

Prepared Remarks by Bert Ely for the FDIC
Conference on Deposit Insurance
January 29, 1998

I want to thank Chairman Hove and the FDIC for the opportunity to speak today on privatizing banking regulation and its attendant deposit insurance and systemic risks by statutorily delegating to a new private-sector marketplace the full responsibility for ensuring the prudent operation of individual depository institutions. Legislation to privatize today's cross-guarantee system has been introduced by Rep. Tom Petri (R-WI).¹

The heart of this regulatory delegation is the cross-guarantee contract. **Figure 1** illustrates the four parties to each such contract: the guaranteed institution; its direct guarantors, called the cross-guarantee syndicate; an independent firm, called a syndicate agent, which monitors the guaranteed institution's compliance with its cross-guarantee contract; and a government agency charged with enforcing certain risk-dispersion rules applicable to each contract.

Each bank and thrift which elects to become a guaranteed depository institution will have its own cross-guarantee contract, which will be the product of a negotiation between it and those direct guarantors (largely other banks and thrifts) who voluntarily agree to guarantee the specified liabilities of that institution under the terms of the negotiated contract. This volunteerism, an essential feature of any marketplace, is absent in today's cross-guarantee system since every bank and thrift, through deposit insurance assessments, effectively guarantees every other bank and thrift. In effect, privatizing cross-guarantees is comparable to a country shifting from an army of sullen conscripts to a professional army of gung-ho volunteers.

A key provision in each cross-guarantee contract will be the negotiated, risk-sensitive formula for calculating the cross-guarantee premium which the guaranteed institution will pay to its direct guarantors. Premium formulae developed within the cross-guarantee marketplace undoubtedly will be based on leading indicators of banking risk, specifically internal risks, such as risk mismatches, rapid growth, and poor internal controls, as well as external risks, notably excessive credit exposure to emerging speculative bubbles. Basing premiums on leading indicators of risk also will compensate guarantors in advance of any losses they may incur, thus undermining any rationale for using taxpayer funds to protect guarantors facing large losses.

Because banking risk changes constantly, cross-guarantee premium rates will be recalculated frequently. A bank's capital effectively serves as an insurance deductible, so a bank's premium rate will increase as its riskiness rises, unless the bank's capital rises sufficiently to offset the higher risk to guarantors. The reverse also will be true.

While cross-guarantee premiums will be the primary deterrent to unwise risk-taking by banks, cross-guarantee contracts will contain other provisions designed to ensure the guaranteed bank's sound operation. These provisions, and not statutes or one-size-must-fit-all regulations, will define what a bank can and cannot do. Through the negotiation process,

an individual bank or thrift will effectively be able to tailor its regulatory strictures to the business strategy it has selected; today, regulation drives business strategy, which leads to herd effects within banking and periodic financial crises. Cross-guarantee contracts also will specify the conditions under which a syndicate can step in and take action if the institution that it has guaranteed is sliding into serious trouble, further lessening herd effects. Therefore, in addition to reducing systemic risk, contractually tailored regulation will lead to a much more efficient banking industry.

The parties to a cross-guarantee contract will designate a syndicate agent firm to ensure compliance with the contract, which it will do through direct, on-going access to non-public data about the institution. In effect, syndicate agent personnel will replace government safety-and-soundness regulators. There will be numerous syndicate agents, which will introduce competition into the regulatory business without creating the competition-in-laxity sometimes found in government regulation. Whereas government regulators tend to favor their regulatees, the designated syndicate agent under a cross-guarantee contract will carefully balance the interests of both the guaranteed institution and its guarantors since it can be fired by either side. For competitive reasons, syndicate agents will have to diligently protect the competitive secrets of guaranteed institutions, something government regulators apparently do not fear, according to a recent news report.² If syndicate agent firms do not perform satisfactorily, they will go out of business and their personnel will be unemployed; this is not a concern of government regulators.

In order to ensure systemic stability by eliminating the incentive to run, each cross-guarantee contract will explicitly protect all depositors as well as all other funding-type creditors, except stockholders and subordinated debt, from any loss for any reason. Therefore, as **Figure 2** illustrates, all insolvency risk now borne by depositors and other unsecured general creditors, except non-funding obligations,³ will be shifted to the direct guarantors of the guaranteed institution. In effect, the concept of guarantor discipline is substituted for the notion of depositor discipline, which is of dubious efficacy for too-big-to-fail banks. As a bonus, this shift to guarantor discipline will bring all guaranteed institutions an AAA credit rating, which will greatly enhance their competitiveness.

The federal government's role in a privatized cross-guarantee system is limited to enforcing four risk dispersion rules designed not to prevent the failure of individual institutions -- that is a private-sector responsibility -- but solely to ensure that losses from individual failures are contained entirely within the universe of private-sector guarantors, thereby not falling upon depositors or taxpayers. These rules have been designed to handle banking problems far worse than those experienced during the Great Depression. **Table 1** summarizes these risk-dispersion rules; I will not discuss them further.

Four other features of privatized cross-guarantees are worth noting. First, in order to broaden the cross-guarantee system's capital base, the Petri bill authorizes "non-depository" guarantors, or NDGs. NDGs can be any person or entity with a net worth of at least \$100 million which has first obtained a "stop-loss" contract that guarantees the NDG's cross-guarantee obligations.

Second, it keeps FDIC insurance in place so that banks and thrifts can continue displaying the FDIC sticker. Further, this insurance will be backstopped by a new FDIC-administered fund, called the Back-Up Fund, or BUF, which will be funded by shifting monies to it from the BIF and SAIF as banks and thrifts obtain cross-guarantee contracts. However, because the entire cross-guarantee system will stand behind every guaranteed obligation, including deposits also insured by the BUF, the BUF will never pay a loss unless the entire cross-guarantee system collapses after a disaster far worse than the Great Depression. In that event, though, it will be highly problematic if the federal government could meet its deposit insurance obligations. Since the BUF will suffer no losses, it will collect no premiums.

Guaranteed banks and thrifts will display a second sticker, which will state that all deposits are fully guaranteed under an approved cross-guarantee contract. Eventually, the new sticker will gain the public trust now attributed to the FDIC sticker, thereby eliminating the need for the FDIC sticker and the BUF.

The third feature is the market-driven transition to privatized cross-guarantees. Briefly, the privatization process will be subject to two market tests. First, privatization will not launch until at least 250 banks and thrifts with at least \$500 billion of assets have voluntarily obtained approved cross-guarantee contracts. Thereafter, individual banks and thrifts will have the option of deciding whether to switch. Switching, though, is strictly a one-way street; once a bank or thrift becomes a guaranteed institution, it cannot, for obvious moral hazard reasons, revert to a federally regulated institution.

The switching option will exist as long as government regulation and the FDIC can pass a second market test -- at least 10 percent of the nation's banks and thrifts or institutions holding at least 10 percent of all U.S. banking assets elect to remain in the present system. However, if the government's market share drops below 10 percent, then the remaining institutions will have two years to obtain a cross-guarantee contract or be deemed a failed institution.

Fourth, the Petri cross-guarantee legislation, as introduced, authorizes the cross-guarantee concept only for FDIC-insured banks and thrifts. However, with just a few definitional changes, the cross-guarantee concept can be expanded to encompass any type of financial services provider, specifically securities firms, insurance companies, and managers of financial assets. Further, the Petri bill gives cross-guarantee contracts global applicability. Hence, the cross-guarantee concept provides a way, and perhaps the only way, to satisfactorily address the safety net concerns arising from an increasingly integrated and globalized financial services industry.

Table 2 illustrates something that should be quite evident by now -- the many similarities between the present regulatory/deposit insurance system and a privatized system of cross-guarantees. However, as the bullet points note, there are some important differences, too. Time does not permit further discussion of this table -- I do hope that you will review it at your convenience.

Five specific factors which make a privatized cross-guarantee system much more attractive than the present regulatory system warrant some discussion. First, privatization will eliminate "regulatory moral hazard,"⁴ which arises when regulators do not utilize in a timely manner their unique access to non-public information about their regulatees to discipline them or close a failing bank before it becomes insolvent. The S&L debacle of the 1980s and the more recent Asian banking crises amply demonstrate the dangers of regulatory moral hazard.

Second, the Petri legislation incorporates even stronger taxpayer protection than FIRREA⁵ and FDICIA⁶ currently provide, for two reasons. One, the inclusion of NDGs in a privatized cross-guarantee system will broaden the capital base over which insolvency losses can be spread. Two, because guarantors will not be a source of funding for guaranteed institutions, politicians will not fear a bank liquidity crisis if they do not bail out the guarantors.

Third, the Petri cross-guarantee bill enthusiastically embraces for all banks the underlying concept of too-big-to-fail, which is that depositors should not suffer when a bank fails even if the institution disappears, its stockholders are wiped out, and its employees lose their jobs. Too-big-to-fail is a political reality of the industrialized world, as we have seen time and again, most recently in Asia, and properly so, because no matter how fast regulators act to close an insolvent or possibly insolvent institution, the smartest, most savvy, and best connected depositors will flee soon enough and far enough to avoid any loss. That reality ensures systemic instability if a large institution is shut down or only its protected liabilities are transferred to another institution. Politicians therefore recognize that too-big-to-fail is a very wise policy, not only to ensure systemic stability, but also because the underlying cause of banking failures has been government regulatory failure.

Fourth, the opportunity to switch to the privatized cross-guarantee system should be very attractive to banks and thrifts for many reasons, including those cited above. Privatization should be especially attractive to community banks, in part because cross-guarantee contracts will end the too-big-to-fail discrimination that community banks now face.⁷ However, as I noted above, privatizing cross-guarantees will not occur unless a sufficient number of banks and thrifts voluntarily obtain cross-guarantee contracts. Hence, if privatization does not have the appeal that I believe it does, it will never occur, despite enactment of the Petri bill.

Fifth, the private competitive marketplace for cross-guarantees created by the Petri legislation will outperform a government monopoly or even competing government regulators. Specifically, markets can differentiate much more in tailoring a product or service to a customer's needs than can government agencies, which must operate under one-size-must-fit-all rules. Also, markets can much more effectively use the pricing mechanism to deter unwise risk-taking by banks.

In closing, just ask yourself who, as a taxpayer, would you rather have protecting your desire for a sound banking system -- government regulators with their incentives or

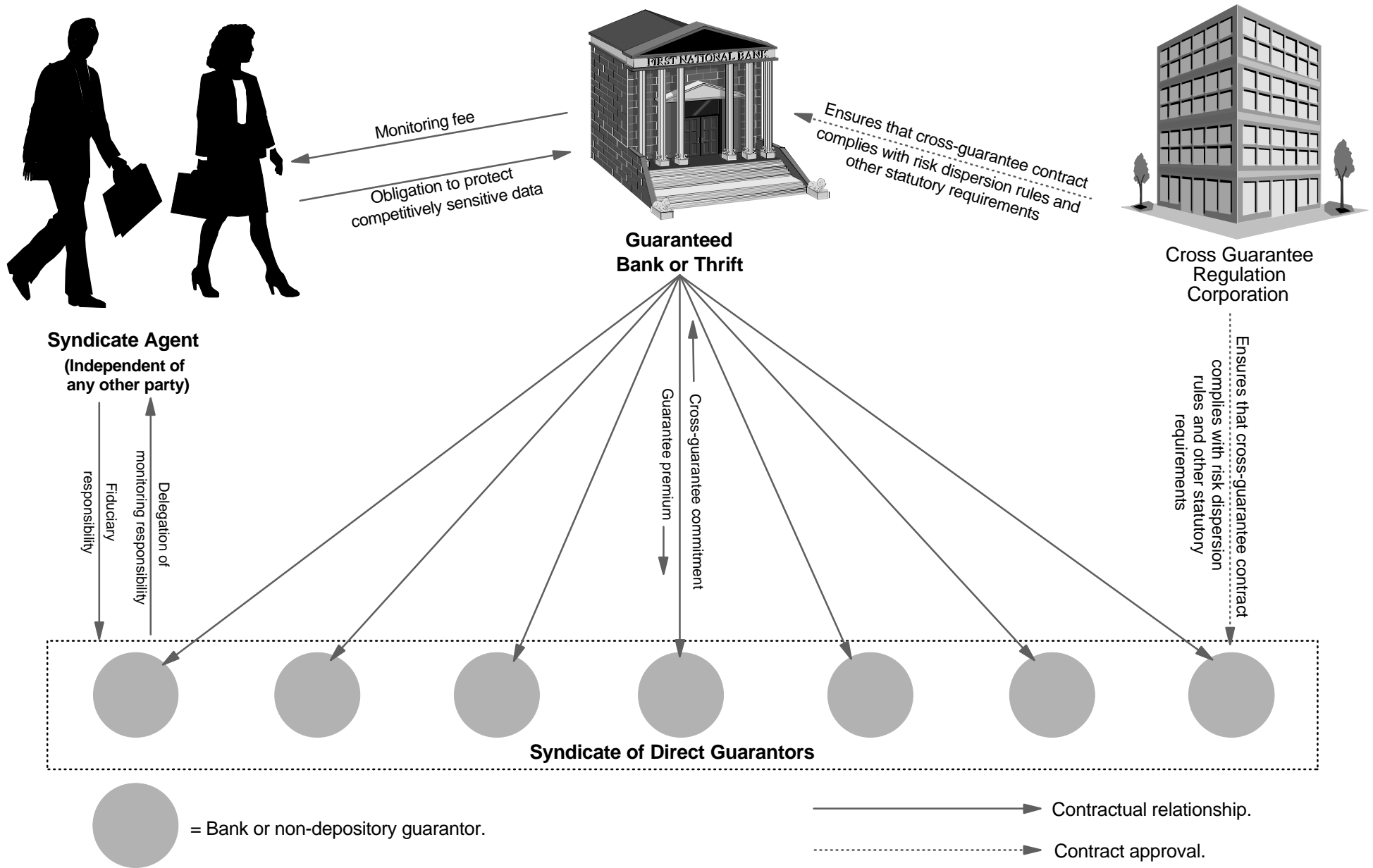
private parties who have put their own capital at risk and therefore have a powerful financial incentive to do a good job?

A recent Treasury Department report, "American Finance for the 21st Century," observed quite accurately why banking regulation must rely much more on market mechanisms -- "[m]arkets tend to be less forgiving than regulators, who may be more willing to give a troubled institution time to work through its problems."⁸ Privatizing the existing cross-guarantee system will provide the banking system with that much-needed market regulation.

Endnotes

1. Mr. Petri introduced H.R. 4318 on September 28, 1996. He will introduce a slightly revised version of this bill in 1998. This bill can be accessed at <http://thomas.loc.gov/cgi-bin/query/z?c104:H.R.4318>: A synopsis of the 1998 version of the Petri bill is attached.
2. Timothy L. O'Brien, "Bank Regulators Circulating Secret Data: Some Lenders Worry About How Korean Records Will Be Used," The New York Times, January 14, 1998.
3. Non-funding obligations include trade accounts payable, leases and employment contracts, tort claims, and other liabilities not unique to banking organizations.
4. The concept of regulatory moral hazard is explained in a paper, titled "Regulatory Moral Hazard: The Real Moral Hazard in Federal Deposit Insurance," that the author presented at the 1997 meeting of the Southern Finance Association, November 22, 1997. This paper can be accessed at <http://www.cais.com/ely/sfa1197.pdf>.
5. Financial Institutions Reform, Recovery, and Enforcement Act of 1989.
6. Federal Deposit Insurance Corporation Improvement Act of 1991.
7. An attachment lists nine reasons why privatization of the existing cross-guarantee system will be especially beneficial for community banks.
8. Robert E. Litan, with Jonathan Rauch, "American Finance for the 21st Century," The United States Department of the Treasury, November 17, 1997, pg. ???. This report (inexplicitly minus page numbering) can be accessed at <http://www.treas.gov/whatsnew/amfin.pdf>.

The Parties to a 100% Cross-Guarantee Contract



The Cross-Guarantee System Shifts All Creditors' Insolvency Risk in a Bank or Thrift to an Independent Set of Guarantors

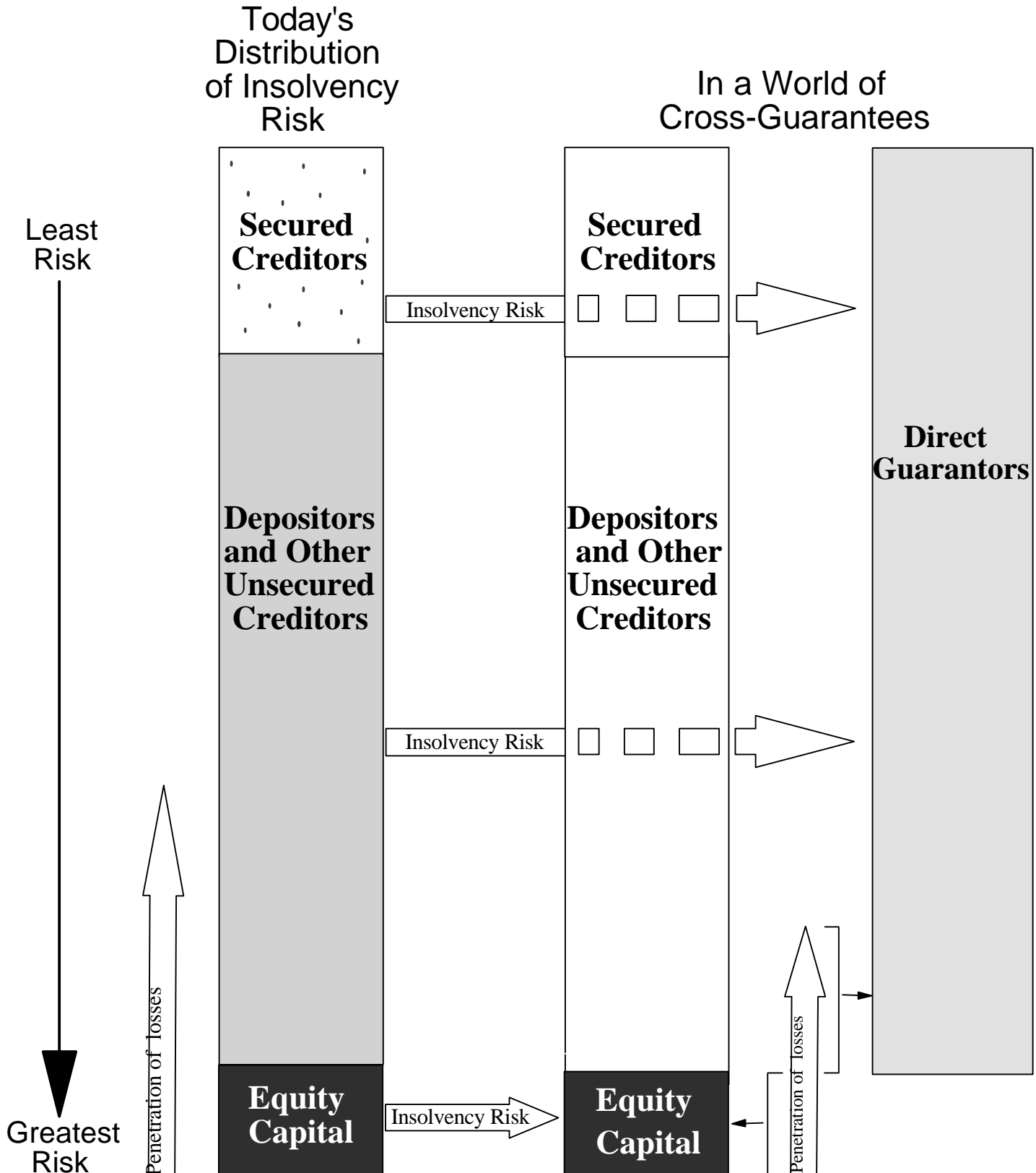


Table 1

The Four Principal Risk-Dispersion Rules of a Privatized Cross-Guarantee System

Rule No. 1 (the cardinal rule)

Every guarantor must itself be guaranteed at all times by other guarantors with regard to all of its cross-guarantee obligations.

Rule No. 2

Every cross-guarantee contract (for guaranteed depository institutions) and stop-loss contract (for non-depository guarantors) must have a minimum number of direct and second-tier guarantors, with no direct guarantor assuming more than a specified share of the risk under the contract. For example, a bank with more than \$10 billion of assets must have at least 100 direct guarantors, no one of which can assume more than 1 percent of the bank's cross-guarantee risk. Further, the direct guarantors of the bank must themselves have at least 250 unique guarantors (second-tier guarantors of the guaranteed bank), some of whom also can be direct guarantors of the bank.

Rule No. 3

Each guarantor is subject to two cross-guarantee premium limitations:

- In the aggregate, a guarantor cannot earn in any twelve-month period cross-guarantee and stop-loss premium income exceeding 3 percent of its net worth. For a guarantor which is a guaranteed depository institution, net worth is defined in its cross-guarantee contract. For a non-depository guarantor, net worth is defined under generally accepted accounting principals.
- For any one contract, a guarantor cannot earn in any twelve-month period cross-guarantee or stop-loss premium income exceeding 3 percent of its aggregate premium limit for that period.

Rule No. 4

Each guarantor is subject to a uniform, mandatory stop-loss rule which provides that a guarantor will pass through to its own direct guarantors all cross-guarantee and stop-loss losses that it accrues in any twelve-month period that exceed five times the amount of cross-guarantee and stop-loss premium income that it accrued in that twelve-month period. Since, therefore, losses in any twelve-month period cannot exceed 15 percent of a guarantor's net worth -- less than one year's earnings -- no guarantor should ever fail by virtue of being a guarantor.

Table 2

Parallels Between the Present Regulatory/Deposit Insurance System and Privatized Cross-Guarantees
(Bullet points highlight important differences)

Present Regulatory/Deposit Insurance System

Regulatory philosophy

- Government regulates individual, with backup marketplace discipline, to ensure systemic stability.

Regulatory framework

- Statutes, regulations govern bank activities
- Competition in laxity
- Regulation shapes business strategy

Regulatory personnel

- Government employees
- Regulators do not suffer personally if high losses occur

Risk-sensitive premiums

- Based on lagging indicators of risk
- Premium spread is too narrow

Market discipline

- Uninsured depositors expected to run from troubled banks if regulators fail to act

Banks, thrifts insure deposits

- Every bank must guarantee every other bank
- Deposits insured to \$100,000

Too-big-to-fail

- For big banks only
- Ex post TBTF assessments under systemic risk exception provision of FDICIA
- Unfair to "too-small-to-save" banks

FDIC sticker on the door

- No additional guarantees

Cross-Guarantees (C-G) Concept

Regulatory philosophy

- Regulation of individual institutions delegated to C-G system; government enforces risk-dispersion rules

Regulatory framework

- C-G contracts govern bank activities
- Competition in excellence
- Business strategy shapes regulation

Regulatory personnel

- Private-sector syndicate agents (SAs)
- SAs go bankrupt; SA personnel lose jobs if high losses occur

Risk-sensitive premiums

- Based on leading indicators of risk
- Market-determined premium spread

Market discipline

- Risk-sensitive premiums, monitoring by SAs, financial interest of guarantors

Banks, thrifts guarantee deposits

- Voluntary guarantee bank-by-bank
- All deposits fully guaranteed

Too-big-to-fail

- For all banks and thrifts
- Ex ante C-G premiums protect all deposits, which effectively provides TBTF protection for all depositors in all banks and thrifts eliminates need for depositor discipline

FDIC sticker on the door

- Second sticker on the door notes existence of C-G contract that protects all deposits

BIF and SAIF insurance funds

- Funds must be kept at 1.25% minimum

Taxpayer risk

- Banking capital only protection

BUF (Back-Up Fund)

- BUF will never be drawn upon

Taxpayer risk

- Capital of all guarantors

Synopsis of The Deposit Insurance Reform, Regulatory Modernization, and Taxpayer Protection Act of 1997

Inherent and Irreparable Flaws in Federal Deposit Insurance

- As President Roosevelt warned in 1933, federal deposit insurance protects bad banks as well as good ones. It also puts a premium on unsound banking and, in the case of the S&Ls, cost taxpayers billions of dollars.
- As bank and S&L insolvency losses soared during the 1980s, regulators moved too slowly to deal with failing institutions. Their inaction made deposit insurance losses even worse.
- Deposit insurance mispricing caused a substantial misallocation of credit in the 1980s that prolonged the recovery from the last recession. The FDIC's supposedly risk-based premiums reflect lagging indicators of banking risk; consequently, its premiums do not discourage bad banking. Deposit insurance must be priced to reflect the riskiness of individual banks, but the FDIC cannot properly set risk-sensitive premiums because accurate prices can be established only in private, competitive markets.
- Banking has become a captive of government regulatory micromanagement that cannot keep up with rapid changes in a financial world driven increasingly by electronic technology. Government regulation has become counterproductive and harmful to good banks and thrifts as well as to America's international competitiveness. Regulation now shapes banking strategy, which occasionally creates dangerous herd effects. Instead, a bank or thrift's safety-and-soundness regulation should be tailored to the business strategy that it has selected.

Basic Principles of the 100% Cross-Guarantee Solution

- For banks and thrifts that elect to become guaranteed, the cross-guarantee solution will:
 - End all taxpayer risk and bailouts by ensuring that private-sector equity capital always protects from loss ALL deposits of guaranteed banks and thrifts.
 - Let private markets set risk-sensitive deposit insurance premiums, based on leading indicators of banking risk, thus discouraging unwise banking practices.
 - Shift "safety-and-soundness" regulation for banks and thrifts and the decision to close a failing institution to those who bear the risk of loss, which will be those guarantors actually bearing that risk. These guarantors have the strongest incentive to minimize losses and should therefore control the risks that they have assumed.

- Use a "stop-loss" mechanism and risk-dispersion rules to spread the bank/thrift insolvency risk widely, and therefore thinly, over the equity capital of all guarantors.
- Retain government regulation and the \$100,000 FDIC insurance limit for those banks and thrifts that do not elect to become guaranteed institutions.

Specifics of the 100% Cross-Guarantee Solution

- Each bank and thrift enters into a contract with a syndicate of voluntary guarantors (largely other banks and thrifts) that guarantees the original contractual terms of all deposits and most other liabilities of the guaranteed institution.
- Premium rates and other contractual terms are negotiated on a syndicate-by-syndicate basis and are NOT subject to government regulation or approval.
- Numerous safeguards protect taxpayers against another deposit insurance bailout. Every guarantor must be guaranteed with regard to its cross-guarantee obligations. Risk dispersion rules require a minimum number of guarantors for any one bank or thrift and limit both the aggregate risk assumed by a guarantor and the amount of risk that any one guarantor can assume for any one bank or thrift. A mandatory "stop-loss" mechanism caps a guarantor's losses; excess losses get passed through to its guarantors.
- Cross-guarantee contracts cannot be canceled unless the guaranteed bank or thrift first obtains a replacement contract or is acquired by another guaranteed bank or thrift. Once guaranteed, no institution can operate without a cross-guarantee contract in place.
- Each syndicate retains an agent, called the syndicate agent, to monitor the financial condition of the bank or thrift it has guaranteed to ensure adherence to all contractual terms and to act as a buffer to protect the competitive secrets of the guaranteed institution.
- A small, new agency regulates the cross-guarantee process, primarily to ensure that all guarantors are guaranteed with regard to their cross-guarantee obligations and that the risk-dispersion rules are complied with. Safety-and-soundness concerns for individual institutions shift to the syndicates.
- The first cross-guarantee contracts become effective when 250 banks or thrifts, with total assets of at least \$500 billion, have approved contracts in hand. The existing system of government regulation and FDIC insurance is retained indefinitely for institutions that do not wish to obtain cross-guarantee contracts, provided that at least 10% of all banks and thrifts or those institutions holding at least 10% of the industry's assets stay within the federal system. If the government's market share drops below 10%, then the remaining federally insured institutions will have two years to obtain cross-guarantee contracts.

- A competitive market with an ample pool of potential guarantors will protect guaranteed institutions against premium overcharges, end concerns about capital adequacy in the banking system, and permit guarantors to accept or reject individual cross-guarantee risks as they see fit. Guaranteed institutions can "net down" their cross-guarantee cost through the profits they earn as guarantors.
- Cross-guarantee contracts will protect loans Federal Reserve banks makes to guaranteed institutions; these institutions, though, should never experience liquidity problems.

CROSS-GUARANTEES' MANY BENEFITS FOR COMMUNITY BANKS

1 - By protecting all deposits, cross-guarantees will eliminate the "too-big-to-fail" discrimination against community banks. Under the cross-guarantee system, all deposits will be protected against loss, not just those up to \$100,000. This greater protection for depositors will enable smaller institutions to compete on an equal footing with larger institutions for large deposits, as large depositors will no longer have a better chance of being protected against loss at banks deemed too-big-to-fail. This leveling of the playing field will extend to non-deposit funding and to other lines of business, such as letters of credit, since an institution's credit-like, non-deposit obligations will also be fully guaranteed under the cross-guarantee system.

2 - Smaller institutions will pay cross-guarantee premiums geared to their own riskiness. The FDIC's risk-based premiums do not properly reflect a bank's insolvency risk because those premiums are based on lagging measures of banking risk. The competitiveness of the cross-guarantee marketplace, however, will ensure that cross-guarantee premium rates will be based on the leading indicators of insolvency risk for each bank. Also, cross-guarantee premiums will not include a "fund building" charge of the type that boosted FDIC premiums so high in recent years. Also, "group cross-guarantee contracts" will further reduce the cost of guaranteeing community banks.

3 - The cross-guarantee system will have ample capacity to ensure that a sound community bank will not experience any difficulty in obtaining a cross-guarantee contract. All guaranteed banks will be eligible to be guarantors of other banks, both large and small. Because community banks, as a group, have many times the amount of capital needed to guarantee all community banks, these banks will not be dependent upon large banks as guarantors. As a practical matter, though, banks of all sizes will find it profitable to guarantee other banks of all sizes.

4 - A community bank will have the opportunity to substantially reduce, or even eliminate, the cost of its own cross-guarantee contract by being an active guarantor of other banks. The risk-dispersion rules are such that sound community banks will be able, as active guarantors, to earn five or six times as much in cross-guarantee premiums as they pay for their own cross-guarantee contract. Under the risk-dispersion rules, however, a very large bank will not be able to fully offset the cost of its cross-guarantee contract with premiums it earns as a guarantor.

5 - Smaller banks will enjoy sharply lower regulatory compliance costs. Small banks will enjoy relatively greater benefits than larger banks from the regulatory relief provided by the cross-guarantee system, in large part because the safe banking practices spelled out in cross-guarantee contracts for community banks will be much simpler than today's "one-size-must-fit-all" government regulations geared to larger banks. Regulatory compliance today is more costly for small banks because of the "economies of scale" in complying with complex regulations. Moreover, much of this regulatory burden is not relevant to the operation of smaller institutions, yet they must comply with the same regulations as larger institutions with more complex operations. For example, guarantors will demand far less financial data of smaller banks than of larger banks.

6 - Cross-guarantees will allow community banks to better compete for rate-sensitive deposits. Guaranteed banks of all sizes will be AAA-rated financially. That rating, plus the lower operating costs guaranteed banks will enjoy, will enable community banks to profitably compete against today's less regulated financial intermediaries. Bank deposits, for example, will offer much more competitive risk-adjusted yields, compared to mutual funds, than is the case today. Also, rural banks will be able to compete more effectively against the Farm Credit System because these banks will be able to obtain low-cost, fixed-rate medium and long-term funding in the capital markets.

7 - Cross-guarantees will give smaller banks more flexibility in picking operating strategies. Cross-guarantees will make it easier for smaller institutions to specialize. Regulation's "one-size-must-fit-all" mentality hampers smaller institutions that seek to follow a more specialized strategy. By tailoring its cross-guarantee contract to fit its unique circumstances and chosen business strategy, a smaller bank will be better positioned to compete for business free of regulatory restraints and to meet the particular needs of its customers. Cross-guarantees will also give smaller institutions greater operating latitude within an agreed upon business strategy. Regulation has made banking far too bureaucratized. While cross-guarantee contracts will discourage reckless banking, they will, for example, permit more judgment in the lending process.

8 - Cross-guarantees will make it easier for community banks to attract and retain directors. The regulatory environment in recent years has made it more difficult for community banks to attract outside directors because of the potential liabilities facing bank directors. Also, the cost of directors' and officers' insurance is still too high. The low level of bank failures under cross-guarantees will sharply lower the insolvency losses that give rise to suits against directors. Also, guarantors will have little basis for suing directors of a failed bank since the guarantors' syndicate agent will have had full access to the books and records of the institution. Even if legal action is commenced, guarantors will be private-sector parties; therefore, they will not be able to avail themselves of the draconian powers the bank regulatory agencies have gained in recent years.

9 - Cross-guarantees will ease consolidation pressures on community banks. Depository institutions have been losing market share to less-taxed and less-regulated competitors for many years. More recently, the total assets of the banking industry, on an inflation-adjusted basis, have declined. This contraction of the banking industry increases the pressure on smaller and mid-size banks to be acquired by larger banks as there simply is not enough room within a shrinking pie for the present number of banks. Cross-guarantees will ease consolidation pressures for two reasons. First, cross-guarantee contracts will be much easier and therefore cheaper to comply with than one-size-must-fit-all government regulation. Second, the banking industry will begin to grow again because cross-guarantees will restore the competitive edge banks have lost in recent years because of higher deposit insurance premiums, uniform capital requirements, and mounting regulatory burdens.