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Banking reform in the United States: A survey of causes, responses and avenues for further changes.

I. INTRODUCTION

For some time, there has been widespread agreement among various observers on the need for major reform of the U.S. banking system. Taxpayer funds were being placed at undue risk by the existing structure of federal deposit insurance and other elements of the federal safety net. At the same time, outdated structural and regulatory restrictions were increasend singly hampering the ability of the U.S. banking industry to operate efficiently and to compete effectively both at home and abroad with other providers of financial services. Recent landmark legislation, the Federal Deposit Insurance Corporation Improvement Act of 1991 ("FDICIA"), contained many features designed to promote a safer and more prudent banking system. However, the legislation not only failed to provide relief from the outdated competitive straitjacket, it also imposed substantial additional regulatory burdens on virtually all banking institutions.

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The views expressed are those of the author and do not necessarily reflect those of the Board of Governors or of its staff.
This paper first provides a general description of the U.S. depository system and the governmental framework that regulates and provides assistance to these institutions and their depositors. The next section presents a summary of difficulties in the U.S. banking system over the last decade, the effect of those difficulties on the deposit insurance funds, and the predominant influence of the latter on the scope and content of FDICIA. The next section discusses FDICIA, both its accomplishments and, at least in the author's views, its shortcomings. The final section provides recommendations for further banking reform.  

II. U.S. DEPOSITORY SYSTEM

Institutional Structure

With more than 26,000 depository institutions and nearly $4.8 trillion in assets, the U.S. depository system is the largest in the world in both number of institutions and total assets. The system is composed of three major sectors: commercial banks, savings and loan associations and savings banks ("thrift" institutions), and credit unions.

Commercial banks, numbering over 11,000, have combined assets of about $3.5 trillion and are easily the largest segment of the system. These institutions serve as a key source of financing to businesses, households, and units of government, both domestically and abroad, and are important repositories for savings and liquid assets.

Savings and loan associations and savings banks (collectively referred to as "thrift institutions") have always accounted for a much smaller segment of the depository system. As a result of serious problems over the past decade, this segment has been losing relative market share. Currently, there are about 2,200 thrift institutions, with about $1 trillion in assets. Thrifts traditionally have provided financing to consumers, particularly for the purchase of a home. In recent years, however, thrifts also have been permitted to offer their services on a limited basis to business concerns.

Credit unions make up the third sector of the U.S. depository system. There are over 13,000 of these institutions, but they are generally quite small, with aggregate assets of about $300 billion. They also concentrate in consumer

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1 Both the overall framework of this paper and considerable portions of sections II and III are based on a speech entitled "Supervision and Rescue of Financial Institutions: the U.S. Experience" that was delivered by Edward W. Kelley, Jr., Member, Board of Governors of the Federal Reserve System, before the Governors of Central Banks of the American Continent, Santiago, Chile, October 5, 1991.
lending, but only to members sharing a common but broadly-defined bond, such as individuals employed by the same firm or industry.

Supervisory Structure

Both state and federal authorities charter, regulate, and supervise commercial banks. At the federal level, the Office of the Comptroller of the Currency (part of the U.S. Treasury Department) charters and supervises nationally- (or federally-) chartered banks. The Federal Reserve supervises state-chartered banks that also are members of the Federal Reserve System, and the Federal Deposit Insurance Corporation (FDIC) supervises those state-chartered banks that are not member banks. Both agencies perform these duties in cooperation with authorities of the chartering state.

Thrifty and credit unions are chartered either by state or federal authorities and at the federal level are supervised, respectively, by the Office of Thrift Supervision and the National Credit Union Association.

Federal Safety Net

The FDIC assesses and collects insurance premiums from banks and thrifts and serves as the receiver of insolvent and failed institutions. As receiver, the FDIC assures that deposits insured up to $100,000 are protected in full if necessary by providing funds in excess of the failed institution's liquidation value and arranges for the orderly resolution of failed depository institutions. The Federal Reserve serves as a "lender of last resort" for solvent banks and more generally for the depository system. That assistance is intended to provide temporary liquidity to institutions that are unable temporarily to obtain funding on a reasonable basis in the private market.

Both the thrift and the credit union sectors have their own deposit insurance funds. They also have their own arrangements for providing liquidity assistance to industry members and for resolving weak and failed institutions. But, as noted earlier, the Federal Reserve is authorized to lend to thrifts and credit unions if liquidity assistance from their own industry sources is not available.

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2 The Federal Reserve also supervises and regulates companies that own commercial banks (bank holding companies), as well as their nonbank subsidiaries.
3 Before 1989, the bank and thrift deposit insurance funds were financed and administered separately. Following the insolvency of the thrift fund (which is discussed later in this paper), it was recapitalized and moved under the administration of the FDIC as a separate fund. In this new structure, the commercial bank insurance fund is called the Bank Insurance Fund (BIF), while the fund for thrifts is called the Savings Association Insurance Fund (SAIF).
Federal deposit insurance and access to the Federal Reserve's discount window are two of the three elements of the federal "safety net" that protects the U.S. banking system.  

III. DIFFICULTIES OVER THE PAST DECADE IN THE U.S. DEPOSITORY SYSTEM

Thrifs

Among the most troubling developments in the U.S. depository system during the past decade were the widespread problems in the thrift industry. The origins of these problems can be traced to the industry's long-standing practice of financing its mostly fixed-rate, long-term assets (primarily home mortgages) with relatively short-term deposit liabilities. This funding structure was protected for many years by regulations limiting the rates depository institutions could pay on deposits. In the late 1970s and early 1980s, however, rising inflation and interest rates on the one hand, and on the other hand competition from mutual funds and others that offered investment alternatives not subject to rate limitations, forced -through disintermediation and the resultant liquidity problems of depository institutions- the removal of these deposit rate ceilings. This removal, in turn, led to serious earnings problems at many thriffs, as increased funding costs outpaced relatively fixed returns on assets. These losses began to erode industry capital.

Even after rates had declined by the mid-1980s, a large number of thriffs remained in weakened condition because of poor capital positions. In the face of these problems, a policy of supervisory forbearance was adopted, which allowed troubled thriffs to continue operating with deficient and sometimes negative capital accounts. In addition, statutory changes were made to expand the permissible activities of thriffs so that, it was hoped, they could survive and compete more effectively.

Many thriffs took advantage of this new environment and tried to grow out of their problems by channeling funds into assets with higher risks and higher expected returns, particularly into loans on commercial real estate properties and high risk bonds. This growth often was financed by aggressive efforts to attract deposits, sometimes on a nationwide basis, through the facilities of brokers. In order to alleviate investors' concerns, these funds were typically divided into portions sufficiently small as to be covered by the deposit insurance system. The unfortunate result of these policies and growth strategies was that the problems of many thriffs were intensified, and the volume of already high failures rose sharply.

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4 Federal Reserve management of the payments system constitutes the third element.
The industry's difficulties were so substantial that by 1988, its deposit insurance fund was exhausted. The U.S. Congress responded by confirming that the obligations of that fund were backed by the full faith and credit of the government. The Congress also took steps to revise the industry's regulatory, supervisory, and insurance framework. A government agency, the Resolution Trust Corporation (RTC), was established to resolve failed thrifts, and a new thrift industry insurance fund was incorporated under the FDIC. In resolving the large number of insolvent thrift institutions, losses had reached about $80 billion by September 1991 and were expected to climb higher as other troubled thrifts were resolved.  

Commercial Banks

The commercial banking industry in the United States also has been troubled by substantial problems over the past decade. Many of the industry's largest institutions entered the early 1980s managing significant loan exposure to developing countries and to highly leveraged firms. The larger banks also were facing growing competition from thrift institutions and foreign banks, as well as from securities firms that were helping prime borrowers sidestep their banks. In addition, banks in energy-producing states in the southwest region of the United States were holding deteriorating energy-sector credits and searching desperately for an important new source of earnings. These banks, along with many others, sought to find better profits through increased lending in the commercial real estate sector.

By the middle of the decade, however, southwest real estate values had plunged, many related loans were uncollectible, and banks throughout the region were beginning to fail. In addition, weak commodity and land prices were contributing to the collapse of hundreds of small banks in agricultural communities throughout the midwest, further compounding pressures on the federal deposit insurance fund. In most other parts of the United States, commercial real estate markets and related bank lending remained strong, despite rising levels of office vacancy rates. However, that condition reversed beginning in 1989, when economic problems surfaced in New England. These problems worsened when the rest of the nation slipped into recession in the summer of 1990, signaling the latest round in what has been characterized as the most turbulent period for U.S. banks since the Great Depression of the 1930s.

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5 Between August 1989, when the RTC was established, and July 1993, 663 thrifts were closed, with losses totalling $86 billion.
6 In addition to Kelley, "Supervision and Rescue of Financial Institutions: the U.S. Experience," also see "Statement by John P. LaWare, Member, Board of Governors of the Federal Reserve System, before the Committee on Banking, Housing and Urban Affairs, U.S. Senate, June 10, 1992," Federal Reserve Bulletin, vol. 78 (August 1992), pp. 597-598.
In particular, overbuilding through much of the 1980s, combined with weak demand toward the end of the decade, produced the greatest contraction of real estate values in the United States since the 1930s. Beyond the real estate sector, the earlier buildup in corporate leveraging together with the sluggish economy also contributed to the general deterioration in the quality of large bank's loan portfolios. While smaller banks generally were less affected by commercial real estate conditions, they did not escape without problems of their own, attributed primarily to general weaknesses in the economy rather than to specific major events.

Overall, between 1980 and autumn of 1991, more than 1,250 commercial banks, with assets totalling nearly $200 billion, had either failed or required government support. More than 1,000 of those banks had failed since 1985, resulting in a decline in the bank insurance fund from more than $18 billion to its official level in September 1991 of $4.5 billion. With an additional 1,000 commercial banks considered at that time to be "problem" banks, the total cost of resolving failed banking institutions was expected to increase even further, possibly exhausting the bank insurance fund by year-end.7

Thus, as occurred previously with the thrift fund, the bank fund had to be recapitalized for the FDIC to continue to meet its obligations. At the same time, fundamental issues with respect to the federal safety net protecting the U. S. depository system had to be faced.

Effects of the Safety Net

The provision of safety net assistance during the past decade has had important positive effects. Despite the large number of failures of depository institutions, insured depositors, and, to a large extent other depositors as well, did not suffer losses. Moreover, the existence and use of the safety net shielded the broader financial system and the real economy from instabilities in banking markets. More specifically, the safety net protected the economy from the risk of deposit runs, especially the risk of such runs spreading from bank to bank and disrupting credit and payment flows and the level of trade and commerce. Confidence in the stability of the banking and payments systems has been deemed the major reason why

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7 By year-end 1991, a total of 1,381 banks had failed since 1980. The balance in the bank insurance fund stood at a negative $7 billion; however, this reflected in part a change in accounting standards that required the FDIC to book a reserve fund for losses. By year-end 1992, although an additional 122 banks had failed, the insurance fund balance had strengthened to a negative $100 million. It is expected to be positive by year-end 1993.

It also should be noted that U.S. banks have had record earnings in the last year and have been able to rebuild their capital despite substantial charge-offs of poor assets and record build-up of loan loss reserves.
the United States has not suffered a financial panic or systemic bank run in the last half century.  

On the other hand, safety net assistance has had various adverse effects as well, including lessened discipline of the marketplace over the activities of depository institutions; inequities in the treatment of different depositors and different institutions; substantial direct and indirect costs to the deposit insurance funds making necessary a large increase in deposit insurance premiums; and a heavy cost burden on U.S. taxpayers.

In particular, the availability and existence of federal deposit insurance deterred many depository institutions, prior to the Basle Capital Accord, from building the capital bases needed to succeed in a riskier, more competitive environment. Indeed, an excessive degree of “moral hazard” seemed to have been allowed to develop in the U.S. insured depository system. That is, the safety net had so lowered the risks perceived by depositors that many had become indifferent to the financial condition of the depository institutions where they kept their funds. In turn, the incentive of some bank owners to control risk-taking was lowered. Profits associated with risk-taking accrued to owners, while losses in excess of bank capital that otherwise would fall on depositors were absorbed by the deposit insurance fund. The end results were the growth of excessively risky assets at many depository institutions, and the substitution of insured deposits for private capital in funding those assets.

Thus, the issue of how best to administer the safety net involves questions of balance, guarding against systemic risk on the one hand, yet at the same time taking steps to avoid the direct and indirect costs of providing assistance too readily to troubled institutions.

IV. FDICIA

The Federal Deposit Insurance Corporation Improvement Act of 1991 (“FDICIA”) was enacted on December 19, 1991. The first provision of the Act was the recapitalization of the FDIC’s Bank Insurance Fund (BIF). The FDIC’s line of credit at the U.S. Treasury was increased from $5 billion to $30

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11 While some provisions of the Act were effective immediately, others were scheduled for implementation at various times over the course of two years.
billion. The borrowings were available to cover FDIC losses and were intended to be repaid through higher bank deposit insurance premiums. The FDIC was required to establish premiums sufficient to repay all "loss" borrowings and rebuild BIF reserves to 1.25 percent of insured deposits within 15 years.12

FDICIA also contained a number of "safety and soundness" provisions intended to minimize the chance that a BIF recapitalization would ever again be needed. One of the more prominent such provisions is the one referred to as "prompt corrective action," which institutes a regime of corrective measures that become successively more stringent as a bank's capital deteriorates through five capital levels. Many bankers and some regulators have expressed concern that the "prompt corrective action" provision imposes an inflexible, mechanical set of rules that, at worst, could accelerate the demise of an undercapitalized bank, and, at best, make its recovery more difficult. However, the Federal Reserve has noted that the provision does not require agencies to take a mechanical and mindless response to declining capital at a bank. Rather, it supplements the discretionary tools that are available to address the problems of troubled institutions. It also is important to note that the required actions imposed on undercapitalized banks are in circumscribed areas, namely the elimination of dividends, the prohibition of brokered deposits, the submission of an acceptable capital restoration plan, and restraints on growth. Further, prompt corrective action imposes little new burden on banks that meet minimum capital requirements and that otherwise operate in a safe and sound manner.13 Overall, by serving to offset moral hazard incentives created by federal deposit insurance, prompt corrective action is one provision of FDICIA that should have beneficial results.14

Some other provisions of FDICIA also should be constructive in limiting the exposure of the safety net to troubled institutions. Examples include those provisions that place limits on the authorities' ability to protect large domestic depositors and depositors at foreign branches, as well as to use the discount window for weak banks. And, there are procedures for exceptions when there is genuine systemic risk.15

Although the above provisions of FDICIA should prove helpful, the Federal Reserve also has noted that the legislation is flawed in at least two major ways. First, it piled increased regulatory burdens on an already highly-burdened

12 I should note that not one dollar of the $30 billion Treasury line has had to be used by the FDIC to cover losses. And, as mentioned earlier, as bank positions have improved in the U.S., the size of the insurance fund has begun once again to rise from its very low levels.
14 LaWare statement of June 10, 1992, p. 602.
15 Greenspan, "Putting FDICIA in Perspective,"
industry, taking what has been characterized as a "shotgun approach" to past problem areas. Further, many of the provisions thrust the regulators increasingly into the micro-management of the banks they supervise. These provisions include limits on interbank credit exposures, thereby risking the disruption of interbank markets and longstanding banking relationships, as well as further restrictions on bank directors, which, coupled with already-existing law, add to the difficulty banks experience in attracting qualified people. FDICIA also imposed a large number of record-keeping requirements in areas such as branch closings, auditing, small business loans, and truth-in-savings. In addition, it required the agencies to impose operational standards for internal controls, interest rate exposure, asset growth, compensation of bank employees, and minimum earnings and market-to-book ratios. It also required guidelines for loan documentation and credit underwriting.

It is recognized that in each of the areas addressed by recent requirements for additional regulation, a number of examples can be found of abysmally poor bank management, or of regulator judgments and decisions that should not have been made. Thus, it is understandable that while the Congress was deciding to provide substantial taxpayer funding to replenish the bank insurance fund, there was an inclination to take all steps to see that these poor management practices would never recur. However, in the view of at least some observers, the collection of micro-management regulations that finally emerged in FDICIA represents an overreaction that imposes significant costs by absorbing real resources and removing desirable flexibility at the nation's banks. As a more desirable alternative, each of these issues could be addressed in the supervisory process without the need for detailed implementing regulations.

A second, and perhaps even more serious, flaw in FDICIA is that it failed to provide relief from outdated structural restrictions that prevent the U.S. banking industry from operating more efficiently. The legislation provided banking institutions with few opportunities either for new revenue sources or for reorganizing or expanding in more cost-efficient ways.

Thus, with banks still forced to operate in an over-regulated environment and under an over-restrained structure, considerable further room exists for banking reform.

LaWare, statement of June 10, 1992, p. 602.
Greenspan, "Putting FDICIA in Perspective."
LaWare, statement of June 10, 1992, p. 602.
V. RECOMMENDATIONS FOR FURTHER REFORMS

Reducing Regulatory Burden

One provision of FDICIA required that the Federal Financial Institutions Examination Council (FFIEC) review the policies, procedures, and record-keeping and documentation requirements that are administered by the federal banking agencies and the U.S. Treasury. The purpose of the review was to identify, and report to the Congress on, burdens that could be removed without diminishing compliance with, or enforcement of, consumer protection laws or endangering the safety and soundness of insured institutions. That study, submitted to the Congress on December 17, 1992, noted that financial institutions in general, and banks and savings associations in particular, are among the most heavily regulated businesses in the American economy. Much of the regulation arises ultimately from four fundamental public policy concerns: bank safety and soundness, banking market structure and competition, monetary and systemic stability, and consumer protection in financial matters.

Defined broadly, regulatory burden consists of any opportunity losses, operating costs, or cost-causing activities that are necessitated by government actions and that would not arise in the normal course of business except for the government policy. Defined broadly in this way, burden ultimately arises from two sources: (1) prohibitions that prevent regulated institutions from engaging in activities that they otherwise would undertake; and (2) requirements for certain actions or behaviors that regulated institutions would not undertake in the absence of the requirements. Restrictions on activities fall into the first category, while paperwork and required compliance activities fall into the second.

Both prohibitions and requirements can be costly to the regulated entity. Although precise measurements of either type of burden are difficult, various studies have attempted to measure the costs of regulatory requirements and found that such costs are substantial. Despite methodological and coverage differences, findings are reasonably consistent that regulatory costs to commercial banks might be 6 to 14 percent of noninterest expenses. This estimate included the expense of deposit insurance premiums but excluded any...

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20 The FFIEC is composed of principals of the five federal banking agencies: the Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation (FDIC), National Credit Union Administration (NCUA), Office of the Comptroller of the Currency (OCC), and Office of Thrift Supervision (OTS).

21 Another finding from the cost studies is that regulatory burden seems to fall disproportionately on smaller banks, which do not have the resources to acquire the specialized personnel to ensure compliance with the growing number of statutes and regulations.
measurement of the opportunity cost of reserve requirements or prohibited activities; the estimate also excluded most, if not all, of the costs associated with FDICIA. The above range, when applied to the actual 1991 noninterest expenses for commercial banks of $124.6 billion, suggests that regulatory costs could have been between $7.5 billion and $17 billion in that year.22 23

The FFIEC study identified over 60 initiatives that the agencies could take themselves to relieve individual burden requirements.24 However, many of those actions addressed problems that were largely technical in nature and not highly significant in terms of their effect on total regulatory burden. Indeed, significant relief from regulatory burden requires more substantial changes. Because legislation is often very detailed in its requirements and agency regulations must track the statutory provisions, the agencies are limited in their ability to address many provisions that impose substantial burdens.

**Fundamental review of approaches to regulation.** It is difficult to quarrel with the purposes of regulation. Nevertheless, the magnitude of the costs of carrying out a substantial number of policies, no matter how highly desirable, has begun to threaten the competitiveness of the banking industry itself. In the view of the Federal Reserve, what is needed is a fundamental review of approaches to regulation, in search of mechanisms that will achieve the same goals but with less burden and without the problems that accompany the current approach.25 New approaches to regulation that are more sensitive to cost-benefit trade-offs must be sought and considered. In particular, existing market forces and incentives should be harnessed as much as possible to achieve regulatory goals rather than relying on micro-level regulations that eliminate the flexibility that is important in a dynamic industry.

To the greatest extent possible, banking regulation should provide flexibility by tailoring requirements to specific facts and circumstances and, where appropriate, by distinguishing among institutions according to meaningful criteria such as condition, size, and management competence. Regulations that provide insufficient flexibility can cause unnecessary regulatory burden and

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22 When applied to 1992 noninterest expenses of $131.8 billion, the range of regulatory costs is between $7.9 billion and $18.5 billion.
24 Those initiatives were in addition to numerous actions undertaken by the agencies during 1991 in response to a presidential directive on regulatory burden reduction.
create inefficiencies by preventing depository institutions from finding the most cost-effective means of complying with the law or regulation and by impairing the ability of banking institutions to react to changing market conditions.

Independent commission. The Federal Reserve has suggested that these approaches must be applied not only to future regulatory actions but to existing regulations as well. Efforts to reduce regulatory burden substantially will undoubtedly raise difficult questions about the trade-offs to be made between competing public policies. Because achieving political consensus for change likely will be difficult, the Federal Reserve has suggested that an independent nonpolitical commission be created, charged with exploring possibilities for legislative change. Such a commission could address a broad range of banking issues, such as regulatory burden and the competitive position of U.S. banking organizations, offer suggestions and guidance for legislative and regulatory changes, and assist the U.S. Congress in developing a specific legislative agenda.

Structural Reforms

As noted earlier, maintaining a strong and competitive banking system is of primary importance in minimizing the cost of the safety net. Healthy, competitive banks are less likely to take excessive risks and fail. Thus, they must be able to operate profitably in today's highly competitive financial service.

Over the past decade, this market has changed quite radically as technological advances and innovations in financial instruments and services have increased competitive pressures. Advances in computer and telecommunications have so lowered the cost of information processing that it has become increasingly possible for borrowers and lenders to contract directly, rather than going through a commercial bank. Examples here include the commercial paper and mortgage-backed securities markets and, somewhat more recently, securitization of other financial assets. Another aspect of how technological change has increased competition for banks is the increased ability of many nonbank firms, such as money market mutual funds, automobile finance subsidiaries of the automobile producers, and small business and consumer finance companies, to provide banking services. The increased globalization of financial markets, including the expansion of foreign bank activity in the U.S., also has intensified competitive pressures on U.S. banking institutions.

The effect of these and other such developments on U.S. depository institutions has been intensified because key U.S. laws and regulations

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restricting bank activities have not changed and, consequently, have limited the ability of banks to compete. Thus, some relaxation of strictures on banking activities clearly seems to be in order.

**Interstate branching.** One principal structural change that has been strongly advocated by the Federal Reserve is elimination of the long-standing restrictions on interstate branching. At this time, interstate branching is prohibited in the U.S., and, with some minor and technical exceptions, out-of-state entry can take place only through bank holding company acquisitions of subsidiary banks.28 However, this form of out-of-state entry can be expensive, since considerable duplication of effort is required, such as separate boards of directors, senior management, and certain types of asset/liability management.29 The Federal Reserve has suggested that full, nationwide interstate branching powers would enable banks not only to reduce their costs of operating interstate and thus improve their efficiency, but also to diversify their risks geographically and to respond more effectively to financial market needs. In turn, the safety and soundness of the banking system would be enhanced.30

**New Activities.** A second important change supported by the Federal Reserve would be to increase the range of financial activities that bank holding companies with well-capitalized and well-managed bank subsidiaries can conduct. New activities would include insurance sales and underwriting and full investment banking powers.31 The Federal Reserve has suggested that well-capitalized banks rely far less on the safety net and thus should be permitted a broader range of activity. In addition, the reward of expanded powers for well-capitalized and well-managed banks should provide a powerful incentive for banks to build and maintain their capital and to be managed prudently.32

The Federal Reserve has argued that the expansion of bank activities should occur within the holding company organization form for at least two reasons. First, the separation of the insured bank from other, noninsured parts of the organization (including subsidiaries engaged in investment and insurance activities) would be facilitated. This insulation, known as "corporate separateness," helps to ensure both that safety net subsidies are not extended beyond the insured bank, and that risks residing in uninsured subsidiaries are not passed onto the insured bank and hence onto the U.S. taxpayer.33 Second, the

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28 Two U.S. laws govern interstate banking: the McFadden Act of 1927, which prohibits interstate branching by national and state member banks, and the Bank Holding Company Act of 1956, which allows bank holding companies to acquire banks in another state only if permitted by that state.
31 The Glass-Steagall Act restricts combinations of investment and commercial banking.
32 LeWare, statement of June 23, 1992, p. 610.
33 The legal protections of the holding company form are unlikely to be complete, but they do
holding company form facilitates regulation of a given activity by the regulatory agency responsible for that activity. For example, in the United States, at the federal level securities firms are primarily regulated by the Securities and Exchange Commission, while banks are regulated by the Federal Reserve, the Comptroller of the Currency, or the Federal Deposit Insurance Corporation. Because each subsidiary of a holding company is a separate legal entity, the holding company organizational form facilitates "functional regulation" by the appropriate agency. However, because the legal protections provided by the holding company are unlikely to be complete, the Federal Reserve also argues that one "umbrella" regulator would be needed to have overall responsibility for making sure that the taxpayers' interests in the insured bank are protected.

**Interest on reserves.** The Federal Reserve also supports the payment of interest on required reserves that depository institutions must hold, thereby reducing costs imposed on depository institutions as regulated entities.

**VI. CONCLUSION**

In sum, over the past decade, widespread problems in the thrift and commercial banking industries led to a large number of depository institution failures, which, in turn, drained the deposit insurance funds. A variety of factors contributed to the problems. In particular, however, the availability and existence of deposit insurance, while providing financial stability, also reduced the market discipline needed to temper risk-taking.

The Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA) facilitated the recapitalization of the bank insurance fund and, at the same time, instituted a number of provisions intended to help ensure that such a recapitalization was never again needed. Some of these provisions indeed should prove constructive in limiting the exposure of the deposit insurance fund as well as other elements of the safety net to troubled institutions.

However, FDICIA went too far by imposing significant additional regulatory burdens, many at the micro-management level, on what a number of observers considered an already over-burdened industry. In addition, FDICIA failed to provide banking institutions with relief from outdated structural restrictions that inhibit them from competing profitably in today's highly competitive financial markets.
Thus, much remains to be done to bring both regulations and prohibitions to a more realistic, manageable level and, in turn, to improve the efficiency and competitiveness of the U.S banking industry.