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## Bank Nationalization Isn't the Answer

*Trust me. I've done this before.*

By [WILLIAM M. ISAAC](#)

People who should know better have been speculating publicly that the government might need to nationalize our largest banks. This irresponsible chatter is causing tremendous turmoil in financial markets. The Obama administration needs to make clear immediately that nationalization -- government seizing control of ownership and operations of a company -- is not a viable option.

Unlike the talking heads, I have actually nationalized a large bank. When I headed the Federal Deposit Insurance Corporation (FDIC) during the banking crisis of the 1980s, the FDIC recapitalized and took control of Continental Illinois Bank, which was then the country's seventh largest bank.

The FDIC purchased Continental's problem loans at a big discount and hired the bank to manage and collect the loans under an incentive arrangement. We received 80% ownership of the company, which increased to 100% based on the losses suffered by the FDIC on the bad loans.

We replaced Continental's senior management and most of its board of directors. We required the bank to submit a business plan to shrink to half its size within three years. All major decisions required FDIC approval, including the hiring, firing and compensation of senior management, and the undertaking of new business endeavors.

The takeover occurred in 1984, the FDIC completed the sale of its ownership stake seven years later, and Continental was purchased by Bank of America in 1994. The old shareholders ultimately received nothing, all creditors and preferred shareholders came out whole, and the FDIC suffered what we considered a reasonable loss: \$1.6 billion.

So, you might wonder, what's so bad about nationalization? It appears to have worked well at Continental.

Let's begin with the fact that today our 10 largest banking companies hold some two-thirds of the nation's banking assets, and some are enormously complex. Continental had less than 2% of the nation's banking assets, and by today's standards it was a plain-vanilla bank. This is important for three reasons.

First, any bank we nationalize will be forced, both by the regulators and the marketplace, to shrink dramatically. We are in the middle of a serious economic downturn where deflation is a realistic concern. Do we really think that dismantling our largest banks would be helpful? I don't.

What's more, we won't be able to stop at nationalizing one or two banks. If we start down that path, the short sellers and other speculators that the Securities and Exchange Commission still refuses to re-regulate will target for destruction one after another of our largest banks.

Second, for nationalization to work there needs to be a reasonable exit strategy. In the case of Continental, we had

scores of options for returning the bank to private hands, including a public offering or a sale to any number of domestic and foreign banks and investor groups.

Today, who has the wherewithal, legal authority, and desire to purchase our largest banks? No one comes to mind, particularly if we rule out foreign groups, which I suspect would not pass muster due to national security concerns about ceding that much power over our economy to foreign powers.

Third, who will run these companies when we dismiss the existing senior managers and board members? We had significant difficulties attracting quality people to Continental even without today's limits on compensation.

So-called experts frequently cite the success of the Swedish experience with bank nationalization in the last decade. Nothing could be less relevant. Sweden's population, economy and banking system are roughly the size of Ohio's. Sweden's largest bank is roughly 10% the size of each of our three largest banking companies. Moreover, Sweden nationalized only Gota Bank -- and that was after it had already collapsed.

The Obama administration should declare that nationalization of any major bank is off the table; that the government stands behind our entire banking system; and that our banks will continue to receive a nonvoting form of equity capital, such as convertible preferred stock, from the government to the extent needed. Yesterday's joint announcement to this effect by the Federal Reserve, FDIC, the Comptroller of the Currency, and the Treasury is a critical step toward healing our banking system and economy. Well done.

**Mr. Isaac, chairman of the FDIC from 1981-1985, is chairman of the Washington financial services consulting firm The Secura Group, an LECG company.**

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