

Federal Deposit Insurance, Regulatory Policy, and Optimal Bank Capital*

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ABSTRACT

This paper seeks to explain the combination of explicit and implicit pricing for deposit insurance employed by the FDIC. Essentially, the FDIC sells two products—insurance *and* regulation. To span the product space, it must and does set two prices. We argue that the need to establish regulatory disincentives to bank risk-taking is the heart of the controversy over the adequacy of bank capital and that the ability to close risky banks before exhausting their *charter value* (i.e., the value of their right to continue in business) stands at the center of these disincentives and in front of the FDIC's insurance reserves.

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