Remarks
Of
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FDIC; International Association of Deposit Insurers
Fifth Annual Conference;
Rio de Janeiro, Brazil
November 16, 2006

Good afternoon. Thank you, Ray LaBrosse, for your kind introduction. I am very pleased to be here today at the Fifth Annual International Association of Deposit Insurers (IADI) Conference. Before I begin, I would like to extend thanks to Gabriel Jorge Ferreira and Antonio Carlos Bueno and the staff from Fundo Garantidor de Créditos (FGC) for their warm and generous hospitality. I would also like to thank Jean Pierre Sabourin and Ray LaBrosse for their leadership in organizing this conference. This gathering presents a unique opportunity for us to exchange views and information with colleagues from around the world on ways to promote financial stability through more effective deposit insurance systems.

Today I would like to talk to you about three topics. First, I would like to update you on the recent significant deposit insurance reforms enacted by the United States (U.S.) Congress which the Federal Deposit Insurance Corporation (FDIC) will begin to implement next year. Second, I would like to discuss the important role that deposit insurance plays in maintaining the stability of banking systems around the world. And third, I would like to discuss the critical role that IADI plays in supporting deposit insurance agencies through information sharing, training, and guidance.

Deposit Insurance Reform in the United States

For more than 70 years, the FDIC has played a key role in maintaining public confidence in the U.S. banking system and ensuring that Americans have a safe place for their savings and retirement funds. Prior to this year, the last major reform of the U.S. deposit insurance laws took place in 1991, in the aftermath of the U.S. banking crisis in the late 1980s. Following that crisis, our Congress enacted a law which, among other reforms, introduced a system of prompt corrective action that mandated intervention by regulators if bank capital fell below required levels. In addition, our system for assessing banks a premium for deposit insurance was changed from a flat-rate system to one that was risk-based. A target reserve ratio was also established for our fund.

The reform act that was signed into law in February of this year contained five key elements of reform: (1) merging the two separate funds that existed for our banking and thrift industries, (2) strengthening the FDIC's authority to manage the merged fund, (3) allowing the FDIC to price premiums to more accurately reflect risk, (4) raising deposit insurance coverage on certain retirement accounts at a bank or thrift to $250,000 from $100,000, and (5) providing for an inflation adjustment on both the basic insurance coverage of $100,000 and retirement account coverage of $250,000 every five years beginning in 2011.

Of these five elements, perhaps the two most critical reforms were strengthening the FDIC's authority to manage the deposit insurance fund and allowing us to price premiums to more accurately reflect risk.

Under the old law, if the reserve ratio for our deposit insurance fund fell below the statutory target, the FDIC was required by law to impose very large premiums to return the reserve ratio to the target regardless of economic conditions. This system created an undesired strong pro-cyclical effect and raised the possibility that we would have to raise premiums during economic downturns when banks would be least able to afford them. The new law gives us flexibility to raise premiums during good economic times so that we don't have to raise premiums during bad economic times. This strengthens our ability to manage the fund and is a key feature of the reform's intent to maintain a stable and strong banking system.

The second key element of deposit insurance reform authorizes the FDIC to charge all banks for the risk they pose to the system. From the outset, the FDIC adopted an important guiding principle in implementing this reform - to establish a system that is fair, open and transparent and to allow the general public an opportunity to comment on any changes we proposed. The new system reflects months of discussion with bankers, trade group representatives and other regulators, as well as extensive FDIC staff analysis.

Two weeks ago, the FDIC Board adopted a new risk-based deposit insurance premium system effective January 2007. The assessment approach adopted relies on an institution's supervisory ratings, financial ratios, and long-term debt issuer ratings. For most institutions, supervisory ratings will be combined with financial ratios to determine assessment rates. For large institutions (over $10 billion in assets) with long-term debt issuer ratings, assessment rates will be based on supervisory ratings combined with debt ratings.

The adopted rule allows for some pricing discretion by the FDIC with respect to certain large institutions, recognizing that proper assessment of the risk of large complex institutions cannot always be adequately measured using a formulaic approach. In such cases, other market information, as well as additional supervisory and financial information, will be used to determine whether a limited adjustment to an institution's assessment rate is warranted. All of this additional information will help ensure that institutions with similar risks pay similar rates. Some additional details remain to be worked out regarding the guidelines for making such adjustments and the FDIC will release proposed guidelines for the adjustment process and seek comment on those specifics in the near future.

The Board also established a deposit insurance premium rate schedule at its November meeting. Not surprisingly, this was an area of considerable interest to the industry. The recommended final rule sets the minimum assessment rate at 5 basis points of domestic deposits and most institutions will pay rates between 5 and 7 basis points. The Board based this rule on several factors, including strong deposit growth and the need to address a recent downward trend in the reserve ratio. The adopted rule also reflects the intent of Congress to build up the deposit insurance fund in good economic times so that premiums do not have to be imposed during economic downturns, thus providing for long-term stability in premiums.

Looking forward, in many ways our work is just beginning. While much has been accomplished this year, we now look forward to implementing these changes. Historically, major deposit insurance reform in the US has coincided with a banking crisis. We were fortunate in this case that we were able to introduce these reforms during a period of economic strength, which will put us in a stronger position to cope with challenges in the future when economic conditions may not be as favorable.

The Role of Deposit Insurance Systems in Strengthening Financial Stability

Now I would like to turn to my second topic, the role that well-designed deposit insurance systems can play in strengthening financial stability globally. Experience indicates that all countries in effect have some form of federal deposit insurance, explicit or implicit. When a financial crisis develops and bank depositors begin to withdraw their funds, governments typically take steps to protect depositors to stop banks runs and restore public confidence.

History has shown, however, that well-designed, explicit deposit insurance systems that are understood by the public help prevent bank runs, limit the severity and the resolution costs of financial crises, and contribute significantly to overall financial stability. The U.S. experience with deposit insurance would seem to bear this out. Our system was adopted during the Great Depression in the 1930s. Prior to its creation, during the first few months of 1933, 4,000 banks suspended operations, leading to bank runs and the imposition of a national banking holiday. In the following year, 1934, only nine banks failed. And during the most serious subsequent financial crises that occurred in the U.S. in the 1980s and 1990s, no bank runs occurred and there was no loss of confidence in the banking system.

In recent years, many countries around the world have also adopted explicit deposit insurance programs after experiencing their own financial crises. In addition, numerous countries that have not experienced local financial crises have adopted or are moving to establish explicit deposit insurance systems after observing the financial hardships that can occur in the absence of such systems. We believe this worldwide evolution toward explicit, well-designed deposit insurance systems is a positive development.

The critical challenge is to ensure that deposit insurance systems are well designed and maintained properly to keep pace with the rapidly evolving financial marketplace. The moral hazard problem exists and can undermine the purposes of deposit insurance if not properly managed. Strong prudential supervision is critical for this purpose and is only possible with a suitable legal framework and appropriate accounting rules.

In the view of the FDIC, a well-designed deposit insurance program can enhance the discipline in the financial system by establishing standards for institutions to qualify for insurance such as capitalization, internal controls and sound risk-management practices. In some cases, differential premiums based upon risk also can contribute a measure of discipline. But where the legal or accounting infrastructure is lacking or prudential supervision is lax, deposit insurance will not be effective in playing this role.

Other essential features of a well-designed deposit insurance program include: (1) access to information on insured institutions as necessary for the deposit insurer to monitor risk exposure and to arrange resolutions for failing banks; (2) an efficient process for closing banks and promptly paying depositors and other creditors; (3) reliable funding sources for the timely resolution of bank failures; and (4) strong corporate governance for the deposit insurance organization. The specific design features that work best will vary from country to country, but these key challenges always have to be addressed.

The Role of IADI

IADI has a critical role to play in strengthening the contribution of explicit deposit insurance systems in maintaining the stability of banking systems around the world. IADI is a forum for deposit insurance agencies to exchange views, share experiences and expertise, and provide guidance and technical assistance. In addition, IADI is well-positioned to play a leadership role by integrating the collective experience and expertise of its members into the larger set of international efforts to ensure safe and sound banking systems worldwide. This includes working through and alongside multilateral organizations such as the IMF and World Bank, multilateral development banks, and international bodies composed of financial-system supervisors and regulators such as the Financial Stability Forum, the Basel Committee on Banking Supervision, and the International Conference of Bank Supervisors.

In its short history under the extraordinary leadership of Jean Pierre Sabourin, IADI has laid a solid foundation for this role. The association has built an infrastructure that is now supporting the development of guidance on deposit insurance and a comprehensive a training program that will cover all aspects of deposit insurance design, operations and crisis management. There will be further discussion of plans for these training programs later today and tomorrow. The FDIC views training as a key function of IADI and is committed to helping establish a strong training program that would be available to all members of IADI.

In addition, IADI is taking steps to forge a stronger working partnership with the European Forum of Deposit Insurers (EFDI). An important facet of this partnership with EFDI will include joint work on cross-border issues and international crisis management, which is already underway and will be the topic of discussion at a jointly sponsored event in May of next year. Deposit insurers can and should take the lead in developing effective processes and protocols for international crisis management. Collaboration between IADI and EFDI is, in my view, a very good place to start.

The FDIC sees this as a time of great opportunity for IADI and is strongly committed to the work of this association. Working together, I believe that the members of IADI can contribute significantly to enhancing the effectiveness of deposit insurance systems around the world.

Thank you very much.

Last Updated 12/22/2006