Remarks by
Ricki Helfer
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before the
Kansas Bankers Association

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Thank you.

The bankers of Kansas are fortunate, indeed, to have Harold Stones represent you. Harold is a passionately eloquent man who believes in doing his homework. For example, to make certain that I had an understanding of this audience, he recently sent me a "demographic" breakdown of the banks in Kansas, which stated that eight-out-of-ten of the banks here are in communities of fewer that 10,000 people. To make certain that I would not miss the point, Harold stressed in a cover note: When you look up "Small town traditional community banks" in the dictionary, it is spelled K-A-N-S-A-S."

As the saying goes: I can relate to that.

I grew up in Smyrna and Murfreesboro, Tennessee, small towns south of Nashville. I grew up with friends whose fathers were farmers -- and I spent summers on the farms of my two North Carolina grandfathers. Today, if you pull off the interstate and drive into Murfreesboro, you can still pass a farm or two along the way. If you veer away from the interstate, farms spread across the county. My sister is county executive of my home county. The largest town in the county has a population of 44,000, but when I grew up my family lived in a town of 5,000 people.

Growing up, I witnessed first hand the contribution that banks can make to strengthening the community -- particularly where they work hand-in-hand with local leaders. In small towns, bankers make things happen -- those things are growth, development, and prosperity.

I know how banks and bankers throughout Kansas contribute to their communities, such as -- the bank that designed an Economics of Staying in School program that it presented in the junior high schools of Wichita -- the bank in Argonia that committed to finance technology in the public school system there -- the banker in Tampa who trained to be an emergency medical technician

because her community did not have one -- and the bankers in Miami County who sponsor a Christmas in October program to renovate housing for disabled and low-income people.

It has also been my personal experience that community bankers take the extra step to serve their customers. I went to college -- and graduate school -- on scholarship. Consequently, I was always on a tight budget.

When I was in college, my family banked at a community bank in Smyrna, Tennessee. I will never forget that the banker called my mother when my checking account dropped below $25 to make sure I had enough money to cover unexpected expenses. We were not big customers of the bank, as you can see -- far from it -- but this banker had the welfare of all his customers -- including me -- at heart.

So -- as always -- it is a personal, as well as a professional, pleasure to be with -- as Harold would say, "Small town traditional community bankers."

With Nashville the nearest city, I heard a lot of political folklore growing up. One quotation I will never forget was attributed to Sam Houston, Governor of Tennessee in the late 1820s. Once, when the legislature was deadlocked in debate, he sent the following message to the lawmakers: "Sometimes we have to rise above principle and do what is right."

Not too long ago, I heard Harold Stones use the words "doing what is right."

He was testifying in March at a public hearing at the Federal Deposit Insurance Corporation (FDIC) on insurance premiums for the Bank Insurance Fund (BIF) and the Savings Association Insurance Fund (SAIF). That hearing was part of our painstaking effort to make sure that, in significantly lowering bank insurance premiums -- an action I strongly support -- we do it right. Such an effort assures that there is no basis for challenge either in the courts or by the General Accounting Office -- the audit arm of Congress -- to the final premium schedule the FDIC Board will adopt.

At our public hearing, FDIC Vice Chairman "Skip" Hove -- no stranger to community banking -- noted that community bankers in Kansas and Nebraska and a lot of other places are good responsible public citizens. Vice Chairman Hove asked Harold if community bankers would come forward and take some responsibility if they perceived that there was a serious problem with ramifications beyond Kansas and Nebraska. Specifically, he asked: if there is a crisis, "is it your feeling that these bankers would come to the table in some way and participate in solving this crisis . . .?"

Harold replied: "Mr. Vice Chair, that is a very heavy question because you hit us right in our vulnerability, and that is, you have appealed to our sense of patriotism and our sense of doing what is right for America, and we will always answer that call."

I came here today to ask you to consider doing what is right. I want to talk with you about a problem the FDIC has. As you know, the Savings Association Insurance Fund is managed by the FDIC -- and it is grossly undercapitalized.

Because the SAIF problem is an FDIC problem, bankers are not completely insulated from it.

The problem is this: Although the Bank Insurance Fund is in good condition and its prospects appear favorable, SAIF is not in good condition and its prospects are not favorable. Both funds are FDIC insured.

The FDIC Board must be concerned that when SAIF steps up to the plate on June 30 to begin paying for the losses from thrift failures, it will have two strikes against it. The first strike is that the fund is undercapitalized. The second is that half of its assessments are drained away to continue to pay old debts from thrift failures in the mid-1980s. We cannot help but be concerned when one unexpected large thrift failure, or several sizable unexpected failures could bankrupt the fund. Although such losses are not predicted, they are possible.

Consider the three parts to this problem more closely.

Part one: The SAIF is significantly underfunded. At year-end 1994, the SAIF had a balance of $1.9 billion, or 28 cents in reserves for every $100 in insured deposits. Under current conditions and reasonably optimistic assumptions, the SAIF would not reach $1.25 in reserves for every $100 in deposits until at least the year 2002.

Part two: SAIF assessments have been -- and continue to be -- diverted to purposes other than the fund. Of the $9.3 billion in SAIF assessment revenue received from 1989 to 1994, a total of $7 billion has been diverted to pay off obligations from thrift failures in the 1980s.

Without these diversions, the SAIF would have been fully capitalized last year. It would have reached the reserve target of 1.25 set by Congress in 1994 -- before the BIF hit the target, in fact. Most of the money was diverted to pay interest on bonds issued by the Financing Corporation, or FICO. SAIF assessment revenue currently amounts to just over $1.7 billion a year and FICO interest payments run $779 million a year, or about 45

percent of all SAIF assessments annually. The FICO claim will remain as an impediment to SAIF funding for 24 years to come.

Part three of the SAIF problem: The SAIF will assume responsibility for resolving failed thrifts after June 30 of this year. Given the underfunding of the SAIF, significant insurance losses in the near-term could render the SAIF insolvent and put the taxpayer at risk.

The outlook for the SAIF is further complicated by the fact that the law limits SAIF assessments that can be used for FICO payments to assessments on insured institutions that are both savings associations and SAIF members. Because assessment revenue from institutions that do not meet both tests cannot be used to meet debt service on FICO bonds, more than 32 percent of SAIF-insured deposits were unavailable to meet FICO payments in 1994.

At current assessment rates, an assessment base of $325 billion is required to generate revenue sufficient to service the FICO interest payments. The base available to FICO at year-end 1994 stood at $486 billion. The difference of $161 billion can be thought of as a cushion which protects against a default on the FICO bonds. If there is minimal shrinkage in the FICO assessment base -- 2 percent -- a FICO shortfall occurs in 2002. If shrinkage increases -- for whatever reason, including efforts by thrift institutions to leave the SAIF -- the shortfall could occur earlier.

If the SAIF were to approach insolvency, the erosion of the SAIF assessment base would likely accelerate. Strong institutions would want to distance themselves from a demonstrably weak insurance fund. If assessments were increased, the incentive to leave would be even greater than it is now.

As the manager of the insurance funds, we at FDIC have a duty to do the best job that we can.

Over the last several weeks, a consensus has begun to emerge in Washington on how to address the issue of the undercapitalization of the SAIF.

It is simply this: The members of the SAIF must make a cash payment -- up front -- to capitalize the fund -- a cash payment that works out to be in the neighborhood of $6 billion. Thrift institutions are not pleased about this prospect.

It is not just in the FDIC's interest that the SAIF be fully capitalized -- it is in the interest of the thrifts and in the interest of a stable financial system.

The issue rises above principle -- it is the right thing to do.

It is in all our interest to contemplate what would happen if the SAIF becomes insolvent.

Deposit insurance is a fundamental part of the financial industry safety net. This safety net is important to community bankers. It is how you differentiate yourselves from much of your competition -- such as mutual funds. No one has ever lost a single cent of a deposit insured by the FDIC. No taxpayer has paid a cent in taxes for that protection. Deposit insurance is part of the security that you sell your customers as a service.

As part of the larger safety net, the deposit insurance system not only protects individual depositors but serves to buttress the banking and thrift industries during times of stress by substantially eliminating the incentives for depositors to engage in runs on banks. It provides security for bank customers -- and it provides security for banks.

In 1933, the year the FDIC was created, there were 4,000 bank failures. In 1934, the first year the FDIC was in operation, there were nine bank failures. The FDIC provided stability to the banking system by giving everyone confidence in the safety net. As we saw again in the 1980s and the early 1990s, the FDIC assured the stability of the banking system. The safety net worked.

The failure of the SAIF would undermine the confidence Americans have in the FDIC as a source of stability for the financial system and would call into question the government safety net for financial institutions.

Confidence in the government's backing for the safety net was a major reason that the financial troubles of the 1980s and early 1990s did not lead to widespread panic and economic disarray. The Bank Insurance Fund borrowed from the U.S. Treasury when its balance dropped below zero but ultimately paid the money back with interest.

The deposit insurance system and the other components of the financial industry safety net rest ultimately on confidence -- on the belief that the full faith and credit of the government support the safety net. That confidence could be damaged if government is perceived as no longer willing to support one or more components of the safety net.

In fact, that confidence could be damaged if government is perceived as once again merely pushing the problem into the future in hopes that it will go away.

We have learned from earlier mistakes -- and the public has learned, too.

The government's early, half-hearted efforts in addressing the S&L crisis -- such as the inadequate $10 billion authorized in 1987 to recapitalize the Federal Savings and Loan Insurance Corporation, or FSLIC, with the issuance of FICO bonds -- ended up later costing much more than an early comprehensive solution to the problem would have cost. On top of that, the costs in terms of confidence to the system cannot be measured in dollars.

A friend of mine who came to Washington in the late 1970s to work as a banking reporter told me an interesting story soon after I became Chairman.

His second or third week on the job, he learned that the FDIC rebated part of the insurance premium to the banks. He asked his bureau chief, a financial writer with more than 25 years of experience in journalism, if that was a good idea. The bureau chief replied: "The FDIC has nine billion dollars in its insurance fund -- the way that banks are regulated today, it is inconceivable that anything could happen that would cost that much money."

That kind of confidence in the system was an intangible asset -- one that all community bankers shared.

The SAIF, the BIF, and the FDIC are distinguishable to only a small segment of the population. To most, only one acronym -- "FDIC" -- makes a difference.

Bank customers and thrift customers do not know the difference between BIF and SAIF. Indeed, Congress insisted that the SAIF become "FDIC-insured" precisely to assure confidence in its future. You all benefit from the FDIC seal of assurance. All of us who participate in the financial system benefit.

Related to the issue of the soundness of the SAIF is the question of what would happen if the FICO bonds go into default if the SAIF-insured deposit base shrinks. Again, bankers -- particularly community bankers -- would not be sheltered from the fallout.

The more widespread effect could include downward pressure on the prices of securities issued by government-sponsored enterprises such as Fannie Mae, Freddie Mac, Farmer Mac, and Sallie Mae, as well as upward pressure on the interest rates on these obligations. A default could also add to the cost of bank capital if the obligations of government-sponsored enterprises were to carry higher risk weights under risk-based capital standards.

Experience with underfunded state deposit insurance funds in Maryland, Ohio, and Rhode Island, and with the underfunded FSLIC, shows that permitting an insurance fund to limp along in an undercapitalized condition is an invitation to much greater difficulties. Regulators and legislators in the past have become paralyzed when large or visible institutions insured by a grossly weakened fund began to falter. Fear of runs on deposits has inhibited actions. Because of an insurance fund's weak financial condition, failed institutions have been handled in a manner that minimizes or defers cash outlays, but ultimately increases costs. Stronger institutions look for greener pastures free from the debris of a collapsed regulatory edifice. In short, the failure to take corrective actions allow the problems to worsen.

Congress, of course, will make the final decisions on how the problem of SAIF is resolved. As you know, three sources of revenue have been widely discussed in the press and in Congress: the taxpayers, the thrifts, and the banks. While other financial institutions could benefit from assuring a solution to the SAIF problem, only bank and thrift deposits are FDIC insured, and that seems to be the distinction that many are making.

In the last several weeks, another consensus has appeared to be emerging in Washington. More and more lawmakers have told us that it is less and less likely that taxpayer funds will be available to replenish the SAIF. That is the reason for the growing consensus that thrifts must replenish their fund. Unfortunately, more and more lawmakers are saying that taxpayer funds will be unavailable to meet the debt service on FICO bonds as well. It is important to remember, however, that the SAIF carries the full faith and credit guarantee of the U.S. government. The availability of taxpayer funds to backstop an overall, immediate solution to the SAIF problem may, in fact, save taxpayer money by assuring that this problem is not allowed to worsen.

In my first public appearance as FDIC Chairman, I spoke to the American Bankers Association Government Relations Council last December. After my speech, I took questions from the floor, and in response to a question about the SAIF problem, I urged bankers to take a constructive part in resolving the problem of SAIF -- to do what is right -- what is right for America -- and what is right for bankers themselves -- who benefit from FDIC insurance and from the federal safety net. Regardless of what the cynics say, what is right for America and what is right for banks are not necessarily mutually exclusive. Indeed, as my early experience growing up in a small town in Tennessee taught me, they often coincide. Bankers have frequently stepped up to the plate to help their communities and their country -- especially when they have seen benefits to their institutions in doing so.

I again urge you to be a part of the solution. I hope and believe you will do what is right for all of us.

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