF 100'000.

If a Swiss bank client has several accounts in the same bank, the global limit remains CHF 100'000. If a client has several accounts in different banks, the limit is CHF 100'000 *per* institution or bank.

If a depositor can abide by the strict minimum balance policy of a Swiss cantonal bank account, this account comes with 100% deposit insurance offered by the local cantonal government in Switzerland. It is similar to an Implicit System of DPS.

The Swiss government tripled the limits of deposit insurance to CHF 100'000 in November 2008 from the previous CHF 30'000 francs as part of a package to shore up

the country's crucial financial industry in the face of the global economic crisis. The increase in the Swiss deposit guarantee came after the European Union agreed in October 2008 to raise its minimum guarantee in the EU bloc to 50,000 euro's (U.S. $68,300), with the European Commission proposing a further rise to 100,000 euro's by the end of 2009. The Swiss Government has stated it is raising the total amount it has ready to guarantee to protect investors to CHF 6 billion from the prior CHF 4 billion—a one-third increase. However, based upon the huge deposits held by Swiss institutions pursuant to its well-known bank account secrecy acts, this appears to be a very modest funded DIF. In response, the Swiss government claims that the level of protection for deposits in Switzerland is now substantially higher than the new EU limit and Swiss banks are obliged to keep sufficient assets in the country to cover guaranteed deposits, a demand it said most banks already meet.

f. DEPOSIT INSURANCE ON THE CONTINENT OF AFRICA[53]

i. The Country Of Nigeria[54].

NIGERIA DEPOSIT INSURANCE CORPORATION
Promoting stability and public confidence in insured financial institutions.

Nigeria, a large oil exporter, maintains a deposit insurance law governed by the Nigerian Deposit Insurance Corporation, or the NDIC.

The history of Nigeria Deposit Insurance Corporation (NDIC) has its origin in the report of a Special Committee (the "Committee") set up in 1983 by the Board of Central Bank of Nigeria to examine the operations of the banking system in Nigeria[55]. The Committee in its Report recommended the establishment of a Depositors Protection

Fund. Consequently, the Nigeria Deposit Insurance Corporation was established through the promulgation of Decree No. 22 of June 15, 1988. The Fund is approximately 20 years old. Information on Fund assets is not fully transparent and current information is difficult to obtain.

The practice and implementation of the deposit insurance scheme in Nigeria is claimed to be modeled after the FDIC system in the United States. The NDIC has the usual mandate to insure deposits of all deposit-taking financial institutions in the country. However, as at this time, the NDIC only insures deposits in conventional banks, while steps are being taken to insure deposits of other financial institutions (Community Banks and Mortgage Institutions). Participation in the NDIC by all but the excepted banks is made compulsory for all financial institutions so as to minimize the problem of banking instability associated with spotty voluntary participation.

The rapid increase in the number of Nigerian banks from 40 in 1986 to 120 in 1992 and further growth since has led to increasing and admitted sharp practices to gain a competitive edge as well as troubling integrity issues with bank owners and managers. In terms of the deposit insurance coverage, the insured amount per depositor which was pegged at a shockingly low maximum of (N) 50,000.00 per institution (or approximately (U.S.) $337 and €226) is being reviewed for upward increase as it has remained at that very low level for over 20 years.

However, insurance currently excludes deposits of insiders defined in this case to include staff and directors of the insured institutions and customers who maintain both a deposit and loan account where the deposits serves as collateral for the loan.

Participating banks pay deposit insurance premiums based upon deposits house. Currently, there is a flat rate of 0.9375% or 15/16 of 1% used in the determination of premium payable by each of the insured financial institutions.

Essentially, the Nigeria deposit insurance scheme is designed to act as a traditional safety-net for very modest and smaller depositors who may not be in a privileged position to obtain or interpret technical market information relating to the state of health of a banking institution. This category of depositor is the typical saver in the Nigerian banks.

Currently, banking more generally, and the Nigerian deposit insurance fund more specifically, are each facing many serious challenges. First, the Nigerian banks are in relatively poor condition as mentioned below. Second, the Fund housing the premiums has unknown solvency and appears modestly to seriously underfunded in light of recent bank seizures. Third, capital appears to be unavailable to Nigerian banks at this time even for the healthiest Nigerian banks.

The fast growing banking market in Nigeria, and its volatile oil wealth (which has recently suffered with major declines in oil prices), has come to an abrupt end. In August of 2009, Nigeria faced the imminent collapse of five of its weakest banks due to potential fraud. Exchange trading for these five banks was halted at the time this dissertation was being finalized as the stock of each was in literal freefall. Nigeria has been forced to infuse (N) 420 billion into its banking system (approximately (U.S.) $2.55 Billion) to avoid an entire systemic failure of the Nigerian banking system.

Prudential regulation appears weak in Nigeria but is starting to regain some momentum with international attention being placed on it. The Managing Directors and Executive Directors of each of the five banks, which were collectively about 5.00% of the assets and deposits of Nigerian banking market, were removed from their positions by the Nigerian Central Bank in mid-August, 2009 as this work was ending. The reason for this drastic action was the uncovering of a huge number of undisclosed bad loans, fraudulent borrowing and a near collapse in prudent lending; poor corporate governance; and, claimed reckless behavior. Also, money laundering and obtaining loans under false pretense continue to be major problems for Nigerian banks. It is thought that following exams that other banks could fail.

The Central Bank of Nigeria has tried to instill order by making it clear that those banks and bank managers who do not maintain prudent operations will be closed or removed from their offices. Still, the current economic crisis has returned Nigeria to the dark days of the 1950's and 1990's when confidence in Nigerian banking was low, Nigerian banks were prone to failure and the banks in Nigeria failed and were liquidated far above the norms of worldwide banking. This has direct impacts upon Nigerian deposit insurance and the confidence levels it is designed to instill.

Therefore, the NFIC, despite its good intentions, and modeling on the FDIC, seems wholly ineffective to relieve this troubled African country of its current dysfunctional banking system and continue confidence in Nigerian banking as a deposit insurance system intends. Rather, banking appears to require a complete systemic change in Nigerian to regain saver confidence.

ii. *The Country of South Africa.*

The Country of South Africa currently has no specific deposit insurance plans although a scheme remains under ongoing, serious discussion.

Price Waterhouse, in a 2009 study of this county's banking systems, found that there is increasing support for deposit insurance by existing banks operating in South Africa. There is reason for this support as foreign investment in South Africa continues to weaken and slip and deposit insurance helps to maintain confidence in South Africa institutions. There also remains uncertainty about the readiness and success of the 2010 FIFA World Cup efforts that South Africa has placed so much economic hope.

Fifteen of the banks participating in the Price Waterhouse survey, which asks if deposit insurance was practical for South Africa, found that nearly 70.00% of the current deposit market was favourably inclined towards the adoption of deposit insurance. The survey concluded that now may well be the appropriate time for implementation of deposit insurance in South Africa due to economic forces that are working against the growth of the country. A significant finding in the survey and report relates to the retreat of certain foreign banks from South Africa since the 2008 financial crisis began. This move is the result of the current global financial crisis, which has forced foreign banks to consider the increased volatility of the South African markets closely and reconfigure their future strategy away from the country. Only six of the major foreign banks were judged to have a strong commitment to the South African market at present—a

weakening result. For the first time in 2009, the majority of banks considered it unlikely that there would be further foreign bank investments in South Africa at the present time.

Five banks in the Price Waterhouse survey believe the insurance should be directed at the low end of the market, up to (R) 50,000 of deposits, or (U.S.) $6,800 , €4500 while six banks suggested the insurance should cover deposits at a higher ceiling level from (R) 100,000 to (R) 500,000, or (U.S.) $13,600 to (U.S.) $68,500. However, both of these levels are modest in comparison to Western standards.

iii. *The Country of Zimbabwe*[56]



Zimbabwe maintains a 'deposit board' form of regulation of its deposit scheme. The Deposit Protection Board of Zimbabwe (DPB) is an autonomous statutory body established under the Banking Act Chapter 24:20, to administer the Deposit Protection Fund (the DIF or 'Fund').

The DPB was recently created and commenced operations on July 1 2003, and its primary objective is to provide deposit insurance to depositors in registered deposit-taking institutions including commercial banks, merchant banks, finance houses, discount Houses, and building societies. The creation of the Fund is a Government policy response to a growing need to moderate the growing instability in the Zimbabwe banking sector during banking crises and to protect the public, especially the small depositors in Zimbabwe, against the worst consequences of bank failure.

The Fund offers very modest and limited coverage and guarantees that small depositors will be paid in full up to the insured amount discussed below in the event of bank failure. Currently, the prescribed maximum deposit compensation covers in full 93.00% of all depositors operating accounts in contributory institutions.

The DPB states that it is committed to promoting depositor's confidence in the banking system and to contributing to growth in stability and soundness in the financial sector. The Board works closely with the Bank Supervision Department of the Reserve Bank of Zimbabwe. In this regard, it supports bank exit procedures by giving the DPB early notice of pending bank failures that allow supervisors greater flexibility and freedom to manage the liquidation process for failing banks to minimize loss to the Fund.

Zimbabwe has an inflated currency and has recently passed various actions to eliminate zeros from its currency that masks the terrible inflation in countries with such problems. Therefore, the reader should not be too impressed with the size of the protected sum. Currently, deposits by the same depositor in different institutions are insured separately and therefore enjoy coverage of (Z) $15,000,000.00 or (U.S.) $42,000 per depositor. However, to gain this additional protection, deposits must be held in separate institutions and not different branches of the same institutions.

Joint accounts are insured separately from individual accounts. The maximum coverage for all deposits having the same joint owners at each institution covered by the Scheme is (Z) $15,000,000.00, or (U.S.) $42,000 (collectively, not per individual owner).

Each person's share in a joint account will be considered equal unless stated otherwise on the deposit records.

Funds deposited by a company, partnership or association are also insured up to a maximum of (Z) $15,000,000.00, or (U.S.) $42,000. Business accounts are insured separately from the personal accounts of its shareholders, partners or members. Accounts owned by a business but designated for different purposes are not separately insured. These will be added together and insured up to a maximum of (Z) $15,000,000.00. In the case of a sole proprietorship, the business is individually owned and as such, its account will be treated as an individual one will be added to his business account and insured up to a maximum of (Z) $15,000,000.00.

iv. The Country of Kenya[57]

Twenty years after independence from the UK in 1983, the stage was set for Kenya's first post-independence banking crisis when several indigenous Kenyan banks developed acute liquidity problems. In spite of Kenyan Treasury and Central Bank efforts to bail out the ailing institutions, Kenya's first institution was closed soon thereafter in December 1984. This crisis and failure exposed the inadequacy of the Kenyan financial safety-net and failure resolution mechanisms existing at the time. This event, in effect, precipitated amendments to the [Kenyan] Banking Act in 1985 to expand the safety net and improve the bank failure resolution mechanism, including the adoption of deposit insurance.

The DPFB, or the Fund and Board, was established as a deposit insurance scheme to provide cover for small depositors and act as liquidator to banks which could not be saved from failure by other means. The same amendments gave the Central

Bank of Kenya the responsibility of risk minimization through prudential regulation, supervision and surveillance. The function of curator and revival of ailing institutions was also entrusted to the Central Bank of Kenya.

The early 1990s saw many institutions falling within and under the jurisdiction of the Fund and Board. Since the mid-1990's, the Fund and Board has grown in strength and has dealt with numerous bank failures in a more orderly fashion than in the first decade of Kenyan independence, namely, two bank failures in 1994, three in 1996, one in 1997, five in 1998, one in 1999, one in 2001, two in 2003 and one building society in 2005. In the middle of all these failures, and despite their occurring, the Fund has grown in financial terms and now reports assets in excess of (Kshs.) 13.8 billion (U.S.) $189 Million).

Specifically, the Fund and Board were established under Section 36 of the Banking Act, Chapter 488 of the Laws of Kenya as an autonomous body corporate. The Fund is under the management of a Board of Directors comprising the Governor of the Central Bank of Kenya as Chairman, The Permanent Secretary to the Kenyan Treasury and five other members appointed by the Minister for Finance to represent the interests of contributory institutions. The Board is responsible for policy formulation and direction while day-to-day management is under a CEO nominated by the Central Bank. The Act also obligates the Central Bank to provide all other facilities necessary for the proper and efficient exercise of the Board's functions. The appointment of DPFB as a liquidator by the Central Bank has the same effect as the appointment of a liquidator under the Companies Act and the liquidation is under the supervision of the High Court of Kenya.

Membership is compulsory for all institutions licensed to carry on business as Commercial Banks, Financial Institutions, Mortgage Finance Companies and Building Societies. Currently the fund has 44 members. All members pay flat-rate contributions based on the level of deposits taken by the institution in the previous twelve months (see below for assessments).

The Board and Fund is mandated to collect assessed premiums from all members and invest the funds in Kenyan Government Paper. It is also mandated to receive funds from other sources including grants and borrowings from Central Bank of Kenya. The other mandate of the fund is to liquidate institutions whereby it is appointed as liquidator and apply liquidation proceeds in paying depositors and other creditors.

The Board and Fund is mandated to provide deposit insurance coverage of up to (Kshs.) 100,000/(U.S.) $1,370 to each depositor of an institution licensed to carry on banking or finance business in Kenya. The deposit insurance covers all types of deposit accounts including Current; Savings; Time; Bankers Checks; Money Orders; Drafts etc for which a protected institution is liable. However, payment is restricted to one depositor per institution (in other words all accounts of a depositor with more than one account in an institution are first consolidated before settlement as one claim to the maximum protected limit of Ksh.100,000). This limit was set after analysis of returns submitted by the institutions.

Determination of the size of the Fund, which is premised on the need to sufficiently protect the interests of depositors, is largely guided by information compiled from the mandatory returns member institutions file with both the Board and the Central Bank of Kenya.

At the moment, the Act limits premiums to a maximum of 0.4 per cent of the average of a members total deposit liabilities in a twelve month period prior to assessment. Currently, the annual premium is assessed at 0.15% of the average total deposit liabilities or (Kshs.) 300,000 (U.S.) $4,100 per member, whichever is higher. It is applied uniformly and assessments are carried out in July and premium payments are expected by August of each year.

The Board has announced several key challenges, as follows:

- Insurance coverage is still very low in relation to the total exposure of the Fund. Consequently, there is need to continue building the fund as well as ensuring that the financial system is sound.
- There is urgent need to wind up some institutions under liquidation where all the valuable assets have been realized and continuation of the liquidation is no longer financially sustainable.
- Difficulty in realization of securities held especially family land and properties in rural areas.
- Although the Board endeavors to ensure prompt payment by placing several public advertisements in the print and electronic media, a significant number of depositors fail to lodge claims for protected deposits and declared dividends until they are barred by the statutory notice period.
- There is need for proactive engagement in the resolution of problems affecting weak institutions before they become insolvent and thereby fall into liquidation.

- Loan recovery is hampered by slow and costly court process in which debtors have undue advantage of procedural technicalities to the detriment of creditors and the financial sector.
- Operations of the Fund are governed by different laws: The Central Bank Act; The Banking Act; The Companies Act, etc. and this has presented limitations to its smooth operations and hence the now urgent need to harmonize the relevant sections in a single piece of legislation.

Other problems not mentioned by the Kenyan Government regarding deposit protection include:

- Ongoing concern about corruption in the Country of Kenya;
- Volatility caused by armed conflict in the Country of Kenya.

g. DEPOSIT INSURANCE IN THE MIDDLE EAST/MENA REGION (INCLUDING ISLAMIC BANKING)

i. The Country of Israel.

Israel has no explicit deposit insurance plan and with no current plans for adoption[58]. The Bank of Israel, which is Israel's Central Bank, does have implicit authority, with governmental approval, to retroactively guarantee the deposits of a failed bank and on a few occasions has already done so. However, such a system is *ad hoc* at best and there is no *ex ante* funding for any deposit insurance fund.

Business Data Israel has warned that because Israel is one of the few advanced, Westernized countries lacking any form of deposit insurance, there is significant risk of capital flight to countries that have it. BDI notes that foreign residents

have (U.S.) $23.2 billion in deposits in Israeli banks and those deposits could be considered volatile if deposit protection becomes important to off-shore bank depositors.

ii. The Country of Jordan[59]

The competent authority, the Jordanian Deposit Insurance Corporation ("JODIC") is an independent governmental corporation which was established on September 2000, to reimburse depositors up to (JD) Dinas 10,000, (U.S.) $14,200 and €9,500 per depositor per bank if a bank fails. To be eligible for insurance, deposits must be held in Jordanian Dinars. As an insured depositor, one does not have to apply for deposit insurance, or incur any insurance expenses whatsoever. Being a depositor at a branch of any member bank creates, in essence, automatic coverage.

JODIC is a corporation that enjoys a governmental corporate entity status with a financial and administrative independence. It aims at protecting depositors with banks in order to encourage savings and strengthen confidence in the Jordanian banking system. The Corporation is the sole legal liquidator of any bank whose liquidation has been decided. It does this by reimbursing depositors of any member bank whose liquidation has been decided by the Central Bank of Jordan, with a prompt reimbursement (within one month from submitting the claim) for their deposits in Jordanian Dinars.

The maximum insurance level is Ten Thousand Jordanian Dinars per depositor and per bank. JODIC pays out (JD) 10,000, (U.S.) $14,200 for each depositor within one month of submitting the claim, afterward depositors will be paid back from the proceedings of the bank, under liquidation, according to legal priority of claims and on

pro- rata basis. Except for Interbank, Government deposits, and cash collaterals within the limits of the value of the extended facilities guaranteed by the said collaterals, all customer deposits in Jordanian Dinars are insured, including: Demand & Current accounts, saving accounts, time- deposits, notice deposits and certificates of deposits (CDs). Currently, the JODIC does not insure deposits in foreign currencies, but the current Jordanian law left the door open for insuring deposits in foreign currencies in the future. All Jordanian banks and branches of foreign banks operating in Jordan are insured, *excluding Islamic banks*, where the law makes it optional for them to join the JODIC. The depositor incurs no cost, member banks pay the cost from their operating expenses. The relationship between JODIC and the Central Bank of Jordan, Jordan's Central Bank, is an institutional one that aims at establishing a national safety-net, in which participants coordinate and harmonize their policies and procedures. The relation is based on continuous cooperation and communication to facilitate information and experience sharing.

iii. *The Country of Egypt*[60]

Egypt has no explicit deposit insurance plan. Any plan to guarantee deposits is, at best, informal and implicit; at worst, it is like that of the ad hoc Israeli plan. However, an explicit plan has remained under study for decades and is again being considered seriously.

Following the infamous BCCI bank failure, where a branch of BBCI directly and significantly impacted Egypt and its bank customers, Egypt promised in the early 1990's

to strengthen its central bank oversight as a result and implement a deposit insurance scheme. Those reforms have yet to occur.

iv. *The Country of Bahrain*[61]

The current deposit protection scheme was established in July 1994, following the issuance of Prime Ministerial Resolution No. (3) of 1993. The scheme is administered by a Board, comprising of 10 members, drawn respectively from the Central Bank (2 members, including the Chairman of the Deposit Protection Scheme Board), retail banks (4 members) and Government (4 members).

The scheme applies to all non-banking private sector deposits, denominated in Bahraini Dinars ("BD") and other currencies, held with the Bahrain offices of all retail banks by residents and non-residents. Certain specific exclusions apply, such as deposits held by other retail institutions. Eligible depositors are protected up to an amount which is the smaller of: 75.00% of the combined total of eligible deposits held by a depositor, and (BD) 15,000.

The total amount that the scheme may pay out in any calendar year is limited to (BD) 25 million, together with any unutilized portion of the preceding year's amount and the entitlement of the succeeding year, i.e. limiting the Board's financial resources to an absolute total of (BD) 75.0 million at any one time.

Full details of the scheme are given in Modules CP, of Volumes 1 (conventional banks) and 2 (Islamic banks) of the Central Bank of Bahrain's Rulebook. Following the introduction of the Central Bank of Bahrain and Financial Institutions Law 2006, a new deposit protection scheme is now in the process of being legislated and finalized. The

scheme is intended to be (*ex ante*) pre-funded, in contrast to the current scheme, which is (*ex-post*) funded.

v. *Other Middle East Countries (Mena Region); The Special Case of Islamic Banking and Deposit Insurance*

In the Mena Region, and aside from Jordan and Bahrain, the Countries of Oman, Morocco, Lebanon, Turkey and Sudan have explicit deposit insurance while an explicit plan is pending or under study in Yemen. The phrase 'Mena Region' generally covers an extensive region, extending from Morocco in northwest Africa to Iran in southwest Asia. It generally includes all the Arab Middle East and North Africa countries, as well as Iran and Israel but excludes the Country of Turkey.

There has been generally concern shown regarding the general lack of deposit insurance in the area of Islamic banking as those institutions grow larger and more popular. In some ways, Islamic banks are currently seen as a special case situation and are also generally viewed as less risky than conventional banks.

For example, Islamic banks generally pass through what an IMF Survey has referred to as a 'negative shocks' from the asset side (such as from a worsened economic situation that causes lower cash flow) to the various depositors. This shock-absorbing, risk-sharing arrangement on the deposit side, arguably, provides another layer of protection for Islamic banking in addition to its capital and retained earnings and seems to negate the need for deposit insurance. Also, Islamic banks tend to be more conservative in their operations. This is because investors (depositors) share in the risks of account gains and losses and, as a result, they have more incentive to exercise more oversight over bank management. Islamic banks also assess conservative rates of interest, if interest is assessed beyond nominal rates at all. Finally, Islamic banks

have traditionally held a larger proportion of their assets than commercial banks in conservative reserve-type accounts with central banks or in correspondent accounts with other highly solvent banks.

h. *Summary of Worldwide Systems.*

As can be seen from the many variations and varieties of plans, schemes and other attributes of the above-referenced systems, the challenges of adopting a harmonized system and implementing Core Principles can be seen. However, certain common attributes can be found and they include the following:

- Many worldwide systems attempt to protect smaller depositors.
- Many worldwide systems have ceiling or maximum levels of protection (partial protection). This is, it is assumed, to counter any Moral Hazard issues. However, when crisis swamps systems, they often opt for full protection plans. It seems like full coverage should be offered pre-crisis if that is the normal outcome and trend.
- Core deposit accounts are generally covered; however, there are great variations in which other accounts may or may not be covered between systems in various countries. One cannot assume that their form of account is covered without verifying that fact.
- Some systems liberally define account types; other systems provide a narrow, single allotment per bank and effectively do not recognize account types at all.
- There is a broad range of complexity in the claims process and how quickly claims are paid from easy/quick to almost an ad hoc system.

- Many systems purport to be *ex ante* funded systems but, in reality, are poorly funded and are, in reality, ex post funded by governments in one form or another. Related, several funds have unknown solvency and the fund appears to be partially or wholly unfunded at this time.

CHAPTER 5—ENDNOTES

---

[1] A useful guide for coverage, funding and design issues, as of April, 2008, can be found at the CESifo DICE Report site, http://www.cesifo-group.de/portal/page/portal/ifoHome/b-publ/b2journal/40publdice. Another fairly current survey of worldwide deposit insurance schemes can be found at the IADI website, www.iadi.org and is entitled *Characteristics of Selected Deposit Insurance Systems: IADI Member Profiles* (December 3, 2007); however, this database is now substantially out-of-date as to several members due to the fast-moving changes following the economic crisis that commenced shortly thereafter. For general and additional background information regarding worldwide deposit insurance, see, Kunt, *Deposit Insurance Around The World Dataset* (2005). This is a cross-county database data as of 2003 and is now substantially obsolete as to coverage and plan design issues. Another dated 'quick guide' can be found in web article www.whitecase.com, *Deposit Insurance Systems Around The World* (as of September 2005); another dated guide for explicit and implicit deposit insurance schemes can be found at website www.jdic.org/depositinsuranceschemes.htm and is entitled *Deposit Insurance Schemes-A Comparative Analysis* (see Tables 1 and 2).

[2] Banking systems in other countries can impact financial stability elsewhere. Mishkin, p. 31.

[3] See, Hoelscher, Appendix, p. 28-77.

[4] See, Mas, *Deposit Insurance In Developing Countries* (1990). Although quite dated, the article remains relevant on many key points.

[5] See, also, International Directory of Deposit Insurers (2007) Compiled By The FDIC

[6] See a dated Q&A (2002) from the South African Central Bank regarding *What Deposit Insurance Would Mean For You?* which can be found at www.reservebank.co.za.

[7] For an overview of East Asian deposit insurance after the Financial Crisis of the 1990's, see Campbell, p. 117.

[8] Additional Information on the HK DPS can be found at the HK DPS website at www.dps.org.hk. See, Kunt, p. 335-360, discussing China's current implicit system and the country's efforts to consider moving to an explicit insured system. Although explicit insurance does not yet exist in China, efforts are being taken to improve bank management, reduce nonperforming loans, and improve financial performance. The problem is with China's planned economy and the ever-present hand of the Chinese Government in the affairs of banks. The author believes that there are considerable risks in China considering explicit deposit insurance and the costs could be very high if the gamble of introducing traditional cover is introduced and banks fail.

[9] See online article at www.hktdc.com: *Deposit Protection: What is and what is not-protected?*

[10] There are several excluded forms of accounts.

[11] This forms one of my specific recommendations in Chapter 7, below.

[12] There is no specific notice requirements for deposit insurance in the United States, for example.

[13] Many depositors take the restrictions and exclusions of deposit insurance for granted and might act differently if they understood its parameters.

[14] http://www.pbc.gov.cn/english/showaccdoc.asp?col=6400&id=509.

[15] More information on the Japanese deposit insurance system, implemented by the Deposit Insurance Corporation of Japan, can be found at http://www.dic.go.jp.Japan has a n extensive deposit insurance guide entitled Deposit Insurance Corporation of Japan, A Guide To The Deposit Insurance System: Outline of the System and Q&A (As Of April 2005).

[16] See, Asano Article; Asian Article.

[17] Enoch, p. 191.

[18] See, Yokoi-Arai, *The Relationship Between Single Financial Regulator and the Deposit Insurance System: Analyzing Japan* (2005)

[19] More information on the Korean deposit insurance program can be found at the following website: http://www.kdic.or.kr.

[20] Further information about the Indian deposit insurance fund, the DICGC, can be found at the DICGC website, www.rbi.org. See, web articles, www.rbi.org.in, *Brief History of Deposit Insurance In India; and, A Guide To Deposit Insurance.*

[21] Commercial and Cooperative Banks. The cooperative banks in India started functioning almost 100 years ago. The Cooperative bank is an important constituent of the Indian Financial System, judging by the role and the expectations the cooperative is supposed to fulfill, their number, and the number of offices the cooperative bank operate. Though the cooperative movement originated in the West, but the importance of such banks have assumed in India is rarely paralleled anywhere else in the world. The cooperative banks in India plays an important role even today in rural financing. The businesses of cooperative bank in the urban areas also has increased phenomenally in recent years due to the sharp increase in the number of primary cooperative banks.

[22] This type of scheme looks at maximum principal balances and not at account balances.

[23] See, also, Kunt, p. 315-334 discussing Russia's experience with deposit insurance prior to the current crisis; also, see: web article, in.reuters.com, *Russia Cuts Banks' Deposit Insurance Burden.*

[24] See, IADI, The Effect Of DIS On Banking Sector Development: The Example of Kazakhstan, Russia and Ukraine (Research Paper) (January 2009).

[25] Also see, Camara, Deposit Insurance and Banking Reform In Russia (2006); World Bank: Banking and Deposit Insurance In Russia that may be found at www.worldbank.org.ru/files/rer/RER-9.2-eng.pdf; and, IADI, Member Profile, Deposit Insurance Agency (Russia) that may be found at www.iadi.org.

[26] http://www.asv.org.ru/en/legislation/law_4/

[27] See, Gegenheimer, *Bank Regulatory Reform In Ukraine* (2005) for efforts of a former Soviet Union satellite country's effort to reform their banking system to conform to an EU-type model.

[28] More information regarding the Malaysian deposit protection scheme may be found at the Malaysian Deposit Protection Corporation site, http://www.pidm.gov.my/. See, Kuen, *Malaysia Deposit Insurance Ready For The Worst* (April 6, 2009)

[29] Other Islamic countries have had success with deposit insurance. See, Enoch, p. 335 (Indonesia)

[30] Vietnam implemented a deposit insurance program approximately ten years ago. More information regarding the Vietnamese program can be found at www.div.gov.vn.See, IADI *Member Profile, Deposit Insurance Vietnam* at www.iadi.org. Also, see, web article, www.div.gov.vn, *DIV- 5 Years Of Construction and Growth.*

[31] The Report of the Wallis Commission is summarized here: http://austlii.edu.au/~alan/wallis-report.html.

[32] Australia had a low incidence of bank failures.

[33] The concern was primarily for the failure to lend new capital in Australia.

[34] This actually has not materialized to the extent feared.

[35] Deposit insurance is certainly one of the core confidence-building steps a nation can take.

[36] It is assumed that it will be refunded if the scheme is abolished.

[37] This was surprising to many. Certainly, the Australian bank industry entered the world of deposit insurance with a noticeable appearance.

[38] However, see discussions in Chapters 2 and 4 regarding Moral Hazard and its applicability to such circumstances.

[39] Information on the New Zealand Guarantees can be found at www.treasury.govt.nz/economy/guarantee ; information on the retail scheme at www.treasury.govt.nz/economy/guarantee/retail; information regarding the wholesale funding scheme at www.treasury.govt.nz/economy/guarantee/wholesale .

[40] Mayes, p. 160.

[41] New Zealand has decided on a two year limited deposit guarantee scheme trial and will cap the size of the guarantee to NZ $1 million per depositor and per guaranteed institution. The contingent liability of the scheme is estimated to be a maximum of NZ $450 billion.

[42] The relationship between Australia and New Zealand is exceptionally close on both the national and interpersonal scales. This close relationship goes back to the time of World War I and the ANZAC Spirit forged at Gallipoli. Famously, former New Zealand Prime Minister Mike Moore declared that Australians and New Zealanders have more in common than New Yorkers and Californians. Relations are especially close given the number of tourists that travel between the two countries and the (generally) common economic policies. Immigration, employment, and

residency policies are also very liberal and generous between citizens of either nation, similar to a two-nation model European Union.

[43] This creates a problem as deposits from New Zealand could make their way into Australian banks just as the deposits from the UK began to flow into Ireland after they announced their blanket guarantee.

[44] More information can be found regarding the Canadian DPS at the CDIC's website found at www.cdic.ca.

[45] Campbell, p. 10.

[46] Additional information regarding the FGC may be found at http://www.fgc.org.br.

[47] Further information regarding the IPAB may be found at its website located at www.ipab.org.mx. Kunt, p. 219-251 discusses a Mexico with and without deposit insurance. Mexico experimented with various uninsured models for much of the early 20th Century; then turned to an implicit system for almost 60 years; and then adopted full-blown Blanket Coverage through 1996. Since 1996, the deposit insurance scheme in Mexico has been much more moderate.

[48] See, Haber, *Banking With and Without Deposit Insurance: Mexico's Banking Experiments, 1884-2004* (2005)

[49] Enoch, p. 228.

[50] See, Mishkin, *Can Emerging Market Bank Regulators Establish Credible Discipline? The Case For Argentina, 1992-99,* p. 147-155.

[51] For an excellent timeline on the Icelandic financial crisis, see web article, www.telegraph.co.uk,, *Icelandic Financial Crisis: Timeline* (18 August 2009).

[52] See, Buiter, *The Icelandic Banking Crisis and What To Do About It: The Lender of Last Resort Theory of Optimal Currency Areas*; also, see, web article, www.reuters.com, *Thousands Protest Against Iceland Repayment Bill* (August 13, 2009).

[53] For unique issues dealing with banking in Africa, see Guma, *Banking in Africa and Its Future Outlook* (2008); for unique deposit insurance issues in developing countries, see Talley, *Deposit Insurance In Developing Countries* (1990).

[54] Information regarding the NDIC in Nigeria can be found at http://www.ndic-ng.com.

[55] Campbell, p. 325.

56 The Zimbabwe deposit protection fund can be found at the Deposit Protection Board website, http://www.dpb.co.zw/index.htm.

[57] Additional information regarding the Kenya deposit protection scheme can be found at the Deposit Protection Fund Board of Kenya/Central Bank of Kenya site, http://www.centralbank.go.ke/dpfb/Default.aspx. See, web article, www.allafrica.com, Ringa, *Kenya: Govt To Set Up Deposit Insurance Body, Says Governor* (7 July 2009)

[58] See, Baharv Article.

[59] The Jordanian deposit insurance scheme can be found at http://www.dic.gov.jo.

[60] See web article, www.nytimes.com, Hedges, *Egypt Wants Powerful Central Bank* (09/16/91); also, see: El-Shazly, *Incentive-Based Regulations and Bank Restructuring In Egypt* (Subpart 4).

[61] The Country of Bahrain's deposit insurance scheme can be found at the Deposit Protection Schemes Board/Bahrain Monetary Agency located at the following website: http://www.bma.gov.bh.

CHAPTER SIX

6. OPTIONS, MODELS AND CORE PRINCIPLES NECESSARY FOR EFFECTIVE DEPOSIT INSURANCE SYSTEM OPERATION: AN ANALYSIS OF THE FDIC, EU, IADI AND BASEL COMMITTEE'S BEST PRACTICES' PROPOSALS[1]

In Chapter Five, it was demonstrated that deposit insurance systems or schemes differ widely around the world. Some schemes are formal; some remain implicit or *ad hoc*; and, certain countries have yet to adopt any system of deposit insurance at all. In this Chapter 6, we will complete the general case for an elimination of widely disparate approaches and turn away from an *ad hoc* adoption of deposit insurance around the world and offer a more common approach and as near to a single universal deposit protection set of best practices[2] as is possible in the design of laws, rules and regulations in this area[3].

In the final Chapter 7, I will update the best practices discussed in this Chapter 6 and offer my own supplemental suggestions and recommendations for improving the design and implementation of universal deposit insurance in light of the current financial crisis of 2008 and 2009 and that may be utilized as a guide for a harmonized worldwide legal standard.

In this Chapter 6, we will first examine the FDIC 'Options' and 'Keeping The Promise' Papers that predated the current financial crisis but lend considerable depth to our discussion; next, we will review the European Union's recent analysis of various models to fund deposit insurance; and, finally, we will review the BCBS-IADI's 'Core Principles' released in the Summer of 2009 that sets forth a series of recommended

best practices and principles for the drafting of effective and cogent deposit insurance laws, rules and regulations.

I appreciate that there are many approaches to best practices in this area. Some approach the issue from a fair pricing issue; some from a solvency of the DIF point; others approach the issue from the free market/private insurance perspective; and, many choose to emphasize discipline by banks, depositors or even by the securities markets that seem to push banks to become more profitable—and thereby undertake unacceptable risk[4]. I have tried to fairly present all these positions in this Chapter.

a. *FDIC's August 2000 'Options' and FDIC's April 2001 'Keeping The Promise' Papers.*

As we shall see later in this Chapter 6, periods of relative calm are a good time to study, refine and fine tune deposit insurance. In August 2000, at about the mid-point of the last period of bank calm and prosperity and well before our current severe financial crisis, the FDIC presented a lengthy paper entitled "Options Paper" which examined many of the issues we have already highlighted, such as the need to reform the deposit insurance system; pricing issues; funding issues; coverage issues; and, quite literally, the 'next steps'. Within a few months thereafter, the then Chairman of the FDIC offered his thoughts on the effectiveness of deposit insurance in economic cycles. We will review each to see if they remain relevant to our current financial crisis and known outcomes from it.

i. *FDIC's 2000 Options Paper.*

The Options Paper[5], which is a form of consultation similar to that found in the EU, was presented in the aftermath of the *S&L Crisis* and just a few years after the

FDICIA legislation mentioned in Chapter 4 was passed. Approximately five years after the conclusion of the *S&L Crisis*, the FDIC recognized in this paper that although the crisis cost more than (U.S.) $130 billion to clean up the failures of hundreds of poorly conceived, managed and regulated S&L institutions, bank profitability inevitably returns in time (and had returned in earnest by the date this Options Paper was crafted in 2000) and deposit insurance is able to recharge its reserves in time (and had recharged the DIF to (U.S.) $42.0 billion as of a date just a few years before this work with the help of recapitalization and bank profitability). However, the FDIC had just come through a harrowing ten year period of serial failure when the Options Paper was written and obviously is trying to avoid a repeat of the *S&L Crisis* and is suggesting that reforms be considered to avoid just that event.

- *The Pricing of Bank and Deposit Loss Risk*[6].

The FDIC's first concern in this paper is as to the fair and equitable *pricing of risk*[7]. The FDIC acknowledges that the version of deposit insurance that existed at that time in 2000 had devolved into a form of "*penalty system for the few, rather than a [fairly] priced service for all.*" It is not fair that the same rate of deposit premiums is paid by vastly disparate banks even if the DIF is on course to reach its target levels of funding. In fact, states the FDIC, Moral Hazard, can be exacerbated when two banks with grossly different risk profiles pay the same rate of deposit premium.

The FDIC is also concerned about the huge wave of deposits that would likely come flooding into banks if the securities markets turned volatile. This is called disintermediation. At the time of the Options Paper, the FDIC believed that this sum

may be in the range of (U.S.) $11.0 trillion. In the current economic crisis, after losses that cut down non-bank investments by up to half, much of the equity capital indeed was disintermediated and came flooding into the banks for safe haven status just as the FDIC predicted. There are few banks in America who currently and urgently need deposits for this reason and this partly explains the very low deposit rates on interest-bearing and term products. This has increased deposits; insurance premium paid; but has also increased risk should the market for banking again decline (and we know that within 8 years of the Options Paper it did just that).

The FDIC reaffirms in the Options Paper the need to fund reserves into the DIF during good times on a high *ex ante* basis. To lighten up on funding during the good times is to deny that banking is cyclical and that the *Boom to Bust Bank Cycle* does not exist. There can be no long term 'loss-pricing' formula for deposit insurance. Also, there can be no pass given to institutions in paying for outflow periods during the happier inflow periods by funding significant deposit insurance premiums. It is not appropriate for banks to pay higher premiums only during stress periods. However, the reality is that is precisely what the FDIC had been.

The FDIC proposes that risk be assigned to an institution based upon the probability of a default by that bank; the bank's exposure; and the severity of loss that would occur if the bank did default. In essence, states the FDIC, each bank should be assigned a credit rating just as we each receive such a rating. We have some to know this rating as a form of stress testing. This could be accomplished by leveraging market information, utilizing existing CAMELS ratings, and selecting other 'barometers of credit

risk'. Whether risk is analyzed from the top down or from the bottom up is also a consideration.

- *The Setting of Revised Coverage Limits.*

Next, in the Options Paper the FDIC examined coverage levels and whether laws should be redesigned on the coverage issue. While deposit insurance was established to protect small savers, the FDIC reminds us that "*Deposit insurance has a simple, but important purpose: to provide a safe place for depositors to keep their money, as a way to prevent bank runs and maintain the stability of the banking and financial system.*"[8] Yet, the FDIC pointed out that the then coverage limit of (U.S.) $100,000 per insured account had lost about half its value based upon the Consumer Price Index; adding to levels of deposit insurance in the United States is the fact that ownership types or account types can create multiple levels of coverage in these separate rights and capacities. The FDIC, itself, cites to the fact that a family of four (at the then-existing $100,000 coverage level) can insure deposits of at least (U.S.) $2.0 million in various account types at a single institution. While coverage limits should likely be raised because of the aging of America, our old friend, Moral Hazard, is still seen as a concern. Empirically, the FDIC states that the 1980 increase (that more than doubled the prior coverage level in America) certainly contributed to an increased cost associated with savings and may have contributed to the late 1980's S&L Crisis as a result. However, this correlation is far from being clear or proven.

The FDIC cited to the fact that as the coverage level is raised, more deposits come into the banking system—and this effectively raises more deposit premiums. In

this Options Paper, the estimate of the American Bankers Association was that if the coverage level was again doubled to $200,000, that $230 billion more in deposits would come into the banking system; and while that would provide additional insured deposits it would also reduce the coverage reserve ratio and potentially require an increase in deposit premiums. Of course, the level was raised even higher than the American Banker's number to $250,000, and in some cases to unlimited coverage for a temporary period. However, because financial crisis intervened, we still cannot be sure what the effect of such a dramatic increase of deposit insurance coverage would have been in a non-crisis highly competitive atmosphere.

The FDIC also questioned whether increased cover well above $100,000 would really alter behavior as bank customers already realized near complete guarantee of deposits simply by splitting deposits or utilizing various account types and in that regard remain fully insured. The FDIC then proposed maintaining the status quo; possibly, indexing coverage; or allowing excess coverage to be purchased or offered at the expense of a third party. Obviously, the status quo remained as to coverage for another 8 years until 2008.

Of interest is that the IADI, the umbrella group for deposit insurers, has stated the assumption that many deposit insurance programs start with high coverage and gradually lower coverage levels to address Moral Hazard issues. The IADI has, therefore, approached this issue from the opposite approach. They have a Research Paper assisting its members in transitioning from a Blanket Guarantee to a Limited Coverage System.[9]

- *The Proper Funding Of Deposit Losses*[10].

The FDIC also examined different approaches to funding premiums based on coverage assumptions. Since 1991, FDICIA had given broad discretion to the FDIC to implement a risk-based premium system[11]. The FDIC considered two options: a user fee model; or, a mutual model. A user fee model for risk-rated deposit premiums views the government as the provider of deposit insurance—not the banking industry. The government is responsible for determining the risk of guaranteeing bank deposits. The banking industry, in essence, pays an access fee to utilize this governmental system. Various approaches can be found to determine the correct 'hard target' fee, but this would be a governmental system in the end.

The mutual model introduces more private sector features into the deposit insurance system. It is viewed more like private sector insurance underwriting than a governmentally provided premium for coverage scenario.

Finally, in an ominous foreshadowing of the events that would occur less than 8 years later, the FDIC included the following section in the Options Paper at Page 30:

> *Funding Systemic Risk*[12]
>
> *Congress has created a new and separate assessment system for recouping the costs of assisting or resolving very large institutions whose failure poses a systemic risk to the nation's financial system; this system has not yet been put into action. During the banking crisis of the 1980s and early 1990s, the FDIC sometimes granted assistance to open banks and often resolved large failing institutions in such a way that uninsured depositors and even all creditors were paid in full, a practice often referred to as "too big to fail", The FDIC recouped the resulting costs through regular insurance assessments. (emphasis added)*

Of course, we have found that in the current crisis there was no way for the FDIC to absorb the losses of potentially dozens of large mega-banks failing at one time. Systemic risk and institutions too big to fail had become a hard reality by the financial crisis of 2008 and 2009. Recouping costs were of far less of a concern as to such systemically important institutions; rather, their bringing down the entire financial system was the growing and immediate concern.

ii. *The FDIC's 2001 Keeping The Promise Paper*[13]

This document, with a cover letter from the former FDIC Chairman, seeks to illuminate that the current system distorts economic incentives for insured institutions, forces them to pay the highest premiums during the worst economic times, and fails to maintain the value of insurance coverage for depositors with smooth and predictable adjustments for inflation.

The FDIC made the following 'core' recommendations:

- Merge the Bank Insurance Fund and the Savings Association Insurance Fund (and this has been done as noted in our earlier chapters of this work);
- Charge risk-based premiums to all institutions, regardless of the fund's size (and this has been generally done in more developed nations of the world);
- Allow the insurance fund to build or shrink gradually around a target or range (this remains to be accomplished);
- Establish rebates that are based on past contributions to the fund ; and,

- Index insurance coverage to the Consumer Price Index to maintain its real value (this was not done; instead, temporary increases were implemented).

The FDIC recommendations were not intended to significantly alter costs for insured institutions; instead, they were designed to spread out the costs more evenly over time and more fairly across all banks. The report emphasizes that the recommendations are interrelated and should be implemented as a package, because piecemeal implementation could introduce new distortions and aggravate the problems the recommendations are designed to address.

b. *The EU's Latest "Models" For Funding Deposit Insurance*[14].

The European Union, in addition to the consultation to revamp the current Directive on deposit insurance in the EU as mentioned above in Chapter 3, has further proposed in June 2009 suggestions regarding converting flat rate deposit insurance premium schemes now existing in some of the Member States and candidate countries to differential or risk-based schemes. It is the intention of the EU that any revisions made to the Directive include a risk-rated premium provision. The challenge is how will the transition occur and how will the risk be assigned to render the system fair?

The investigation of risk-based models for computing contributions of Deposit Guarantee Scheme (DGS) members has become a crucial goal for the European Commission (EC) as the global crisis hits the banking sector all over the world. Article 12 of Directive 94/19/EC explicitly calls for the exploration of possible models for introducing risk-based contributions and requires the Commission to submit to the European Parliament and to the Council a report on the topic by the end of 2009.

Basically, there are three models to assess premiums based upon a risk-based model. They are: (i) a single indicator model; (ii) a multiple indicator model; and, (iii) a default risk model. These models differ based upon the factors they focus on and whether they are lagging or forward indicators.

Four key areas are normally assessed in the first two 'lagging' models and should be familiar and logical at this point in my discussion: capital adequacy, asset quality, profitability and liquidity. These are the common 'indicators' of the financial health (or lack thereof) of banks and banking in most countries. It is recognized that these models utilize a backward-looking set of criteria and are not forward-looking at all—as such they provide lagging indicators. The data, whether helpful to the bank or not, is usually several months to up to one year old. This would tend to assess against a bank premiums based upon risks demonstrated in the past and would be a lagging indicator of risk. The third model, the default risk model, is more forward looking based upon predictive data and would avoid some of the lagging characteristics of the other two models. However, the predictions, being fallible, could turn out to be incorrect.

The criteria for selection of funding models, especially for funding at a risk-rated or differential premium rate, is in accord with 7 important criteria, which are:

- Simplicity and understandability;
- Accuracy in describing relative risk;
- Avoiding the gathering of unnecessary or burdensome information;
- The method should not cause insolvency in premium payment structures and should be 'bearable' (possibly requiring a maximum cap);
- Adjustable possibly based upon the country of origin for the plan;

- Open and transparent so its legitimacy can be verified; and,
- The funding method must be equitable, impartial and fair.

c. *IADI and Joint IADI-BCBS Suggested 2008 "Core Principles" For Deposit Insurance Systems.*

In February 2008, before the severe downturn in the economy had fully taken hold, the IADI, or International Association of Deposit Insurers, produced a draft 'Core Principles' guideline to assist deposit insurers in creating effective deposit insurance programs and to standardize, to the greatest extent possible, deposit insurance and the introduction of it across the globe. Use of these Core Principles had been used in the area of banking supervision before[15]. This IADI draft document led to the Basel Committee-IADI Core Principles For Effective Deposit Insurance Systems we will see and review below.

The Forward to this IADI Draft is particularly meaningful and is paraphrased here. It is made clear that policymakers have choices regarding how they can protect depositors and contribute to financial system stability. Explicit, limited-coverage deposit insurance has become the preferred choice compared to other alternatives such as reliance on implicit protection (such as that found in Egypt or certain areas of China) and, of course, no deposit protection at all.

The IADI believes that the introduction or the reform of a deposit insurance systems can be made more successful when a country's banking system is currently healthy and its institutional environment is already operating in a sound manner. That would appear to advocate against radical change at this time despite need. To be credible, a deposit insurance system needs to be part of a well-constructed financial

system and a broader safety-net, properly designed and with proper implementation. It needs to be supported by strong prudential regulation and supervision, sound accounting and disclosure regimes, and a credible enforcement mechanism with effective laws. An effective deposit insurance system should also be fully transparent and supported by a high level of public awareness about its existence, its benefits and its limitations. A deposit insurance system should be able to deal with a limited number of simultaneous bank failures, but the resolution of a systemic banking crisis requires that all financial system safety-net participants work together effectively to counter the larger threat as early as possible.

In essence, the IADI acknowledges that systemic threats often swamp a deposit fund if the deposit fund is the only real line of defense to multiple or large bank failures.

In developing its twenty-one 'Core Principles', IADI drew heavily on the practical experience of its existing insurer-members. Thus, the Core Principles are reflective of, and designed to be adaptable to, a broad range of country circumstances, settings and structures. The Core Principles need to be elastic and change with future circumstances.

The Core Principles are broadly categorized into eleven groupings referenced below: Setting objectives and the external environment (IADI Core Principles 1 to 2); Mandates and powers (IADI Core Principles 3 to 4); Governance (IADI Core Principle 5); Relationships with other safety-net participants and cross-border issues (IADI Core Principles 6 to 7); Membership and coverage (IADI Core Principles 8 to 10); Funding (IADI Core Principles 11 to 12); Public awareness (IADI Core Principle 13); Selected

legal issues (IADI Core Principles 14 to 15); Failure resolution (IADI Core Principles 16 to 18); Reimbursing depositors; claims and recoveries (IADI Core Principles 19 to 20); and, Moral Hazard (IADI Core Principle 21). It will be helpful to examine and summarize all of the twenty-one of the IADI Core Principles by grouping and summary.

IADI Grouping 1: *Setting Objectives and the External Environment.*

- IADI Core Principle 1: *Public-policy objectives.*

Public policy objectives of a deposit insurance system must be clear and should be continuously reviewed and improved to match the goal of stabilizing the financial system and protection of unsophisticated depositors.

- IADI Core Principle 2: *Situational Analysis.*

Deposit protection plans must be realistic and recognize actual situations occurring within the financial system of the country. A 'situational analysis' should review conditions and factors that must be realistically addressed and where those conditions, factors or situations are not ideal it should be candidly noted so defenses can be mounted to difficult challenges.

IADI Grouping 2: *Mandates and Powers.*

- IADI Core Principle 3: *Mandates.*

The deposit insurance program can be broad or narrow but should match the stated objectives. There should be a formal mandate that clarifies the role of the deposit insurance within the broader safety-net of the country.

- IADI Core Principle 4: *Powers.*

A deposit insurer should have all powers, including contractual, necessary to fulfill its mandate and obtain sufficient information to insure it is meeting its obligations to depositors promptly.

IADI Grouping 3: *Governance.*

- IADI Core Principle 5: *Governance.*

Agencies that address safety-net issues (such as deposit insurance) must be sound, independent, and accountable. The competent authority must be insulated from

undue political pressures as well as industry influence, such as banking lobby activity. The agencies must have legitimacy and credibility. The deposit insurance system should be structured such that the potential for undue political and industry influence and conflicts of interest respecting members of the governing body and management is minimized.

IADI Grouping 4: *Relationships with other safety-net participants and cross- border issues.*

- IADI Core Principle 6: *Relationships with other safety-net participants.*

The need for close coordination and timely, accurate, and relevant information sharing among financial system safety-net participants is essential in all cases. Activities between the various safety-net providers should be coordinated.

- IADI Core Principle 7: *Cross-border issues.*

Provided confidentiality is ensured, all relevant information should be exchanged between deposit insurers in different jurisdictions and possibly between deposit insurers and other foreign safety-net participants when appropriate. Duplicative coverage should be avoided and deposit insurance already provided by the home country system should be recognized in the determination of levies and premiums.

IADI Grouping 5: *Membership and Coverage.*

- IADI Core Principle 8: *Compulsory membership.*

Membership should be compulsory for banks meeting membership criteria to avoid adverse selection.

- IADI Core Principle 9: *Coverage.*

Definition of what is an insurable deposit should be clear and credible. Periodic adjustments are necessary due to inflation and other factors.

- IADI Core Principle 10: *Transitioning from a blanket guarantee to a deposit insurance system.*

If a country decides to transition from a blanket guarantee to a partial deposit insurance system, the transition should be as rapid as a country's circumstances permit. The change should be carefully planned and public attitudes must be considered.

IADI Grouping 6: *Funding*

- IADI Core Principle 11: *Funding.*

Ex ante funding is more advantageous as to prompt reimbursement and maintaining confidence. However, in any system, sound funding arrangements are critical to the effectiveness of a deposit insurance system.

- IADI Core Principle 12: *Differential Premiums.*

In line with the EU's Models discussed, above, if a differential premium system is utilized the bases and criteria used in a risk-adjusted differential premium system should be transparent to all participants and that the system is administered fairly and appropriately.

IADI Grouping 7: *Public awareness*

- IADI Core Principle 13: *Public awareness.*

Depositors must be informed about the benefits and limitations of the deposit insurance system. The characteristics of a deposit insurance system should be publicized regularly to maintain and strengthen public confidence. The objectives of the public awareness program should be clearly set out and consistent with the public policy objectives and mandate of a deposit insurer.

IADI Grouping 8: *Selected legal issues*

- IADI Core Principle 14: *Legal protection.*

Legal protection for good faith decisions as part of deposit insurance must coexist in an environment where there is clear accountability. This means that while individuals should be legally protected, they must be required to follow appropriate oaths of office, conflict-of-interest rules and codes of conduct to ensure they remain accountable. Legal protection should be codified in legislation and administrative procedures, and under appropriate circumstances, cover legal costs for those indemnified.

- IADI Core Principle 15: *Dealing with parties at fault in a bank failure.*

A deposit insurer, or other relevant safety-net participant, should be provided with the power to investigate and if necessary litigate against those parties at fault in a bank failure. The power of investigation into officers, directors, managers, auditors and related parties of the failing/ failed bank can help improve recoveries for an insurer.

IADI Grouping 9: *Failure resolution*

- IADI Core Principle 16: Trigger mechanisms for prompt corrective action.

The determination and recognition of when a bank is or is expected to be in serious financial difficulty should be made early and on the basis of well defined and transparent trigger mechanisms by safety net participants with the operational independence and legal authority to act.

IADI Core Principle 17: Effective failure resolution processes.

Three basic resolution options exist: liquidation and reimbursement of depositor's claims, purchase and assumption transactions (sales) and open-bank financial assistance. Establishing a special resolution regime for banks should be considered. Effective failure-resolution processes should: meet the deposit insurer's obligations, ensure that depositors are reimbursed promptly and accurately, minimize resolution costs and disruption of markets, maximize recoveries on assets, settle bona-fide claims on a timely and equitable basis, and reinforce discipline through legal actions in cases of negligence or other wrongdoings.

- IADI Core Principle 18: *Bridge-Bank Authority.*

The deposit insurer or other relevant safety-net participant should have the authority to establish a bridge-bank (or related resolution mechanism) to help preserve critical banking functions by acquiring the assets and assuming the liabilities of a failed bank until a final resolution can be accomplished.

IADI Grouping 9: *Reimbursing depositors; claims and recoveries*

- IADI Core Principle 19: *Reimbursing depositors.*

Early notice to the deposit insurer of a bank closure is important. Depositors should be told the time frame over which reimbursement will take place and whether any advance or interim payments will be made.

- IADI Core Principle 20: *Claims and recoveries.*

Asset-management, claims and disposition strategies should be guided by commercial considerations and their economic merits, the quality of the assets, the depth and condition of markets, the availability of expertise in asset management and disposition, legal requirements relating to the disposition of assets, and public-policy objectives.

IADI Grouping 10: *Moral Hazard*

- IADI Core Principle 21: *Mitigating moral hazard.*

Ensuring that a deposit insurance system contains certain design features can also mitigate moral hazard. These features may include: placing limits on the amounts insured; excluding certain categories of depositors from coverage; implementing differential or risk-adjusted premium systems; minimizing the risk of loss through early closure of troubled banks; and demonstrating a willingness to take legal action, where warranted, against directors and others for improper acts.

d. *Basel Committee on Banking Supervision/IADI Joint Core Principles For Effective Deposit Insurance Systems (June, 2009).*

In June of 2009, the Basel Committee on Banking Supervision (the "Basel Committee") and the International Association of Deposit Insurers ("IADI") together offered its collective Core Principles For Effective Deposit Insurance Systems ("Core Principles")[16]. This effort would not be complete without a discussion of these Core Principles despite the fact that they were introduced only in the last few months of this work.

In July of 2008, soon after the IADI draft Core Principles had been presented, the Basel Committee on Banking Supervision (BCBS) and the IADI decided to collaborate to further improve the twenty-one point Core Principles in the IADI Draft.

Consultations started in the spring of 2009 to address a wide range of issues involving deposit insurance coverage issues, funding issues and the need for prompt reimbursement. The Basel Committee also discuss in the Core Principles issues related to the public's awareness of deposit insurance, the resolution of failed institutions and cooperation amongst the other safety-net participants (mainly prudential regulators and the central banks that often are the parent or umbrella organizations for deposit insurance schemes in many countries as we have seen in Chapter 4, above). Out of those consultations, an eighteen point set of Core Principles were agreed to.

The BCBS-IADI Core Principles recognize that the recent financial crisis has increased the urgency for cooperation and to have authorities from the various nations agree upon an international set of principles for the effective design, implementation and use of deposit insurance. While not binding, these Core Principles already have had an impact and many countries, such as our prior discussion of China mentioned in Chapter 4. I trust we will be hearing as much about the Core Principles dealing with deposit insurance and in a similar way as the Basel Committee influenced capital requirements and adequacy with their Basel I and II Accords pronouncements last decade and their subsequent worldwide impact.

The crux of the BCBS-IADI Core Principles is eighteen principles denoted as Principles 1 through 18 and categorized into ten groupings. Each grouping addresses a particular aspect of deposit insurance that we have already seen or previewed above and, in many ways, reach a similar outcome with refinements. In essence, the eighteen Core Principles are attempting to obtain agreement and consensus between the world's financial systems as to what deposit insurance should include and address in every country.

As with the draft IADI Principles, the combined Basel-IADI Core Principles recognize that policymakers have choices regarding how they can protect depositors. An explicit deposit insurance system or scheme is preferable[17] to implicit systems as it clarifies and defines the system; promotes confidence; and the financial safety net in every country must include the additional participants of prudential supervision, a lender of last resort as well as a sound deposit insurance system.

Additionally, the Core Principles state in their introductory provisions that a DPS is not intended to fend off systemic risk or systemic failure of the banking system, such as appeared to be occurring in the American and certain EU system late in 2008 and 2009. The DPS is not designed to and cannot support the huge costs of systemic failure. Deposit premium funding that anticipates a widespread collapse of a number of larger banks at a single time and within one country would create costs that most banks and any deposit insurance system funded by them could not bear alone. Rather, the Core Principles recognize that governments and central banks working together must be called upon to counter systemic collapses in banking.

A well-designed DPS is designed to isolate single banks and counter the lack of confidence their closure would cause by insuring deposits. This is best demonstrated by the approximate one trillion dollars the U.S. Government had to inject into the American system through various bailouts and reliefs in the American systemic failure of several banks such as Bank of America, Citibank, Wells Fargo and others all at one time and a sum likely not realistic to be held in reserve by a DIS.

The Core Principles also recognize that a well-developed legal framework is a precondition to an effective DIS. We shall now visit each grouping and determine how that grouping impacts best practices in any system or scheme:

- *Setting DIS Policies and Policy Objectives: BCBS-IADI Principles 1 and 2.*

Principles 1 and 2 are the two classic decision points for a deposit insurance debate in any country. Principle 1 of the Core Principles states that the very first decision to be made by any nation as to deposit insurance is to clearly define the public

policy objectives the system seeks to achieve. The system is to be tailored to these objectives carefully and they must be obvious. They should be formally specified and be clearly integrated into the laws, statutes, ordinances and interpretations governing the DIS in any county.

Suggested policies and objectives are to contribute to the stability of the financial system and to protect depositors; however, other objectives are certainly possible. For example, objectives as to funding or to policies designed to eliminate competitive distortion. These objectives should be framed at the start of the legislation. For example, in a preamble to the legislation as is common in European directives.

Principle 1 goes further to recognize a paradox that one of the key constituents of deposit insurance are those depositors least likely to actually understand deposit insurance. A key policy and objective should be, therefore, the protection of the depositors who can least afford to lose their deposits but may also be the least informed as to how to protect those deposits. The deposit insurance laws, regulations and rules must act to protect just sort of a saver.

Principle 2 addresses our old friend, *Moral Hazard*. It does this by accentuating the fact that a well-designed DIS should include appropriate design features to avoid reckless conduct by banks or unnecessary risk to be imposed on any country's financial safety net. Of course, this is more difficult than it might first appear as there is always effort to increase deposit insurance and protect more and more of average deposit bases.

By insuring that a DIS contains appropriate design features such as carefully determining ceilings of coverage and placing limits on the amount insured; excluding certain categories of depositors otherwise able to protect themselves from coverage or who might unfairly profit; and, implementing a differential or risk-adjusted premium system a country can control or mitigate Moral Hazard. Some of these concepts are not universally accepted, however. As we shall see in Chapter Seven, it is not clear that the broad inclusion of depositors in a DIS or blanket protection necessarily heightens moral hazard and as to Principle 2, your author is not in total agreement. The Core Principles also suggest the control of Moral Hazard by concepts of good corporate (bank) governance, creating incentives for good risk management and good frameworks for sound prudential regulation. As to these points, there is little disagreement.

- *DIS Mandates and Powers: BCBS-IADI Principles 3 and 4.*

As with the IADI Core Principles, the Basel Core Principles call for all deposit insurance programs to have a clear public policy objective and there be consistent application of powers to those public policy mandates. The powers should include all those necessary to contract, budget and meet the required obligations promptly.

- *Governance: BCBS-IADI Principal 5.*

Deposit insurance programs must have independence, transparency, accountability and the avoidance of unnecessary political and industry interference and influence.

- *Relationships With Other Safety-Net Participants and Cross-Border Issues: BCBS-IADI Principals 6 and 7.*

Close coordination and frameworks are necessary between safety-net participants that include adequate information sharing. There should be adequate accountability among the various departments and participants. Coordination must be clearly and explicitly stated. A prudential regulator should be candid and share information with a deposit insurer so that reasonable decisions as to bank closure, liquidation and the minimization of loss can be undertaken. This can include cross-border arrangements for institutions that have broad, diverse operations.

- *Membership and Coverage: BCBS-IADI Principles 8, 9 and 10.*

Because of the tendency of higher risk banks to opt for deposit insurance and lower risk banks to opt-out, compulsory membership is the best approach for a deposit insurance scheme. If the system is mandatory, a deposit insurer and a prudential regulator must be careful to approve applications for authorization or licensing on a coordinated basis. With regard to coverage, what an insurable deposit is much be clearly defined by applicable laws, rules and regulations. The level of coverage should be quickly determinable. It should adequately cover the large majority of depositors adequately. Transitions from blanket guarantees to more limited coverage should be rapid and public attitudes must be closely monitored.

- *Funding: BCBS-IADI Principle 11.*

Primary responsibility for paying the cost of deposit insurance should be borne by banks as they benefit from such a system. If differential premium systems are used, they must be transparent to all participants.

- *Public Awareness: BCBS-IADI Principle 12.*

Public awareness regarding deposit insurance, and how it works, plays a significant role in any deposit insurance system. This also strengthens public confidence. Employing diverse and a variety of tools and approaches to educate depositors as to the system and its public policy objectives are important. The deposit insurer should be the focal point for depositor information regarding the system; however, banks are important parties in the process. Contingency plans should be ready for bank failures scenarios of all types.

- *Legal Protection and Fault Issues: BCBS-IADI Principles 13 and 14.*

Incentives are enhanced when those working within a deposit insurance system are immune from personal liability for good faith acts. Therefore, legal protection should apply to those who are a part of the deposit insurance system and for reasoned decisions made in the normal discharge of their duties. The deposit insurance should have a degree of statutory immunity for acts taken with the scope of its duties. There should be appropriate indemnification for legal expenses of any participant. However, there also must be accountability for poor decisions, decisions outside the scope of the statutory scheme and those actions not taken in good faith. In addition, the deposit insurer should be allowed to enhance deposit insurance funds by seeking recourse against any parties at fault for the bank failure when laws, rules or regulations have been broken.

- *Failure Resolution: BCBS-IADI Principles 15 and 16.*

Early detection of bank problems and potential failure is critical. This helps reduced the cost of resolution and could increase options to resolve the circumstances. The resolution of troubled banks presents various options. In addition, other options

should be considered including the creation of a bridge bank to hold assets of a failed bank on an interim basis.

- *Reimbursing Depositors and Recoveries: BCBS-IADI Principles 17 and 18.*

The deposit insurance system should give depositors in a bank failure scenario prompt access to their funds. The process for seeking funds should be clear and not unduly complex. Assistance should be provided to those seeking a claim. Also, the deposit insurer should liquidate the assets of the failed bank in a commercially reasonable manner.

The above Options, Models, and Core Principles and the more refined BCBS-IADI Core Principles have all taken place contemporaneous with the writing of this work and have tracked some of the reasons for this work when it was initiated back in 2005. Many, although certainly not all, of these principles and best practices are supported by most of those knowledgeable of these concepts. However, in the final Chapter 7, I will attempt to add my own reflections on some of these Options, Models, Core Principles and practices as well as to further supplement these concepts with my own.

CHAPTER 6—ENDNOTES

[1] Many helpful suggestions are suggested by the Committee On Capital Markets Regulation in their white paper entitled 'The Global Financial Crisis: A Plan For Regulatory Reform (May, 2009) which can be found at www.capmktsreg.org/research.html,; Although somewhat dated, a fine overview of this topic can be found in Garcia, *Deposit Insurance: Actual and Good Practices* (2000) produced by the International Monetary Fund as an Occasional Paper.

[2] At least one author believes that 'Best Practices' differ for bank deposit insurance in normal times from times of systemic crisis. See, Enoch, p. 468-472.

[3] There are many books articles in this area that cover these and other issues in various periods. For example, the IMF also has 'good practices' in this area. See, Kuppens, p. 114; DiGiorgio, p. 321.

[4] Carnell summarizes these various approaches very effectively. See, Carnell, p. 326-333.

[5] The Options Paper can be found at http://www.fdic.gov/deposit/insurance/initiative/OptionPaper.html. It was produced in August of 2000 as part of a comprehensive review of the United States deposit insurance system.
[6] For an excellent review of pricing models, which are left for an economics dissertation, see Kunt, p. 81. The models differ in many ways. For example, some countries assess a premium against total deposits; others only as to insured deposits. Another example shows expected loss ranging from very conservative to very optimistic models. These all can radically change deposit premium pricing instantly if changed. Of course, the banks are normally advocating for the least-cost pricing alternatives.
[7] See, Carnell, p. 328 for suggestions on improving risk-based pricing models.
[8] See, Cooper, p. 16.
[9] IADI, Asia Regional Committee, Transitioning From A Blanket Guarantee To A Limited Coverage System (Research Paper) (September 2005)
[10] The IADI has a specific Guidance Paper On This Issue entitled Funding of Deposit Insurance Systems (6 May 2009) which may be found at www.iadi.org.
[11] The IADI has an extensive General Guidance For Developing Differential Premium Systems (February 2005) which may be found at www.iadi.org.
[12] See, Masciandaro, Handbook of Central banking and Financial Authorities In Europe, pp. 50-53
[13] *Keeping The Promise: Recommendations For Deposit Insurance Reform, Including A Cover Letter From Donna Tanoue, FDIC Chairman* (April 2001); For Commentary on this item, see: Bloecher, *Options For Pricing Federal Deposit Insurance* (2003). Also, see: Blinder, *FDIC Reform of Deposit Insurance, Reform Of Deposit Insurance (A Report To The FDIC)* (March 20, 2001).
[14] European Union, Joint Research Centre, *Possible Models For Risk-Based Contributions To EU Deposit Guarantee Schemes* (June 2009)
[15] See, BCBS/BIS, *Core Principles For Effective Banking Supervision* (October 2006)
[16] Basel Committee On Banking Supervision/International Association Of Deposit Insurers, Core Principles For Effective Deposit Insurance Systems (June 2009); Press Release Regarding Issuing Core Principles (18 June 2009).
[17] See, Campbell, p. 1

CHAPTER SEVEN

7. RECOMMENDATIONS AND CONCLUDING REMARKS

a. The Current Outcomes of Our Global Deposit Insurance System: A Very Stressed Scenario Where Stressed Banks (and Deposit Insurers) Abound.

We have now completed our analysis of the history, development, structure, design and latest suggestions regarding the impact of deposit insurance from centuries ago to today's severely troubled financial times. The pieces should be falling into place as to where we need more vision and resources.

We have seen the European and American systems close-up. We have also reviewed other systems from around the world and a vast array of approaches to deposit insurance. We have also examined the very latest options, best practices, models and principles for the design, implementation and funding of deposit insurance in the future. The nature and purpose of deposit insurance, including its significant limitations, is much clearer now.

However, it appears to be the unfortunate custom in this area that deficiencies are identified and found in deposit insurance; actively debated; intensely analyzed; and then summarily neglected[1]. I will not be as neglectful and I hope to spark action. I feel this work would not be complete without my adding a series of updated recommendations for action that through this work and the extensive research behind it have become rather apparent and, quite possibly, just a little obvious. Many of these recommendations are practical, such as the challenges ahead for bank supervision

which is of significant concern[2] and premium costs which are rising faster than some smaller, community banks can bear the strain of[3]; some are designed to impose a clearer dose of moral conduct and ethics into the design of deposit insurance; and, most of those suggestions can be implemented with reasonable speed. Others, such as breaking apart banks *TBTF* or requiring universal coverage for deposit insurance is, admittedly, more grandiose and will require answers to far more problematic and controversial questions to be made a reality. However, most of these additional reforms are, indeed, possible; many are urgently needed; and most are long overdue.

Specifically, our review now turns back towards the issue of trust and confidence that we started with and if deposit insurance can fill the holes in the trust relationship between bankers and depositors caused by calamitous events that cannot often be predicted. However, as banks provide a continuous stream of operational metrics that tend to identify troubling trends, it s more and more stunning to find that regulators of banks do not or did not see such important failures coming long before they arrive. It would appear that many of these events are in the category of slow motion train wrecks.

In this work we have seen that deposit insurance did not really save us from our latest crisis—if anything did save us from an even worse fate, the massive borrowing and liquidity programs did. The sound management and prudential regulation of banks is always the front line defense to bank failure, and deposit insurance must always remain a secondary safety-net device along with direct lending to banks when absolutely necessary and when systemic failure is at the door. However, the worldwide schemes and programs of deposit insurance would not have been able to withstand the current financial crisis alone.

We are left to ponder, then, if deposit insurance is even worth the effort since more and more financial crises are deemed 'global' and 'systemic' and, as we have seen, deposit insurance does not have a good track record of finding a cure for those more serious financial illnesses we are faced with every decade or two. Recall, at the start of this work, it was questioned whether deposit insurance may be working at cross-purpose with other forms of safety-net devices. It is still not clear after hundreds of pages of inquiry we have now completed if that is so, or not. We still manage bank panics reactively and that is worrisome. The true spirit of deposit insurance is to manage bank crises proactively and that task remains an unfulfilled vision.

But if we are to continue with deposit insurance as a safety-net device, and I along with you am likely and inclined to say we should, what is its next form for the near term and for its distant future? How can we deliver the promise of confidence through its operation that 75 years of changes, adjustments and refinements have yet to fully realize and deliver[4]?

As the recommendations below show, if we have ill-informed depositors unable to describe deposit insurance coherently, we already have a serious design problem. Many of the solutions are, thus, clear. Let us improve the information flow and make deposit insurance very understandable. Further, if we have under-funded deposit insurance funds, we again have a major design problem. The solution should also be clear. Let us move to fund the DIF's properly and stop the shell game of fund solvency. If losses incurred by banks are cutting though an 8.00% or 9.00% capital level effortlessly and causing huge outflows of DIF reserves and taxpayer risk, the solution should not be in doubt. Let us raise the capital levels much higher so the erosion of

capital is less severe. If banks are truly *TBTF*, let's label them as such; request divestiture of product and service businesses; and make them revert to a size and complexity of a fully manageable institution as we did with computer giants and telecom leviathans. If governments lack political will to do any or all of this, let's expose them to their short-comings. It takes only modest inertia to turn such thinking from the claimed *Pollyannaish* thinking to an utterly real outcome.

Therefore, as we examine the recommendations that follow do not be fooled. Deposit insurance, and all its complex web or intricate laws, rules and regulations, performed marginally, at best, in the financial crisis of 2008 and 2009. Or, put another way, deposit insurance certainly did not save have the resources to save even some of the largest banks. We appear to have progressed little since J. P. Morgan scurried around his office 102 years ago in 1907 to save American banking as he knew it then. Deposit insurance may, indeed, still need to function as an important safety-net player—*but it is still not yet the deep and resourceful safety net player many savers have been told it is*. In fact, it is a rather minor part of the real safety-net when the storm clouds and overwhelming costs of systemic risk appear on the horizon and the taxpayers are asked to get their wallets out or the world might end as we all know it. It is taxpayer cash and the massive infusion of liquidity from central banks across the globe (which is both an intensely inflationary practice and a staggering debt burden on future generations) that saved us from our current severe round of bank failure. We were no Joseph with a vision to save for the future. We were not thrifty. We did not save enough for the bad times by deposit insurance programs that work well and is well funded. Instead, we were complacent and pushed into the future what we should have paid for long ago.

However, we now have a great opportunity directly in front of us. The clouds are starting to part on the crisis of our lifetime and we can now see the faint outlines of a path to follow to make the safety net much deeper and the deposit insurance schemes much more resourceful, robust and sound. But, already, many are once again turning complacent. It is, therefore, in an effort to firmly defeat complacency that I offer the following additional recommendations:

b. Eighteen (18) Specific Recommendations To Improve Deposit Insurance Worldwide[5].

- *Recommendation 1:*

  - *Deposit Insurance Should Be Universal; All Deposit Taking Institutions Should Be Subject to Basic Governmentally-Sponsored Deposit Insurance Coverage; Only One Plan Should Be Allowed Per Country; Coverage Should Include Not Only Account Balances—But The Account Bargain.*

To maintain its place in the global financial economy, each country, and universally, should maintain a base-level deposit insurance program for its deposit accounts and administer that program through an independent governmental or quasi-governmental agency for the protection of a broad range of deposit accounts. As to this core protection, all deposit institutions must participate. There should be no exception allowed as a condition to be a member of the world financial marketplace. This should come as little surprise to nations as deposit insurance has existed for over 75 years in various forms and proposals for universal coverage have been made for at least 30 years.[6]

This would mean, for example, that credit unions in the United States could not use private insurance for core-level of protection any longer; and pooled plans in Europe could no longer be possible for this basic level of protection. This would mean

that the Country of Israel would be required to adopt an explicit plan of deposit insurance and the Country of China has to stop 'studying' deposit insurance for its mainland provinces and actually implement its responsibilities to insure all Chinese savers. All accounts would be insured by the government that authorized the institutions that house them. We also need but one deposit insurer per country for understandability and clarity. Finally, within the coverage limits set, the account value, and not just the account balance, should be insured. Placing people back in the marketplace during a period of bank failure only shifts costs and burdens to savers.

Justification: Prudential regulation of the safe and sound practices of banking has failed depositors in recent years. Universally mandated coverage is the only deposit insurance design that will insure strong prudential supervision because it will place taxpayers of the nation authorizing the bank operations of each bank directly in the 'line of fire' for bank failure and create the responsibility, culpability and political will necessary to insure that banks are well run and properly capitalized. Deposit insurance backed by the full faith and credit of a nation makes that nation accountable. Accountable nations avoid risk, fraud, and poorly managed institutions. A country does not require multiple systems of deposit insurance. For clarity, it only requires but one. That system should recognize that there is a real cost to a depositor for bank failure and insure that cost, not just provide a refund of an account balance.

- *Recommendation 2:*
    - *Excess Cover For Deposit Accounts Above Core Governmental Protection Levels Should Be Offered And Easy For Those Wishing Additional Cover*

Depositors should not have to seek *de facto* coverage solutions and invest funds in multiple banks to protect those funds from loss. This simply masks ineffective

prudential regulation. Either the applicable system should provide Blanket Coverage, or excess cover should be obtainable from a governmental or private insurer to the limits of the account balance and reasonable rates based upon real risk.

Justification: Every deposit insurer must clearly identify where core insured protection ends and find a suitable means to protect all deposits in a single institution so that complex deposit insurance schemes are not a trap for the unwary. If a system seeks to avoid Blanket Coverage due to Moral Hazard, then, that is a deposit insurance scheme's right. However, it is its reciprocal obligation to provide easy, efficient and cost effective means to protect the uninsured account balance without forced splitting of deposits or utilization of strained account designations.

- *Recommendation 3:*
    - *Deposit Insurance Is Weakened By Hyper-Complex Rules; Avoid Netting Loans Against Insured Deposits.*

The term "insured accounts" in every deposit insurance scheme should include any account wherein a saver has made an investment in a financial institution with the intention to receive the deposit back, with or without investment interest. That should be the extent of the definition. It should include commercial businesses and other entities such as estates, trusts and funds held in a fiduciary capacity. There should be few exceptions as any account representing bad conduct or improper action can be approached through other laws and restricted under other legal theories.

In addition, the failure of an institution should never trigger a netting of loans against deposits. This illogical practice prematurely 'calls' a loan or unfairly delays pay-out of an insured deposit. Under either scenario, this practice is patently unfair as the

borrower/saver did not cause the bank's demise and should not have to pay a higher cost for it.

Justification: This is an area of common sense. If deposit insurance is to be a universal confidence building device, it must act like it and be broadly construed and not narrowly interpreted as so many countries attempt to do. Trying to overlay devices to reduce the cost of deposit insurance by introducing hyper-complex conditions, restrictions, exceptions and carve-outs works at cross-purposes and undermines all the purpose and effort of deposit insurance and demonstrates that deposit insurance is, at times, a concept to be more suspicious of than it is a protective concept.

- *Recommendation 4:*
    - *A Deposit Insurer Must Always Have A Strong And Decisive Role In The Life Cycle, Recapitalization or Closure of Troubled Deposit Institutions.*

Every deposit insurer must be involved in fostering the health of banks as well as in managing their failure. As shown by the FDIC model, a deposit insurer must have all regulatory supervision powers to assess and control risk during the entire life cycle of a bank—from its birth, through normal operations to the end of its operation for whatever cause that may result from. *Cradle to grave* bank supervision along with the normal financial and prudential regulators.

One who has responsibility for pay-out must be able to fully control risk before pay-out is required. The deposit insurers remit amongst the team of prudential regulators is to steer the safety-net participants away from increasing loss to the deposit insurance system. Weak prudential regulation only increases deposit risk and deludes depositors as *ex ante* funded schemes quickly turn into soured *ex post* bailouts. The

deposit insurer needs to be a front line and an active participant in the regulation of banks so problems can be avoided by prompt corrective action; however, banks that cannot promptly correct unacceptable current outcomes or risks quickly and decisively must not be allowed to operate amongst fully compliant banks and the deposit insurer must have the right to close banks simply on those grounds alone.

Justification: A deposit insurer needs to constantly monitor bank risk and increasing loss exposure as an early warning device. This requires that a deposit insurer actually regulate banks constantly throughout their entire life cycle and that they have a strong voice to heading-off increasing loss or risk to the system. This will result in steep, added costs, most certainly; however, this is the societal and real price to be paid for avoiding systemic risk and its even higher costs we have now experienced. The current financial crisis shows that both the involvement of the prudential regulator and deposit insurer in bank-related solvency and liquidity issues needs to remain robust when a bank is healthy and continuing that robust regulation to manage every decline in profitability or susceptible to risk—not to become robust when that same bank is already sickly, insolvent or illiquid.

- *Recommendation 5:*
    - *The Rate Of Deposit Insurance Premium Should Be Assessed At A Differential Or Risk-Rated Rate; Bank Risk-Ratings Must Be Made Public; Do Not Make Depositors Guess As To Information Regarding The Risk Profile Of Their Institution.*

Risk is a choice and involves a societal cost. As in all other areas of financial activity, banking is a competitive business and risk-based decisions are a daily occurrence, they are natural and I would never imply they are inherently evil. But they imply a corresponding societal choice; and, cost. Standardizing risk by assigning the

same deposit premiums to well-managed Bank A as far riskier Bank B is illogical and ignores this societal choice and cost. The banks that are star performers and outpace their peers in the control of risk and loss, and not just focus on profitability, should be rewarded with lower governmental oversight costs and fees in the form of deposit premiums. Those that take risks and manage poorly, at least until closed, should pay for those decisions. This creates a positive incentive to perform at high levels of propriety or to pay far more heavily for not doing so.

The rate of core governmental deposit insurance premiums (and under the proposal above, private forms of excess insurance as well), should be based upon the capitalization, management and the risk-rating of an institution. Risk should be assessed amongst similar bank types and with peer-group ranking and analysis. Well-managed and capitalized banks should be rewarded with lower differential premium costs. In addition, bank and peer group ratings should be made fully public and routinely published on an easy to understand source, such as an Internet website[7]. Savers would likely benefit from understanding the risk-tolerance of their institution.

Justification: The days for the need for reports of examination and bank ratings to be kept secret as unduly creating public panic is at an end. This arcane practice assumes that savers will simply further weaken an already weak bank if they learn the true account of its declining and miserable finances. This leaves only the select few who can find this information in other reports or by intense analysis to stay ahead of institutional failure. Is this the way our safety-net is suppose to work? Of course, it is not. In a world of transparency initiatives, banking is and should be no special case.

Recommendation 6:

- *Deposit Insurance Only Serves Its Public Policy Goals If It Is Adequately Funded In Advance (Ex Ante); Governments Need To Assist Banks In Recapitalizing Deposit Insurance Funds Promptly; Thereafter, Banks Must Fund Deposit Insurance Themselves At Sustainable High Ex Ante Levels.*

While some deposit insurance funds are more solvent than others, most funds are now at or soon will be in an *ex post* deficit condition as a result of our current financial crisis. It is unrealistic (and actually misleading) to cause the taxpayers of each nation with a fund in this condition to believe that the surviving banks, alone, can quickly recapitalize these insurance deposit funds in a short timeframe. That is fantasy as shown by the Japanese bank recapitalization experience of recent times where after a decade repayment is not complete and a banking system with sever financial shocks clearly cannot recover quickly without long-term governmental support effort to bridge the restored health of a nation's banks.

Aside from proper fund capitalization from the start, governments must quickly act to appropriate funds to recapitalize the deposit insurance funds to acceptable and adequate levels. Thereafter, deposit insurance should involve high *ex ante* funding through deposit premiums computed on a conservative actuarially basis of realistic bank failures by each institution based upon quarterly reporting. The funds held in a deposit insurance fund must be fully restricted from other governmental use and not be available for any other purpose. *Ex post* funding of deposit insurance is to be avoided except in start-up phases as it offers little (if any) realistic and prompt front-end protection.

Justification: Improper funding of deposit insurance schemes based upon poorly conceived contribution level settings is counter-intuitive to depositor confidence as depositors know the fund will deplete quickly in a major financial crisis involving systemic risk and this hardly stems financial panic and may accelerate it on a classic 'first in-first out' theory. *Ex post* funding is even a worse choice for confidence. We need to admit that many of the existing deposit funds are currently insolvent; governments must now bridge loan or grant the required funds to recapitalize the drained funds of deposit systems across the globe; and all must do a much better job of building sufficient and adequate reserves in the future[8].

- *Recommendation 7:*
    - *All Banks In Every Country Should Report Individual Bank Performance At The Same Time and In The Same Manner; Review Of Bank Performance Should Be Easy To Obtain and Quick To Compare; An Early Warning System For Failure and Competition Will Be Heightened By Such An Effort.*

In addition to ratings mentioned in Recommendation 5, above, financial Institution should be fully transparent as to financial condition and should report their results of operations in consistent, common, plain language and all information should be made public and published freely. This is what some authors refer to as the 'early warning system' for bank fragility or failure[9]. An example of this is the transparency of bank information on the www.fdic.gov website using bank 'call report' information. Information combined with the after-effect of market forces is the best cure for poorly designed or operated deposit insurance systems and will shine an intense spotlight on troubled banks in such an environment. Important categories of reporting could include, at a minimum:

- Capital ratios.
- Percentage of Classified Loans.
- Loan Loss Reserves.
- Liquidity.

Justification: As in all areas of financial information, opening hidden information deemed too sensitive for saver consumption and exposing it to the sunshine of the marketplace, allows the markets to identify risk and expose abuse far earlier. By paternally hiding information based upon the argument of trying to maintain confidence in banks and banking, regulators are actually creating a lack of confidence in this new and clearly information-driven marketplace and world.

- *Recommendation 8:*
  - *Regulators Should Not Be Allowed To 'Dump' Failed Bank Assets and Thereby Transfer The Risk Of Loss From Bank Management To Governments and/or Taxpayers.*

The FDIC, and other insurers, are pressured to liquidate assets at a 'least cost resolution' unless using that least-cost resolution would have serious adverse effects on economic conditions or financial stability[10]. If an institution fails, bank assets (primarily loans and branch property) must be liquidated by the deposit insurer or another authorized entity; contracts repudiated; and other bank-to-bank relationships disentangled[11]. The use of non-banks, equity funds, 'vulture' funds, profit-seeking companies, etc. to liquidate failed bank assets unnecessarily increases deposit risk; does not serve the banking industry or its depositors; and, harms innocent borrowers. Only banks should be allowed to buy other (failed) bank assets of this type and any

purchasing bank must be prepared to honor any loan purchased or asset acquired on the terms previously negotiated unless proven to have been entered into for fraudulent reasons[12].

Justification: Allowing failed bank assets to be sold for 'pooled values' or arbitrary discounts where good loans or properties are grouped together with substandard loans or properties and sold at an artificially low net price is re-imposing bank failure cost on governments and taxpayers and artificially benefiting unrelated commercial interests. All commitments of any failed bank to innocent borrowers must be honored and so long as the obligation is paid as agreed, must never be repudiated. This includes funding of any unfunded portion of a loan or honoring revolving lines of credit until their expiration.

- *Recommendation 9:*
    - *Coverage Levels Must Be Harmonized In Amount Or Formula Between Countries To The Greatest Extent Possible.*

Coverage and account types must be made consistent by amount or formula for distortions not to appear in the global marketplaces of depository choices. Consistency levels the playing field and precludes competition issues from arising. The higher rates in Europe paid on depository accounts may reflect disparity in costs between deposit insurance regimes and deposit premiums paid.

Coverage design should include the following features:

- A global monetary sum below which all deposits of every country and every depositor, with few exceptions, are insured by the government authorizing their institution. Or, a formula that insures a median deposit sum so that 50.00% of the depositors are insured to 100% cover; and the remaining 50.00% of the depositors are insured from a range of 99.00% cover to full cover. As stated in

Recommendation 2, excess deposit insurance could be purchased for the excess of deposits not covered.

- No Co-Loss provision for any sum below this threshold. In essence, Blanket Coverage to the threshold amount.

Justification: Using these criteria, basic account balances, at least to the median point of that country's deposit, would be protected by a universal bank deposit premium system. This would be a fully rational system that would protect the least wealthy savers fully and still provide opportunity to the saver above the mid-point to fully insure his or her deposits as extraordinary balances could be covered by the excess insurance system. Of course, to avoid excess costs, a depositor could elect to deposit in multiple institutions; yet, this allows depositors comfortable with a single bank relationship to remain fully covered as to the most typical deposits.

- *Recommendation 10:*
    - *Capital Standards For Banks Must Be Raised Significantly From 6 to 8% Levels to at least 10% Capital Levels; Lending Limits and Concentrations Must Be Reciprocally Lowered.*

The current financial crisis has demonstrated that banks can quickly become capital deficient[13]. The current situation also reveals that banks concentrate their loan assets in certain types of loans and the risk of doing so can lead to systemic losses. Despite state and national laws on base levels of capital and lending limits[14], banks must recapitalize at higher capital ratios[15]. Banks should no longer be allowed to take highly leveraged positions into the marketplace and markets must adjust to banks and not expect to realize as high of a profit ratio or return as a result. Banks are too central to our economy to allow their activities to be highly leveraged to maximize profit opportunities if that activity contributes to the possibility of systemic risk and increased bank failure.

Justification: Capital is the first line of defense to prevent or forestall bank failure. Due to the unique status of banking in our complex financial world, profitability must yield to reasonable leverage and conservative profitability margins and rational returns on assets and investments for a financial services business with conservative outcomes. Banks cannot be expected to perform at the same levels of profitability as manufacturing and commercial businesses without bearing an unacceptable level of risk. As banking markets normalize in the coming years, it should come to be expected that banks are a unique investment choice and should be selected for being seasoned and steady providers of income and not for a rapid growth orientation. In this way, they will attract capital willing to receive a comparable and steady rate of conservative return.

- *Recommendation 11:*
    - *Non-Bank Activity Must Be Greatly Restricted As To Banks; Glass-Steagall-Type Laws Should Be Immediately Restored, Globally. Traditional Banking Is Not Compatible With Investment Banking.*

The separation of banking, on the one hand, from investment, securities, options, swaps, derivatives, hedges, insurance, real estate speculative activity, on the other hand, and all matters outside the core of traditional banking must not be allowed to continue through use of assets of any banking enterprise as they pose a real risk of causing an otherwise healthy institution to fail due to mismanagement of such financial products. If a parent bank holding company wishes to engage in any such activity, they must fully disclose its nature and engage in that activity separate and apart from the banking activity or utilizing bank assets; they must retain sufficient capital at the parent holding company level to remain a source of strength to the subsidiary bank(s) they own even if any non-bank activity fails; and, there can be no affiliate transactions possible

between the banking and non-banking entities that could lead to an indirect failure of the subsidiary bank(s).

Justification: The dismantling of *'Glass-Steagall'* type laws under the ruse of deregulation was a serious mistake in America and elsewhere around the world and contributed to the severity of the current financial crisis. There is an inherent conflict of interest when a bank uses deposit-type assets to speculate in any volatile form of investment or to make financial promises backed by bank assets. A bank should be fully precluded from using bank assets to invest in any investment for which the bank's Asset and Liability Committee, operating independently of internal management, has not made a specific finding after due consultation with regulatory experts is entirely appropriate for an authorized and licensed bank.

- *Recommendation 12:*
    - *Banks Must Periodically Explain Deposit Insurance For Specific Accounts To Savers; Deposit Insurance Must Be Fully Transparent To All Depositors.*

Banks owe an essential duty to act on behalf of deposit insurers and fully and candidly explain deposit insurance coverage. This not only should include topics of coverage and claims procedure, but the actual effect of bank failure on account terms, rates and loans, if any. As the Hong Kong plan discussed above provided, institutions must be required to periodically notify each customer as to the deposit insurance scheme or plan and if their accounts are covered or not and what they would be expected to receive if their institution failed.

Justification: On balance, bank savers have a poor understanding of deposit insurance. It is a negative concept often not disclosed by member institutions with their

customers unless questions are asked. Taking a proactive view, banks should welcome the opportunity to secure bank's special place as being governmentally guaranteed and emphasize the availability of deposit insurance. This provides greater clarity and transparency and should be implemented by all deposit insurance programs. Many countries already have a periodic program for revealing privacy and other issues and this would not realize a large additional obligation.

- *Recommendation 13:*
    - *Accounting Rules Must Reflect Realistic Market Values For Bank Investments and Assets and Fairly Value Loans So Declining Investment and/or Asset Values Can Be Monitored; Impose 'Sarbanes-type' Obligations On Outside Directors To Certify the Monitoring of Investments and Strength of Loans.*

Banks are heavily dependent on various forms of national and international accounting rules and requirements that often distort the timing and receipt of income; the valuation of assets and collateral; and the valuation of risk. The accounting rules must be made consistent and error on the side of causing bank financial performance to reflect real-world analysis and actual valuation.

Justification: Accounting rules cannot be allowed to distort the financial condition of financial institutions.

- *Recommendation 14:*
    - *Bank Executive Compensation Must Be Curbed; Executive Pay For Bank Officers and Directors Must Have Caps or Limits Or Mandated Stock-Based Compensation Should Be Substituted.*

The compensation of bank executives and senior managers has been illegitimately tied to the profitability of banks and banking. This link has been proven to be a poor indicator of success in banking and, instead, creates incentives to incur risk and realize an economic benefit until the risk may overwhelm an institution.

The compensation of bankers should be, instead, directly tied to the bank's ratings, performance and risk-management activities. Profitability should not be the benchmark of compensation. Strong management, safe and sound bank operation and superior bank ratings indicate success in banking.

Justification: Creating a compensation system based upon profitability can only lead to heightened risk taking and short-term strategies for the future of an institution. A bank compensation program should be built on far different criteria: strong management, risk avoidance and loss control. The current thirst for compensation tied to profitability has now run its course and has proven to be utterly disastrous and public relations disaster for banks. It is now time to create strong incentives to return to the core positive virtues of banking and not to create incentives for those negative attributes that can destroy an institution.

Related to this recommendation, bank boards of directors need to study compensation approaches and find better ways to incentivize its senior staff while not incentivizing risk-based models. Long term strategies based on shared growth or deferred compensation after long service are the better approaches to strong banking rather than to create short term rewards for obtaining short term profits.

- *Recommendation 15:*
    - *Improve Bank Supervision; Impose Significant Civil Money Penalties For Abusive Practices; Terminate or Suspend Deposit Insurance For Noncompliant Institutions; Restrict the 'Shopping' of Regulators By Institutions.*

Effective bank supervision is the way to reducing the need for deposit insurance[16]. Prudential regulation designed to foster sound and safe banking, rules should be tightened regarding redomestication of banking activities or other avoidance

techniques designed to avoid prudent regulation. 'Regulator Shopping' should be strongly discouraged.

The regulators have two powerful weapons to control bank conduct and risk. The first is significant civil money penalties.[17] The second, is the right to suspend or terminate authorization as a bank or membership in the deposit insurance scheme.[18]

Justification: Too many examples of bad conduct by banks trace to decisions by banks to change authorization and licensing parameters to gain the advantage of more lenient regulatory regimes. This practice needs to be tightly controlled and effectively eliminated.

- *Recommendation 16:*
    - *Annual Bank Self-Assessments Should Be Mandatory of Bank Lending, Operations and Governance Areas.*

All banks need to conduct intra-examination period annual self-assessments for the following aspects of their operations:

- Adherence to the institution's business plan
- Capital adequacy[19]
- Loss and other risk analysis of business lines
- Plan for corrective action, if necessary
- Explaining and quantifying the risk of each new line or business or product.

Justification: Engaging in self-assessment between examination cycles brings into concrete form the weaknesses of an institution and focuses the institution on improvement.

- *Recommendation 17:*
    - *Work to Dismantle (Break-Up) Banks Adjudged TBTF (Too Big To Fail).*

Strengthening prudential regulation and bank supervision is easy to require; but hard to accomplish. Banks are complex institutions and there are many contrasting approaches to bank regulation[20]. Banking, as a business, does not require banks of enormous size to function efficiently. Banks that are too big to fail, or TBTF, pose unacceptable and unusually greater risks to the banking system. They offer almost no advantages in return and are often unmanageable. Any institution rendered TBTF is an institution that must be required to reduce its assets or operations to a size where it, alone, does not pose a high degree of systemic risk.

Justification: Institutions deemed to be TBTF pose an unnecessary risk to the banking system and, as with any unnecessary risk, this risk must be removed or ameliorated.

- *Recommendation 18:*
    - *Create a Coordinated International Approach to Deposit Insurance and Offer Strong Incentives To Avoid Future Risk.*

The final recommendation is the most pragmatic one. We need to coordinate efforts globally[21] as to deposit insurance plans and schemes. It is critical to substitute a thirst for unrealistic profits in banking with positive incentives for adherence to good banking standards; proper risk assessment; loss avoidance and control; and overall strong oversight.

These incentives could be in many forms far too numerous to mention here. However, they include, but are certainly not limited to: lowered deposit insurance premiums from common plan design; more favorably priced borrowing from

governments and central banks; liberalized branching and expansion opportunities; waived examinations; ability to acquire less fortunate banks that need to be merged to avoid failure; increased executive compensation ceilings; and, many other incentives.

Justification: Strong banking is always good business. It not only helps deposit insurer's but it helps savers. Well managed banks are every prudential regulator and deposit insurer's end goal and we all need to offer real and positive incentives to return banks to their core operations and mission and to avoid reinforcement of risky behavior.

c. Concluding Remarks.

We have seen in this dissertation the evolution of banking culminating in the need for deposit insurance in the early 1930s. Deposit insurance came into our world to correct the abuses of the *Great Crash*. It has since been developed and implemented in many of the nations of the world for good reason. Without a better remedy to calm troubled bank markets, deposit insurance is now an accepted safety-net participant in most financial systems around the world, including the Americas and the European Union. Along with central bank monetary policies and prudential supervision, it is one leg of a many-legged safety-net stool[22]. It reaffirms that banking is, indeed, a very special relationship—the very question we first posed hundreds of pages ago in Chapter 1 now being answered. The difference is that as our banking profession globalizes, so must the global remedies for prudential supervision and safety-net design.[23]

However, deposit insurance is being overwhelmed by the size and complexity of the global markets and by its own *ad hoc* approach to confidence-building in the marketplace. While deposit insurance is our modern day affirmation of the Millennium-

old concept of trust and confidence in banking relationships that we so carefully developed, deposit insurance also is antiquated and tired and needs new direction as systemic risk is attacking it from many directions and it is not able to control the risk it was designed to counteract.

Bank savings is the one place where we have, collectively, and as a rational and caring society, tried to push risk aside and maintain a form of investment that does not have to be watched, is safe from volatility and is easily understood. The current financial crisis has shaken this belief once again in new ways and made people cynical and questioned the ability of bankers to understand their own commitments to us and has demonstrated new ways to cause the failure of a financial institution. We are once more at the cross-roads of confidence in banking and we need to return banking to the correct path to regain its position as being risk-resistant and loss-free. We have more way to go to do this in light of our current state of affairs; but a rethink of deposit insurance, using the core principles we have seen and adding recommendations such as those offered will help to serve savers as deposit insurance intends—while also serving bankers in preserving their time honored trade. This is not time to change the promise or the social compact of banking. It is time to return it and its root concepts.

Being at the cross-roads of confidence in worldwide banking as we now are, there is an important decision to make. This was the decision the world needed to make in 1929 and now, 80 years later and almost to the day, it is once more before all of us again. Do we return to allowing banks to manage our financial system *or do we manage banking because of its core importance*? We have seen ways where banks can function profitably but with a rededication to controlling risk; providing transparency; and, giving

savers choices. We are not fundamentally changing banks by the problems we have pointed to and the proposals we have made—we are restoring the business of banking to what it was intended and designed to always be. We need to now move beyond discussion and actually implement our changes. This is our chance. It is before us now and our contingency planning must turn to practical implementation[24].

This work has tried to explain how the house of deposit insurance was built; where its imperfections are; and, the problems that have been laid at the feet of bankers over many centuries of banking; and how 'we', collectively, have addressed them in the past and more recently. It has attempted to show the way forward towards a harmonized and coherent plan of deposit insurance for every country to remedy more current problems facing bankers in our modern age. The *ad hoc* days of deposit insurance as an obscure concept with uncertain importance has now passed with the inadequacies this latest financial crisis has exposed and laid bare. We need a coherent plan and a harmonized process for tomorrow, the year after and ten years from now. We know the goals; we have the tools; we are not asking for too much[25]; and, the time is now for us to finish this essential safety-net participant. In essence, the rethinking of Bank Regulation and, as one author stated, '*Til Angels Govern* [26]

Yes, there will be consequences to banks, a societal cost to chart the proper future course for banking, and a need for improved safety-net protections that may displease many and reduce profits for some. However, there will be a heavier cost if a harmonized and coherent safety-net plan is not adopted as well and *very soon*—just ask the American depositor who will be paying for the various TARP allotments and

other relief programs for a lifetime; or, the Japanese saver who has been paying for much of his or her lifetime for the borrowings of the past.

So it is no coincidence that we see a flood of proposals, of best practices, principles and positive suggestions bubbling to the top now and there will be more. The secrets of good financial supervision are not hard to decipher and many are already well known[27]. We have all grown tired of the abuses—the obscene salaries of bank executives, the banks too big to fail, the gross mismanagement of banking for transitory profit, the lack of supervision of institutions, the misunderstood risks, the unbridled greed and the financial responsibility shifted to taxpayers over the past decades. The outrage has allowed the door of change to open once again with this enormous crisis and while those who would return us to our complacent path are trying to shut it tight we need to not let that happen before change is complete. Deposit insurance is where we can get our foot in the door and wedge it further open and even wider. In fact, it is with deposit insurance revision where we can make a huge leap in restoring financial rationality to the financial system and each other and encourage (once again) a life of thriftiness and industry that we, as a society and people, can protect and value.

We should not miss the opportunity to do this as financial stability will be our reward[28]. We just need the will to change the poor choice of economic road we have taken and soon the vision will sharpen, the light will flood in and the new path will be clear. If we lack that will, and become complacent again, the next crisis may not go as well for us and the next bank to fail may be your bank or mine and the next person standing in a bank closure line may be you or me. We can redirect and change this dysfunctional system we currently and inappropriately call banking and return it to

something our ancestors would call by the same name. For we have altered what the Romans created, what the Lombard's engaged in and what those in London knew of it in the 18th Century, and we created something far too complex, much too remote and a pretty ugly and distant relative to banking in the name of profit and greed. Banking was ours to break; we broke it; and, it is now ours to fix. There is still time to honor the promise we made to each other so many centuries ago when the first person took a chance and trusted another with their wealth and their future—and we called him our *banker.*

Alan B. Rabkin

CHAPTER 7—ENDNOTES

[1] For example, see the critique that was offered 25 years ago on the structure and design of deposit insurance and how many of those same or similar problems continue to exist today. Kane, p. 59.
[2] Kaufman, p. 121.
[3] This is not a new issue, either. See, Kaufman, p. 177. The crippling cost of deposit premiums has been addressed for decades.
[4] See, Article Thies, *Deposit Insurance: A History of Failure.*
[5] For other recommendations, see: Kane, Appearance and Reality In Deposit Insurance: The Case For Reform (1986).
[6] For example, see the 1979 book: Grubel, *A Proposal For The Establishment Of An International Deposit Insurance Corporation.*
[7] Current financial reporting requirements are set forth in Williams, p. 229.
[8] See, Bryant Article.
[9] Kaufman, p. 287.
[10] 12 United States Code, Section 1823(c).; Gibson, at p. 4; Also, see, Platt Article.
[11] For example, see FDIC, Repudiation and Asset-Backed Securitization and Loan Participations (12/30/98).
[12] For an interesting discussion of the marketing and packaging failed banks, see ASBA, p. 52.
[13] For a detailed explanation of bank capital requirements, see Williams at 291 at to the United States. In the European Union, capital requirements or adequacy is generally regulated by Directive 2006/49/EC as amended by Directive 2009/27/EC; see, also, Malloy, p. 260; Cranston, p. 89; Mayes, p. 200; Felsenfeld, p. 40; FDIC Working Paper 98-1 (Capitalization of the Bank Insurance Fund). See, also, the Internal Markets webpage on Regulatory Capital found at http://ec.europa.eu/internal_market/bank/regcapital/index_en.htm and also note the recent consultation regarding further changes that ended on 4 September 2009.
[14] See, for example, 12 United States Code, Section 84 (as to commercial loans); 12 United States Code, Section 371 (as to residential mortgages).
[15] See, Barth Article.
[16] Kuppens, p. 112.
[17] Carnell, p. 667.
[18] Carnell, p. 670.
[19] See, Buser Article.

[20] Barth, p. 18-74, 75-177. There are public interest approaches, private interest regulatory views, entry restrictions, increased capital requirements, market monitoring and, our focus, safety-net support. However, so much of the scope of the regulation of financial activity has become unclear. For example, where do the lines of bank activity end and the lines of investment activity begin and end? Are we creating impossible turf battles where no one knows where these lines are? Also, how can bank regulators even begin to assess risk that cross over to banking activities from non-banking activities so as to require commensurate capital to cover? The regulation of banks may simply be impossible in their current form and, quite possibly, that form needs to be down-scaled, made less systemic, and the conglomerate financial services company needs to come to an end simply by necessity.

[21] Campbell, p. 288.

[22] Masciandaro, p. 25, p. 109

[23] Enoch, p. 378, 517

[24] Campbell, p. 212.

[25] See, Helfer, *What Deposit Insurance Can and Cannot Do* (1999).

[26] Barth, p. 307-316; see, also, Enoch, p. 464.

[27] Mayes, p. 65.

[28] See, *Cull, Deposit Insurance and Financial Development,* p. 3.

APPENDICES

Appendix A	List of Countries Currently With Deposit Insurance Programs
Appendix B	Letter By Alan B. Rabkin, Esq. on behalf of the Nevada Bankers Association and the Arizona Bankers Association to the FDIC dated March 27, 2009 Regarding Emergency Special Assessment
Appendix C	Excerpt of Keynote Address of Alan B. Rabkin at the Nevada Business Summit, November 17, 2008

APPENDIX A

List of Countries Currently With Deposit Insurance Programs

The following is a list compiled by the International Association of Deposit Insurers as of June 2009 and further updates can be found at http://www.iadi.org/iadi_members.html:

1. Albania*
2. Algeria
3. Argentina*
4. Armenia
5. Australia
6. Austria (5)[1]
7. Azerbaijan
8. Bahamas*
9. Bahrain
10. Bangladesh*
11. Barbados*
12. Belarus
13. Belgium
14. Bosnia and Herzegovina*
15. Brazil*
16. Bulgaria*
17. Canada* (and Quebec*)[2]
36. Hungary*
37. Iceland
38. India*
39. Indonesia*
40. Ireland
41. Isle of Man
42. Italy (3)[6]
43. Jamaica*
44. Japan*[7]
45. Jordan*
46. Kazakhstan*
47. Kenya*
48. Korea*[8]
49. Kyrgyz Republic
50. Lao PDR
51 Latvia
52. Lebanon*
71. Paraguay
72. Peru*
73. Philippines*
74. Poland (2)*[11]
75. Portugal (2)[12]
76. Puerto Rico
77. Romania*
78. Russian Federation*
79. Serbia
80. Singapore*
81. Slovakia
82. Slovenia
83. Spain[13]
84. Sri Lanka
85. Sudan*
86. Sweden*
87. Switzerland

18. Chile
19. Colombia* (2)[3]
20. Croatia
21. Cyprus (2)[4]
22. Czech Republic*
23. Denmark
24. Dominican Republic
25. Ecuador*
26. El Salvador*
27. Estonia
28. Finland
29. France*
30. Germany (8)[5]
31. Gibraltar
32. Greece
33. Guatemala*
34. Honduras
35. Hong Kong*
53. Liechtenstein
54. Lithuania
55. Luxembourg
56. Macedonia
57. Malaysia*
58. Malta
59. Marshall Islands[9]
60. Mexico*[10]
61. Micronesia[9]
62. Moldova
63. Montenegro
64. Morocco*
65. Netherlands
66. New Zealand
67. Nicaragua*
68. Nigeria*
69. Norway
70. Oman
88. Taiwan*
89. Tajikistan
90. Tanzania*
91. Thailand*
92. Trinidad and Tobago*
93. Turkey*
94. Uganda
95. Ukraine*
96. United Kingdom*
97. United States*[14]
98. Uruguay*
99. Uzbekistan
100. Venezuela*
101. Vietnam*
102. Yemen
103. Zimbabwe*

[*The asterisk denotes an IADI Member]

[1]There are five deposit insurance systems in Austria: Einlagensicherung der Banken und Bankiers Gesellschaft m.b.H., Österreichische Raiffeisen-Einlangensicherung reg. Gen.m.b.H., Hypo-Haftungsgesellschaft m.b.H., Sparkassen-Haftungs AG and Schulze-Delitzsch Haftungsgenossenschaft reg.Gen.m.b.H.

[2]In addition to the Canada Deposit Insurance Corporation (CDIC) and Quebec Deposit Insurance Board (QDIB), there are 10 other deposit insurers in Canada. These largely insure provincially-chartered credit unions. There is separately one in each province, save for Manitoba which has two (one for credit unions and one for caisses populaires).

[3]There are two deposit insurance systems in Colombia: there is the IADI member Fondo de Guarantias de Instituciones Financieras (FOGAFIN) covering deposits in banks, also the Fondo de Garantias de Entidades Cooperatives (FOGACOOP) to deal with deposits in cooperatives.

[4]The two deposit insurance systems in Cyprus are the Deposit Protection Scheme and the Deposit Protection Scheme for Co-operative Societies.

[5]There are eight deposit insurance systems in Germany including the private Association of German Banks.

[6]The three deposit insurance systems in Italy are Fondo Interbancario di Tutela dei Depositi (FITD), Fondo di Garanzia dei Depositanti del Credito Cooperativo and Fondo di Garanzia dei portatori di titoli obbligazionari emessi da banche appartenenti al Credito Cooperativo.

[7]While the Deposit Insurance Corporation of Japan, is responsible for insuring deposit-taking institutions in general, the agricultural and fishery cooperatives, etc. are separately insured by the Agricultural and Fishery Cooperative Savings Insurance Corporation (AFCSIC) due to the different risk features of these institutions.

[8]The Korea Deposit Insurance Corporation provides deposit insurance for banks, insurance companies, securities companies, merchant banks and mutual savings banks. In the case of credit unions, their deposits are protected by the National Credit Union Federation of Korea.

[9]Though the Marshall Islands, Micronesia and Puerto Rico do not have their own deposit insurance system, deposits with banks are insured by the US Federal Deposit Insurance Corporation (FDIC).

[10]In Mexico, in addition to the Instituto para la Protección al Ahorro Bancario (IPAB) a provision in law provides for several private trusts, under the generic name of Fondo de Protección (one for each supervising entity that encompasses various popular credit and savings institutions) to cover deposits made in such institutions.

[11]There are two deposit insurance systems in Poland : there is the IADI member Bank Guarantee Fund insuring deposits with banks (both commercial and cooperative) and deposits with credit unions are insured by the Polish Cooperative Saving and Credit Union Mutual Insurance Society.

[12]There are two deposit insurance systems in Portugal: Fundo de Garantia de Depósitos and Fundo de Garantia do Crédito Agrícola Mútuo.

[13]The Spanish system comprises three deposit guarantee funds: for banking institutions (Fondo de Garantía de Depósitos en Establecimientos Bancarios), savings banks (Fondo de Garantía de Depósitos en Cajas de Ahorro) and cooperative credit banks (Fondo de Garantía de Depósitos en Cooperativas de Crédito), all managed by the Sociedad Gestora de los Fondos de Garantía de Depósitos en Entidades de Créditos, A.I.E.

[14]A number of deposit insurers exist in the US in addition to the Federal Deposit Insurance Corporation (FDIC). All federal credit unions are insured by the National Credit Union Share Insurance Fund (NCUSIF), a subsidiary of the National Credit Union Administration. Some state-chartered credit unions are also insured by NCUSIF. However, certain states have non-federally insured credit unions. These institutions tend to be insured by private schemes, the largest of which is American Share Insurance.

APPENDIX B

LETTER WRITTEN BY ALAN B. RABKIN, ESQ. ON BEHALF OF THE NEVADA BANKERS ASSOCIATION AND THE ARIZONA BANKERS ASSOCIATION TO THE FDIC DATED MARCH 27, 2009 REGARDING EMERGENCY SPECIAL ASSESSMENTS

MELVIN D CLOSE JR
JOSEPH W BROWN
ALBERT F PAGNI
JOHN P SANDE, III
WILLIAM J RAGGIO
GARY R GOODHEART
MICHAEL E BUCKLEY
RICHARD F JOST
JANET L CHUBB
DOUGLAS M COHEN
KIRK B LENHARD
KEVIN R STOLWORTHY
JAMES L WADHAMS
JODI R GOODHEART
PAUL A LEMCKE
MICHAEL G ALONSO
ANN MORGAN

KRIS T BALLARD
WILLIAM C DAVIS, JR
KARL L NIELSON
PATRICK J SHEEHAN
CLARK V VELLIS
JOHN P DESMOND
SCOTT M SCHOENWALD
CONSTANCE L AKRIDGE
EDWARD M GARCIA
TAMARA BEATTY PETERSON
ELIZABETH M FIELDER
MOLLY MALONE REZAC
DAVID A CARROLL
RYAN W HERRICK
BRIAN R IRVINE
MATTHEW T MILONE
BRETT J SCOLARI

JONES VARGAS

ATTORNEYS AT LAW
TWELFTH FLOOR
100 WEST LIBERTY STREET
PO BOX 281
RENO, NEVADA 89504-0281

TEL (775) 786-5000 FAX (775) 786-1177

WWW JONESVARGAS COM

WHITNEY D BOCCHI
LOUIS M BUBALA III
JUSTIN J BUSTOS
ADAM K BULT
KENNETH K CHING
TRACY A DIFILLIPPO
ANTHONY J DIRAIMONDO
KATHLEEN L FELLOWS
NICOLE M HARVEY
MICHAEL A KELLER
BENJAMIN W KENNEDY
WAYNE O KLOMP

DANA B KRULEWITZ
CURT R LEDFORD
BRYAN A LINDSEY
CHRISTOPHER C MONEY
RICHARD A RAWSON
JOHN P SANDE, IV
BRADLEY SCOTT SCHRAGER
STEVEN C SHEVORSKI
DANIEL H STEWART
JESSE A WADHAMS
CHRISTINA H WANG
GORDON H WARREN

CLIFFORD A JONES (1912 - 2001)
HERBERT M JONES (1914 - 2008)
GEORGE L VARGAS (1909 - 1985)
JOHN C BARTLETT (1910 - 1982)
LOUIS MEAD DIXON (1919 - 1993)
GARY T FOREMASTER (1953 - 1998)

RICHARD Q BARRIER
ROBERT E BRUCE
AMANDA J COWLEY
ALAN B RABKIN
STEVEN T POLIKALAS
OF COUNSEL

E-Mail Address
arabkin@jonesvargas.com

March 27, 2009

BRIAN J. MATTER
EXECUTIVE DIRECTOR

Robert Feldman, Executive Secretary
Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington, DC 20429

RE: *Proposed FDIC Emergency Special Assessment (RIN 3064-AD35)*

Dear Mr. Feldman:

I represent the Nevada Bankers Association ("NBA") and the Arizona Bankers Association ("AzBA") and I am writing to you on their behalf.

These bank associations are both 'close to the ground' bank industry groups who are involved with banking issues on a local, state and, in this case, national basis. Amongst banking organizations they are true leaders.

I felt we could collectively provide the FDIC with insight on the proposed FDIC Special Emergency Assessment proposal (the "Special Assessment") that is now pending for comment and our member institutions, numbering well over one hundred, appreciate this opportunity to do so.

By way of background, and as I am sure you are quite aware, NBA is a bank industry group consisting of national and state chartered institutions and affiliate members in Nevada with an ongoing interest in maintaining stable and well managed banking within the State of Nevada. AzBA is similar in its orientation and represents an even larger group of institutions with regard to the State of Arizona. However, service to their member banks is only the start of their mission as they are actively involved in consumer financial issues and community financial education.

Our member banks range from small branch banks in the far North of Nevada and they run continuously south through major urban cities such as Reno, Las Vegas, Phoenix and Tucson and end at the Mexican border. Together, the various institutions in this huge swath of land represent a wide cross section of community, regional and national institutions and serve

hundreds of thousands of rural and urban families and regional and local businesses as well as the employees who serve them on behalf of our member banks.

We mention this as our response is on behalf of all of these banks—big and small—and all of their customers and borrowers--as all banks will be immediately, directly and negatively impacted by the Special Assessment in the manner and for the reasons discussed below.

As we understand the proposal, the Special Assessment is a further add-on to the new permanent assessment scheme set forth in FIL-12-2009 (effective April 1, 2009) that will already impose significant new deposit premiums on our institutions in the future. Both the permanent assessment and Special Assessment are obviously designed to assist in the stabilization and future funding of the FDIC Fund (sometimes referred to as the "DIF"). So there is no misimpression, we agree that a stabilized DIF is a good thing to work towards systematically.

The Special Assessment additional element to the ongoing DIF assessments is designed to impose a 20 basis point increase in DIF contributions by banks by way of deposit insurance premiums (with possible additional 10 basis point assessments in certain circumstances). The Special Assessment is not risk-weighted. Your authority to charge this Special Assessment would be preapproved without further input or discussion and would not be subject to notice and further comment as to the circumstances that existed at the time it is imposed.

We believe the Special Assessment creates new risks and problems that should be avoided. Few banks are able to handle increases in the DIF with ease. Fewer 1 and 2 rated institutions now exist and are likely to exist in the near future. Many of our institutions are already rated less favorably than 1 and 2. As a result, all of the down-rated banks will pay far more and compete far less even under the regular DIF assessments going forward. Adding the possibility of a Special Assessment places institutions rated below a 2 at even greater risk, and if Special Assessments are actually assessed, further weakens them. This could have the unwelcome outcome of pushing institutions over the edge in exchange for the transitory comfort of seeing accelerating reserves flood into the DIF.

Banks are no longer able to absorb increasing DIF assessments in an environment of increasing loss. They have reached a natural limit as loss is imposed and increases by operations, audit fees, rising accounting costs and DIF assessments. Loss, of course, equates to reduced capital and the same regulators who impose new and higher assessment costs also are imposing higher capital standards. It is inconsistent and acting at cross purpose to ask for both to occur together and contemporaneously.

Aside from the immediate and counterproductive impact on the DIF caused by further weakening banks without real reason, many of the more challenged institutions exist in our rural and suburban areas and any failures will impact those banks more. Even if larger institutions do not close as bank systems, they may close marginal locations to simply survive

higher regulatory costs, such as the Special Assessment. It is feared the result will be more underserved bank customers.

The current stress that has been placed upon banking in addressing account pricing and, at the same time, to maintain the added cost of loan servicing is well-documented by your own recent exam cycles. Also, calls for capital resound from every regulatory sector. It would appear that rather than drain profits from banks for rapid replenishment of the DIF that a focus should be placed on building capital first as capital is front line in the fight to protect and preserve the DIF.

Further, many institutions in the two states NBA and AzBA operate lost significant money in 2008 and almost assuredly will again lose equally large or greater sums in 2009. Causing an accelerated rate of loss with a Special Assessment is not the solution as banks simply are at an end of their ability to absorb loss and acquire capital in tandem.

Therefore, real impacts on all our communities served will be the real result if Special Assessments are made in advance of sustained bank profitability. The outcomes are all to be anticipated. For example, savings and time certificate account pricing will naturally decline to accommodate the increasing DIF obligation and this squeezes those reliant on fixed incomes. Support for local events and charities is quickly impacted as profits are reduced and community budgets are slashed. Full time positions are reduced to part-time positions to counter the increasing overhead. These are but a few of the real and tragic outcomes of increasing cost in troubled economies.

Our members realize and appreciate that the FDIC is attempting to spread the cost of failed institutions across the wide spectrum of general taxpayers, the current FDIC fund and the remaining healthier institutions that live on. However, rendering banks unprofitable to do so is far too heavy a weight on the backs of American bankers and those in Nevada and Arizona. It is disproportional when banks, alone, shoulder such a burden over a compressed period in one of the worst economies in our lifetimes. Regulatory action should never be disproportional.

We urge a different strategy. As we all await the far deeper regulatory overhaul proposed by Treasury, the Federal Reserve and your agency, let us all reflect, be less reactive and measure our need to accelerate the restoration of the DIF all at once. As the engine of banking increases above its current rough idle level, new DIF issues and assessment costs are easier to address as the economy increases. Doing so without banks profitable only artificially forces issues that may, in fact, have resolved themselves.

Before assuming the banks in Nevada and Arizona can easily absorb these fees, know that this is not backed by your own data and bank ratings. If weakening of banks is of a concern to you, please reconsider the use of your many other borrowing resources at the Treasury; fees related to the various capital and guaranty programs; and appropriations to bridge the current wicked economy and the gap in funding to restore the DIF to full health.

Create proportional responses to a DIF being drained of its resources—not a reactive response that will simply create the need for a cascade of additional responses.

On behalf of NBA and AzBa, I sincerely appreciate the opportunity to offer these comments on behalf of our members, their families and the employees who serve them.

Very truly yours,

JONES VARGAS

Alan B. Rabkin
Of Counsel

ABR:ar

cc: Nevada Bankers Association (Attn. William Uffelman)
Arizona Bankers Association (Attn. Tanya Wheeless)
American Bankers Association (Attn. Wayne Abernathy/Jim Chessen)

APPENDIX "C"

EXCERPT OF KEYNOTE ADDRESS OF ALAN B. RABKIN, ESQ. AT THE NEVADA BUSINESS SUMMIT:

"Someday deposit insurance will legally protect all savers worldwide and in a uniform manner. It will be an easy to understand scheme to the common saver and it will periodically notify customers of their precise coverage and any exceptions with understandable information. It will cover all deposit accounts and for a substantial portion of a typical deposit. It will include non-residents, companies, other banks or governments. It will pay-out quickly. It will be adequately and responsibly pre-funded with an understandable risk-rated or differential premium. It will eliminate or reasonably control the use of deposit insurance to gain competitive advantage and allow banks to compete on the basis of products and services and not on fears of bank volatility and solvency. It will never blame depositors for failures of bank management or the lack of prudential supervision. It will not use Moral Hazard as an excuse for proper prudential supervision. It will liquidate banks in an orderly way and without increasing liability to the fund.

After that day, deposit insurance will be taken for granted and the confidence it imparts will return banking to a solid footing and start to repair the loss of trust repeatedly caused by and between banks and their savers with each ensuing financial crisis. It will deliver the most important outcome possible for a deposit insurance system: it will deliver confidence.

That someday is not yet at hand but remains within our reach. It evades us only due to lack of political will, cost and our failure to admit that many deposit protection programs are insufficient. However, while an entirely agreed-upon and harmonized system is not yet at hand, we, the global financial community, now insist on it and have made a renewed start in the aftermath of the current financial crisis which has taken its toll from Dublin to Buenos Aires and from New York to Beijing. As we approach a history of deposit insurance that spans its first century as a worldwide tool for avoiding bank runs and financial panic, the time could not be more right to complete the attainable task of solidifying the banking system with improved prudential supervision, better capitalized institutions and a full safety-net of protections including deposit insurance and in the process making clear for all future generations that banking is not irrelevant but remains a stable, core institution in our broader financial services' marketplace of choices."

Keynote Presentation of Alan B. Rabkin, Esq.
Nevada Business Summit,
University of Nevada
November 17, 2008

REFERENCE LIST (BIBLIOGRAPHY)

A. Books and Reference Texts.

American Bar Association ("ABA") — *Bank Mergers and Acquisitions Handbook* ABA, Section of Antitrust Law (2006)

Amicorum, Liber ("Liber") — *Legal Aspects Of The European System of Central Banks,* European Central Bank (2005)

Association of Supervisors ("ASBA") — *Effective Deposit Insurance Schemes and Bank Resolution Practices*, Association of Supervisors of Banks of the Americas (September, 2006)

Barth, James R. ("Barth 1") — *Rethinking Bank Regulation: Till Angels Govern* Cambridge University Press (2006)

Barth, James R. ("Barth 2") — *The Reform of Federal Deposit Insurance: Disciplining the Government and Protecting Taxpayers* Harper Collins Publishers (1992)

Battilossi, Stefano ("Battilossi") — *European Banks and the American Challenge: Competition and Cooperation in International Banking Under Bretton Woods* Oxford University Press (2002)

Bogaert, R. ("Bogaert") — *A History of European Banking* Fonds, Mercator Paribas (1994)

Campbell, Andrew ("Campbell") — *Deposit Insurance* Palgrave Macmillan (2007)

Carisano, Rita ("Carisano") — *Deposit Insurance: Theory, Policy and Evidence* Dartmouth Publishing (1992)

Carnell, Richard Scott ("Carnell") — *The Law of Banking and Financial Institutions: Fourth Edition* Wolters Kluwer/Aspen Publishers (2009)

Cooper, George ("Cooper") — *The Origin of Financial Crises: Central Banks, Credit Bubbles and the Efficient Market Fallacy*, Vintage Books (2008)

Cotter, Anna-Marie Cooney ("Cooney") — *Banking & Corporate Financial Services* Law Society of Ireland and Cavendish Publishing Limited (2003)

Craig, Paul ("Craig") — *EU Law: Text, Cases and Materials: Third Edition* Oxford University Press (2003)

Cranston, Ross ("Cranston") — *Principles of Banking Law*, Second Edition Oxford University Press (2005)

Demirguc-Kent ("Demirguc") — *Deposit Insurance Around The World: Issues of Design and Implementation,* MIT Press (2008)

Ellinger, E.P. ("Ellinger") — *Ellinger's Modern Banking Law: Fourth Edition* Oxford University Press (2002)

Enoch. Charles ("Enoch") — *Banking Soundness and Monetary Policy*: Issues and Experiences in the Global Economy, International Monetary Fund (1997)

Farrell, Kathryn L. ("Farrell") — *Law and Banking: Fifth Edition* American Bankers Association (2005)

Federal Deposit Ins. Corp. ("FDIC 1") — *Federal Deposit Insurance Corporation: The First Fifty Years*; *A History of the FDIC* 1933-1983, FDIC (1984)

Federal Deposit Ins, Corp ("FDIC 2") — *A Brief History of Deposit Insurance In The United States,* (September 1998)

Felsenfeld, Carl ("Felsenfeld") — *International Banking Regulation*, Second Edition Juris Publishing

Gilbart, W.S. ("Gilbart") — *History, Principles and Practice of Banking*, George Bell & Sons (1907).

Grubel, Herbert G. ("Grubel") — *A Proposal For The Establishment Of An International Deposit Insurance Corporation*, Princeton University No.133 Essays In Int'l Finance (1979)

Haan, Jakob de ("Haan") — *The History of the Bundesbank:* Lessons for the European Central Bank, Routledge (2000)

Hall, Maximillan J. B. ("Hall 1") — *The Regulation & Supervision of Banks: Deposit Insurance* (The International Library of Critical Writings In Economic Series, I, II, III and IV), Edward Elgar (2001)

Vols.

Hall, Maximillan J.B. ("Hall 2") — *Deposit Insurance Reform In Japan*, Research Paper, Loughborough University Banking Centre, Loughborough University (1998)

Hazen, Thomas Lee ("Hazen") — *Principles of Securities Regulation: Second Edition* (Concise Hornbook Series), Thomson West (2006)

Hemetsberger, W. ("Hemetsberger") — *European Banking and Financial Services Law*, Kluwer Law In Association With EAPB (The European Association of Public Banks and Funding Agencies) (1 July 2006)

Hoelscher, David S. ("Hoelscher") — *The Design and Implementation of Deposit Insurance Systems:* Occasional Paper 251, International Monetary Fund (2006)

Howarth, David ("Howarth") — *The European Central Bank: The New European Leviathan?* Palgrave Macmillan (2005)

Kane, Edward J. ("Kane")	*The Gathering Crisis In Federal Deposit Insurance* MIT Press (1985)
Kaufman, George G. ("Kaufman")	*Bank Fragility and Regulation: Evidence From Different Countries*; Vol. 12, Research In Financial Services: Private and Public Policy, JAI/Elsevier Science (2000)
Kennickell, Arthur B. ("Kennickell")	*Households' Deposit Insurance Coverage: Evidence and Analysis of Potential Reforms*, Federal Reserve Board, Finance and Economic Discussion Series, Paper No. 95-5 (1995)
Kindleberger, Charles ("Kindleberger")	*A Financial History of Western Europe* Oxford University Press (1993)
Konstas, Panos, ("Panos")	*Reforming Deposit Insurance: The Case To Replace FDIC Protection With Self Insurance*. Jerome Levy Institute (2006)
Kremers, Jeroen J. M. ("Kremers")	*Financial Supervision In Europe* Edward Elgar Publishing (2003)
Kuppens, Thea ("Kuppens")	*Banking Supervision At The Crossroads* Edward Elgar Publishing (2003)
Loranth, Gyongyi ("Gyongyi")	*Multinational Bank Regulation With Deposit Insurance and Diversification Effects*, Centre For Economic Policy Research, Paper No. 4148 (2003)
Lovett, William A. ("Lovett")	*Banking and Financial Institutions Law* (West Nutshell Series) Sixth Edition, Thomson West (2005)
Lucey, Brian M. ("Lucey")	*Fair Deposit Insurance Premiums For Two Irish Banks,* Research Paper 93/4, Institute of European Finance, University of Wales (Bangor) (1993)
Macey, Jonathan R. ("Macey")	*Banking Law and Regulation: Third Edition* Aspen Publishers (2001) [Fourth Edition Under Carnell]
MacDonald, Ronald (""MacDonald")	*Deposit Insurance*, Centre For Banking Studies, Paper No. 9, Bank of England (1996)
Malloy, Michael P. ("Malloy")	*Principles of Bank Regulation: Second Edition* (Concise Hornbooks Series), Thompson West (2003)
Masciandaro, Donato ("Donato 1")	*Financial Intermediation in the New Europe: Banks, Markets and Regulation in EU Accession Countries,* Edward Elgar Publishing (2004)
Masciandaro, Donato ("Donato 2")	*Handbook of Central Banking and Financial Authorities in Europe: New Architectures in the Supervision of Financial Markets,* Edward Elgar Publishing (2005)

Mayes, David G. ("Mays") — *Improving Banking Supervision* Palgrave (2001)

McKillop, Donal ("McKillop") — *Deposit Insurance: Moral Hazard and UK Credit Unions.* Research Paper 95/8, Institute Of European Finance, University College of North Wales (1995)

Mishkin, Frederic S. ("Mishkin") — *Prudential Supervision: What Works and What Doesn't* University of Chicago Press (2001)

Morrison, Alan ("Morrison") — *Is Deposit Insurance A Good Thing, and If So, Who Should Pay For It?* Discussion Paper No. 4424, Centre For Economic Policy Research (CEPR) (June 2004)

Pollard, Alfred ("Pollard") — *Banking Law of the United States*, Third Edition, Juris Publishing (April 2006)

Poloucek, Stanislav ("Poloucek") — *Reforming The Financial Sector In Central European Countries* Palgrave Macmillan (2004)

Robb, Thomas B. ("Robb") — *The Guarantee of Bank Deposits* Houghton Mifflin Company (1921)

Rothbard, Murray N. ("Rothbard 1") — *The Case Against the Fed* Ludwig von Mises Institute (1994)

Rothbard, Murray N. ("Rothbard 2") — *A History of Money and Banking in the United States: The Colonial Era to World War II*, Ludwig von Mises Institute (2005)

Russell, Thomas H. ("Russell") — *Banking Credits and Finance*, Whitman Publishing (1916)

Salsman, Richard M. ("Salsman") — *The Collapse of Deposit Insurance—the Case For Abolition,* American Institute For Economic Research, Economic Education Bulletin (1993)

Scheller, Hanspeter K. ("Scheller") — *The European Central Bank: History, Role and Functions* European Central Bank (2004)

Schich, Sebastian ("Schich") — *Financial Turbulence: Some Lessons Regarding Deposit Insurance*, OECD's Committee on Financial Markets (2008)

Schoenmaker, Dirk ("Schoenmaker") — *Home Country Deposit Insurance?* LSE Financial Markets Group Special Paper Series, Paper No. 43 (1992)

Schoppman, Herman ("Schoppman") — *European Banking and Financial Services Law* Kluwer Law International (2006)

Shibut, Lynn ("Shibut") — *Should Bank Liability Structure Influence Deposit Insurance Pricing?,* FDIC Working Paper Series 2002-01 (January 2002)

Stern, Gary H. ("Stern") — *Too Big To Fail: The Hazards of Bank Bailouts*, Brookings Institution Press (2004)

Temperton, Paul ("Temperton")	*The Euro* John Wiley & Sons (1998)
Wallison, Peter J. ("Wallison")	*Back From The Brink: A Practical Plan For Privatizing Deposit Insurance and Strengthening Our Banks and Thrifts*, American Enterprise Inst. (1990)
Williams, Harding de C. ("Williams")	*Federal Banking Law and Regulations: A Handbook for Lawyers* ABA, Section of Business Law (2006)

B. Articles, Papers and Journal Publications.

ABA, *Bank Compliance*, *FDIC Proposes To Extend TAGP*, ABA Center For Regulatory Compliance (June 30, 2009) ("ABA Compliance Article 1").

ABA, *Bank Compliance*, *How Are You Handling FDIC Insurance Changes?*, ABA Center For Regulatory Compliance (January/February, 2009) ("ABA Compliance Article 2").

ABA Advisory, *FDIC Clarifies Sweep Disclosure Rule, Repo Requirements*, American Bankers Association ("ABA Advisory Article")

ABA, American Bankers Association, Institute Of Certified Bankers, *Obama Releases Sweeping Reform Plan; ABA Preps Bankers For Battle For Banking's Future* (June 2009) ("American Bankers Article")

ABA, *International Legal Developments In Review: 2008; Financial Products and Services*, American Bar Association, Section of International Law, The International Lawyer, Vol. 43, No. 2 (Summer 2009) ("ABA Article")

Acello, Richard, *Big Save: ABA Helps Convince FDIC To Extend Banking Protections To IOLTAs*, ABA [American Bar Association] Journal (February 2009) ("Acello Article")

Arner, Douglas W., *The Global Crisis of 2008: Causes and Consequences,* American Bar Association, Section of International Law, The International Lawyer, Vol. 43, No. 1 (Spring 2009) ("Arner Article")

Asano, A., *The Paradox of Limited Deposit Insurance Under the Amajudari Practice in the Japanese Banking System*, Journal of Asian Economics [DATE] ("Asano Article")

Asian Development Bank, Financial Sector Legal and Regulatory Toolbox, Part B: Depositor Protection Schemes; Part C: Deposit Insurance: International Standards (2009) ("Asian Article")

Baharav, Ronen, *Financial Services In Israel*, Herzog, Fox & Neeman (2006) ("Baharv Article")

Barth, James R., *Bank Capital Adequacy Regulation Under The New Basel Accord*, Journal of Financial Intermediation, Vol. 13, Issue 2 (April 2004) ("Barth Article")

Beck, Thorsten, *Deposit Insurance As Private Club: Is Germany A Model?*, the World Bank, Financial Sector Strategy and Development Department, Working Paper 2559 (February, 2001) ("Beck Article")

Binder, Jens-Hinrich, *Regulatory Competition Between the Deposit Insurer and a Single Financial Regulator—The Case of Germany*, American Bar Association, Section of International Law, The International Lawyer, Vol. 39, No. 1 (Spring 2005) ("Binder Article")

Brewer, Edward C., *The Fat Cat In The Hat: A Tale of Banks, Bankers and Regulators*, Business Law Today, a Publication of the American Bankers Association, Section of Business Law, (November/December 1999) ("Brewer Article")

Bryant, John, A Model of Reserves, Bank Runs and Deposit Insurance, Journal of Banking & Finance, Vol. 4, Issue 4 (December 1980) ("Bryant Article")

Buser, Stephen A., *Federal Deposit Insurance, Regulatory Policy, and Optimal Bank Capital*, The Journal of Finance, Blackwell Publishing, Vol. 36, No. 1 (March 1981) ("Buser Article")

Buiter, Willem H., *The Icelandic Banking Crisis and What To Do About It: The Lender of Last Resort Theory Of Optimal Currency Areas,* CEPR Policy Insight No. 26, Centre For Economic Policy Research (October 2008) ("Buiter Article")

Calomiris, Charles W., *Deposit Insurance: Lessons From The Record*, Federal Reserve Bank of Chicago Paper (From "Economic Perspective") (May 1989) ("Calamiris Article")

Calomiris, Charles W., *Is Deposit Insurance Necessary? A Historical Perspective*, The Journal of Economic History, Cambridge University Press, Vol. 50, No. 2 (June 1990) ("Calomiris Article 1")

Calamiris, Charles W., Bank Failures In Theory and History: The Great Depression and Other Cantagious Events, NBER Working Papers 13597, National Bureau of Economic Research, Inc. (2007) ("Calamiris Article 2")

Camara, Modibo K., *Deposit Insurance and Banking Reform In Russia*, World Bank Policy Research Working Paper 4056 (November 2006) ("Camara Article")

Carey, Brian, *Irish Banks Are Saved In €7 Billion Bailout*, The Sunday Times Online (December 21, 2008) ("Carey Article")

Cebula, Richard J., *The Impact of Federal Deposit Insurance On Savings and Loan Failures: A Reply To Ira S. Saltz*, Southern Economic Journal, Vol. 62, Issue 1 , Southern Economic Association (July 2005) ("Cebula Article")

Chan, Yuk-See, *Is Fairly Priced Deposit Insurance Possible?*, The Journal of Finance, Vol. 47, No. 1 (March 1992) ("Chan Article")

Chari, V.V. (Federal Reserve Bank of Minnesota), *Banking Without Deposit Insurance or Bank Panics: Lessons From A Model Of The U.S. National Banking System*, Minnesota Federal Reserve Bank (Summer, 1989) ("Chari Article")

Cihak, Martin, *Study Shows Larger Islamic Banks Need Prudential Eye*, International Monetary Fund, IMF Survey Magazine, IMF European Department (May 19, 2008) ("IMF Article")

Chu, Kam Hon, *Deposit Insurance and Banking Crises In The Short and Long Run*, The Cato Journal (Cato Institute) Vol 23, Issue 2 (September 2003) ("Chu Article")

Cordella, Tito, *Financial Opening, Deposit Insurance and Risk In A Model of Banking Competition* , Centre For Economic Policy Research (1998) ("Cordella Article")

Crear, Senious, *Cooperative Banks, Credit Unions and the Financial Crisis*, World Council of Credit Unions (April 28, 2009) ("Crear Article")

Cull, Robert, *Deposit Insurance and Financial Development*, World Bank Policy Research Working Paper 2682 (September 2001) ("Cull Article")

Demirguc-Kunt, Asli, *When Is Deposit Insurance a Good Idea?*, Vol. 3, No. 4, World Bank (Research Digest) (Fall, 2008) ("Demirguc Article 1")

Demirguc-Kunt, Asli, *Deposit Insurance Design and Implementation: Policy Lessons From Research and Practice*, World Bank Policy Research Working Paper 3969 (July 2006) ("Demirguc Article 2")

Demirguc-Kunt, Asli, *Deposit Insurance Around The Globe: Where Does It Work?*, Working Paper 2679, The World Bank, Development Research Group (Finance), (September 2001) ("Demirguc Article 3")

Demirguc-Kunt, Asli, *Deposit Insurance Around The Globe: A Comprehensive Database* (As Of 2003), Working Paper 3628, The World Bank, Development Research Group (Finance), (April 2005) ("Demirguc Article 4")

Demirguc-Kunt, Asli, *Deposit Insurance Around The Globe: Where Does It Work?,* The Journal of Economic Perspectives, American Economics Association, Vol. 16, No. 2 (Spring 2002) ("Demirguc Artcle 5")

Detragiache, Enrica, *Does Deposit Insurance Increase Banking System Stability?*, International Monetary Fund, IMF Working Paper 00/3 (2000) ("Detragiache Article")

Diamond, Douglas W., *Bank Runs, Deposit Insurance and Liquidity*, Federal Reserve Bank of Minneapolis Quarterly Review, Vol. 24, No. 1 (Winter 2000) ("Diamond Article")

Di Noia, Carmine, *Structuring Deposit Insurance In Europe: Some Considerations and a Regulatory Game*, Wharton School Center for Financial Institutions, Paper No. 94-31 (December, 1994) ("DeNoia Article 1")

Di Noia, Carmine, *Should Banking Supervision and Monetary Policy Tasks Be Given To Different Agencies?*, Universitat Pompeu Fabra, Economics Working Paper No. 411 (1999) and also published by the Wharton School Center For Financial Insitutions, Working Paper 00-11 (1999) ("DeNoia Article 2")

Dubel, Hans-Joachim, *Europe's Second Pillar: A European Deposit Insurance System, Complementing Monetary Union*, The International Economy, Vol. 22, Issue 4 (September 22, 2008) ("Dubel Article")

El-Shazly, Alaa, *Incentive-Based Regulations and Bank Restructuring In Egypt*, Cairo University Research Paper, to be found at http://www.luc.edu/orgs/meea/volume3/elsahzly.pdf ("El-Shazly Article")

Ely, Bert, *Regulatory Moral Hazard: The Real Moral Hazard in Federal Deposit Insurance*, Independent Review, Vol. 4, Issue 2, Page 241 (September 22, 1999) ("Ely Article")

England, Catherine, *Replacing The FDIC: Private Insurance For Bank Deposits*, Policy Paper No. 229, Cato Institute (12/02/82) ("England Article 1")

England, Catherine, *Private Deposit Insurance: Stabilizing The Banking System*, Cato Policy Analysis Paper No. 54, Cato Institute (06/21/85) ("England Article 2")

Field, William, *Deposit Insurance: A Market-Based Reform Proposal (Federal Deposit Insurance Corporation)*, Review of Business, St. John's University, College of Business Administration, vol. 13, issue 3 (December 22, 1991) ("Field Article")

Garcia, Gillian G. H., *Deposit Insurance: Actual and Good Practices*, International Monetary Fund, Occasional Paper 197 (January 2000) ("Garcia Article")

Gegenheimer, Gary A., *Bank Regulatory Reform in Ukraine*, American Bar Association's The International Lawyer, Vol. 39, No. 4 (Winter 2005) ("Gegenheimer Article")

Gropp, Reint, *Deposit Insurance and Moral Hazard: Does The Counterfactual Matter?*, Working Paper 47, European Central Bank Working Paper Series (March 2001) ("Gropp Article 1")

Gropp, Reint, Deposit Insurance, Moral Hazard and Market Monitoring, Working Paper 302, European Central Bank Working Paper Series (2004) ("Gropp Article 2")

Gruebel, Herbert G., *A Proposal For The Establishment Of An International Deposit Insurance Corporation*, Essays In International Finance, No. 133, Princeton University (July 1979) ("Gruebel Article")

Gual, Jordi, *The Integration of EU Banking Markets*, Working Paper No. 504, IESE Business School, Universidad de Navarra (April 2003) ("Gual Article")

Hager, Stephen, *Banking With and Without Deposit Insurance: Mexico's Banking Experiments, 1884-2004*, Stanford University (August 16, 2005) ("Hager Article")

Hane, George, *Deposit Insurance Reform: State Of The Debate*, Division of Research and Statistics, FDIC (2000) ("Hane Article")

Heaton, J.B., *Solvency Tests*, ABA The Business Lawyer, Vol. 62 (May 2007) ("Heaton Article")

Hein, Scott, The New FDIC Insurance Premium Assessments: A Better Way, Graduate School of Banking at Colorado (April 6, 2009) ("Hein Article")

Helfer, Ricki T., *What Deposit Insurance Can and Cannot Do*, Finance & Development (an IMF Publication), Vol. 36, No. 1 (March 1, 1999) ("Helfer Article")

Herbst, Christian, *Austria: Legislation To Stabilize Financial Markets In Times of Market Crisis*, Corporate Counsel (2009) ("Herbst Article")

Honohan, Patrick, *Controlling the Fiscal Costs of Banking Crises*, World Bank Policy Research Working Paper 2441 (September 30, 2000) ("Honohan Article 1")

Honohan, Patrick, *What Went Wrong In Ireland?* Paper Prepared For World Bank Review, Trinity College Dublin (May, 2009), which may be found at http://www.tcd.ie/Economics/staff/phonohan/ ("Honohan Article 2")

Honohan, Patrick, *Irish Banking Policy During and After The Crisis*, Paper Presented At The 2009 MacGill Summer School (07/21/09), which may be found at http://www.tcd.ie/Economics/staff/phonohan/ ("Honohan Article 3")

Honohan, Patrick, *POLICY PAPER, Resolving Ireland's Banking Crisis*, The Economics and Social Review, Vol. 40., No. 2 (Summer, 2009), pp. 207-231, which may be found at http://www.tcd.ie/Economics/staff/phonohan/ ("Honohan Article 4")

Huizinga, Harry, *Deposit Insurance and International Bank Liabilities*, Discussion Paper 3244, Centre For Economic Policy Research (CEPR), PL-363-40 (March 2003) ("Huizinga Article 1")

Huizinga, Harry, *Deposit Insurance and International Bank Liabilities*, Centre For Economic Policy Research (2003) (also published in the Journal of Banking and Finance (2003) ("Huizinga Article 2")

Huizinga, Harry, *The EU Deposit Insurance Directive: Does One Size Fit All?,* Discussion Centre For Economic Policy Research (CEPR), Discussion Paper 5277 (October 2005) ("Huizinga Article 3")

Ioannidou, Vasso, *The Impact of Explicit Deposit Insurance On Market Discipline*, Tilburg University, Center For Economic Research, Discussion Paper 5 (2006) ("Ioannidou Article")

Kahn, C. M., *Allocating Bank Regulatory Powers: Lender Of Last Resort, Deposit Insurance and Supervision*, European Economic Review, Vol. 49, Issue 8 (November, 2005) ("Kahn Article")

Kane, Edward J., *Designing Financial Safety Nets To Fit Country Circumstances*, World Bank Working Paper 2453, The World Bank, Development Research Group (Finance), (September 2000) ("Kane 1 Article")

Kane, Edward J., *Appearance and Reality in Deposit Insurance: The Case For Reform*, Journal of Banking & Finance, Vol. 10, Issue 2 (June 1996) ("Kane 2 Article")

Keeley, Michael C., *Deposit Insurance, Risk, and Market Power In Banking*, The American Economic Review, American Economic Association, Vol. 80, No. 5 (December 1990) ("Keeley Article")

Kirpatrick, Lockhart & Gates, *Dust Off Your Files: The FDIC Is Back In Town* (August 4, 2008) and available at www.klgates.com/newsstand/Detail.aspx?publication=4807 ("Kirkpatrick Article")

Konstas, *Peter, Reforming FDIC Insurance With FDIC Sponsored Self-Insurance*, FDIC Working Paper 2005-04 (June 2005) ("Konstas Article")

Kuttner, Kenneth N., *The Federal Reserve As Lender Of Last Resort During The Panic of 2008,* Council of Foreign Relations, Committee on Capital Markets Regulation (December 30, 2008) ("Kuttner Article")

Imai, M., *Market Discipline and Deposit Insurance Reform In Japan*, Journal of Banking and Finance (2006) ("Imai Article")

Lane, Jason, *New Banking Laws Dominate Congressional Agenda,* California Banker (June 2009) ("Lane Article")

Laeven, Luc, *The Political Economy of Deposit Insurance*, World Bank, Policy Research Working Paper Series 3247 (2004) ("Laeven Article")

Mas, Ignacio, *Deposit Insurance In Developing Countries*, IMF Finance & Development Journal, Vol 27, No. 4 (December 1, 1990) ("Mas Article")

McDill, Kathleen, *Sources of Historical Banking Panics: A Markov Switching Approach*, FDIC Working Paper 06-01 (2006) ("McDill Article 1")

McDill, Kathleen, *Resolution of Costs and the Business Cycle*, FDIC Working Paper 04-1 (2004) ("McDill Article 2")

Merton, Robert C., *An Analytic Derivation of the Cost of Deposit Insurance and Loan Guarantees: An Application of Modern Option Pricing Theory*, Journal of Banking & Finance, Vol. 1, Issue 1 (June 1977) ("Merton Article")

Nier, Erlend Walter, *Financial Stability Frameworks and the Role of Central Banks: Lessons From The Crisis*, IMF Working Paper WP/09/70, International Monetary Fund (2009) ("Nier Article")

Niinimaki, Juha-Pekka, *Fairly Priced Deposit Insurance Under Adverse Selection*, School of Business, University of Jyvaskyla (Finland), Finnish Economic Papers Vol. 16, No. 1 (Spring 2003) ("Niinimaki Article")

Norton, Joseph J., *Financial Regulatory Symposium (Introduction)*, American Bar Association, Section of International Law, The International Lawyer, Vol. 39, No. 1 Spring 2005) ("Norton Article 1")

Norton, Joseph J., *Global Financial Sector Reform: The Single Financial Regulator Model Based on the United Kingdom FSA Experience—A Critical Reevaluation*, American Bar Association, Section of International Law, The International Lawyer, Vol. 39, No. 1 Spring 2005) ("Norton Article 2")

Norton, Joseph J., *Underpinnings of the New Breton Woods II Global Financial System Framework,* American Bar Association, Section of International Law, The International Lawyer, Vol. 43, No. 1 (Spring 2009) ("Norton Article 3")

Nyborg, Kjell, *Hiding Behind Moral Hazard*, Business & Finance, Credit Crunch Section (14 March 2008) ("Nyborg Article")

O'Hara, Maureen, *Deposit Insurance and Wealth Effects: The Value of Being "Too Big To Fail"*, The Journal of Finance, Blackwell Publishing, Vol. 45, No. 5 (December 1990) ("O'Hara Article")

Okeahalam, Charles C., Deposit Insurance Design and Bank Regulation In South Africa, Journal of Financial Regulation and Compliance, Vol. 9, Issue 2 (2001) ("Okeahalam Article")

Oravec, Ing. Peter, *Deposit Protection In The Slovak Republic and Countries of the European Union*, BIATEC, Volume XI, Narodna Bank Slovenska (09/20/03) ("Oravec Article")

Pecchenino, Rowena A., *Risk-Based Deposit Insurance: An Incentive Compatible Plan*, Journal of Money, Credit & Banking (November 1, 1992) ("Pecchenino Article")

Penalti, George, *The Effect of Implicit Deposit Insurance On Banks Portfolio Choices With An Application To International 'Overexposure*, Paper 19-86, Rodney L. White Center For Financial Research, Wharton School (1986) ("Penalti Article")

Pennacchi, G., *Deposit Insurance, Bank Regulation and Financial System Risks*, Journal of Monetary Economics, Vol. 53 (2006) ("Pennacchi Article")

Reisinger, Sue, *Stayin Alive: How BNY Mellon's Legal Team Helped The Bank Weather Last Fall's Financial Meltdown*, Corporate Counsel (February, 2009) ("Reisinger Article")

Richards, David Alan, *Sovereign Wealth Funds and U.S. Real Estate Investments*, ABA Probate & Property (July/August 2009) ("Richards Article")

Richardson, Gary, *Deposit Insurance and Moral Hazard: Capital, Risk, Malfeasance and Mismanagement*, Econ Journal Watch, Vol. 4, No. 3 (September 2007) ("Richardson Article")

Ronn, Ehud L., *Pricing Risk-Adjusted Deposit Insurance: Option-Based Model*, The Journal of Finance, Blackwell Publishing, Vol. 41, No. 4 (September 1986) ("Ronn Article")

Schobel, Thomas, *Home Country or Recipient Country—Confining the Extraterritorial Reach of Domestic Banking Law*, American Bar Association, Section of International Law, The International Lawyer, Vol. 41, No. 1 (Spring 2007) ("Schobel Article")

Schumacher, Liliana, *Bank Runs and Currency Runs In A System Without A Safety Net: Argentina and the 'Tequila' Shock*, Journal of Monetray Econimics, Vol. 46(1) (2000) ("Schumacher Article")

Shadoan, Donald, *Deposit Insurance and the Unsophisticated Investor: FDIC Insured?*, Business Forum, California State University Los Angeles, Vol. 17, Issue 4 (1992) ("Shadoan Article")

Sheehan, Kevin P., *Capitalization of the Bank Insurance Fund*, FDIC Working Paper 98-1, Federal Deposit Insurance Corporation, Division of Reaesrch and Statistics (1998) ("Sheehan Article")

Talley, Samuel H., *Deposit Insurance In Developing Countries*, World Bank, Financial Policy and Systems Division, [A Voluminous Article Of Over 100 Pages], IMF Working Paper WPS 548 (November 1990) ("Talley Article")

Thies, Clifford F., *Deposit Insurance: A History of Failure*, Cato Journal, Vol. 8., No. 3 (Winter 1989), Cato Institute ("Thies Article")

Vaez-Zadeh, Reza, *MODIS: A Market-Oriented Deposit Insurance Scheme*, International Monetary Fund, IMF Working Paper WP/02/207 (December 2002) ("Vaez Article")

Wagster, John D., *Wealth and Risk Effects of Adopting Deposit Insurance In Canada: Evidence of Risk Shifting by Banks and Trust Companies*, Journal of Money, Credit & Banking, Thompson Gale (October 1, 2007) ("Wagster Article")

Walshe, Don, *Post Crunch Controls*, Business & Finance Magazine (Ireland) (11 April 2008)

Walters, Sean, *Irish Banks Blue Christmas*, Wall Street Online, Heard On The Street (December 22, 2008) ("Walters Article")

Weill, Laurent, On The Relationship Between Competition and Efficiency In The EU Banking Sectors, LARGE, Universite Robert Schuman, Institut d' Etudes Politiques (November 2003) ("Weill Article")

Yokoi-Arai, Mamiko, *The Relationship Between a Single Financial Regulator and the Deposit Insurance System: Analyzing Japan*, American Bar Association, Section of International Law, The International Lawyer, Vol. 39, No. 1 Spring 2005) ("Yokoi Article")

C. Internet (Web) Articles, Blog and Web-Based References; Online Sites

Note: Date(s) Accessed Are Listed In Parentheses and Website Address May Be To First Level Or Home Page

www.abanet.org — *FDIC Rules On IOLTA Protection* (12/31/08) ("web article, abanet.org")

www.allafrica.com — *Kenya: Govt to Set Up Deposit Protection Body, Says Governor* (08/06/09) ("web article, allafrica.com 1")

www.allafrica.com — *South Africa: Banks Keen On Deposit Insurance* (06/10/09) ("web article, allafrica.com 2")

www.americanshare.com — Website For Private Insurer of (U.S.) Credit Union Share Drafts ("web article, americanshare.com")

www.atimes.com — *China Business: Beijing Ponders Deposit Protection Insurance* (01/19/07) ("web article, attimes.com")

www.americanbankingnews.com — *FDIC's Deposit Fund May Need 25% of U.S. Banking Profit in 2010* (08/23/09) ("web article, americanbankinnews.com 1")

www.americanbankingnews.com — *FDIC Eases Investor Guidelines Ahead Of Quarterly Briefing* (08/26/09) ("web article, americanbankingnews.com 2")

www.ap.org — *Bank Insurance Fund Down 20 Percent In 2Q* (08/27/09) ("web article, ap.org")

www.bankinfosecurity.com — McGlasson, Linda (Managing Editor), *FDIC Asks Banks To Prepay $45 Billion* (09/29/09) ("web article, bankinfosecurity.com")

www.bankinforsecurity.com — McGlasson, Linda, *(U.S.) Failed Banks and Credit Unions, 2009 (Interactive Map)* (Last Accessed: October 5, 2009)

www.bbc.co.uk — Fraser, Douglas, *More Banks, Please* (20 August 2009) ("web article, bbc.co.uk")

www.bethoudrecorder.com — *How Safe Is Your Bank Account? Understanding FDIC's Insurance Coverage* (April 30, 2009) ("web article, berthoudrecorder.com")

www.bizjournals.com — *Independent Community Banks of America Backs Legislation to Slap Premium Insurance On Giants,* Tampa Bay Business Journal (June 17, 2009) ("web article, bizjornals.com 1")

www.bizjournals.com — Casacchia, Chris, *Irwin Union Bank Could Be Shut Down* (09/18/09) (web article, bizjournals.com 2")

www.biz.thestar.com — Kuen, Yap Leng, *Malaysia Deposit Insurance Ready For The Worst* (04/06/09) ("web article, biz.thestar.com")

www.bloomberg.com — *Anglo Irish CEO, Chairman Resign Over Loan Disclosure* (December 19, 2008) (12/19/08) ("web article, bloomberg.com 1")

www.bloomberg.com — *Advanta Faces Deposit Halt, $35 Million Restitution* (07/02/09) ("web article, bloomberg.com 2")

www.bloomberg.com — *Blair Says [FDIC] Insurance Fund Could Be Insolvent This Year* (03/04/09) ("web article, bloomberg.com 3")

www.bloomberg.com — Nwanma, Vincent, *Nigerian Stock Exchange Suspends Trade In Five Banks* (08/17/09) ("web article, bloomberg.com 4")

www.bloomberg.com — Vekshin, Alison, *FDIC Problem Bank List Surges Putting Fund At Risk* (08/27/09) ("web article, bloomberg.com 5")

www.bloomberg.com — Vekshin, Alison, *FDIC May Add To Special Fees As Mounting Failures Drain Reserve* (08/20/09) ("web article, bloomberg.com 6")

www.bloomberg.com — Vekshin, Alison, *FDIC Proposes Banks Prepay Deposit Fees Through 2012* (09/29/09) ("web article, Bloomberg.com 7")

www.boston.com — *Consumers Likely To Find Increased Bank Costs : Federal Insurers Have Big Shortfalls* (07/02/09) ("web article, boston.com")

www.businessdayonline.com — *Nigerian Banking Sector: The Value Of Disclosure* (25 August 2009) ("we article, businessdayonline.com")

www.businessinsider.com — *Overhaul Is Good News For The Shiela Bair Haters* (06/18/09) ("web article, businessinsider.com")

www.business.theage.com.au — *Momentum Builds For New Review Into [Australian] Banking System* (07/26/09) ("web article, business.theage.com.au")

www.capmktsreg.org — *The Global Financial Crisis : A Plan For Regulatory Reform* (May 2009), which may be found at www.capmktsreg.org/research.html ("web article, capmkts.org")

www.cdi.org — Naumenko, Larisa, *Fledgling [Russian] Deposit Insurance Plan Takes Off* (11/02/05) (Special To Moscow Times) ("web article, cdi.org")

www.clearstarfcu.com — *Important News : Clearstar Financial Announces Acquisition By United Federal Credit Union* (09/30/09) ("web article, clearstarfcu.com")

www.cnb.com — *City National Bank: Stability In Volatile Times* (05/23/09) ("web article, cnn.com 1")

www.cnb.com — *City National Bank: New FDIC Insurance Limits* (05/23/09) ("web article, cnn.com 2")

www.cnn.com — *Australia to Guarantee Bank Deposits* (10/12/08) ("web article, cnn.com 3")

www.cnn.com — *Feasting On Failed Banks* (08/14/09) ("web article, cnn.com 4")

www.cnn.com — Isidore, Chris, *BB&T Buys Colonial Bank* (08/14/09) ("web article, cnn.com 5")

www.cnn.com — Purefoy, Christian, *Nigerian Banks Get $2.6 Billion Injection* (08/17/09) ("web article, cnn.com 6")

www.money.cnn.com — [List Of] *Bank Failures* [2008-2009] (As of 10/10/09) ("web article, cnn.com 7")

www.money.cnn.com — Goldman, David, CNNMoney.com's [U.S. Bank] *Bailout Tracker* (As of 08/14/09) ("web article, cnn.com 8")

www.money.cnn.com — Barr, Collin, *Feasting on Failed Banks* (08/14/09) ("web article, cnn.com 9")

www.money.cnn.com — Barr, Collin, *Barbarians Back At Bank Gates* (08/27/09) ("web article, cnn.com 10")

www.money.cnn.com — Ellis, David, *Problem Bank List Tops 400* (08/27/09) ("web article, cnn.com 11")

www.money.cnn.com — Goldman, David, *6 Countries In Recovery* (09/23/09) ("web article, cnn.com 12")

www.money.cnn.com — Barr, Colin, *Bank Bailout Problem: No Easy Answers* (09/29/09) ("web article, cnn.com 13")

www.money.cnn.com — Barr, Colin, *FDIC Asks Banks For Help* (09/29/09) ("web article, cnn.com 14")

www.money.cnn.com — Cyran, Robert, *How To Give The FDIC Some Clout* (10/06/09) ("web article, cnn.com 15")

www.columbiacu.org — *Deposit Insurance* (Columbia Credit Union) (09/30/09) ("web article, cnn.com 16")

www.costar.com — Heschmeyer, Mark, *Corus Bank Closure Could Help Establish Bottom* (09/16/09) ("web article, cnn.com 17")

www.counterpunch.org — Kaufman, William, *The Bi-Partisan Origins of the Financial Crisis: Shattering Glass-Steagall Act* (09/19/08) ("web article, counterpunch.org")

www.creditunionrising.com — *When Will NCUA Give Back To Credit Unions Their $1.0 Billion Dollars?* (06/22/09) ("web article, creditunionrising.com")

www.dailyfinance.com — Epstein, Lita, *Banks May Lend Money To FDIC* (09/22/09) ("web article, dailyfinance.com")

www.dig.bg — [List of Worldwide] *Deposit Insurers* ("dig.bg") ("web article, dig.bg")

www.difxs.com — Website For Private Insurer of Savings Banks In The American State of Massachusetts ("web article, difxs.com")

www.div.gov.vn — *Deposit Insurance Vietnam (DIV) – 5 Years of Construction and Growth* (04/09/09) ("web article, div.gov.vn")

www.economist.com — *Deposit Insurance: A Useful Fiction* (10/02/08) ("web article, economist.com 1")

www.economist.com — *Europe's Deposit Insurance Mess* (05/01/08) ("web article, economist.com 2")

www.econlib.org — Kaufman, George, *Deposit Insurance* (05/01/09) ("web article, econlib.org")

www.esacoastonline.com — Morgillo, Elaine, *Protecting Your Investments: SIPC Coverage* (08/24/09) ("web article, esacoastonline.com")

www.europa.eu — *Deposit Guarantee Schemes* (02/09/08) ("web article, europa.eu 1")

www.europa.eu — *Commission Sets Out Proposal To Increase Minimum Protection For Bank Deposits To €100,000* (11/21/08) ("web article, europa.eu 2")

www.europa.eu — *Amendment of the Directive on Deposit Insurance Schemes* (11/21/08) ("web article, europa.eu 3")

www.fdic.gov — *Guidance For Developing Effective Deposit Insurance Systems* (05/31/09) ("web article, fdic.gov 1")

www.fdic.gov — *FDIC Info and Deposit Insurance Q&A/EDIE* (05/30/09) ("web article, fdic.gov 2")

www.fdic.gov — *A Borrower's Guide To An FDIC Insured Bank Failure* (05/30/09) ("web article, fdic.gov 3")

www.fdic.gov — *Failed Bank List* (Last Accessed: 10/17/09) ("web article, fdic.gov 4")

www.fdic.gov — *Bank Failures & Assistance* (02/08/09) ("web article, fdic.gov 5")

www.fdic.gov — *Insured or Not Insured?* (02/09/08 and 05/30/09) ("web article, fdic.gov 6")

www.fdic.gov — *Reform of Deposit Insurance* (12/31/08) ("web article, fdic.gov 7")

www.fdic.gov — *A Brief History of Deposit Insurance* (12/31/08) ("web article, fdic.gov 8")

www.fdic.gov — *Financial Institution Letters: FDIC Coverage; Extension of Temporary Increase In Standard Maximum Deposit Insurance Amount* (06/18/09) ("web article, fdic.gov 9")

www.fdic.gov — *Deposit Insurance Assessments: Assessment Rate Cases and Outlook for DIF* (06/18/09) ("web article, fdic.gov 10")

www.fdic.gov — *Guidance For Developing Effective Deposit Insurance Systems/Discussion Papers* (Including 16 Discussion Papers, Bibliography and Glossary) (05/31/09) ("web article, fdic.gov 11")

www.fdic.gov — *Financial Stability Forum* (Working Group On Deposit Insurance) (07/27/09) ("web article, fdic.gov 12")

www.finra.org — *Your Rights Under SIPC Protection* (09/13/09) ("web article, fdic.gov 13")

www.ffhsj.com — *21st Century Money, Banking & Commerce, Chapters 1-19* (04/21/07) ("web article, ffhsj.com")

www.forbes.com — Condon, Bernard, *The Reverse Bank Run* (06/02/09) ("web article, forbes.com 1")

www.forbes.com — *Analyst: Up To 200 More Banks May Fall In Crisis* (08/24/09) ("web article, forbes.com 2")

www.gavinsblog.com — *Irish Bank Bailout, Part 3* (December 21, 2008) ("web article, gavinsblog.com")

www.globes.co.il — Horesh, Shira, *BDI Urges Deposit Insurance [For Israel]* (10/15/08) ("web article, globes.co.il")

www.gmanews.tv — *Arroyo signs bill doubling deposit Insurance* (04/27/09) ("web article, gmanews.tv")

www.guardian.co.uk — Gow, David, *Greece's Deposit Guarantee Deepens EU Financial Rift* (3 October 2008) ("web article, guardian.co-uk")

www.historyworld.net — *History of Banking* (04/22/07) ("web article, historyworld.net")

www.irishexaminer.com — *State Exposure Under Bank Guarantee Falls To €346 bn* (9/12/09) ("web article, irishexaminer.com")

www.istockanalyst.com — Denninger, Karl, *Ah, The Game Is Afoot!* (08/27/09) ("web article, istockanalyst.com")

www.jdic.org — *Deposit Insurance Schemes: A Comparative Analysis* (06/23/09) ("web article, jdic.org")

www.jpost.com — *What's New In The EU: EU Commissioner Seeks To Improve Investor Protection* (03/01/09) ("web article, jpost.com")

www.ktbs.com — *FDIC Extends $250,000 Deposit Insurance* (06/18/09) ("web article, ktbs.com")

www.thehindubusinessline.com — *A Case For Higher Deposit Insurance* (10/17/08) ("web article, thehindubusinessline.com")

www.ifsra.ie — [Irish Financial Regulator] *Banking & Credit Institutions: Deposit Protection Schemes; Deposit Protection In Ireland* (02/09/2008) ("web article, ifsra.ie" or "financialregulator.ie")

www.independent.ie — *Irish Lenders' ECB Borrowings Rise To €39 BN* (11/29/08) ("web article, independent.ie 1")

www.independent.ie — *Bank Guarantee Scheme To Be Reduced, Says Fitch* (09/09/09) ("web article, independent.ie 2")

www.investoroffshore.com — *Offshore Banking Deposit Guarantees, Insurance and Protection* (07/25/2009) ("web article, investoroffshore.com")

www.irishtimes.com — Opinion: Morgan Kelly (Economics Department, UCD): *Bailout Inept and Potentially Dangerous* (10/02/08) ("web article, irishtimes.com")

www.israelinsurancelaw.com — *State-Insured Bank Deposits – Are Citizens Deposits Secure?* (08/05/09) ("web article, israelinsurancelaw.com")

www.latimes.com — *FDIC Releases Plan To Regain Solvency – Banking: Proposal Calls For Rebuilding Insolvent Insurance Fund Over 15 Years Without Taxpayer Help.* (06/17/09) ("web article, latimes.com 1")

www.latimes.com — Harney, Kenneth, *Consumer Financial Protection Agency: An Overview* (08/02/09) ("web article, latimes.com 2")

www.lewrockwell.com — French, Doug, *Dead Banks Walking* (06/18/09) ("web article, lewrockwell.com 1)

www.lewrockwell.com — Paul, Ron, *The Trouble With Deposit Insurance: The Dissenting View of Ron Paul* (05/01/09) ("web article, lewrockwell.com 2")

www.livemint.com — Bandyopadhyay, Tamal, *Why Govt Should Not Raise Deposit Insurance Cover* (21 December 2008) ("web article, livemint.com")

www.machinenation.forumakers.com — *Morgan Kelly: Bank Guarantee Likely To Deal A Crippling Bow To The Economy* (10/28/08) ("web article, machinenation.forumakers.com")

www.marketwatch.com — Kim, Jane, *Burned Investors Won't Find Strong [SIPC] Safety Net* (12/16/08) ("web article, maketwatch.com 1")

www.marketwatch.com — Nutting, Rex, *Government Officials Defend Their Lies: The World Couldn't Handle The Truth* (10/5/09) ("web article, marketwatch.com 2")

www.msnbc.msn.com — *Text of Fed Chairman Bernanke's Comments: Bernanke Says The Economy Is On The Verge Of A Long-Awaited Recovery (Reflections On A Year Of Crisis)* (08/21/09) ("web article, msn.com 1")

www.msnbc.msn.com — Steverman, Ben, Don't *Be Surprised To See More Bank Failures* (09/15/09) ("web article, msn.com 2")

www.msnbc.msn.com — AP, *Ireland OKs World Leading Bank Guarantee* (10/02/08)

www.mortgagedfuture.com — Zielinski, Bill, *Credit Union Bailout Needed – NCUA Insurance Fund Insolvent* (03/23/09) ("web article, mortgagedfuture.com")

www.news.com.au — Gluyas, Richard, *Customers Could Recover $20,000 If Australian Bank Collapses* (03/28/08) ("web article, news.com.au 1")

www.news.com.au — Uren, David, *OECD Report Blasts [Australian] Bank Deposit Guarantee* (01/05/09) ("web article, news.com.au 2")

www.newswatchngr.com — Banks: One Crisis Too Many (24 August 2009) ("web article, newswatchngr.com")

www.nolanchart.com — Towne, Jake, *The Banksters: The FDIC Is Bankrupt* (08/17/09) ("web article, nolanchart.com")

www.nytimes.com — *Egypt Wants Powerful Central Bank* (09/16/91) ("web article, nytimes.com 1")

www.nytimes.com — *Federal Deposit Insurance Corporation* (05/01/09) ("web article, nytimes.com 2")

www.nytimes.com — Hurt, Harry, *[Iceland:] The Little Economy That Couldn't* (08/22/09) ("web article, nytimes.com 3")

www.nytimes.com — Hedges, Chris, *Egypt Wants Powerful Central Bank* (09/16/91) ("web article, nytimes.com 4")

www.nytimes.com — Editorial, *Facts and the Financial Crisis* (09/13/09) ("web article, nytimes.com 5")

www.nytimes.com — Labaton, Stephen, *FDIC May Borrow Funds From Banks* (09/21/09) ("web article, nytimes.com 6")

www.nytimes.com — Hansell, Saul, *Company Plans Private Bank Deposit Insurance* (03/10/93) ("web article, nytimes.com 7")

www.oxfordscholarship.com — Bodenhorn, Howard, *State Banking In Early America* (2002) ("web article, oxfordscholarship.com")

www.politico.com — Allen, Mike, *Barack Obama To Create Consumer Financial Protection Agency* (06/17/09) ("web article, politico.com")

www.pwc.com — *Price Waterhouse Coopers South Africa: Demands For Deposit Insurance At Banks Gain Further Support* (2009) ("web article, pwc.com")

www.realdeal.hu — (From MTI-ECONEWS), *Hungarian Government Makes Quick Move To Insure All Bank Deposits* (10/08/08) ("web article, realdeal.hu")

www.reservebank.co.za — *Deposit Insurance: What Would It Mean For You?* (03/13/02) [South African Reserve Bank Website] ("web article, reservebank.co.za")

www.in.reuters.com — *Russia Cuts Banks' Deposit Insurance Burden* (09/23/08) ("web article, reuters.com 1")

www.reuters.com — Wutkowski, Karey, *FDIC's Bair Says Big Firms Can and Will Fail* (06/18/09) ("web article, reuters.com 2")

www.reuters.com — *Britain Expands Bank Deposit Insurance* (10/03/08) ("web article, web article, reuters.com 3")

www.reuters.com — *U.S. Regulators Close Seven Small Banks* (07/27/09) ("web article, reuters.com 4")

www.reuters.com — *Thousands Protest Against Iceland [Bank] Repayment Bill* (13 August 2009) ("web article, reuters.com 5")

www.reuters.com — Tattersall, Nick, *Some Nigerian Debtors Got Loans Fraudulently* (08/25/09) ("web article, reuters.com 6")

www.reuters.com — Fabrichnaya, Elena, *Russia Cuts Banks' Deposit Insurance Burden* (9/23/08) ("web article, reuters.com 7")

www.reviewjournal.org — Edwards, John, *Regulators Shut Down Reno-Based Credit Union* (09/26/09) ("web article, reviewjournal.org")

www.rbi.org — *A Guide To The [India] Deposit Insurance and Credit Guarantee Corporation* (DICGC) (07/25/09) ("web article, rbi.org 1")

www.rbi.org — *Brief History of Deposit Insurance In India* (07/25/09) ("web article, rbi.org 2")

www.rbnz.govt.nz — Reserve Bank of New Zealand: *Deposit Insurance* (07/26/09) ("web article, rbnz.govt.nz")

www.schwab.com — *How Secure Is The FDIC Deposit Insurance Fund?* Other Choices Article (06/08/09) ("web article, schwab.com")

www.sipc.org — *What SIPC Covers* (06/28/09) ("web article, sipc.org")

www.statesman.com — *Federal Agency That Insures Bank Deposits May Need Help* (08/27/09) ("web article, statesman.com")

www.stuff.co.nz — *Talks Needed Ahead of [New Zealand] Deposit Insurance Scheme,* (06/10/08) ("web article, stuff.co.nz")

www.tax-news.com — Pilgrim, Robin, *Irish Deposit Guarantee Scheme Bill Published* (06 May 2009)

www.telegraph.co.uk — *Iceland Financial Crisis: Timeline (Ten Months of Turmoil)* (18 August 2009) (From Reuters) ("web article, telegraph.co.uk")

www.telegraph.co.uk — Evans-Pitchard, Ambrose, *IMF Tells Europe To Come Clean On Bank Losses* (08 June 2009)

www.theadvocates.org — Hummel, Jeffrey Rogers, *Privatize Deposit Insurance* (July 1989) ("web article, the advocates.org")

www.treasury.govt.nz — The [New Zealand] Treasury: *Guarantees* (2 March 2009) ("web article, treasury.govt.nz 1")

www.treasury.govt.nz — The [New Zealand] Treasury: *Retail Deposit Guarantee Scheme* (13 Jul 2009) ("web article, treasury.govt.nz 2")

www.treasury.govt.nz — The [New Zealand] Treasury: *Wholesale Funding Guarantee Facility* (23 July 2009) ("web article, treasury.govt.nz 3")

www.thenewzealandjournal.blogspot.com — *New Zealand Deposit Insurance Capped at $1 Million Per Account* (10/22/08) ("web article, thenewzealandjournal.com")

www.vnbusinessnews.com — *Deposit Insurance System of Vietnam* (10/20/08) ("web article, vnbusinessnews.com")

www.wall-street.ro — Vrinceanu, Claudiu, *Romanian Policy Makers Increase Amounts Covered By The Deposit Insurance Scheme To 50,000 euros* (13 October 2008) ("web article, wall-street.ro")

www.washingtonpost.com — Johnson, Simon, *Lehman Brothers and the Persistence of Moral Hazard* (09/15/09) ("web article, washingtonpost.com")

www.whitecase.com — Scott, Kathleen, *Deposit Insurance Systems Around The World* (09/07/05) ("web article, whitecase.com)

www.whitehouse.gov — *Fact Sheet: Plan To Stabilize Financial System Is Limited In Size, Scope and Duration* (10/17/08) ("web article, whitehouse.gov")

www.woccu,org — *WOCCU Helps South Africa Develop Country's First Deposit Insurance* (06/22/09) ("web article, woccu.org")

www.worldbank.org.ru — *Banking and Deposit Insurance In Russia* (2005), which can be found at www.worldbank,org.ru/files/rer/RER_9.2_eng.pdf ("web article, worldbank.org")

www.wsj.com — Drezner, Daniel, *The Making of a Meltdown: The Saga of Iceland's Boom and Bust* (08/19/09) ("web article, wsj.com 1")

www.wsj.com — Paletta, Damian, *TARP Oversight Panel Urges Transparency, Accountability* (01/10/09) ("web article, wsj.com 2")

www.wsj.com — Paletta, Damian, *FDIC Prepayment Likely For Bank*s (09/29/09) ("web article, wsj.com 3")

www.wsh.com — Connaghan, Clare, *Fall of Romania Coalition Threatens Reform* (10/2/09) ("web article, wsj.com 4")

www.zawya.com — *Deposit Insurance May Help Ease Flow of Credit* (01 April 09) ("web article, zawya.com")

D. Speeches, Analyses, Presentations, Recommendations, Releases, Newsletters, Reports, Surveys, Summaries and Scholarly Studies.

Bair, Sheila, *Remarks by the FDIC Chairman Shiela Bair to the Economic Club of New York* (April 27, 2009 ("Bair Remarks 1")

Bair, Sheila, *Remarks by the FDIC Chairman Sheila Bair Before the Committee on Banking, Housing and Urban Affairs of the U.S. Senate On Regulation and Resolving Institutions Considered "Too Big To Fail"* (May 6, 2009) ("Bair Remarks 2")

Basel Committee On Banking Supervision, *Core Principles For Effective Banking Supervision* (September 1997) ("Basel Core Principles 1")

Basel Committee On Banking Supervision, *Press Release, Basel Committee and IADI Issue Core Principles For Effective Deposit Insurance Systems*; Ref No. 26/2009 (18 June 2009) ("Basel Core Principles 2")

Basel Committee, *Core Principles For Effective Deposit Insurance Systems*, Bank of International Settlements/IADI (June 2009) ("Basel Core Principles 3")

Basel Committee, *Core Principles For Effective Banking Supervision*, Bank of International Settlements (October 2006) ("Basel Core Principles 4")

Blinder, Alan, *Reform Of Deposit Insurance: A Report To The FDIC, Parts I, II, III, IV* (March 20, 2001) ("Blinder Report")

Bloecher, Gary, *Options For Pricing Federal Deposit Insurance*, FDIC Banking Review, Vol. 15, No. 4 (2003) ("Bloecher Options")

BPK (Bulgarian Deposit Insurance Fund), *Fifth Anniversary of the BPK International Conference* (11-12 November 2004) ("Bulgarian Presentation")

California Bankers Association, *FDIC Deposit Insurance Coverage Issues*, Tele-Web Seminar (06/03/09) ("Cal Bankers Issues").

Caprio, Gerard, *Bank Regulation Is Changing: But For Better or Worse?*, PowerPoint® Presentation, Williams College (2007) ("Caprio Presentation")

CEBS (Committee of European Banking Supervisors), *CEBS—Role, Programme and Challenges* (May-June 2005) ("CEBS Programme")

CESifo DICE, *Deposit Insurance: Authority* (July 2007) ("CESifo 1")

CESifo DICE, *Deposit Insurance: Coverage* (July 2007) ("CESifo 2")

CUNA (Credit Union National Association), CUNA Issue Summary: Private Share Insurance (April 8, 2009) ("CUNA Summary")

Deposit Insurance: Actual and Good Practices, International Monetary Fund Occasional Paper 197 (Gillian G. H. Garcia) (January 2000) ("IMF Good Practices")

ECB, *European Central Bank: The Eurosystem,* ISBN 978-92-899-0276-0 (April 2008) ("ECB Euosystem")

EFDI, European Forum For Deposit Insurers, EU Committee, *Response To European Commission Consultation Document: Review of Directive 94/19/EC On Deposit Insured Guarantee Schemes* (17 July 2009) ("EFDI Forum")

European Banking Committee (EBC), *European Banking News*, Issue 10, Secretariat of the European Banking Committee of the EU (17 March 2009) ("EBC News")

European Commission, Directorate General Joint Research Centre, *Scenario Analysis: Estimating The Effects Of Changing The Funding Mechanisms of EU Deposit Insurance Guarantee Schemes*, Final Report (February 2007) ("EU Funding Mechanisms")

European Commission, *Current Challenges Facing Global Banking Sector (a Presentation By Commissioner For Internal Markets, Charlie McCreecy)*, Speech 07/828, Kuwait Global Forum (18 December 2007) ("EU Global Challenges")

European Commission, *Review of the Deposit Guarantee Schemes Directive (94/19/EC)*, DGS 001/2005 (14 July 2005) ("EU Directive Review")

European Commission, Report on Minimum Guarantee Level of Deposit Guarantee Schemes Directive 94/19/EC ("EU Report")

European Commission, *Consultation Document: Review of Directive 94/19/EC On Deposit Guarantee Schemes (DGS)* [40 Questions], Consultation Period: 29.05.2009 to 27.07.09 (2009) ("EU Directive Consultation")

European Commission, *State Aid: Overview of National Rescue Measures and Deposit Guarantee Schemes*, MEMO 08/614 (10 October 2008) ("EU State Aid")

European Commission, *State Aid: Commission Welcomes Revised Irish Guarantee Scheme,* MEMO/08/615 (12 October 2008)

European Commission, *Revision of EU Rules on Deposit Guarantee Schemes – Frequently Asked Questions*, Memo/08/622 (15 October 2008) ("EU FAQ'S")

European Commission, *Commission Sets Out Proposal To Increase Minimum Protection For Bank Deposits To €100,000,* IP/08/1508 (15 October 2008) ("EU Increase")

European Commission, *Citizens Summary: Improvement Of Depositor Protection* (15 October 2008) ("EU Improvement")

European Commission, *Proposal For A Directive Of The European Parliament And Of The Council Amending Directive 94/19/EC, et al.*, COM(2008) 661 final/2008/0199 (COD) (15 October 2008) ("EU Proposal For A Directive")

European Commission, (Draft) *Minutes, Informal Experts Roundtable On Deposit Guarantee Schemes (DGS)* on 31 March 2009 In Brussels, H1/TB/DK D(2009) 91832 (27 April 2009) ("EU Roundtable")

European Commission, *European Guarantee Schemes* (07/27/09) ("EU Guarantee Schemes")

European Commission, *Possible Models For Risk Based Contributions To EU Deposit Guarantee Schemes,* European Commission, Joint Research Centre, Econometrics and Applied Statistical Unit (June 2009) ("EU Risk Models")

FDIC Press Release, *FDIC-Insured Institutions Lost 3.7 Billion In The Second Quarter Of 2009* (08/27/09) ("FDIC Press Release 1")

FDIC Press Releases, *Statement By FDIC Chairman Sheila Bair At The Quarterly Banking Profile Press Conference, August 27, 2009* (08/27/09) ("FDIC Press Release 2")

FDIC Press Releases, *First National Bank, National Association Assumes All Of The Deposits Of Irwin Union Bank*, FSB (09/18/09) ("FDIC Press Release 3")

FDIC, *FDIC Deposit Insurance Options Paper* (Comprehensive Reform Study, 72 Pages) (August 2000) ("FDIC Options Study")

FDIC, *Strengthening Financial Risk Management At The FDIC*, Final Report (July 16, 2003) ("FDIC Risk Report")

FDIC, *Keeping The Promise: Recommendations For Deposit Insurance Reform* (April 5, 2001) ("FDIC Reform")

FDIC, *The S&L Crisis: A Chrono-Bibliography* (12/20/02) ("FDIC S&L Crisis")

FDIC, *A Brief History of Deposit Insurance In The United States* (September 1998) ("FDIC History")

FDIC, *FDIC State Profiles*, (Second Quarter 2009) ("FDIC State Profiles")

FDIC, *Summary of Deposits* (October 2009, Estimated) ("FDIC Deposits")

FDIC, *Statistics At A Glance As Of Second Quarter June 30, 2009, Year-To-Date, 1990-2008* (08/27/09) ("FDIC Statistics")

FDIC, *Frequently Asked Questions On Prepaid Assessments* (09/30/09) ("FDIC Prepaid FAQ's")

FDIC, *FDIC Consumer News* (Summer 2009) ("FDIC Consumer News")

FDIC, *Insured or Not Insured?* (10/04/08) ("FDIC Insured Brochure")

Guma, Dr. X. P., South African Reserve Board, *Banking In Africa and Its Future Outlook,* Presentation to the African Banking Congress 2008, South Africa (8 July 2008) ("Africa Outlook")

Hong Kong Monetary Authority, Press Releases, LCQ7: *Deposit Protection Schemes* (03/11/09) ("Hong Kong Schemes")

IADI, *Core Principles For Effective Deposit Insurance Systems* (02/29/08) ("IADI Core Principles")

IADI, *Public Awareness of Deposit Insurance Systems*, Guidance Paper (May 6, 2009) ("IADI Awareness")

IADI, *Funding of Deposit Insurance System*, Guidance Paper (May 6, 2009) ("IADI Funding")

IADI, *General Guidance For Developing Differential Premium Systems* (February, 2005) ("IADI Differential")

IADI, *The Effect of DIS On Banking Sector Development: The Example of Kazakstan, Russia and Ukraine*, Research Paper (January, 2009) ("IADI Russia/Ukraine")

IADI, *Transitioning From A Blanket Guarantee To A Limited Coverage System*, Research Paper (September, 2005) ("IADI Blanket Guarantee")

IADI, *Deposit Insurance Systems For IADI Member Countries and Other Countries With Deposit Insurance Systems* (Prepared By Donna Schull, Division of Insurance and Research, FDIC) (02/05/08) ("IADI DIS")

IADI, *Countries With Deposit Insurance Systems Under Study, Planned or Pending* (2006/2007) ("IADI Countries")

IADI, *Third Annual Conference,* Symposium Papers On *Global Financial Sector Reform and the Mega-Regulator Issue* (October 26-27, 2004, Brunnen, Switzerland) ("IADI Symposium")

IADI, Banking Profile of Selected African Countries (Undated, But Likely 2007) ("IADI African DIS")

IADI, *Deposit Insurance Laws* (Links To Statutory Websites) (2008) ("IADI Laws")

IADI, Member Profile, *Bulgarian Deposit Insurance Fund* ("IADI Bulgarian")

IADI, Member Profile, *Deposit Insurance Agency (Russia)* ("IADI Russian Profile")

IADI/FDIC, Characteristics of Selected Deposit Insurance Insurance Systems: IADI Member Profiles (Originally Produced November, 2006; Updated December, 2007)

IMF, *Letter Of Intent By And Between The Country of Romania and The IMF For Financial Support* (April 24, 2009) ("IMF Romania")

Ludwig, Eugene, *Remarks Before The American Bankers Association's Annual Convention* (10/05/96) ("Ludwig Remarks")

Matheson, Ormbsy Prentice Client Update, *Details of the Irish Bank Guarantee Scheme Published* (16 October 2008) ("Matheson Update")

McCoy, Patricia A., *The Moral Hazard Implications of Deposit Insurance: Theory and Evidence*, IMF Seminar on Current Developments In Monetary and Financial Law, Washington, DC (October 23-27, 2006) ("McCoy Seminar")

Rabkin, Alan B., *The Harmonisation and Rationalisation of Deposit Protection Schemes,* Trinity College Dublin, Doctoral Discussion Powerpoint® Presentation (2007) ("Rabkin Presentation 1")

Rabkin, Alan B., *Restoring Public Confidence In Banking: The Recent Financial Crisis Impacts Deposit Insurance,* Trinity College Dublin, Doctoral Discussion Powerpoint® Presentation (2008) ("Rabkin Presentation 2")

Rabkin, Alan B., Keynote Presentation, UNR Business Summit, University of Nevada, 2008 ("Rabkin Keynote")

Roldan, Jose M., *Deposit Insurance In The European Union* (Powerpoint® Presentation), Committee of European Banking Supervisors (CEBS) (13 October 2005) ("Roldan Remarks")

Schich, Sebastian, *Financial Turbulence: Some Lessons Regarding Deposit Insurance*, OECD Committee on Financial Markets (CMF), Meeting Presentation (April 2008) (Schich Presentation")

Sheehan, Kevin P., *Capitalization of the [FDIC] Bank Insurance Fund*, FDIC Working Paper 98-1 (1998) ("Bank Capitalization")

Smith, James E., *Key Issues Forum between ABA and FDIC* (April 25, 2000) ("Smith Issues Forum")

Stern, Gary H. (President, Federal Reserve Bank of Minnesota), *Better Late Than Never: Addressing 'Too Big To Fail'*, Speech Before The Brookings Institution, Washington, D.C. (03/31/09) ("Fed Speech TBTF 1")

Stern, Gary H. (President, Federal Reserve Bank of Minnesota), *Addressing The 'Too Big To Fail Problem'*, Committee on Banking, Housing and Urban Affairs, U.S. Senate (May 6, 2009) ("Fed Speech TBTF 2")

Tripe, David, *Deposit Insurance In New Zealand*, Powerpoint® Presentation, Centre For Banking Studies, Massey University (Undated) ("Tripe Presentation")

World Bank Database, Deposit Insurance (CESifo DICE Report) (April, 2008) ("World Database")

E. Deposit Insurance Fund or Related Brochures, Lists, Forms and Pamphlets

AIB (Allied Irish Bank) (Ireland), *Deposit Protection In Ireland,* AIBM/REG 13 (08/07)

City National Bank (United States), *Important Information Regarding FDIC Transaction Account Guarantee Program*

Deposit Insurance Corporation of Japan, *A Guide To The Deposit Insurance System: Outline of the System and Q&A* (April 2005)

FDIC, *How Expanded FDIC Deposit Insurance Coverage Affects You* (Issued By Heritage Bank) (10/14/08)

FDIC, *Quarterly Certified Statement Invoice* (Deposit Premium Assessment Form), OMB No. 3064-0057 (April, 2007)

FDIC, *Failed Bank List* (current list found at www.fdic.gov/bank/individual/failed/banklist.html) (05/01/09)

FDIC, *'Symbol of Confidence For 75 Years'*, FDIC-017-2008 (2008)

FDIC, *Your Insured Deposits: FDIC's Guide To Deposit Insurance Coverage*, FDIC-001-2007 (2007)

FDIC, *Insuring **Your** Deposits*, FDIC-002-2007 (2007)

FDIC, *Insuring **Your** Deposits*, FDIC-002-2006 (Updated April 2006)

FDIC, *International Directory of Deposit Insurers*, FDIC-024-2007 (2007)

(Irish) Financial Regulator (Rialtoir Airgeadais), *Consumer Protection Code For Financial Services Firms* (Your Little Red Book) (08/07)

(Irish) Financial Regulator (Rialtoir Airgeadais), *Deposit Protection Return Form* (Deposit Base Calculation) (January, 2007)

(Irish) Financial Regulator, *Credit Institutions Register* (as of 2 October 2009)

(Irish) Financial Regulator, *Register of Credit Unions Under The Credit Union Act, 1977* (As Amended) (as of 2 October 2009)

Heritage Bank (United States), *How Expanded FDIC Deposit Insurance Coverage Affects You*, FDIC-SE08NIB (Wolters Kluwer Financial Services, 10/14/08)

NCUA, *How Your Accounts Are Federally Insured* NCUA 8016 (October 2008)

NCUA, *NCUA Share Insurance and You: Maximize Your Insurance Coverage* (October 2008)

SIPC, *What SIPC Covers...What It Does Not* (June 2009)

SIPC, *How SIPC Protects You: Understanding The Securities Investor Protection Corporation* (2009)

F. Newpaper Articles and References (Date Noted Is Date Of Publication).

AP, *Banks Post Rare Quarterly Loss*, The Orange County Recorder, Business Section (02/27/09)

Blinder, Alan S., *Blanket Deposit Insurance Is A Bad Idea*, Wall Street Journal Online (10/15/08)

(The) Dominion Post, Weir, James, *New Zealand Resists Trend To Insure Deposits* (10/07/08)

Honohan, *Banking Debate Has Been Reduced To False Dichotomy*, Irish Times (05/21/09)

New York Times, Nocera, Joe, *You Gotta Love Shiela Bair* (07/24/09)

Strange, Paddy, *Government Must Ensure Our Money Is Safe In Banks*, Irish Independent (07/27/09)

USA Today, *FDIC Seeks More Fees From Banks To Insure Consumer Deposits* (10/08/08)

USA Today, *Banking Emergency Spreads To Iceland* (10/10/08)

G. Legislative Reports, Studies and Hearings Regarding Deposit Insurance and Related Issues.

The Run On The Rock (Northern Rock Bank), Chapters 5 and 6
UK Parliament, House of Commons, Treasury Committee (HC 56-1)
Treasury Fifth Report (Northern Rock), Session 2007-08 (24 January 08) found at
www.publications.parliament.uk/pa/cm200708/cmselect/cmtreasy/56/5602.htm (179 Pages)

Oversight of the FDIC and the RTC's Use of D'Oench Duhme Doctrine, Committee on Governmental Affairs, United States Senate, 104th Congress, First Session (Hearing 104-37) (January 31, 1995)

GAO, *Troubled Asset Relief Program (TARP), Statement Of Gene L. Dodaro*, Before The Committee On Financial Services, U.S. House of Representatives (12/10/08)

SIGTARP (Office For Special Inspector General For The Troubled Asset Relief Program , *Quarterly Reports To Congress* (07/21/09, 04/21/09 and 02/06/08)

H. Comprehensive and Annotated Existing Bibliographies and Glossaries.

Deposit Insurance: *An Annotated Bibliography (Update 2000-2003)*, which can be found at www.fdic.gov/deposit/deposits/international/bibliography/2005/diab2005.txt (as of 2005)

FDIC Glossary, which can be found at www.fdic/edie/glossary.html (as of 05/30/09)

CNN's bank bailout glossary, found at (www.money.cnn.com,news/economy/bailout_glossary/index.htm), *Language Of The New Economy: The Bailouts Have Brought A New List Of Terms To The Conservation About The Economy* (07/27/09)

I. Deposit Insurance Consumer and Awareness Surveys; Unbanked Studies.

Federal Deposit Insurance Corporation (FDIC), *Household Survey on Deposit Insurance Awareness* (April 2001) (this survey available at www.fdic.gov/deposit/insurance/initiative/household/index.html)

Federal Deposit Insurance Corporation (FDIC), FDIC Survey Of Banks' Efforts To Serve The Unbanked and Underbanked (February 2009)

J. Communications and Reports of the EU

European Commission: EU Membership—Iceland Clears First Hurdle (28 July 2009) This item can be found at http://ec.europa.eu/news/external_relations/090728_en.htm

Communication From The Commission To The European Parliament And The Council Concerning The Review of Directive 94/19/EC, COM(2006) 729 final (27.11.2006)

Report From The Commission To The Council And The European Parliament On The Application Of The Export Prohibition Clause…Of the Directive On Deposit Guarantee Schemes, COM(1999) 722 final (22.12.1999)

K. FDIC Orders, Memorandums and Opinions

FDIC Memorandum From Arthur J, Murton, Director, Division of Insurance and Research to the Board of Directors of the FDIC, *Outlook for the Deposit Insurance Fund (DIF)*, May 7, 2007

L. Governmental 'eChannel' Presentations (available on the FDIC Channel hosted at www.youtube.com)

FDIC Deposit Insurance Coverage--Introduction (June 30, 2009)

FDIC Deposit Insurance Coverage—Single Accounts (June 30, 2009)

FDIC Deposit Insurance Coverage – Certain Retirement Accounts (June 30, 2009)

FDIC Deposit Insurance Coverage – Revocable Trusts (June 30, 2009)

FDIC Deposit Insurance Coverage – Business Accounts (June 30, 2009)

M. NCUA and Credit Union Matters

NCUA Letter To Credit Unions (Regarding Corporate Stabilization Fund Implementation), Letter No. 09-CU-14 (June 2009)

N. SIPC Matters

Statement of Stephen P. Harbeck (President and CEO of the SIPC) Before The Committee On Financial Services of the U.S. House of Representatives (01/05/09)

O. Other Laws, Rules and Regulations; Miscellaneous

Federal Law of the Russian Federation Dated October 27, 2008 No. 175-FZ "On Additional Measures To Strengthen The Stability of the Banking System Through December 31, 2011"

Notice To Depositors "Your *Institution Has Been Closed*" issued on August 14, 2009 by the State of Alabama Department of Banking In The Matter of Colonial Bank.

D.A. Davidson & Co Manages Successful $49.9 Million Public Offering For Heritage Financial Corporation (09/22/09)

Comment Letter By America's Community Banks To Proposed Rule For FDICIA Disclosures, Federal Trade Commission (06/15/05)