TESTIMONY OF

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ON

DEPOSIT INSURANCE REFORM

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SUBCOMMITTEE ON COMMERCE, CONSUMER, AND MONETARY AFFAIRS
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Good Morning, Mr. Chairman and members of the Subcommittee. We appreciate this opportunity to testify on deposit insurance reform.

Along with the other federal banking agencies and the Office of Management and Budget, the Federal Deposit Insurance Corporation is participating in the Treasury Department's comprehensive study of deposit insurance. This study was mandated by the Financial Institutions Reform, Recovery, and Enforcement Act of 1989. The Treasury Department intends to complete the study by the end of this year.

Because the study will draw conclusions and make recommendations regarding the subject matter of this testimony, providing comprehensive conclusions and recommendations now would be premature. Since we still are studying these matters with our colleagues, our purpose today is to report on our thinking and define the important issues we believe are involved.

Reform requires recognition of the many interrelationships among industry structure, the deposit insurance system, and regulatory responsibilities. Reform of the deposit insurance system must include reform of the antiquated legal structure burdening the financial industry in general and the banking industry in particular. A healthy deposit insurance system depends ultimately on the existence of a healthy banking system.

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LAYING THE FOUNDATION FOR A SOUND DEPOSIT INSURANCE SYSTEM: RESTRUCTURING THE BANKING INDUSTRY

The competitive environment within which banks operate is changing significantly. Banks and other financial institutions have been hampered by an antiquated legal structure in their ability to adjust to the changes. There are three noteworthy interrelated trends: banking is becoming a riskier, more volatile business; banks are encountering greater degrees of competition; and what constitutes the business of banking itself is undergoing a rapid evolution.

Structural reform should begin by identifying and examining the underlying obstacles to a competitive and viable banking industry. These obstacles are:

1. The Glass-Steagall Act;
2. The ownership and product limitations of the Bank Holding Company Act; and
3. Geographic barriers to bank expansion.

In 1987, the FDIC considered in detail the first two of these topics. The results were set forth in our study titled Mandate for Change: Restructuring the Banking Industry. The events of the interceding three years have only served to

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reinforce Mandate's conclusions that the Glass-Steagall Act and many of the restrictions of the Bank Holding Company Act are not only unnecessary, but also harmful to the banking industry.

Substantial benefits would accrue from eliminating the current ownership and activity restrictions imposed by these laws. Risks could be diversified. Cross-marketing activities could enhance the profitability of the overall organization, so long as there are restrictions on the use of insured funds to support uninsured activities.

Interstate banking restrictions also have contributed to the increase in risk in the nation's banking industry and to the decrease in banks' competitiveness. Removal of these restrictions would permit lower risk through diversification. Banks also would be able to expand operations to match the expansion of banking markets created by technology and economic growth. These archaic geographic restrictions will become even more unpalatable in the near future as the European Community eliminates restrictions on branch banking.

BUILDING A SOUND DEPOSIT INSURANCE SYSTEM: THREE IMPERATIVES

In addition to removing existing obstacles to a viable and competitive banking industry, deposit insurance reform must be tackled. The objectives of reform should be to reduce the

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potential liability of the government for its safety net and to maintain the stability of the financial system.

The deposit insurance system should be designed to ensure that the industry -- both the institutions and their customers -- bears the appropriate costs. The deposit insurance system should not result in a subsidy to the banking industry, particularly a subsidy that eliminates the penalties the marketplace imposes on reckless conduct.

Any system of supervisory controls creates costs and benefits. The issue sometimes comes to the fore only when changes in the supervisory system are considered, or when a disaster such as the savings and loan crisis sheds light on the costs and benefits. Changes in the deposit insurance system, and the bank supervisory structure in general, will entail shifts in costs and benefits.

Much needs to be done to restore the health of the banks and their deposit insurance system. But, three needs stand out. Supervision must be strengthened. Capital must be increased. Risk must be limited.

Supervision. The essence of prudent banking is to avoid making bad loans and investments. Unfortunately, all the rules and regulations in the world are not going to prevent bankers from making unwise lending and investment decisions. Adequate

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supervision, however, can restrain, although not entirely prevent, such decisions. Adequate supervision is built upon hands-on efforts by competent, trained examiners.

Indeed, in many ways supervision is superior to regulation. A number of industrialized nations have been highly successful in governing their depository institutions through systems that rely almost solely on supervision as opposed to regulation.

In the United States, there is a partiality toward written rules and regulations. Fairness is viewed as requiring explicit publicly-known standards. Such explicitness, however, can produce a false sense of security. A law is passed, a regulation is promulgated, and a problem is considered solved. Meanwhile, unnoticed events are occurring that will lead to future difficulties.

Thus, supervision must occupy a central position in the structure for governing the nation's depository institutions. The FDIC is spearheading an effort, in conjunction with the other banking supervisors, to improve and enhance the supervision of U.S. banks. This effort can proceed independently of the deliberations on banking and deposit insurance reform. Indeed, a strengthened supervisory effort is necessary to protect the insurance fund and the taxpayers during the period when appropriate reforms are identified and implemented.

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Among the measures being actively pursued are: a policy of conducting on-site examinations of all banks no less than once a year; assignment of permanent resident examiners to all of the larger banks; a uniform dividend policy that would apply to all banks encountering difficulties; and a common approach to the evaluation of loan underwriting standards.

Capital. While the degree of risk in the banking system has increased since the 1940s, the proportionate amount of capital has remained relatively static. In the 1980's, this adverse change in the relationship between the degree of risk in the banking industry and the level of capital support was joined by -- perhaps even contributed to -- soaring numbers of bank failures. These failures in turn produced a fall in the ratio of the deposit insurance fund to insured deposits to the lowest level in the FDIC's history, 0.60 percent. The FDIC believes that the amount of capital -- the safety cushion -- in the banking industry should be increased.

Capital serves to protect both individual banks and the deposit insurance system. An adequate commitment of capital on the part of the owners of a bank can curtail the temptation to take excessive risks with the bank's funds. Curtailment of risky activity at individual banks would result in a more stable banking system and a healthier deposit insurance fund.

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The federal banking supervisors recently reached agreement on a minimum capital ratio for banks. This is only a minimum, however. Over the long term, more capital is needed. How much is needed? The amount should depend on the riskiness of the activities insured banks are allowed to conduct. In addition to higher capital ratio requirements, an increase in the amount of capital for new bank charters may be called for. This might help improve the staying power of new banks, which historically have experienced a relatively higher failure rate than have longer-established institutions.

Although the FDIC believes an increase in capital requirements is necessary, the increase should not be imposed in isolation. Higher capital requirements should be accompanied by industry structural reforms. These structural reforms concern the product and ownership limitations of the Glass-Steagall and Bank Holding Company Acts and the geographic restraints of the McFadden Act, which were discussed earlier in our testimony.

Risk. The level of risk in the banking industry has increased over the years because, as noted earlier, the banking business itself has become riskier. In addition, many bankers with less aversion to risk have appeared on the scene.

Regarding the latter point, by the time the financially exciting years of the 1980s arrived, the numbers of bankers who

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remembered the devastating times of the 1930s and the cautious times of the 1940s and 1950s were few. The field of finance became an arena for the robust, the daring, the adventuresome. Concern about risk was not high on their agenda.

Perhaps the events of the last few years have restored a healthy appreciation for, and fear of, the perils inherent in financial activities. If not, additional excruciating lessons might have to be endured. The ease of entry into the banking industry can produce a degree of pessimism in this regard as there is a steady influx of individuals who must relearn old truths.

But assuming that the human aspect of the banking industry's risk problem has been mitigated somewhat, the problem of a generally riskier business still remains. The best way to approach this problem appears to be to limit the types of activities that can be supported with insured deposits. In other words, what can be done in a bank should be restricted. If a banking organization wants to engage in riskier activities, it should do so in nonbanking affiliates adequately separated -- both legally and financially -- from the bank. Capital flows between the bank and its subsidiaries must be strictly limited. This view was first put forward by the FDIC in its 1987 Mandate study.

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Determining the activities that could be conducted in the bank -- and consequently that would be supported by insured deposits -- will be difficult. The FDIC is taking a hard look at the issue. One possibility is to limit the bank to making short- and intermediate-term loans that have no attributes of equity instruments. All loans would be with recourse. Other activities, including some activities that banks now engage in, would have to be moved to affiliates.

In such a system, a distinction might need to be drawn between larger banks and smaller banks. The difficulties that smaller institutions would encounter in setting up holding companies or separate subsidiaries, and the lesser danger they pose to the deposit insurance system, might justify fewer restrictions on their activities.

Supervision, capital, risk: these are the three imperatives that must be dealt with if the present troubles engulfing the deposit insurance system and the banking industry are to be overcome.

Regulatory Structure

Regulatory structure reforms should not be the tail that wags the dog. Regulatory structure changes should be addressed only after structural reform of the industry and changes in the

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deposit insurance system. How the regulatory structure should be altered will depend on how the problems of industry structure and deposit insurance reform are resolved.

Issues of regulatory responsibility and supervisory authority should not be allowed to obscure the more important need to rejuvenate banking industry competitiveness and viability. Nor should issues of regulatory reform be the predominant considerations in changes to the deposit insurance system.

Once reforms concerning banking industry structure and the deposit insurance system are agreed upon, the difficult task of improving the rationality and efficiency of the regulatory structure can be tackled. For example, if holding company regulation is substantially eliminated, the Federal Reserve's present role will have to be changed.

Currently the structure consists of three federal bank regulators, one federal thrift regulator, one federal credit union regulator, and a variety of regulators in the 50 states. Responsibilities are often overlapping and redundant. Functional regulation takes second place to institutional regulation. Elimination of many of the outdated aspects of this structure would appear to be both possible and desirable.

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Experience indicates that independence of financial regulators and insurers is essential to supervising the financial system. Further, banking supervisors should not be subject to conflicts that may arise if they are responsible for other important functions and objectives, such as monetary policy, international economic stability, and revenue production.

Supervision can be more uniform than it is today. More uniformity, however, would make it even more important that supervision be kept independent of other public concerns and political pressures.

Conclusions

A healthy deposit insurance system depends ultimately on the existence of a healthy banking system. To halt the deterioration in the health of the U.S. banking system, structural reform of the banking industry is necessary.

Measures to provide a viable and competitive banking industry and to reform the deposit insurance system should be considered in tandem. Our goals must be to reduce the potential liability of the government for its safety net and to maintain the stability of the financial system. To achieve these goals we must strengthen supervision, build capital, and limit risk. We

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also must have adequate, "workable but restricted," insurance coverage.

The foregoing is what is needed to vastly improve the performance of the financial system in the United States and to improve the ability of our financial institutions to compete successfully in the world economy.

QUESTIONS SUBMITTED BY THE SUBCOMMITTEE

1. Who will bear the risk if coverage is reduced? If insurance coverage per depositor is reduced, how can we estimate how much additional risk this will impose on households and firms and which segments of the population will bear this risk? Do we presently have a statistical base for estimating who will bear the additional risk? What further data surveys or analysis are needed to derive useful estimates?

Bank deposit reporting requirements were changed following enactment of the Paperwork Reduction Act. The deposit data collected by the FDIC fall under broad categories. The annual Summary of Deposits survey conducted by the FDIC requires banks to report deposits, by branch, using the following breakdown: "IPC deposits" (i.e., deposits held by individuals, partnerships, and corporations) and "other deposits." In turn, certain items on Schedule O of the Report of Condition ("Call Report"), which banks must submit each June, require banks to report the number and amount of deposits in accounts of less than $100,000 and more than $100,000. This information relates to the entire

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institution and is not broken down by branch. From the June 30, 1990 Call Report data the FDIC has calculated that the average deposit account at BIF-insured institutions is $8,100. However, we cannot determine, for example, whether the account holder might be an elderly widow or a small business owner.

To more accurately determine which depositors would be affected if deposit coverage were reduced, the FDIC would have to ask banks for additional data about each individual depositor, including age, occupation, or other sensitive data. Some banks might already capture the necessary data as part of their marketing strategy. However, requiring banks to obtain such data from customers may conflict with existing constraints on privacy. To the extent that banks would not have the requisite information readily available, requiring this data would increase the reporting burden and attendant costs on banks and ultimately consumers.

The Subcommittee may be interested in a consumer survey conducted in 1983 for the Federal Reserve (Attachment A). This survey, which canvassed 4,000 households, produced a profile of account holders, by size of insured accounts. We understand that this survey currently is being updated for the Federal Reserve by The University of Michigan Survey Research Center.

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2. Is depositor discipline a workable concept? There are two key parts to this issue:

a. Can consumers and small business entrepreneurs pick safe banks? If deposit coverage is reduced, can we safely assume that individuals who hold large liquid balances that exceed insurance limits and who wish to avoid risk (such as elderly individuals, lawyers keeping escrow balances, small business entrepreneurs handling sizable transactions or payroll balances, etc.) will know how to judge the financial safety of depository institutions? Will they be able to choose genuinely safe institutions for their uninsured funds, and will they be able to "discipline" risk institutions?

b. Is depositor discipline compatible with broader stability concerns? Will depositor discipline, in order to work effectively, require the existence of large "hot money" pools of uninsured funds that move abruptly among institutions as rumors of trouble circulate? Is depositor discipline based on such funding shifts a desirable element?

Depositor discipline is useful as it cuts off funding for poor operations. However, in excess -- and in moments of panic -- it can seriously damage the system.

All business enterprises, including banks, are subject to market discipline. This discipline is enforced through the actions of several different economic agents including: customers, suppliers, employees, equity owners, and creditors. Depositors can behave as customers (purchasing services from the bank), suppliers (funding is the raw material of a bank), and investors. Demand deposit holders are distinctive in holding callable debt. This distinguishes them from most debt holders of

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commercial firms. Their actions will differ from those of a commercial debt holder when the viability of the debt issuer is questioned.

A deposit holder has an incentive to liquidate deposits from a troubled institution if transaction costs are less than potential losses. The implementation of a deposit insurance system eliminates the incentives that depositors would otherwise have to run from troubled institutions. Dependence on depositor discipline to relieve the burden on the insurer can create undesirable side effects. These include: 1) an increase in systemic instability; 2) a loss of flexibility in limiting the economic damage of a major bank failure, and 3) a competitive disadvantage for the U.S. banking industry. In addition, it is unclear that the bank deposit market is well suited to imposing discipline on banks.

Systemic Instability and Depositor Discipline. A policy regime that mandates losses on uninsured depositors introduces instability because it increases both the possibility of bank runs and the ripple effects of the bank failure. As the pool of uninsured depositors increases, the likelihood of bank runs also increases, as does the potential for damage in any individual run. When failures occur, the losses imposed on uninsured depositors will have economic repercussions. These include possible impairment of correspondent banks, disruptions to the payments system, and damage to the local economy as firms and

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individuals adjust to their losses. Once again, the greater the pool of uninsured depositors, and the greater the loss at the failed bank, the greater the economic impact will be.

It has been asserted that depositors would make better use of evaluations published by private bank analysts. While such a result would be an improvement, it is important to recognize that there are limits to the information provided by these firms. In many cases, analysts' forecasts are based on bank financial statements and analyzing performance based on key ratios compared to peer groups. This type of analysis offers some insight into a bank's current performance, but does not indicate as much about a bank's prospects. Bad loans and fraud continue to be the major causes of bank failure. Bad loans look good -- and very profitable -- for a long time before they turn sour. Only a few years before failing, Continental Bank was hailed as a model bank organization. The type of analysis required to determine the quality of a loan portfolio is so intrusive, it is doubtful that it could be performed by agents other than bank examiners. Even if the bank were willing to submit to the intrusion of such analysis, the need to maintain confidentiality of customer information may prevent a third party from making an accurate assessment of individual credits.

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Regulatory Flexibility. Any policy that imposes mandatory losses on uninsured depositors only has meaning if it is expected to apply to all bank failures, including the largest. "Too big to fail" would have to be eliminated as an accepted de facto doctrine. However, if legislation is passed prohibiting the FDIC from acting with discretion on large bank failures, other government bodies -- either the Federal Reserve Board or the Department of Treasury -- might act to support a major failing bank. The reality that the largest banks are more likely to receive such treatment will continue to influence market behavior, providing major banks with a competitive advantage over smaller institutions and reducing the effectiveness of depositor discipline on those large banks. A mandatory requirement that no agency could act when a major institution fails would be a radical action out of step with all other major countries at this time.

International Competitiveness. A policy of mandatory losses on uninsured depositors must be reconciled with policies followed by bank regulators in other major industrialized countries. Large depositors would have great incentive to transfer their funds into institutions that are believed to have more government support than others.

The FDIC hosted an international conference of bank regulators last week. An ultimate goal of the conference was to start a process that will lead to international coordination of

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failed-bank policy. It would be better to institute mandatory haircut proposals after international agreements are reached.

3. Does payments system integrity require special insurance treatment for transaction balances?

a. How is the integrity of the payments system related to DI?

b. In terms of the continued smooth functioning of the payments system when an institution fails, does it matter whether that institution's transaction accounts are insured?

c. If so, how should the deposit insurance system apply to transaction accounts specifically?

The Federal safety net, comprised of the deposit insurance system and the discount window, was designed to protect the nation's financial system and, in turn, the economy through its ability to control systemic risk. The purpose of deposit insurance is to protect individual depositors and ensure a safe-and-sound banking system. As such, deposit insurance plays an essential role in helping control systemic risk and providing stability to the financial system.

The payments system's primary activities involving banks are check clearing, automated clearing house payments and wire transfers of funds. Of these, wire transfers constitute the bulk of the system in terms of dollar volume. They are processed by two separate electronic payments networks, FedWire and the Clearing House Interbank Payments System (CHIPS). It is in

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regard to these two systems that the questions of risk and stability primarily arise.

Essentially, the systemic nature of payments system risk arises from the speed and volume of today's electronic payments and the interdependencies of banks using those systems. As such, it is feared that failure of one participating bank could lead to disruptions for many banks. Such a breakdown in the payments system would have serious implications for the domestic and international financial markets. Therefore, in order to ensure the integrity of the payments system, its exposure to systemic risk must be controlled.

The design of FedWire, and to a lesser extent, CHIPS, has built-in features to limit their exposure to systemic risk. Payment finality and restrictions on daylight overdrafts protect the Federal Reserve from the effects of systemic risk on FedWire. Similarly, restrictions on intra-day credit work in conjunction with the system's design to lessen the systemic risk on CHIPS. However, it is the Federal safety net which ultimately protects the payments system, the banking system and the general economy from the systemic risk of bank failure.

In the absence of adequate insurance on transaction accounts, the failure of a bank could lead to significant disruptions in the banking system and the general economy. Under this scenario, the efficiency of the payments system would be

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impaired as well. Transaction balances must be adequately covered so as to ensure the safe-and-sound operation of the banking system (and more broadly, the financial system).

4. How should money market funds be treated under the safety net? Money market mutual funds are a close substitute in many respects for insured depository accounts, and most of them now offer check-writing privileges that permit investors to use them as transaction accounts for payments of a certain minimum size. Holders of liquid balances that are eligible for deposit insurance coverage thus have a genuine choice between insured and uninsured demand accounts with transaction features.

a. Is it appropriate that individuals should in effect select their own desired level of deposit insurance coverage in this way?

b. If so, should we extend this principle to permit banks to offer both insured and uninsured accounts to individuals, with the depositors being free to choose whether their accounts will be insured or not (and presumably paying directly for the insurance premiums on insured accounts)?

c. If not, should money market funds that resemble demand accounts be brought under the deposit insurance system?

Money market funds recently have become an innovation of significance to the financial system. From $3.7 billion in assets at the end of 1975, they have grown to over $450 billion in assets, which equals approximately 70 percent of the $630 billion in transaction accounts at commercial banks. There are about 650 money market funds, with approximately 21.3 million shareholder accounts.

Although strictly regulated by the Securities and Exchange Commission and limited to investments in high-quality assets, money market funds are not without risks. Some funds invest only

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in U.S. Treasury or agency securities, but commercial paper accounts for 50 percent of the industry's total assets.

Since June 1989, two issuers of commercial paper held by several money market funds have defaulted. The issuers were Integrated Resources, Inc., and Mortgage and Realty Trust. The shareholders of the funds were not affected because each fund's investment adviser purchased the defaulted commercial paper. If there were more widespread problems in the commercial paper market -- such as might occur during an economic downturn -- the advisers and managers of money market funds might not be as willing, or able, to offset the funds' losses.

Money market funds are also subject to interest-rate risk. One instance in which this type of risk caused difficulties occurred in 1980. The fund, Institutional Liquid Assets, believed that short-term interest rates had peaked and therefore lengthened the maturity of its government securities portfolio to over 70 days. Interest rates continued higher, however, and the fund was deluged by redemption requests of over $400 million in a three-day period. The sale of securities to meet the requests resulted in a $2 million loss. The fund's distributor and investment adviser provided monetary support.

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To date, no money market fund shareholder has experienced a loss. As the preceding examples show, however, funds do entail credit risk and interest-rate risk. If shareholders of any one fund ever suffered a loss, a general loss of confidence in funds could ensue, and a classic run as experienced by banks in the early 1930s could conceivably occur.

Turning to the question of whether individuals should be able to select their own desired level of deposit insurance by choosing between insured transaction accounts and uninsured money market funds, choice is one of the hallmarks of a free market. Individuals, businesses and the economy in general are better off if competitive forces are free to operate, and if the various economic actors have leeway to make risk versus reward decisions. From this standpoint, it is appropriate that individuals have a choice between insured transaction accounts and uninsured money market funds.

The other side of the coin is that to offset market imperfections and to avoid certain undesirable consequences, the functioning of the free market is restrained in a number of ways. Among the targets of the restraints are instability in financial markets and disproportionate financial losses to individuals of modest means. The purpose of SEC regulation and supervision of money market funds is to preclude such adverse situations and events. The SEC recently proposed amendments to its money market fund rules to tighten up what are already pervasive controls.

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In view of the SEC's extensive regulation and supervision of money market funds, the answer to the question of whether individuals should have a choice between insured transaction accounts and uninsured money market funds is "yes."

The further question of whether banks should be permitted to offer both insured and uninsured transaction accounts to individuals is also "yes." However, the issue is tied to larger issues concerning industry structure. As stated previously, the FDIC believes that the product and ownership restraints the Glass-Steagall and Bank Holding Company Acts put on banking organizations -- meaning parent bank holding companies and both their banking and nonbanking affiliates -- are outdated. Banks, funding their activities with insured deposits, should be limited in what they can do. But their legally and financially separate nonbank affiliates should have much more freedom than they have now.

In such a structure, the offering of uninsured accounts would be from the nonbanking sides of banking organizations. The practical problem to overcome is depositor awareness. The distinction between the bank-offered insured account and the nonbank-offered uninsured account would have to be made very clear to even the most unsophisticated depositor. This could be accomplished through appropriate regulatory control.

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5. Is the present deposit insurance structure an impediment to international competitiveness? What should Congress make of the argument that the fees for deposit insurance and the whole regulatory apparatus that accompanies the deposit insurance system impair the international competitiveness of U.S. banking firms? If there is a genuine impairment here, how should we take that into account in looking at deposit insurance reforms?

Congress should act to revamp a structural and regulatory deposit insurance system since it does impede our international competitiveness. The crux of the problem resides with the structural obstacles that we identified at the beginning of this testimony -- namely, the Glass-Steagall Act; the ownership and product limitations of the Bank Holding Company Act; and geographic barriers to bank expansion. Further, the risks taken with insured deposits and resulting losses has made the cost of insurance a handicap for U.S. banks' competitiveness in world markets.

Relative to other countries the United States has operated for far too long with an economically irrational financial structure. Two examples illustrate this point. The nations of the European Community, which is rapidly removing internal barriers to the movement of goods and services, have nothing that is comparable to our Bank Holding Company Act. Bank supervisory systems in Europe are aimed at the bank rather than at both the bank and any corporate owners. Similarly, our nation's archaic geographic banking restrictions will become even more obvious and unpalatable in the near future as the European Community eliminates restrictions on branch banking. While European banks,

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and U.S. banking organizations with subsidiaries in Europe, make growth decisions based on market opportunities, banks operating in the United States will make growth decisions based to a large extent on what statutory loopholes can be found. Therefore, if structural reforms are not undertaken and if we do not build a sounder banking system with an accompanying sounder deposit insurance system, then fees will continue to rise and hamper the international competitiveness of U.S. banks.

Another way that deposit insurance and the safety net relates to international competitiveness is bound up with the issue of whether some banks should be "too big to fail." The term "too big to fail" is used in referring to troubled banking organizations that supposedly are too large for the government to handle by closing the bank and paying off deposits up to the $100,000 insurance limit. There are many nuances in the resolution methods for troubled banks that are not handled through a liquidation and deposit payoff. To generalize, if the deposit payoff method is not used, a troubled bank resolution is accomplished either by arranging for the bank's liabilities, both insured and uninsured, to be acquired by another institution, or less often by providing direct financial assistance.

Who is aided in the various resolution methods varies. In the past, uninsured depositors and creditors of the troubled bank were benefitted in most cases in which a resolution method other than the deposit payoff method was used. Stockholders and

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management of the institution were benefitted much less frequently. The FDIC's pro rata power -- which was ratified in FIRREA -- enables us to distinguish between categories of uninsured depositors and creditors under all methods of resolving failing banks.

Of more general significance, however, is the fact that "too big to fail" is much more than a problem of the deposit insurance system. Altering the present regulatory structure in an attempt to eliminate the perception of large banks being "too big to fail" would merely shift responsibilities. The possible failure of a large financial organization presents macroeconomic issues that some arm of the government must consider. The evolution of the economy-wide ramifications of the demise of a big bank is a government duty.

"Too big to fail" as an issue would exist even in the absence of an explicit deposit insurance program. And the result of protecting large institutions is to provide 100 percent insurance for the deposits in such institutions. Past experience in all major countries supports the contention that a "too big to fail" policy exists, de facto if not de jure.

Although the FDIC believes that the "too big to fail" concept must be re-examined, we would caution against any unilateral action on the part of the U.S. government to restrict the application of "too big to fail." Action on this issue

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requires international cooperation. If the U.S. were to go it alone and formally renounce "too big to fail," the practical effect would be to cause prudent money managers to withdraw funds from large U.S. banks and redeposit their funds in countries that have either a _de facto_ or _de jure_ "too big to fail" policy. At that point, the U.S. deposit insurance system _would_ hamper the international competitiveness of U.S. banks.

Owing to the importance of the "too big to fail" issue, the FDIC last week convened an international conference to discuss this problem and related issues. One of the clearest points to come from the conference was that other governments, regulators, and bankers do not desire nor practice a policy of tying the hands of those who are ultimately responsible for the resolution of large problem banks. Rather, the emphasis is on _prevention_ of problem situations through the steps we described earlier -- supervision, capital, and limiting risk. When these measures fail, and it happens less often in other countries, the resolution of the situation is determined by the facts at hand; this is what Gerald Corrigan has termed the policy of "constructive ambiguity."

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Characteristics of Account Holders, By Size of Insured Accounts
1983 Survey of Consumer Finances

Item	Size of largest set of accounts at any type of insured institution[1]						
	No account	$1-25K	$25K-50K	$50-75K	$75K-100K	≥$100K	All families
Number of families in group (millions)	10.3	65.8	4.1	1.9	0.7	1.2	83.9
% of all families in group	12.3	78.4	4.8	2.3	0.8	1.4	100.0
% of all household deposits held by group	0.0	33.5	17.4	13.9	6.6	28.6	100.0
% of all deposits held by group	0.0	12.6	6.5	5.2	2.5	10.8	37.6
% of all insured household deposits held by group	0.0	37.9	19.6	15.6	7.5	19.4	100.0
Median age of head	39	41	60	65	65	65	43
Median years of education of head	9	12	12	12	13	15	12
% of group in various occupations							
Retired	26.2	15.5	36.8	41.6	44.0	45.3	19.0
Other not working	35.9	13.0	7.9	13.5	16.6	5.7	15.5
Professionals, managers, administrators	5.2	26.9	34.9	22.5	19.4	35.1	24.6
Sales, clerical, craftsmen, laborers, military	32.0	42.5	17.3	18.7	18.4	8.8	39.0
Farmers	0.6	1.3	3.1	2.9	1.6	5.1	1.4
All occupations	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Median income (thousands)	7.1	21.0	29.8	27.5	32.4	50.4	19.5
Median net worth (thousands)	1.0	35.0	138.0	192.9	183.5	478.7	34.3
Median % of net worth in insured accounts	0.0	6.4	27.4	37.6	50.0	40.2	5.6
Median financial assets ($thousands)	0.0	2.6	45.7	78.9	100.3	238.0	2.3
Median % of financial assets in insured accounts	0.0	100.0	94.9	88.0	92.7	90.3	91.3
% owning stocks/bonds	1.4	21.2	46.8	55.2	52.6	61.0	21.6
% owning business	2.2	14.5	26.8	22.5	33.2	36.8	14.2
% owning investment real estate	5.6	18.7	36.7	38.7	16.8	44.5	18.8

1. A polar assumption was made here to determine the size of a household's largest body of deposits at a given institution. All accounts with a particular type of institution (e.g., commercial banks, savings and loans, etc.) were assumed to be held at the same institution and all accounts were assumed to be held in the same names. This will tend to overstate the number of households in the top groups. Accounts included are checking, money market, savings, IRAs and Keoghs, and CDs.

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