Remarks
by
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Before the
Exchequer Club
Washington, D.C.
March 15, 1995

Thank you.

A number of years ago, I came across a copy of a marvelous letter -- dated April, 1829 -- from Martin Van Buren, then- Governor of New York, to President Andrew Jackson. It began:

"Dear President Jackson:

"The canal system of this country is being threatened by the spread of a new form of transportation known as railroads. The federal government must preserve the canals for the following reasons:

"One -- If canal boats are supplanted by railroads, serious unemployment will result. Captains, cooks, drivers, repairmen and lock tenders will be left without means of livelihood, not to mention the numerous farmers now employed in growing hay for horses.

"Two -- Boat builders would suffer and tow-line, whip and harness makers would be left destitute.

"Three -- Canal boats are absolutely essential to the defense of the United States. In the event of the expected trouble with England, the Erie Canal would be the only means by which we would move the supplies so vital to waging war.

As you may well know, Mr. President, railroad carriages are pulled at the enormous speed of 15 miles per hour. In addition to endangering life and limb of passengers, they roar and snort their way through the countryside, setting fire to crops, scaring the livestock and frightening children. The Almighty certainly never intended that people should move at such breakneck speed.

"Sincerely, Martin Van Buren"

What a gem! Over the years, I have heard the letter quoted to illustrate: one, the attitude of people toward change; two, the fundamentals of persuasive lobbying; and, three, how Washington never changes.

There is only one problem with the letter -- no one can come up with a copy of the original, or a reference to the original anytime near the time it was supposed to have been written.

The letter is -- more than likely -- just mythology -- and as Yogi Berra said: "The problem with mythology is that people believe it."

Belief in mythology can be quite a problem -- as the Federal Deposit Insurance Corporation has found out recently. As I am sure all of you know, here in 1995 we are still wrestling with the problem of how to pay for the costs of savings and loan failures that occurred before the creation of the Resolution Trust Corporation in 1989. Proceeds from bonds issued by the Financing Corporation -- so-called FICO bonds -- went to resolve those failures -- and the savings and loan industry -- through the Savings Association Insurance Fund -- was required to pay the interest on the bonds. The S&Ls have done so -- paying $780 million a year since 1989 to meet that obligation. That is now about forty-five cents out of every dollar that flows into the fund. Because the $780 million comes out of the SAIF, the growth of that insurance fund

has been stunted, and in fact it contains only about $2 billion -- far short of the $8.6 billion it needs to be fully capitalized today. In fact, it is grossly undercapitalized. The Bank Insurance Fund, however, is not. In fact, sometime around mid-year it will be fully capitalized at $1.25 for every $100 in insured deposits -- the target Congress set for both funds. When that target is reached, BIF-insured institutions will see their premiums decline significantly. SAIF-insured institutions, however, cannot see their premiums decline. Thus, a premium differential will exist between institutions insured by BIF and institutions insured by SAIF. So where does the mythology come in?

Some people believe that the FDIC has the means, somehow, to solve this SAIF/FICO problem effortlessly and painlessly -- all we have to do is wave a magic wand, or clap our hands, and the problem will go away.

Nothing is further from the truth. The fact is that the FICO problem arises from assumptions made back in the 1980s about how much and how quickly the S&L industry would grow. Instead of growing, it shrank. Further, the problem is exacerbated by very clear legal constraints that prevent the assessments of some SAIF members from being used to meet the FICO obligation. There is nothing that the FDIC can do to change the mistaken assumptions embedded in the system or the law.

Further, our hands are tied in two of the related matters. First, Congress set the 1.25 reserve ratio for banks and thrifts. If we want to raise the ratio above 1.25 for the Bank Insurance Fund, we have to explicitly state why the conditions in the industry or at individual banks compel us to do so. Second, we are required by the law to set premiums for the BIF and the SAIF independently. Both the law and common sense argue against requiring BIF-insured institutions to continue to pay current premium rates -- which add up to about $6 billion a year for the BIF -- until SAIF is capitalized simply to avoid a differential.

Like the crack in the radiator that triggers the recall of a make and model of automobile, the FICO problem is a structural flaw. It is embedded in the SAIF system. It will not go away by itself -- and the FDIC has no legal authority to fix it.

Most of all, any solution to the FICO problem will require money -- about $8.4 billion, if we were to pay off the obligation right now, today. We do not have that kind of money in any discretionary account nor do we have it hidden away in desk drawers back at 550 17th Street -- not even close. So I cannot see how anyone can say that the FDIC has the means to address the problem, and that we just lack the will. The fact is, we do not have the means.

Someone is going to have to come up with the money. There is no way around that central fact, as painful as it may be. The proposals now circulating on how to address the SAIF/FICO problem look to three groups to pay for the solution, either individually or in combination. Those groups are the savings associations, the commercial banks, and the taxpayers. I have not met anyone willing to wager that, at the end of the day, the S&Ls will be on the hook alone.

I do not want you to get the wrong idea, however. The S&Ls of today are the survivors of the thrift industry melt-down, and the reason they survived was that they were conservatively managed. They are no more responsible for the failures of S&Ls in the 1980s than are the banks or the taxpayers. Still, the bill must be paid.

Not too long ago, we thought we had plenty of time to deal with the SAIF/FICO problem -- months to craft a solution, years until the situation became critical. That is not the case anymore. We did not factor human creativity into the equation - - particularly how creative the human mind can be when money is at stake. A number of savings institutions have recently decided to take the initiative in determining the deposit insurance premiums they pay, and in doing so they have injected a certain urgency into the search for a solution. As we all know, these SAIF-insured institutions want to create BIF-insured institutions so that they can shift deposits from the higher-cost fund to what may well be the lower-cost fund.

Given my Tennessee upbringing -- and meaning no disrespect to anyone -- I cannot help but call these new BIF-insured institutions the "born-again": compelled by the promise of salvation, the old institution goes through a conversion process, and emerges unstained by the sins of the past, beginning life anew.

Born-again banks -- regardless of whether they hold BIF- insured savings bank charters or national bank charters -- change the terms of the debate.

To date, six SAIF-insured financial institutions have indicated in public their intent to be born again. All together, they hold approximately $80 billion in SAIF-insured deposits. If they convert, how big a problem would this be for SAIF? The SAIF assessment base is approximately $714 billion.

One of the six declared converts is Home Savings of America. Home alone holds $35.5 billion in SAIF-insured deposits. Another is Great Western. Great Western alone holds about $26 billion.

Let us say that all six become born again as BIF-insured institutions -- what are the implications for other BIF-insured institutions? If BIF-insured deposits grow by roughly $80 billion, all the BIF-insured members have to come up with an additional $1 billion in assessments to cover the growth in insured deposits. That is about 4 basis points added onto the premium for BIF members for one year -- and many other SAIF members are considering whether to follow suit and become born again, as well. If Home alone converts, BIF assessments go up about $440 million.

If conversion really takes off, what are the implications for the SAIF-insured institutions that do not convert? The Government Accounting Office recently noted that the SAIF assessment base available to pay FICO bond interest is about $500 billion. If the assessment base shrinks to about $325 million, the FICO obligation becomes a problem. In fact, there is no question that FICO bonds will run into debt service problems -- even without the born-again banks -- the only question is when.

I agree with Frank Newman, Deputy Secretary of the Treasury, who on Monday said that Congress should not try to block SAIF-insured institutions from chartering BIF-insured institutions. When there is money at stake, the market -- creative people -- will erode or undermine or bypass every artificial barrier we can construct. Rather than block the exits, we need to address the underlying problem. There is an alternative to conversion -- it is called redemption. We have to find a way to redeem the SAIF so that the members have reason to stay, not reason to flee.

At the FDIC, we want a SAIF that is just as sound and strong as the BIF. At the FDIC, we are open to suggestions on how to fix SAIF. We can fix it now or we can fix it later, but one way or the other, it will have to be fixed.

As I noted before, a wide range of proposals has been made to fix the SAIF's problems. All require legislation by Congress; some require Congressional appropriations. Within these proposals, there are three broad themes: one, have commercial banks shoulder some of the burden; two, have the government shoulder some of the burden; and three, have SAIF members pay a special assessment. There are many combinations and variations on these themes. If you are interested in the details and have not done so already, I suggest you read the GAO's recent report titled: Deposit Insurance Funds.

In reviewing the options, I remember those times in grammar school when we would take a multiple choice test and none of the answers to a problem seemed quite right. If we do not choose the correct answer, however, the SAIF/FICO problem will just come back. In fact, it will not even go away, though it may appear to do so for a while.

I have urged all the parties with an interest in this matter to be a part of the search for a fair and equitable solution. If the interested parties do not develop a solution of their own, they may have one imposed upon them.

As part of the search for a fair and equitable solution, the FDIC Board of Directors on Friday will hold an unprecedented public meeting on the issues related to premium proposals for BIF and SAIF. All I can say

at this point is that we are analyzing the options -- costing them out. We do not have a solution -- we have not made any final decisions -- we are leaving the door open.

By happy coincidence, Friday is also Saint Patrick's Day. Numerous legends are told of his miraculous powers. Perhaps the best known tradition is that he cleared Ireland of its vermin. A story goes that one old serpent resisted him, so Saint Patrick made a box and invited the serpent to enter it. The serpent objected, saying that it was too small; but Saint Patrick insisted it was large enough to be comfortable. Eventually the serpent got in to prove it was too small, whereupon Saint Patrick slammed down the lid and cast the box into the sea. Through debate and deliberation -- a serious effort to find a solution - - I am sure that we too can find a means to deal with the serpent we are wrestling with.

Thank you.

Last Updated 6/28/1999