Remarks by Chairman Donald E. Powell
Federal Deposit Insurance Corporation
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Thank you for the invitation to speak this evening. It is truly an honor to be here in your great city and to meet so many of you.

I have had an interesting first year as Chairman of the FDIC. I am always impressed with the variety of issues faced by bankers today - and with the good job the banking industry has done in dealing with the economic slowdown. As a former banker - who barely survived Texas in the late 1980s - I know firsthand that it could be much, much worse.

I could spend all evening reciting the issues faced by the marketplace and the Washington regulatory community, and tell you where the FDIC will likely come down. But tonight, I would rather spend a few minutes discussing the concept of deposit insurance - and why this part of the financial safety net is important to the American people, to bankers, and to everyone else who has a stake in a safe, secure, and stable marketplace.

Let me begin with a confession: I am a capitalist. I love the free market. And there are occasions when I lie awake at night and think about all the different government agencies involved in the marketplace today. In thinking about our regulatory structure, I keep coming back to a fundamental conclusion: all of us involved in bank regulation should be able to justify our roles to the American people. And we should be able to prove the benefits we provide are worth more than what we spend on our budgets.

I've thought about this quite a bit - particularly in relation to the FDIC. Boiled down to its essence, what exactly is deposit insurance? What role has it played in American financial stability? What role does the FDIC play today, and in the future?

It is good to ask these questions. It is good, on occasion, to re-examine your beliefs and reaffirm your faith. And that is what I would like to do tonight.

At its core, deposit insurance is nothing more than a simple promise: to provide insurance coverage up to $100,000 per depositor in each institution insured by the FDIC.

The promise may be simple, but what lies behind that promise is both complex and always evolving. We must keep up with the latest changes in the industry, keep pace

with the rapid evolution of the marketplace, and ensure we are working in concert with the other regulators - both at the federal and state levels. If we do not adapt, our safety net will soon be out of date - with potentially disastrous consequences for our economy and our banking system.

It is easy to forget this when times are good. From time to time, I hear people question the need for safety-net protections like deposit insurance. They claim it is an unwarranted intrusion by government into the free market. And you sometimes hear the argument that deposit insurance presents a "moral hazard" - giving banks an incentive to take excessive risks.

I hear these arguments, but I do not agree with them. I was a banker for more than 30 years. Most of that time, deposit insurance wasn't on my list of daily, weekly, or even yearly concerns. But for the three years of the banking crisis in Texas - when failing banks were in the news every day - the FDIC seal on the door was very, very important.

Why is this important? It is important because in tough times, we rely on banks to make the kinds of loans that drive the economy. When markets become jittery, market-based funding mechanisms - like commercial paper - have a tendency to dry up. And without deposit insurance, the liquidity in banks would dry up during tough times as well - with severe and escalating impact on the surrounding economy. So, in short, the deposit insurance guarantee provides a rock-solid foundation of confidence for the economy to build on - and it is an important defense against systemic collapse.

To understand the importance of confidence, and what happens when it goes away, you only need to look at the world of 1933 - the world into which the FDIC was born.

While banking panics and crises had been a part of the American financial landscape for decades before the Great Depression, the crisis of the early 1930s went far beyond anything the country had seen before. Indeed, it went beyond anything we can imagine today. From August 1929 to March 1933 the money supply declined by over one third -- vastly more than any prior depression. The safety net put in place over the previous decades - including the creation of a central bank that would act as a lender of last resort - proved unable to stem the economic contraction.

As the crisis worsened, depositors began withdrawing money from their banks. In an attempt to meet these demands, banks sold their bond portfolios. Each such move drove down the portfolio values of the remaining banks - putting even the healthiest institutions at risk.

When banks began to fail, depositors panicked. As they rushed to withdraw their money, 9,000 banks -- a full one third of the U.S. banking system -- failed. This cycle of panic and withdrawal caused sound and weak banks alike to fail as depositor demands far outstripped banks' ability to dispense money.

While the consequences of this banking crisis echoed through the economy, the ordinary American saver was hardest hit. Although there are no official figures of how many depositors lost their savings in the Depression, it has been estimated that close to

six million people, or one family in every four, lost their savings-often their life savings-as the result of bank failures.

Something needed to be done. After President Roosevelt was elected, Congress grappled with ways to end the economy's downward spiral. Among other reforms, Congress decided to promise every American depositor that the full faith and credit of the United States stood behind their bank deposits - up to the amount of $2,500.

With this promise, the devastating cycle of banking panics in the United States ended. Deposit insurance immediately restored the confidence the system needed and money flowed back into the banking system. As Alan Greenspan has observed:

"When the efforts of the Federal Reserve failed to prevent the bank collapse of the 1930s, the Banking Act of 1933 created federal deposit insurance. The subsequent evidence appears persuasive that the combination of a lender of last resort (the Federal Reserve) and federal deposit insurance have contributed significantly to financial stability and have accordingly achieved wide support within the Congress."

Indeed, federal deposit insurance succeeded in achieving what had been a major objective of banking reform for the better part of a century, namely, the prevention of liquidity crises and banking panics.

From the mid-1930s to the mid-1980s, the FDIC led a pretty boring life. It handled a few failures a year, charged the industry minimal premiums and handled the federal supervision of thousands of small state-chartered banks. The stability was so pervasive that nobody could blame the FDIC for feeling like it truly had accomplished its mission.

But while the FDIC was managing the deposit insurance guarantee, the business of banking was changing. The pace of change accelerated during the 1980s as the market for financial services became deregulated and far more competitive. Nonbanking companies encroached on traditional banking markets and banks themselves marketed new products. As a result, banking became a riskier and more demanding business than ever before.

The new deregulated marketplace, regional economic overcapacity, a hostile interest rate environment, and government policy changes all combined, in the late 1980s, to bring about the worst crisis for banking since the FDIC's creation. Suddenly, the agency that whiled away the previous 50 years in obscurity found itself once more in the breach.

During the late 1980s and early 1990s, about 3,000 banks and thrifts were closed or received financial assistance. About half-a-trillion dollars in failed bank assets were filtered through the government safety net and returned to the private sector. While this upheaval was certainly traumatic to many of the banks and thrifts involved, it is important to remember that it was handled without significant disruption to the broader economy and without depositor panic, bank runs, or any other feature that had been so prevalent in previous crises.

This is a remarkable story. I believe the FDIC - in resolving this crisis "peacefully" and without broad economic hardship - performed a remarkable service to the American people.

Importantly, it proved, once again, that the FDIC could do what the Congress intended it to do - stand up in a crisis and maintain confidence in the country's financial system. Since the establishment of federal deposit insurance, the financial system has not experienced runs on federally insured banks and no one has lost a single penny of an FDIC-insured deposit as a result of a bank failure.

It is difficult to reflect on this history without concluding that we should view an effective deposit insurance system and supporting safety net as standard equipment. This is a lesson we've learned at home - but we can see it played out abroad as well.

If you think public confidence in the banking system and a well-run safety net doesn't matter, look at the example of Japan. And they are not the only ones. Without deposit insurance, the experience at home and abroad has too often been unacceptable financial instability and economic turmoil, to the point where citizens question the merits of the free market system and even the government itself.

It is for this reason I view deposit insurance as one of capitalism's best friends. It is the stabilizing influence that allows our free-market system to work its wonders. It allows our markets to work without the threat of banking panics, distressed citizens and economic disasters. And this is key to reaffirming my faith in what we do every day at the FDIC.

So, if we've reaffirmed our faith in the financial safety net, can we now rest on our laurels? Absolutely not. As policymakers and regulators, we always are capable of intruding too much into the marketplace or, alternatively, being too lax in our understanding of the risk. We must work to find the proper balance between these two extremes. Deposit insurance should support, not distort, the marketplace. And we should not dispense our guarantee so liberally that we generate excessive risk-taking by insured institutions at the expense of taxpayers.

And this balancing act requires our ongoing attention. Competition, creativity, and technological advances have all contributed to the transformation of traditional financial markets and the way in which we do our jobs. A lesson that we, at the FDIC, have learned is that our mission cannot be considered apart from the economic and banking environment in which we operate.

We must keep abreast of changes in the business of banking. We must understand the risks and developments inherent in the banking sector and the broader economy. Finally, when banks do fail - and that happens in a free market economy -- we must ensure we never abuse the trust placed in us by the individual depositor.

The trends affecting the banking industry continually bring to the fore interesting policy questions that challenge us as well as the industry. We are meeting this challenge in part through our efforts to reform the deposit insurance system. We also are undertaking a major study on the future of banking in America. And we have opened a

dialogue on how to improve our bank regulatory structure, so that it is better positioned to understand and be responsive to the changing industry that it regulates.

As our work progresses on these important issues, we will solicit industry input and the views of other regulators. And we will share our thinking on these issues, from time to time, as we go along.

I ask you to help us with this important task. Give us your ideas for designing a safety net that is suitable for our new and dynamic financial environment -- one that allows market forces to shape the industry while maintaining the confidence that is essential for banking to fulfill its historic role as a reliable engine of growth for our economy.

Thank you.

Congress created the Federal Deposit Insurance Corporation in 1933 to restore public confidence in the nation's banking system. The FDIC insures deposits at the nation's 9,480 banks and savings association and it promotes the safety and soundness of these institutions by identifying, monitoring and addressing risks to which they are exposed. The FDIC receives no federal tax dollars-insured financial institutions fund its operations.

FDIC press releases and other information are available on the Internet at www.fdic.gov or through the FDIC's Public Information Center (800-276-6003 or (703) 562-2200).

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