Statement
of
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Chairman
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at a
Press Conference
on
Deposit Insurance Issues
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Over the years, FDIC insurance has protected depositors, and in doing so, has helped assure the stability of the banking system and the economy. The FDIC has kept its promise to three generations of Americans. It is keeping that promise today. It will keep the promise tomorrow. FDIC insurance has worked well -- but it can work better.

Today, banking is enjoying extraordinary times - profitability, in fact, has never been better in the 67 years we've been measuring it. For example, last year commercial banks reported about $72 billion in income - an annual record - and savings institutions reported about $11 billion -- remarkable profitability. Rising income in the 1990s and into the new century has enabled banks and thrifts to build strong insurance funds, with combined reserves exceeding $40 billion.

This extraordinary profitability, in turn, presents us with an extraordinary opportunity. There will never be a better time than now to improve our system of federal deposit insurance. There is an old saying - the best time to fix your roof is when the sun is shining. We cannot pass up this opportunity to fix the roof before the next storm hits.

To ensure that deposit insurance continues to protect depositors and contributes -- to its full extent - to the stability of the banking system, the FDIC is engaged in a comprehensive review of the system. And, as part of that comprehensive review, today we are releasing an Options Paper that describes various ways in which we might make improvements to the system. These options are intended to prompt analysis and comment from individuals and organizations that have an interest in the issue. We have identified three fundamental areas for review in our deposit insurance system: One, setting premiums. The current system for pricing deposit insurance creates inappropriate incentives and raises fairness issues. Two, managing the deposit insurance funds. The current system requires banks to fund insurance losses when they can least afford it. And, three, coverage limits. The current system leaves depositors uncertain as to the future real value of FDIC coverage. These issues are interrelated. In the past they have been dealt with piecemeal. Our Options Paper is a step toward dealing with them comprehensively.

How important is it to address these issues?

I'll give you an example: Under the system as it currently stands, it would be possible for banks in an economic downturn to find themselves again paying 23 cents for every $100 of insured deposits they hold - the kind of premiums they paid in the early 1990s. Today, such a premium would drain almost $9 billion from insured banks and thrifts - and could lead to a $65 billion contraction in lending.

In other words, the current system would require banks to pay when they can afford it the least and when the economy - businesses and consumers -- need bank lending the most: in an economic downturn.

Looking at a few charts will illustrate the concerns with the current system.

We want better means to price deposit insurance according to the risk that individual institutions present. One, because Congress mandated a risk-based premium system as a way to curb undue risk. And, two, because it is the fair thing to do.

Here is a profile of two actual banks. As these simple measures show, one presents more risk to the Bank Insurance Fund than the other. But they both pay the same premium to the FDIC - nothing. Is that fair? It isn't fair to the banker who presents a lower risk to the fund to pay the same as a bank that presents a higher risk. But that isn't all.

Because of the way the law stands now, 844 newly established banks and thrifts - with insured deposits worth more than $44 billion - have never paid a penny for their deposit insurance. Never. Is that fair? Not to the bankers who have paid into the fund. But that isn't all.

Established banks that currently pay no premiums can rapidly increase their deposits without paying more for expanded coverage. One investment company is sweeping investment accounts into two banks that it owns. Deposits in these banks grew by about $12 billion from March to June of this year. And FDIC insurance was free. The FDIC simply has to be able to price our coverage according to risk.

Let's look at managing the funds.

The funding of FDIC losses over the years has evolved from a system that featured steady premiums with a fluctuating fund size to a system that targets a specific fund size and that can result in volatile - or zero -- premiums.

As this chart shows, the requirement to maintain a particular fund size can lead to steep premiums during bad times - more than 30 percent of net income in 1991. It can also lead to calls for rebates when the fund is seen as being too large.

Finally, there is the issue of deposit insurance coverage. As this chart shows, since coverage was last increased in 1980, deposit insurance has lost about half its value, based on the Consumer Price Index. As you can see, most of the increases over time more or less reflected cost-of-living adjustments. In real terms, coverage declines because Congress deals with the issue on an ad hoc basis. Since 1935, the basic coverage amount has increased five times.

Our Options Paper asks whether to keep the status quo - or whether coverage should be indexed or otherwise adjusted to keep it more constant in real terms - or whether the current system should be simplified to limit a particular level of coverage to one account per person.

It also discusses concerns with unintended consequences in changing deposit insurance coverage - concerns we have discussed since the beginning of our comprehensive review.

Our Options Paper does not advocate specific approaches. With the exception of merging the BIF and the SAIF, the FDIC does not endorse anything; we're looking at everything. This paper covers the waterfront. We are asking for public comment on it. And, as studies conducted by the FDIC and other organizations begin to generate results, additional discussion may take place. We will try to present recommendations to the FDIC Board in time for early consideration by the next Congress.

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