Remarks by
Ricki Helfer
Chairman
Federal Deposit Insurance Corporation
before the
America's Community Bankers
Annual Convention
Atlanta, GA
October 28, 1996

It is always a pleasure to be with you, but especially here in Atlanta, a city that, through hard work and vision, literally rose from ashes to become an economic pacesetter. For more than a century, the people of Atlanta -- developers and bankers, merchants and newspaper editors, business executives and government officials, as well as many others -- have earned a well-deserved reputation for working together as partners in the city's growth. They recognized they had common problems and they sought common solutions. They took a clearing in the piney woods where an Army engineer drove a stake in 1836 and by 1881 they hosted Atlanta's first World's Fair -- setting out for all to see what had been accomplished in commerce and industry. Over the next century, the modern city of Atlanta grew into a transportation hub, a focus of retail trade, a medical and educational center, the financial capital of the Southeast, a communications giant, and home to leaders of the civil rights movement as well as to the 1996 Olympics.

The history of Atlanta is the story of renewal -- of overcoming a tragic past and creating a better future -- through unity of purpose. That story holds a lesson for all of us.

In the last year, America's Community Bankers has achieved a number of its important legislative goals in Washington. Some of the weight of regulation has been lifted and a complicated tax problem has been resolved, but, most importantly, after more than two years of hard work and several detours along the way, a law was enacted to address the serious problems of the Savings Association Insurance Fund (SAIF). Many of you here today personally devoted time and effort to educating the public and lawmakers on the need to address the problems of the SAIF -- and most of you are among the institutions that together will pay $4.5 billion to capitalize it. I want to thank you for working with the FDIC and other regulators, the Congress and other financial institutions and trade associations to achieve this very important goal.

Those of you whose institutions are insured by the SAIF are the immediate beneficiaries of the newly-sound fund. You are not the only beneficiaries, however. The SAIF's problems were not only an issue of interest to the FDIC as insurer of all banks and thrifts in this country and to SAIF-member institutions, the SAIF's problems, in fact, were a matter of importance to the entire financial system and to the nation. In the end, many participants in the financial system worked together to find a constructive solution to a problem that no financial institution operating today created, and from whose ill effects everyone would have suffered.

The SAIF's problems were a national issue for one reason: Banking rests on public confidence and public confidence rests on the soundness of the two FDIC insurance funds. As I said to you at your annual convention last year, confidence in government's backing for the safety net was a major reason that the financial troubles of the 1980s and early 1990s did not lead to widespread panic and economic disarray. Deposit insurance is essential to the fabric of that safety net. The failure of the SAIF would have undermined the confidence Americans have in the FDIC as a source of stability for the financial system and would have called into question the government safety net for financial institutions. Deposit insurance is one of the few certainties in an uncertain financial world -- a certainty that stabilizes the American financial system and our economy. Had the public come to doubt that certainty, the effect could have spread throughout the financial system.

The problems of the SAIF reminded all of us that every element of the financial system is linked -- directly or indirectly -- to every other element in the system. It will be critical for all of us to keep this linkage in mind while considering a new banking charter, which the Deposit Insurance Funds Act of 1996 sets as the next significant area for legislative consideration. Like an architect, we must concern ourselves with the environment in which a structure will be placed, as well as with the details of its design. The resulting product will be judged by whether it effectively functions as an element of the financial system that benefits the marketplace.

Today I would like to talk with you about four issues that pertain to a new banking charter: one, the merger of the two insurance funds; two, new powers for banks; three, access to credit services; and, four, deposit insurance.

Turning to the first issue, why is a merger of the two funds needed? While the SAIF will soon be fully capitalized and structurally sound, the deposit insurance system even then will not be as strong as it could be.

Almost 10,000 institutions are members of the Bank Insurance Fund (BIF), while fewer than 1,700 are members of the SAIF. Just in terms of numbers, the far smaller SAIF is less actuarially sound than the larger BIF. In addition, thrift institutions that are SAIF members are more concentrated in product line -- typically, mortgage lending -- than are BIF members. These same

institutions are also more concentrated geographically, with the eight largest SAIF-insured institutions operating predominantly in California and together holding almost 20 percent of all SAIF-insured deposits.

A merger of the SAIF and the BIF -- which is anticipated in the new legislation to capitalize the SAIF -- would resolve all of these remaining issues and would make the deposit insurance system as a whole even stronger. The legislation, in effect, establishes a new bank charter as a condition for the merger of the two funds. It is imperative, therefore, that we work together expeditiously to resolve the chartering issues so we can achieve a merger of the two insurance funds as soon as possible. A merger of the two funds is the best way to assure the soundness of the deposit insurance system going into the twenty-first century.

The impetus for a common charter is obvious: the thrift charter no longer serves its special purpose of assuring a particular source of finance for the housing industry. At the end of 1995, thrifts held about 13 percent of home mortgages outstanding, down from the more than 50 percent held in 1980. In the last 15 years, commercial banks picked up much of the difference. In addition, the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation have grown into powerhouses for funding home mortgages -- they have channeled almost $1 trillion of home mortgages into mortgage-backed securities and they hold another $361 billion in their own portfolios. Indeed, one of the business sessions on this convention's program is titled: "Is There a Future in Home Mortgage Finance?" Moreover, various aspects of the thrift charter have come to be seen by many as competitive disadvantages because certain restrictions on thrift activities hamper the ability of thrift institutions to respond to changes in the marketplace.

There are a number of large questions that must be resolved, however, before a new bank charter can be created. What should be the fundamental attributes of the new, merged charter? What should be the range of services offered in financial activities? Should the new bank charter permit new products that are economic equivalents of loans? Should there be a place for state- chartered savings institutions? As to the last question, some people have asked whether the mutual form of ownership should be allowed to continue. Mutuals have been a part of the financial system of this country since the early nineteenth century. Taking away the right of states to permit mutual charters would strike a serious blow to the continued vitality of the dual banking system.

The second area of concern I want to talk about today is one of the large questions that must be resolved: how to determine the powers that banks should have under a new charter.

Historically, banking powers were explicitly granted -- or prohibited -- by legislature or regulator and the decision was generally tied to a prudential judgment of whether the risk from the activity was appropriate for banking. Based on such a judgment, for example, national banks were prohibited from real estate lending for many years. This static approach to bank powers, however, has lost credibility in recent years as technological innovations have led to greater competition between depository and nondepository financial services providers. For almost ten years, the FDIC has held the view that the maintenance of a healthy and viable banking industry requires that the industry generate sufficient returns to attract new capital in support of normal growth and expansion into new areas. To achieve these goals, banks must have the ability to compete on an equitable basis with other business enterprises and their businesses must be permitted to evolve with the marketplace as long as safety and soundness concerns do not arise.

Rather than having to rely on a static list of approved activities, banks should be allowed to structure their businesses under a set of criteria that allow them to compete, while still meeting public policy goals incorporated in statutory and prudential standards. For these reasons, almost two years ago I testified before Congress that the FDIC has long supported repeal of Glass-Steagall restrictions on the securities activities of banking organizations, provided that the repeal is accompanied with appropriate protections for the deposit insurance funds. Under a new bank charter, criteria for new powers should balance both the necessity for competitive equity and the furtherance of public policy goals.

One such public policy goal is the third area of concern I want to talk with you about today -- providing everyone in America with access to credit services. Banks are chartered by governments to meet the convenience and needs of the public. In return, banks are granted special rights -- access to the payments system and federal deposit insurance, to name two. The great debate in the history of American banking -- whether banks should be chartered and supervised by state or federal authorities -- revolved around the concern that federally-chartered entities -- the First and Second Banks of the United States -- were not providing access to credit to all Americans. Their charters were allowed to lapse, and state banks -- because they were thought to be more open to the banking needs of their local communities -- became the dominant force in American finance for decades.

A new banking charter would carry the expectation that institutions meet the convenience and needs of the public. If the new charter includes a significant expansion of new activities, it raises the possibility that insured institutions might move away from providing traditional banking services in order to expand into these new activities. As part of our effort to design a new bank charter, we have to consider the potential effect on small communities, isolated markets, and existing bank customers. While I believe that the marketplace will generally adjust to fill the

needs of underserved markets, there can be anomalies that prevent the efficient functioning of the market -- and sometimes statutes may advertently or inadvertently create such anomalies. We need to try to avoid that result if everyone in the country is to have access to necessary banking services.

The fourth -- and final -- area of concern I want to talk with you about today is how deposit insurance would fit into a new design for banking. As I noted earlier, every element in the financial system is linked to every other element. A failure of the thrift insurance fund would have affected commercial banks directly or indirectly -- directly through the more than 44 percent of SAIF deposits that were held by banking organizations -- and indirectly by the loss of public confidence in the deposit insurance system. The deposit insurance system is also an element of the financial system and is affected directly and indirectly by what insured institutions do -- for example, diversification of products would, logically, strengthen the banking industry and would, therefore, lessen the risk exposure of the insurance funds.

Along with the concept of the lender of last resort, deposit insurance is one of the great advances in banking supervision that stabilized an inherently unstable banking system. Before federal deposit insurance was created in 1933, banking and the economy suffered periodic turmoil -- runs, panics, bank failures, and general economic contractions. Depositors knew that their deposits were not backed by liquid assets. Once a run began, the only way to be certain that one could get all of one's money was to be one of the first to withdraw funds before the bank failed. In this way, if a large enough proportion of a bank's depositors believed a bank would fail, it did, even if the bank had been solvent before the run began. In the banking panic of the early 1930s, more than one-fifth of U.S. commercial banks closed their doors.

Federal deposit insurance solved the problem of bank runs. With deposit insurance, depositors had no reason to panic when problems surfaced at other banks -- or even when problems surfaced at their own. One way to judge the value of deposit insurance is the fact that three generations of Americans have lived without knowing the significant economic contractions that followed bank runs and panics in the past.

Deposit insurance was a great advance, but as in the case of other forms of insurance, it creates a moral hazard problem -- the moral hazard that insured institutions may take more risks than they otherwise would, because insured depositors no longer have an incentive to monitor and discipline banks. Deposit insurance can create incentives for managers to reason "heads I win, tails someone else loses" when they are making high risk/high return investments. If the risk pays off in higher yields, the institution wins, but if it creates losses, the insurance fund loses. Historically the moral hazard problem created by federal deposit insurance was thought to be mitigated by banking regulation and supervision and by insulating banks from competition --

hence the low number of bank and thrift failures for almost 50 years following the creation of the deposit insurance system. Then came the 1980s.

There is little doubt that during the savings and loan crisis inadequately capitalized thrifts took excessive risks, adding greatly to the costs of the crisis. Without effective supervision, deposit insurance can simply become a public resource that risk takers can exploit. Our objective must be to strike a balance that minimizes the moral hazard of deposit insurance, while providing stability to the banking system. To address the problem of moral hazard and discourage risky behavior, in the past few years we have instituted a number of reforms, including higher minimum capital standards, risk-related insurance premiums, and the least-cost test for resolving bank failures.

Because deposit insurance creates distortions in the market, an important consideration in our deliberations on a new bank charter is the balance between expanding the opportunities available to depository institutions on the one hand and limiting the scope of the deposit insurance safety net on the other. To be worthwhile, a new charter must provide banks with sufficient flexibility to meet the needs of their customers and to compete effectively in the rapidly evolving financial services industry. It is important, however, to avoid extending federal deposit insurance protection -- and the distortions it creates, such as the moral hazard problem, as well as the related subsidy -- to nonbanking activities that are better left to market discipline.

As I said two years ago in calling for the elimination of Glass-Steagall limitations on securities activities by banks, securities markets in the United States are dynamic and innovative; they have expanded the growth potential of our economy and have become the envy of the world. Our securities markets do not need the backing of the deposit insurance guarantee, nor do they need the added requirements of bank regulation that come with it. The reality of functional regulation means that it is necessary to separate the insured entity from the securities units of the banking firm.

One way to do this would be to house such activities -- and others where extending insurance coverage would be inappropriate -- in an affiliate or subsidiary of the bank, rather than in the bank itself. Another approach is to create affiliations and subsidiaries under the bank holding company umbrella. There are advantages and disadvantages to both models. I believe that banks should be able to choose the corporate structure that is the most efficient for them, as long as safety and soundness concerns for the insured bank can be mitigated and as long as access to the safety net does not provide a material subsidy to activities that cannot be appropriately characterized as banking in nature. A similar point applies to the related issue of functional regulation -- it makes sense as long as the supervisory system is seamless and effective -- by that I mean, as long as there are no cracks through which problems could fall.

If you were to step out of this hotel onto Peachtree Street in the rain, the water you would see running off to the west side of the street would be destined for the Gulf of Mexico, while the water running off to the east would be headed for the Atlantic Ocean. Just as Atlanta is at a watershed, so, too, is banking today. The line runs between a past characterized by specialization, segmentation and isolation, and a future that holds out the promise of greater equity and freedom to compete. Many questions must be answered before that promise is realized.

Making that promise a reality will require the right answers to those questions -- answers that serve the needs not only of all insured institutions but also the needs of all Americans. Making that promise a reality will require all of us to recognize how closely the elements of the financial system are linked -- that all of us are in this together and that what affects one of us affects all of us. Making that promise a reality will require us to share a vision of the future and to work toward it together.

Generations ago, the people of Atlanta looked around and saw a city in ruin. Fortunately, they saw more -- they saw that they had the opportunity to prosper if they worked together. Banking, today, has the opportunity for making real advances -- advances that would benefit all Americans. To take advantage of the opportunity, everyone involved in the banking system must take a lesson from the history of Atlanta and work together to achieve the goal we all share -- our goal of a more competitive banking system in which institutions can grow and prosper by serving the needs of the American people.

Thank you.

Last Updated 06/28/1999