

**Remarks by
Ricki Helfer
Chairman
Federal Deposit Insurance Corporation**

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Good morning and welcome to the Federal Deposit Insurance Corporation. Because this is the first time I have hosted a Group of Thirty meeting here at the FDIC, I would like to briefly discuss with you who we are and what we do.

Despite the impression the builders wanted to project in the masonry around us outside -- the Egyptian-inspired obelisk in the foreground behind you, for example, and the classical temple in the middle distance -- Washington is a relatively new city. The earliest written record we have for the site on which this building is constructed dates from 1685. By comparison, the Bank of Stockholm issued the first European bank notes in 1661 and the Bank of England was founded in 1694.

When Congress established the nation's capital here in Washington in 1790, only six cities in the United States had a population of more than 8,000 people. Well into the nineteenth century, trees grew where that large gray building to my left is today.

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, and that is especially so in the field of money and banking, upon which all other economic activity rests.

Two experiments in maintaining the presence of the national government in the U.S. banking system ended in disaster before we 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 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.

But we had a painful birth.

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 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, the Chairman of the Senate Banking Committee, 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 -- and 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 -- apart from the 1,250 savings and loans that failed during the same period -- 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 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.

It is, again, my pleasure to welcome all of you here this morning. The Group of Thirty serves the financial system well by providing a forum where we can learn from one another. A former head of state of Canada once observed that "We may not be in the same boat, but we are on the same lake." We here today come from many different boats, but all those boats are affected in some measure by the same winds, currents and tides. Working together, we can enhance our common ability to address the risks that we -- and our financial system -- all face.

Our agenda shows that we have a busy morning ahead of you. I am sure that you look forward to the discussions as much as I do.
