**Remarks to French financial journalists**
**November 8, 1995**

**I would like to discuss briefly with you who we are at the FDIC and what we do.**

**Congress established the nation's capital here in Washington in 1790. At that time, only six cities in the United States had a population of more than 8,000 people. In 1790, the population of Paris was about 600,000. Given the youth of our country, it is not surprising that we in the United States are new at much of what we do here.**

**That is especially so in the field of money and banking, upon which all other economic activity rests. In the early nineteenth century, two experiments in maintaining the presence of the national government in the U.S. banking system ended in disaster. We finally succeeded in establishing a lasting national banking authority in 1863. Before the federal government entered the banking system that year to create a uniform currency and a reliable system of money, there were in circulation some 10,000 currencies issued by 1,600 private banks.**

**Europe, of course, is working on some of these same issues today. We, too, were a confederation before we became a federation, and for us, it was not a linear path from one to the other. Some analysts have said that only the necessities of financing armies in the field during our Civil War could overcome opposition to the presence of the national government in banking. Indeed, our central bank -- the Federal Reserve -- was not founded until 1913. We came to our senses late.**

**In one regard, however, we have led in banking, not followed. The FDIC today manages the oldest national deposit insurance fund in the world.**

**Our birth was painful. Nine thousand banks failed in the four years before the FDIC was created in 1933 -- almost half in the first few months of that year. Those 9,000 failures resulted in losses to depositors of about $1.3 billion. The failure of one bank would set off a chain reaction, bringing about other failures. Sound banks frequently failed when large numbers of depositors panicked and demanded to withdraw their deposits -- leading to a "run" on a bank.**

**The U.S. banking system lay dormant. The U.S. economy was suffering the worst economic depression in modern history. With the U.S. financial system on the verge of collapse, both**

**the manufacturing and agricultural sectors were operating at a fraction of capacity. Between 1886 and 1933, at least 150 proposals for national deposit insurance or a national guaranty of deposits were made in Congress. Many of these proposals came in response to financial crises, although none were as severe as that of the early 1930s.**

**Despite conditions at that time, President Franklin D. Roosevelt and the American Bankers Association voiced opposition to a government guarantee of bank deposits.**

**They believed that such a guarantee would subsidize poorly managed banks at the expense of well managed banks. The bankers association, in fact, led the opposition, holding deposit insurance to be, and I quote, "unsound, unscientific, unjust and dangerous."**

**Public opinion, however, demanded action, and action was taken. A government insurance fund was set up to back deposits. The year after the FDIC was created, nine insured banks failed.**

**One economist summed up the birth of the FDIC in this way: it was the obscure and unwanted Federal Deposit Insurance Corporation that brought the anarchy of unmanaged bank failures in the United States to an end.**

**Over three generations, deposit insurance has brought peace of mind to tens of millions of depositors, who no longer had reason to fear the failure of their banks.**

**More important, by insulating banks from runs and panics, deposit insurance stabilized the U.S. financial system and helped facilitate the Federal Reserve's effort to manage the money supply.**

**Because of our success, we have become a model to other nations interested in establishing deposit insurance operations and particularly so in recent years, a reflection both of the turn to free markets around the world and of the heightened awareness that free financial markets are by definition built on assuming risk.**

**Deposit insurance was so successful in stabilizing the U.S. financial markets that stability -- in the sense of maintaining equilibrium -- began to be taken for granted. A small but vocal group of critics began to question the need for deposit insurance at all. They asked: in a global financial marketplace linked by instant communication, have we not gotten beyond the idea of guaranteeing household savings?**

**No one, however, repealed the business cycle. The failures of nearly 1,400 U.S. banks from 1982 through 1992 reminded us that stabilizing can also mean keeping a deteriorating situation from worsening. Those failures reminded us that guaranteeing savings is not only an end in itself but a means of stabilizing the banking system in times of stress. Those failures reminded us that stability is always a goal, not a given.**

I would not argue, however, that there are not legitimate questions that can be raised about deposit insurance. One area to which we have given a great deal of attention -- and to which we will give more -- is the element of moral hazard presented by our deposit insurance system. In banking, deposit insurance gives bank managers -- whose job it is to maximize shareholder value -- the incentive to increase risk, both by investing in riskier projects than would otherwise be undertaken and by increasing leverage.

Deposit insurance shifts these risks onto the deposit insurer, and in our case, potentially onto the American taxpayer. In other words, it creates a situation where if a bet -- a loan -- comes up heads, the insured institution wins, and if it comes up tails, the insurer loses. In the last few years, we have instituted risk-related deposit insurance premiums, higher minimum capital standards, and other reforms to address the problem of moral hazard. It is difficult, however, to eliminate moral hazard altogether from any deposit insurance system.

In the end, the U.S. government's guarantee of the deposit insurance fund stabilizes our banking system. A similar guarantee would probably be prohibitively expensive for a private, non-governmental insurer. At the FDIC, we are working to monitor, assess and address risks to the banking system more effectively, in an effort to avoid falling back on this guarantee -- and the demand on American taxpayers it represents -- as was necessary during our savings and loan crisis.

In the final analysis, I believe the benefits in terms of stability that flow from our deposit insurance system have outweighed its potential costs and effects.

Let me give you an idea of the magnitude of our work. As you know, we insure deposits of up to $100,000 at banks and savings and loan associations. Last year insured banks in the United States held approximately $2.5 trillion in deposits. We insured $1.9 trillion of those deposits -- about 77 percent of the total. The savings and loans that we insured held $720 billion in deposits. The Savings Association Insurance Fund coverage represented $693 billion of those deposits -- about 96 percent. In addition, in 1994 we examined more than 4,300 institutions for safety and soundness, and we still have about $13 billion in assets to liquidate from banks that failed, mostly from the banking crisis in the late 1980s and early 1990s. Our Bank Insurance Fund has a balance of just over $25 billion and our Savings Association Insurance Fund has a balance of just above $3 billion.

Finally, one of our goals for the future is to identify, monitor and address risk in the financial system more efficiently and proactively, and to that end we are retooling and repositioning the agency to enhance its ability to assess risks to the deposit insurance funds.

I would be happly to address any of your questions.

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