Remarks by
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Many of you, I am sure, know my Deputy for Policy, Leslie Woolley. Before joining me last year, Leslie worked for seven years as Legislative Director for your U.S. Senator Bob Graham. When I asked her why she wanted to be my deputy for policy, Leslie told me of the time a reporter approached Will Rogers during the First World War. The cause of U.S. entry into that war -- they used to tell us in high school -- was that German submarines were sinking American shipping without warning.

The reporter asked Rogers: "What should we do about the German submarine problem?"

Rogers answered: "I recommend that we drain the oceans and send the cavalry out to round up the submarine crews."

Smelling a story, the reporter got excited. He asked: "How are we going to drain the oceans?"

Rogers replied: "Son, I'm in policy, not in operations."

Policy often requires creative thinking.

Given our system of government -- how decisions are developed through deliberation -- policy making also often requires persistence.

The late C. C. Hope -- banker, industry leader, director of the Federal Deposit Insurance Corporation and a good friend to many of us here today -- once told a marvelous story to illustrate the meaning of persistence. During the Civil War, or as some people down here say, "The War Between the States," the Union ran a prisoner-of-war camp in the wilds of northern Michigan. No one escaped from the camp -- ever. In 1863, one of the prisoners began taunting the guards at every opportunity with the words: "General Bragg sure whupped your boys at Chickamauga" -- the battle having recently occurred.

This went on for several weeks.

The Union colonel who ran the camp tried to ignore the taunting, but it soon had the effect of raising the morale of the prisoners while lowering the morale of the guards -- the last thing in the world the colonel wanted -- so he called the Confederate in and gave him a choice. If he took the oath of loyalty to the Union, he would be released and transported South. If he did not, he would spend the duration of the war in solitary confinement.

The Confederate thought hard for a moment and replied: "I'll take the oath."

The Union colonel smiled and administered it.

When it was over, he said to the former-Confederate: "That wasn't so bad, was it?"

"No, sir," was the reply, "it wasn't."

"Permission to speak freely, sir," the former-Confederate requested.

"Permission granted," the Union colonel said kindly.

"Ain't it sad," said the former Confederate, "how General Bragg whupped our boys at Chickamauga?"

I am one of those people who considers persistence a virtue. So -- at the risk of sounding like that Confederate soldier -- I want to discuss an issue I have raised a few times before. I came here today to talk with you about the problem of the Savings Association Insurance Fund (SAIF), which, as you know, is managed by the FDIC.

Some people have taken the position that no problem exists. That conclusion rests on optimistic assumptions -- but in the view of a bank regulator who, after all, is paid to worry about the future, optimism must be tempered by a range of possible outcomes that are not so optimistic.

Some bankers have taken the position that there is a problem -- but it cannot be addressed until the banks get lower deposit insurance premiums. I support significantly lower insurance premiums for banks. That is a separate issue and will be considered by the FDIC Board following its normal administrative procedures for reviewing the 3,200-plus comments we have received on the Board's insurance premium proposals. The comment period closed April 17 and we were still receiving comments on May 25.

Our most recent analysis shows that, as of March 31st, the Bank Insurance Fund (BIF) had a balance of $23.2 billion, with an estimated reserve ratio of 1.22 of insured deposits. We expect the BIF to recapitalize during this quarter, although we cannot confirm the actual number -- as required by law -- until September, because about 7,000 banks file call reports in paper form. We are taking pains in our consideration of our insurance premium proposals 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.

In the meantime, the clock is ticking on the SAIF problem. Bankers are not insulated from that problem because it is an FDIC problem.

Stated simply the problem is this: Although the BIF is in good condition and its prospects appear favorable, SAIF is not in good condition and its prospects are not favorable. There are three parts to this problem.

Part one: The SAIF is significantly underfunded. As of March 31 of this year, the SAIF had a balance of $2.2 billion, or 31 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 reached the reserve target of 1.25 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. The FICO claim will remain as an impediment to SAIF funding for 24 years to come. 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.

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 SAIF, significant insurance losses in the near-term could render the SAIF insolvent and put the taxpayer at risk. One large or several sizable thrift failures could bankrupt the fund. Although such losses are not currently predicted, they are possible, unless one looks only at optimistic scenarios.

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 33 percent of SAIF-insured deposits were unavailable to meet FICO payments as of March 31.

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 as of March 31 stood at $485 billion. The difference of $160 billion can be thought of as a cushion that 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 much 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.

What happens if the SAIF becomes insolvent?

Deposit insurance is a fundamental part of the financial industry safety net. Deposit insurance is designed -- not to isolate individual institutions from the rigors of competition -- but to stabilize markets and protect the system in general. As part of this 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.

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.

Confidence in 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.

That confidence could be damaged if government is perceived as no longer willing to support one or more components of the safety net. That confidence can be shaken, if government is seen as willing to deal only half-heartedly with a problem. Indeed, the FICO bond arrangement that is now so much a part of the SAIF's problem was an element of earlier solutions to the S&L crisis that did not go far enough -- putting off until tomorrow what should have been addressed yesterday. If the FICO bonds run into trouble or default, confidence in the ability of government to solve financial problems in the future will be lessened -- and solutions, therefore, will be more costly for all of us. If default occurs on the FICO bonds, the immediate effect would be that investors holding the bonds would sustain losses.

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.

As we have seen again and again, 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, invariably ended up costing more than a comprehensive solution to the problem would have cost.

The current difficulties of the SAIF pose the danger of such an approach. As I noted earlier, the SAIF problem has three parts: the fund's undercapitalized condition; the drain of the FICO interest obligation; and the looming transfer of responsibility for resolving failed thrifts to the SAIF -- that is to say, the FDIC -- after June 30. Because they have immediate consequences, the last two problems might seem to warrant higher priorities than the first.

This conclusion is incorrect.

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 action. 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 unmarred by the debris of a collapsing regulatory edifice. The failure to take corrective actions allows the problems to worsen. Consequently, all three of the difficulties facing the SAIF -- its undercapitalized condition, and the resulting BIF-SAIF premium disparity, which could lead to a weaker SAIF because of fleeing members; the drain of the FICO interest obligation; and the need to resolve thrift failures after June 30 -- demand consideration in a solution.

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.

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.

The BIF borrowed from the U.S. Treasury when its balance went below zero, but those borrowings were ultimately repaid with interest.

Bankers benefit from this safety net and, therefore, have a direct stake in the effort to find a solution to the SAIF's weak condition.

The FDIC Board must be concerned that, when SAIF steps up to the plate on June 30 to begin paying for the losses from the thrift failures, it will have two strikes against it. The first strike is the undercapitalization of the fund and the second is the drain from the FICO bonds. We cannot help but be concerned when one unexpected large thrift failure, or several sizable unexpected failures, could bankrupt the fund. We are not predicting such failures now, but they could happen.

Over the last several weeks, there has been the beginning of a consensus in Washington on how to address the issue of the undercapitalization of the SAIF. It is simply this: The members of the SAIF may have to take responsibility for capitalizing their fund. That would cost in the neighborhood of $6 billion. Thrift institutions here will not be pleased by 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.

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, 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. At the same time, more and more lawmakers are saying that taxpayer funds will be unavailable to meet the debt service on FICO bonds as well.

I cannot help but think that the lawmakers would be more willing to leave taxpayer money on the table if some people in the banking industry had not made a point of saying that there is no problem today with the SAIF -- and no need, therefore, for taxpayer funds.

What if we wait for a serious crisis to develop -- in two or three years, perhaps -- before we take action? The SAIF assessment base shrinks -- from failures; or from institutions switching funds to avoid higher premium costs or switching funds to escape a contracting, more concentrated insurance fund; or all of these reasons. What happens then? A merger of the two funds becomes compelling.

I have to date opposed such a merger because BIF-members would have to carry the full costs of stabilizing the situation -- costs today in excess of $15 billion. If we wait two or three years to address the situation, there will be no residual Resolution Trust Corporation (RTC) funds even to discuss and the BIF reserve ratio may be diluted by institutions switching from the SAIF. Under that scenario, BIF could end up bearing all the costs. That would be not only unfair, it would also add more than two years to the period when banks could otherwise pass premium savings on to their customers.

It is important to remember that the SAIF carries the full faith and credit guarantee of the U.S. government. I am sympathetic to the concerns of Congress about turning to the taxpayers, but the availability of taxpayer funds to backstop an overall, immediate solution to the SAIF problem may, in fact, save taxpayers money by assuring that this problem is not allowed to worsen. I think we all benefit from solving the SAIF problem: the FDIC, the banks, the thrifts, their customers and the financial system.

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