Remarks by
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I grew up in Smyrna, Tennessee -- southeast of Nashville -- and down the road a piece from Murfreesboro -- home of Middle Tennessee State University -- a town of about 50,000 people now, but one that was smaller when I was growing up. If you were among my neighbors back then and you wanted a home mortgage, you went to Murfreesboro Federal Savings and Loan -- one of hundreds of Federal S&L's created in the mid-1930s after Congress passed the Home Owners Loan Act. In fact, from the beginning of 1934 to mid-1935 -- hardly a boom time for any other business -- nearly 450 new federal savings and loan associations were chartered -- and more than 300 state-chartered institutions were converted. At that time, the newly created Federal Home Loan Bank Board actively promoted the formation of new federal S&Ls by having its employees go from town to town to persuade local businesspeople to organize new institutions.

Murfreesboro Federal grew along with the town. Reflecting some of the changes your industry has gone through, it is now known as Cavalry Banking -- A Federal Savings Bank. Ed Loughry, Cavalry Banking's President and CEO, is here today. I have it on good information that Cavalry Banking is still working to build Murfreesboro.

When I think of the Savings Association Insurance Fund, I think of institutions like Cavalry Banking.

Of course, I also think of institutions like Great Western and Home Savings, too, and after the last two weeks or so, I must say I am thinking about them a lot -- as I have told Jim Montgomery and Charlie Rinehart.

As I have said on a number of earlier occasions, the thrift industry has a problem capitalizing SAIF and a SAIF problem is a problem for the Federal Deposit Insurance Corporation. In other words, it is not your problem, it is our problem.

No one understands that problem better than you do.

Put simply, the past still haunts the savings and loan industry like the family curse haunts the characters in a Southern gothic novel -- part of my literary heritage. Forty-five cents out of every dollar that flows into the SAIF flows out to service bonds that paid

for thrift failures in the mid-1980s before the creation of the Resolution Trust Corporation.

As I have said before -- and will say again -- if you have ever tried to fill a bucket with a big hole in its side, you know what I am talking about.

This drain from the SAIF -- to continue the metaphor -- to meet payments on Financing Corporation or "FICO" bonds -- totals $779 million a year. The FICO obligation is the major current obstacle to the capitalization of SAIF.

There were two other obstacles in the past as well. From 1989 through 1992, the Federal Savings and Loan Insurance Corporation Resolution Fund and the Resolution Funding Corporation drained SAIF revenues. Together, the three obligations -- FICO, REFCORP and FRF -- absorbed 95 percent of total SAIF assessment revenue in those years -- about $5.7 billion.

Without those three diversions syphoning-off revenues, the SAIF would have fully capitalized last year. Without FICO alone, it would have fully capitalized in 1997, based on the latest numbers, including data from the fourth quarter. Instead, today it is grossly undercapitalized.

The SAIF -- as of year-end 1994 -- had $1.9 billion in reserves. It needs approximately $6.7 billion to be fully capitalized at $8.6 billion -- the level of $1.25 for every $100 in insured deposits set by law. In setting a $1.25 reserve target, Congress implicitly recognized that $1.9 billion is not enough to ensure a sound SAIF.

While the thrift industry is now relatively healthy -- as Jonathan Fiechter, acting director of the Office of Thrift Supervision, pointed out just last week -- the law requires thrift resolutions after July 1st to be borne by the SAIF. One large thrift failure -- or a significant downturn in the economy leading to higher than anticipated losses -- could render the SAIF insolvent. The safety cushion is simply too thin. The FDIC must be concerned when one of its insurance funds is undercapitalized. Add to the problem the fact that a third of the income flowing into SAIF cannot be used to service the FICO obligation. The law created two types of institutions whose SAIF assessments cannot be used to meet FICO interest payments -- so-called Oakar and Sasser institutions. Because neither is both a savings association and a SAIF member, the law says their SAIF premiums cannot go toward the FICO obligation.

If things remain much as they have been in recent years, the SAIF has been projected to capitalize in 2002. You know and I know, however, that the assumptions under which that projection was made are not now likely to come to pass -- and, in fact, these assumptions were a baseline analysis against which alternative assumptions could be measured, not predictions of certainty.

One thing is certain, however: the FICO obligation will run into debt service problems. It is a question of when, not a question of whether. This is true regardless of whether the

entire SAIF assessment base were available to meet the FICO obligation or only part of the base. Debt service problem on FICO bonds will come much sooner without assessments from Oakar and Sasser institutions. In fact, we have just now analyzed the fourth quarter 1994 numbers, and they show that during all of 1994 Oakar deposits jumped from $139.8 billion to 180.2 billion. While at the end of the third quarter, 1994, Oakar institutions held 23 percent of the SAIF assessment base, at the end of the fourth quarter, they held 25.2 percent. Sasser institutions continued to represent 7.4 percent of the base.

With 33 percent -- a third -- of the SAIF-insured deposit base unavailable to meet FICO obligations and with the deposit base shrinking at 2 percent annually -- the average rate in recent years -- there are likely to be debt service problems as early as 2005. If the base shrinks at 4 percent, the problems hit in 2001. At 6 percent, they hit in 1999. At 8 percent, they hit in 1998.

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. SAIF can be fixed now -- or it can be fixed later -- but it must be fixed.

Let me suggest, however, that there is a certain urgency in the matter. We may soon see Bank Insurance Fund-insured institutions created to receive deposits from savings institutions so that the insurance coverage of those deposits could shift from SAIF to the BIF. The motive behind creating these institutions, of course, is to enjoy the lower insurance premiums that may apply to BIF institutions later this year, if the FDIC Board votes a lower premium rate for BIF-insured institutions. As you know, if current conditions continue, we expect BIF to recapitalize at the 1.25 target ratio sometime around mid-summer. When that happens -- for reasons I will discuss briefly -- the FDIC believes that it is compelled by law to lower BIF premiums.

First, by law, we must set BIF and SAIF premiums "independently." While the SAIF has a long way to go to capitalize -- BIF is almost recapitalized at the level mandated by Congress. SAIF has a draw from FICO obligations -- BIF is free from those types of problems. SAIF's assessment base has shrunk; BIF's generally has remained more stable. By law, however, none of these differences can be taken into account when we set BIF premiums. Second -- by law -- we are required to manage BIF so that we maintain the fund at the 1.25 target ratio or we are required to identify explicitly the conditions in BIF institutions or the banking industry that require us to reserve at a materially higher level.

This is likely to create a premium differential -- and everyone has recognized that for some time -- certainly since last year. Without question, a differential creates difficulties for SAIF- insured institutions.

Both the law and common sense argue against keeping BIF-insured institutions paying current premium rates -- which add up to about $6 billion a year for the BIF-insured --

until SAIF is capitalized simply to avoid a differential.

So what happens if the idea of transferring SAIF-insured deposits to BIF-insured institutions really takes off?

Those of you left in SAIF would still have to meet the FICO obligation and you would still have the responsibility of replenishing the fund.

I note that in the General Accounting Office report on the deposit insurance funds that was issued just over a week ago, the GAO states: "At December 31, 1994, SAIF's assessment base available to pay FICO bond interest was about $500 billion. Given the current assessment rate of 24 basis points, that base could shrink to about $325 billion before premium rates would need to be raised to meet the FICO obligation."

Some of you, I am sure, know my Deputy for Policy, Leslie Woolley. Leslie is from Oklahoma. She recently reminded me of a story concerning another Oklahoman, Will Rogers. The cause of U.S. entry into World War One -- they used to tell us in high school -- was German submarines sinking U.S. ships. Just before the U.S. declared war, a newspaper reporter asked Will Rogers how he would handle the problem.

"It's simple," he replied, "I'd drain the water from the oceans and send the U.S. cavalry out to round-up the submarine crews."

"Great," said the reporter, "and how would you drain the oceans?"

Rogers replied: "Don't ask me, I'm in policy, not operations."

It is easy to develop policy in the abstract and in a vacuum -- we can always come up with simple and compelling answers that will not work. It is coming up with an answer in the messy real world -- the world in which Cavalry Banking does business -- that is difficult.

Further, the SAIF/FICO problem illustrates the difficulties that arise when you premise a solution on assumptions and the assumptions later go awry. Of course, when facing an uncertain future, the best we can do is make assumptions that are logical and reasonable.

A number of policy prescriptions have been proposed to deal with the SAIF/FICO problem. On the surface, some may appear feasible, but they all carry with them disadvantages as well as advantages -- and all would require legislation by Congress.

Basically, they all look to three groups to pay for the problem, either separately or in combination. Those groups are the savings associations, the commercial banks, and the taxpayers.

Several proposals require tapping the commercial banking industry for funds to service

the FICO obligation -- including a proposal that this organization supports. On this point, the GAO report I mentioned earlier notes: "Arguments have been made that any option that involves the banking industry contributing to service the FICO interest obligation is unfair to the industry. These arguments contend that the FICO obligation was incurred during the thrift crisis of the 1980s and, as such, is an obligation of the thrift industry. However, there are also arguments that those thrift institutions that comprise today's thrift industry still exist because they are healthy, well-managed institutions that avoided the mistakes made by many thrifts in the 1970s and 1980s that ultimately led to the thrift debacle. As such, they argue, they should be no more responsible for the FICO interest burden than the banking industry."

I agree wholeheartedly with that statement in the GAO report. The banks and thrifts of today did not cause the S&L crisis. In fact, we can all agree on this point -- and we are still left with the question: What do we do about the FICO problem and an undercapitalized SAIF?

Another proposal is to make Oakar and Sasser assessment revenue available to meet FICO obligations. That approach would slow capitalization of the SAIF, however, without solving the fundamental problem. FICO bonds will run into debt service problems regardless.

The FDIC's goal is for SAIF-insured institutions to have as strong and as solid an insurance system as banks enjoy as soon as feasible.

Another proposal is to use Treasury funds appropriated for the RTC to remove the FICO obligation.

The RTC could have $9 to 12 billion in unused loss funds after resolving all institutions for which it is responsible, depending on its actual recoveries from resolutions and on the quantity of assets that will be transferred to the FDIC's FSLIC Resolution Fund. At present, SAIF's use of RTC funding is subject to significant legal restrictions. The Congress could pass legislation removing those restrictions and make the funds available to capitalize SAIF or to resolve future thrift failures for a period of time after July 1st. There is, however, significant opposition in the Congress to using taxpayer funds to address the problem.

There are a number of variations on the proposal I have described, which raise similar issues.

Another group of proposals would be for Congress to appropriate new funds to capitalize SAIF, pay the FICO obligation, or both. According to the GAO, SAIF would require approximately $14.4 billion at the end of 1995 in order to reach its reserve ratio and fund its future FICO obligation.

Finally, there is the proposal for SAIF members to pay a premium to capitalize the SAIF quickly -- the special assessment option -- with a number of variations.

In reviewing these 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, of course 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 other parties with an interest in this matter to be a part of the search for a fair and equitable solution.

This Friday -- Saint Patrick's Day -- the FDIC Board of Directors will have an unprecedented public meeting on these and other issues related to proposals to set premiums for BIF and SAIF. America's Community Bankers is scheduled to testify at that hearing. Tradition tells us that Saint Patrick -- the patron saint of Ireland -- was not Irish -- he was a Romanized Briton. The Irish, in fact, kidnapped him as a lad and kept him six years in slavery. Yet, after he escaped home and grew to adulthood, he returned to Ireland because he thought it was the right thing to do. He wanted to help his former captors.

I do not expect your witness on Friday to be entirely disinterested -- much less a saint -- no offense, Jim Montgomery -- but my fellow FDIC Board members and I would appreciate it greatly if you were to give us the benefit of your best thinking to help us work through this difficult problem -- a problem that we share.

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 decisions -- we are leaving the door open. While I do not have a recommendation at this time, I do expect to come forward with one, or several.

Thank you.

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