FDIC Seeks Help From Banks

The Federal Deposit Insurance Corporation (FDIC) is considering borrowing billions of dollars from the very banks it is supposed to be insuring against failure, the New York Times reported on September 21.

The FDIC has taken control of 94 failing banks since January, depleting its cash reserves from about $30 billion to $10 billion, not including another $32 billion that has already been set aside to cover banks that are expected to fail in the near future. This $10 billion is all that there is to back up $4.8 trillion in insured deposits throughout the United States. The failure of a single large bank could leave the fund completely depleted.

Sheila Bair, the FDIC chairwoman, has at least three options. First, Bair could turn to the Treasury Department to take advantage of an already established but currently unused $100 billion line of credit. Second, she could levy a special assessment on banks that are insured by the FDIC to raise extra money. And third, the FDIC could turn to the healthiest banks in America to borrow the billions of dollars it needs.

The first option is akin to asking for a taxpayer bailout of a government agency that is insuring taxpayers against losing their money, an option that would garner Bair a lot of negative political fallout. “Sheila Bair would take bamboo shoots under her nails before going to Tim Geithner and the Treasury for help,” said the president of the Independent Community Bankers, Camden Fine. “She’d do just about anything before going there.”

The second choice to raise money by essentially charging insured banks a special fee would be unpopular with the banks and could impact their profits enough to put them in jeopardy. Such a course could lead to the FDIC setting up banks for the very failures that the agency can’t afford to insure against. Of course, the current administration would be only too happy to bailout these banks, but having the FDIC to blame for the bailout would almost undoubtedly push taxpayer tolerance beyond the breaking point.

The final recourse for Bair and the FDIC is to borrow enough money from the healthiest banks to stay above water. But only down the rabbit hole as told in the tales of Uncle Sam’s Adventures in Federaland will anyone find such an upside-down twist.

“It’s a nice irony,” said Karen Shaw Petrou, managing partner of a consulting firm known as Federal Financial Analytics. “Like so much of this crisis, this is an issue that involves the least worst options.”

The FDIC wants to borrow from the very banks it is supposed to be insuring. Has there ever been an automobile, home, health, or life insurance company that asked to borrow money from those it insures in order to stay in business? Raising premiums, yes, but not borrowing. Wouldn’t the prudent policyholder simply cancel the policy at the earliest possible opportunity rather than stay with such a financially unsound insurer who was unlikely to pay out in the event of a claim?

The Founding Fathers knew that government's proper role was minimal: to protect life, liberty, and property. This means protection only from loss to violence or oppression, not to risks that citizens normally accept as they do business or attempt to make a profit. There is no more constitutional basis for the FDIC than there would be for a federal agency to insure stock-market investors against taking a loss or to reimburse gamblers who lose money to state-run lottery schemes.

Mimicking Petrou's phraseology, the "most best option" is to end the FDIC.

Photo of Sheila Bair: AP Images