

**Remarks by
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I grew up in Tennessee, where people have a reputation for independence -- one that they earned before Tennessee was even a state. At the end of the Revolutionary War, the pioneers who lived in what is now Tennessee, but was then North Carolina, declared themselves a "free and independent state" they called "Franklin." Disgruntled by the treatment they received from the North Carolina state government, they formed a legislature, elected a governor, and, to underscore they were serious, established a militia. They asked the United States Congress for recognition. From their log cabins in Appalachia, they sought international support. North Carolina, my birth state, pursued reconciliation -- a policy that, after four years, was successful in bringing the Tennessee settlers back into the North Carolina community, at least for a time. When I grew up in Tennessee, every student learned about the streak of independence -- and the sense of community -- that we inherited from our ancestors.

History, as it was taught then, was comprised of both fact and reflections on experience. Reflecting on our experience as Tennesseans led to the conclusion that we enjoyed a dual legacy of independence and community. The lessons of history were that we would think for ourselves -- and act together to achieve our common purpose. Those were not bad lessons then, when daily life in small towns in Tennessee reinforced them, nor are they bad lessons today.

The towns in which I grew up were served by community banks. If I had to define a community bank, the type of bank that you manage, I would not do so with asset or deposit figures, or statistics about offices or employees, even though the vast majority of you have numbers to be proud of. Reflecting on my experience, I would say that a community bank is one where the banker knows his or her customers -- not as numbers -- but as neighbors. You offer the services of the financial world to people whose names you know. Because of your experience, you also have a reputation for thinking independently -- and for working together to achieve the purposes you share.

You need to use your talents for independent thinking and for working together to continue to benefit from Federal deposit insurance. In very recent years, the value of deposit insurance has been seriously questioned for the first time since Congress created it in 1933.

I am here today to talk about the value of Federal deposit insurance to the community banker -- and to the communities and customers you serve, as well as to all Americans. I will also talk about how we have improved our approach to Federal deposit insurance in the past few years to address some of the problems we have encountered and to make it even better for the future. Finally, I want to discuss why proposals to change our system by lessening coverage or privatizing deposit insurance would undermine public confidence in the banking system, and why a recent proposal to change the way that we resolve the largest bank failures would destroy the Federal deposit insurance system, if enacted.

As I have noted before, the FDIC was created in the darkest moment of the Great Depression. Nine thousand banks failed in the three years before the FDIC was created. The year following the creation of the FDIC, only nine insured banks failed. As Carter Golembe recently pointed out, at the time of its creation many lawmakers saw Federal deposit insurance as the means to assure the continued existence of the community bank by restoring public confidence in our diverse, dual banking system. These banks, like many of yours, served small businesses, farmers, and the other people of the community in which they operated.

The supporters of federal deposit insurance thought that, without the services of the community bank, the community could wither. This was not a baseless fear: The elimination of more than 20,000 banking offices from 1921 through 1933 had left a large number of communities without banking facilities.

As two noted banking experts pointed out in 1941 after examining the results of these closures: "To the extent the lack of suitable banking facilities is a factor in weakening the smallest communities and in bringing about a greater concentration of population and business in the larger centers, it leads to social losses, for wealth and productive capacity are reduced. Abandoned houses, empty factories, and deserted farms are visible symbols of such losses," these experts said.

In the late 1920s and early 1930s, communities throughout the United States were filled with these visible symbols of loss. It is not much of a coincidence, however, that the National Bureau of Economic Research dates the end of the Great Depression as March 1933, the month and year when the FDIC was created. In restoring public confidence in the banking system, the FDIC gave Americans the security to dream of a better future, and to work toward that future.

Has the confidence that Americans had in deposit insurance been justified?

Almost half a century after the FDIC was created, we confirmed that it was indeed justified. From 1980 through 1994, 1,617 banks were closed or received FDIC financial assistance. We have evidence that, throughout this recent crisis, Federal deposit insurance was the anchor for public confidence in the banking system. In 1989 the American Banker commissioned Trans Data Corporation to survey 1,009 adults throughout the continental United States on their confidence in banking. Ninety-five

percent of the respondents to that survey said that the Federal deposit insurance fund was important to them. Nine out of 10 of the respondents expressed confidence in the current insurance system. When asked what they would do with their money if there were no deposit insurance, 36 percent said they would keep it at home. Only 18 percent said they would keep their funds in a depository institution.

In 1989, it was no secret that the industry was facing difficult times. By 1994, however, the industry had improved dramatically.

Late that year, the Gallup Organization was commissioned to do a statistically valid national survey of 1,002 households that used banks for at least some of their financial needs. The results of that survey, published in October of 1995 -- showed that, despite the greatly improved health of the industry, 94 percent of the respondents agreed that FDIC insurance was important to them -- virtually the same percentage as the American Banker survey in 1989.

It is clear that in bad times and in good, FDIC deposit insurance has been one of the few certainties in an uncertain financial world. Federal deposit insurance has given three generations of Americans a sense of security. The public has confidence in you, in large part, because the public has confidence in the FDIC. The public has confidence in the FDIC because our independence from the political process gives us the freedom to make difficult decisions and to take swift and effective action in addressing bank failures.

Significantly, in the 1980s and early 1990s -- the worst crisis of the post-depression era -- our strong insurance fund granted us the political independence we needed to make the hard decisions necessary to take care of problems as they occurred. Compare our experience to that of the old, defunct Federal Savings and Loan Insurance Fund. It did not have the financial means to address the problems in that industry, and its regulators lowered capital standards, eased other regulatory rules, and even tried forbearance to keep troubled S&Ls -- and a troubled S&L industry -- alive until the S&L industry could grow out of its problems. That strategy did not work. Ultimately, industry losses were many, many times what they would have been had problems been addressed promptly.

The FDIC, too, had its problems with some thrifts during that period -- the Bank Insurance Fund-insured savings banks. In contrast, because we had a strong fund, we had the means to address failing and failed institutions quickly. Because we had a strong insurance fund, we could make the hard decisions necessary to turn other troubled institutions around through strict plans to improve performance. One of the lessons of the 1980s and early 1990s could not be clearer: a strong, politically independent, insurance fund is essential to deal with problem institutions in times of stress.

A strong insurance fund and effective bank supervision work hand-in-hand to maintain stability.

Another lesson of that crisis was that the FDIC could reduce losses to the insurance funds by more market discipline in the bank regulation and resolutions process. Market discipline is as important for banks as it is for any other business. Because public confidence is necessary for stability in banking, however, small insured depositors are granted certainty. That certainty is the price for stability.

Such certainty should not, however, be given to creditors, large depositors and shareholders -- because they can and should bring market discipline to the process.

Since 1991, the FDIC has been required by law to accept the proposal from a potential purchaser of a failed bank that is the least costly to the insurance fund of all the proposals we receive. In more than half of the failures in 1992 -- 66 out of 120 -- uninsured depositors received less than 100 cents on each dollar above \$100,000. That was a significant increase in uninsured depositors experiencing losses as compared to 1991, before the change in the law went into effect, when fewer than 20 percent of the failures involved a loss for uninsured depositors.

Since the least cost test has been applied by the FDIC, large depositors and creditors should understand that they are at risk for losses on their exposures to banks -- and that is the point: these are the parties best able to make sophisticated judgments about the health and strength of a financial institution -- not small depositors.

In addition, over the past few years we have undertaken two reforms in deposit insurance that give shareholders a greater incentive to curb excessive risk taking at their institutions: one is higher risk-based capital standards, and the second is risk-related insurance premiums. Risk-based capital standards expose shareholders of an institution to greater loss. Risk-based premiums are designed to reduce income in institutions that take on excessive risk. That reduction in income is aimed at giving shareholders reason to curb the excesses.

The FDIC stands in the place of the insured depositor. Our examiners assess the condition of institutions because the insured depositor generally cannot. As a supervisor, we bring regulatory discipline to bear because the small depositor cannot bring market discipline to bear. The FDIC recognizes, however, the role that market discipline plays, and it will continue to explore ways to assure that sophisticated financial interests have reasons to care what happens to an insured bank.

In spite of these reforms, a small but vocal number of critics say that the deposit insurance system would be improved by even more market discipline, either by reducing insurance coverage or privatizing the FDIC. There was ample market discipline between 1929 and 1933 when more than 9,000 banks failed in this country, but the price was too high in terms of the instability of the system. In reducing deposit insurance coverage to put insured depositors more at risk, we would undermine the absolute confidence that the American public has in the deposit insurance system. The reason is simple -- deposit insurance assures confidence because it is a certainty, and certainty cannot be lowered by degrees -- it cannot be fine-tuned. Anything less than

certain is uncertain. If we lower deposit insurance coverage once, the implicit message for the American people is that we would do so again. We can offer absolute certainty because the deposit insurance system is backed up by the "full faith and credit" of the Federal government.

Privatizing the FDIC would replace that "full faith and credit" guarantee with something else -- a finite fund, perhaps, or cross guarantees by banks. The experience with private and state-sponsored deposit insurance plans in the 1980s and early 1990s, however, suggests that the limited pool of resources on which finite funds draw inspires less confidence than does the unlimited unconditional guarantee the Federal government offers.

Private insurance plans may be able to handle isolated failures successfully, but our experience in this century and the last one is that limited plans have difficulty handling failures in waves. They are therefore not good at stemming panic or contagion and cannot assure stability.

Further, if private insurance is substituted for Federal deposit insurance, a private insurance plan facing depletion of its fund during a crisis would likely have to seek financing from the banking industry or other private sources of funds at the same time that the economy may be weak and the banking industry is having difficulties.

Moreover, if the private insurance supplier fails, the Congress may have to act to restore public confidence. Congressional action might not happen quickly and could occur only after serious damage has been done and costs have been significantly increased. Market discipline is important, and we should rely upon it whenever we can, but historical fact suggests that when the banking system is under stress, the stability of the system should come first.

In the 1980s and early 1990s the FDIC and other bank regulators focused on maintaining the stability of the system. Some have asked whether we provided too much protection to uninsured depositors, creditors, and shareholders -- especially in larger bank failures. They have questioned whether the desire to maintain stability led the FDIC to extend protection beyond insured depositors in too many instances, undermining the beneficial effects of the market discipline that large creditors and shareholders can provide.

It is easier to answer "yes" to these questions with the benefit of hindsight than it probably was to see the problems in the midst of the crisis. It may have been that bank regulators were too cautious in their approach to larger institutions. In some cases, the decisions might well be made differently today. If the regulators were too cautious, I believe their decisions were made in an effort to preserve communities, although with hindsight, they may have -- prior to 1991 -- lowered the standard of what was "too big to fail."

It is, nevertheless, a fact of life, that there are some -- although probably not many -- whose failure would present a risk to the banking system either because of the institution's size or because of its relationships with other institutions. The issue for all of us is how to preserve the system without unfairly advantaging the large creditors and shareholders of the bigger institutions.

The Federal Deposit Insurance Corporation Improvement Act significantly reduced the discretion regulators have to deal with large failing banks. Importantly, however, the law leaves us with enough flexibility to achieve a solution where the failure would present a genuine risk to the system. The FDIC is permitted to use Federal deposit insurance funds to resolve a bank failure if the resolution does not meet the least cost test only if the Secretary of the Treasury -- in consultation with the President, determines that there would be "serious adverse effects on economic conditions or financial stability." Such a decision can be undertaken only after a super majority of the members of both the FDIC Board of Directors and the Board of Governors of the Federal Reserve System vote in favor of the action. That is a high standard of accountability, particularly when one considers that the recommendation would, of course, have to be defensible to the Congress.

The law requires that any deposit insurance funds used in such a resolution be replaced by an after-the-fact special assessment on the liabilities of insured banks, a requirement which would mean that large banks would pay a bigger share in replenishing the insurance fund.

These standards mean that it is far less likely that the FDIC will cover large depositors, creditors, and shareholders when a large bank fails. These standards assure greater market discipline, and greater fairness -- in resolving bank failures.

Nevertheless, a few critics seem to hold the view that, if the least cost test cannot be met, then only taxpayer funds should be used to address potential systemic problems. Such a view fails to recognize that all of us will benefit if a systemic problem is averted -- including banks of all sizes, and bank customers. Because we are all affected by our economy -- and because our economy rests on the foundation our financial system provides -- we have a community of interest in preserving the stability of the banking system. That community of interest encompasses everyone in our nation -- including bankers on Main Street -- and on Wall Street.

The argument that we should rely only on taxpayer funds to resolve bank failures that pose systemic risk is contrary to much of what we learned in the past 15 years. As we saw in the S&L experience of the 1980s, waiting for appropriations to resolve failures resulted in denial, delay, and greatly increased costs. Our political system has many virtues, but efficiency is not one of its greatest. In the event of a large bank failure, what would be the advantage of leaving the financial system at risk while we attempt to address the failure through the legislative process? We have seen that when the banking system is under stress in a crisis, swift and decisive action maintains public

confidence. That was the lesson of the 1930s -- and the lesson from the crisis of the 1980s and 1990s.

Congress created the FDIC -- as an independent agency -- to take action when necessary. We see that, while history does not repeat itself, the business cycle does. We do not know what will drive the next wave of bank failures -- or when that wave will occur. The purpose of deposit insurance, however, is to spread risk so that problems in individual institutions do not result in catastrophe for all. For Federal deposit insurance to work, the coverage must be comprehensive and universal. Federal deposit insurance is an asset for every banker, every bank customer, every American. It is of special significance, however, for the community banker because it puts you on equal footing with the big banks. Regardless of your size, the people of your community can have faith that their insured deposit is safe in your institution. You supported resolving the problems of the Savings Association Insurance Fund to assure that there would be no doubts about Federal deposit insurance coverage. I am confident that you will continue to recognize that we all have a community of interest in maintaining the independence of the Federal Deposit Insurance Corporation and the continued strength of the Federal deposit insurance system.

Thank you.

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