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Statement of the Financial Regulatory Committee

on

Proposal to Increase Deposit Insurance Coverage to $200,000

May 8, 2000

The Federal Deposit Insurance Corporation (FDIC) is sponsoring a series of public roundtable discussions on deposit insurance reforms, including the possibility of increasing deposit insurance coverage. Several bank trade associations have recently doubling the deposit insurance coverage to $200,000 from the current $100,000 level per account. The Shadow Financial Regulatory Committee opposes the proposed increase in deposit insurance coverage.

In general, deposit insurance as it is currently structured creates a moral hazard problem because it reduces the incentive of depositors to monitor the financial health of banks and to discipline banks that take imprudent risks. The consequence of this is to increase the likelihood of bank failures and the losses to the FDIC fund. Thus, any increase in deposit insurance coverage, such as the proposed increase to $200,000, is likely to exacerbate these losses. The increase in deposit insurance from $40,000 to $100,000 in 1980 is widely viewed as being a contributing factor to the large losses to the Federal Savings and Loan Insurance Corporation (FSLIC) in the 1980's. While it may be argued that some loss of market discipline is warranted to protect unsophisticated depositors of limited means, the major beneficiary of an increase in insurance coverage would be wealthier individuals who own most deposit accounts greater than $100,000.

Those supporting higher deposit coverage argue that this is necessary in order to permit smaller banks to compete effectively with larger banks,
whose deposits, they argue, are already fully guaranteed by the "too-big-to-fail" policy. However, since the enactment of FIDICIA in 1991 uninsured depositors in sizeable failed banks in which the FDIC has suffered a loss have generally borne their share of these losses. It is, nevertheless, true that there has not been a failure of a large money-center bank since 1991, so FIDICIA's restrictions on too-big-to-fail assistance has not been fully tested. The Committee believes that the preferable way to address concerns about too-big-to-fail are to further narrow the conditions under which regulators may invoke the too-big-to-fail exemption, as implied by Federal Reserve Chairman Alan Greenspan in a recent speech.