Remarks By
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America's banks today enjoy their strongest capital levels in thirty years. In recent years, America's banks have repeatedly experienced earnings records. In the last four years, America's banks have largely rebuilt the Bank Insurance Fund.

We at the Federal Deposit Insurance Corporation can say with pride that no bank depositor has lost a penny of insured money and that no U.S. taxpayer has paid a single cent for this depositor protection.

We can say that because you -- the banking industry -- paid for that protection. I congratulate you on your accomplishments.

It is a special pleasure for me to address the Independent Bankers Association of America. Most of the 7,000 institutions the Federal Deposit Insurance Corporation directly supervises are community banks -- banks like the Cascade Community Bank of Auburn, in Washington state; or the Farmers & Merchants Bank, Tomah, Wisconsin; or the First City Bank in my hometown, Murfreesboro, Tennessee.

Indeed, historians have written that the FDIC was created sixty-one years ago to assure the survival of the small, community-oriented bank at a time when many of the most powerful people in the country advocated giant, national organizations as the answer to the banking crisis of the early 1930s.

There is no question that the link between the FDIC and the community bank is a strong and enduring one -- and one that goes back to the FDIC's beginning.

Marriner Eccles, the chairman of the Federal Reserve Board in the 1930s, was no fan of small banks nor of the FDIC. He was, however, widely acknowledged for his intellectual honesty.

In his memoirs, he wrote that the banks the FDIC supervises held a special place in the heart of President Franklin Delano Roosevelt.

Eccles wrote disapprovingly that, in President Roosevelt's view, "the state nonmember banks represented the small, democratically controlled institutions, responsive to local needs, with officers who had the welfare of the homefolks at heart."

In my personal experience, that was certainly true.

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, where we then lived -- down the road a piece -- as we used to say -- from Murfreesboro. 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 -- far from it -- but this banker had the welfare of all his customers, including me, at heart.

That was what community banking was about then.

This is what community banking is about today.

I am not here today, however, to discuss my memories -- however fondly I hold them. Rather, I want to talk about some of the things going on back in Washington -- which has been described as America's largest theme park, where the line between reality and fantasy is sometimes blurred -- often on purpose.

As you know, the FDIC board two weeks ago proposed significantly lowering deposit insurance premiums for banks. Sometime around mid-year, the bank insurance fund will be recapitalized at the level mandated by Congress. By that point, the banks will have built up a reserve of nearly $25 billion.

Sometime around mid-year, we will reach the target the law requires of $1.25 in reserves for every $100 in insured deposits.

The FDIC will not know that goal has been reached when the event occurs because we rely on the call reports you file with us to determine insured deposit levels.

When the goal is reached, however, the time will come to lift the cost and burden on banking from historically high insurance premiums. This cost affects not only banks but also the customers they serve.

Under the FDIC's proposal, premiums would drop significantly for nine-out-of-ten banks in the country. For the banking industry as a whole, assessments would fall from about $6 billion a year to $1.1 billion.

We would still base premiums on the risk that individual institutions pose to the bank insurance fund. We believe the law requires us to do that.

We would try to set assessments in order to maintain the 1.25 target. We believe the law requires us to do that, too.

The $1.1 billion from assessments combined with investment income on the fund would enable us to maintain the target, taking into account projected losses to the fund.

All in all, we are taking a reasonable, cautious approach. The FDIC's proposal rewards good bank management and provides incentives for less than first-rate performers to improve by expanding the premium range from 4 to 31 basis points. This approach is more reflective of losses to the insurance fund and fairer to those institutions that maintain high standards.

The response to the FDIC's proposal has not been uniformly positive. Some banks say 4 basis points is still too high a charge for deposit insurance for the best banks because losses to the Bank Insurance Fund were so low last year. Thrifts insured by the SAIF complain that the FDIC board does not propose lowering the SAIF premiums and they, therefore, will be competitively disadvantaged. Reconciling the competing interests Is not easy, but the law quite explicitly requires the FDIC to set BIF and SAIF premiums independently.

The savings association insurance fund is much farther away from achieving the target of 1.25 in reserves than the BIF is. SAIF stands at about $1.8 billion -- more than $6.8 billion short of the $8.6 billion it needs to capitalize fully.

Assuming modest insurance losses and a decline in thrift deposits over the next few years, SAIF is expected to reach its target in the year 2002, if SAIF-insured institutions continue to pay premium rates at about the same level as they do now.

Some thrift industry executives argue that the public interest requires that no differential exist between BIF and SAIF premiums. That could conceivably mean that bankers would continue to pay somewhere in the neighborhood of $6 billion a year into the BIF until the SAIF recapitalizes in the year 2002 -- or $42 billion more than the $25 billion the BIF will have at mid-year.

Let us look at the facts calmly.

First of all, eighty-six percent of SAIF-members are rated well-capitalized and best-managed -- not too far off from the 91 percent of banks rated at the top of the assessment scale.

Secondly, there is a 1960s mentality at work here in the argument that the BIF premiums should not be lowered until SAIF premiums can be lowered. The argument assumes that banks and savings and loans are close competitors out to serve the same customers -- and that they are the only competitors serving those customers. Therefore, what is good for banks has to be bad for thrifts, and what is bad for banks has to be good for the thrifts -- or so the analysis goes. We all remember the Regulation Q interest rate differential.

The problem with the argument is that the world has changed a great deal since the 1960s. We are not faced with a zero-sum game of "banks win, thrifts lose."

The situation is far more complex than that.

Banks and savings and loans have a host of competitors. Banks and savings and loans can -- if they choose to do so -- segment their markets -- seek market niches. Further, neither banks nor thrifts are monopolistic public utilities. Tens of millions of Americans routinely bypass banks and thrift institutions Altogether, but still have their financial needs met.

As we all know, the market is highly sensitive to competitive advantages and disadvantages. So how did the market react in the first week after the FDIC proposed the new premium schedules for banks? The value of publicly traded SAIF-insured institutions rose 5.9 percent, while the value of publicly traded BIF-insured Institutions rose 3.3 percent. The Dow Jones average over that week rose 2.7 percent.

Having said all that, however, I must note that the thrifts do have a problem in capitalizing the SAIF -- and a SAIF problem is an FDIC problem. As insurer, we have to be concerned that the SAIF is undercapitalized. The answer to the problem is not to disadvantage the banking system. The answer is to build an insurance fund for the thrifts that is just as strong and solid as the fund the banks enjoy.

That is not easy.

The past still haunts the savings and loan industry, and particularly the SAIF. Forty-five cents out of every dollar that flows into the SAIF flows out to service bonds that paid for thrift failures before the creation of the Resolution Trust Corporation. If you have ever tried to fill a bucket with a big hole in its side, you know what I am talking about.

This draw on the SAIF -- to meet payments on financing corporation or "FICO" bonds, as they are called -- totals $779 million a year. This FICO obligation is the major obstacle to the capitalization of SAIF.

This is not a new issue. Eighteen months ago, FDIC acting chairman Skip Hove wrote Congress warning that the FICO obligation created a structural problem in the capitalization of the SAIF.

If there had never been a FICO obligation, the SAIF would capitalize in 1996. If the FICO obligation were removed today and we maintained today's premiums, the SAIF would recapitalize In 1998. After that, a significant differential would be much less likely between BIF and SAIF assessment rates.

Thrift institution executives have told me that if the FICO obligation were lifted from them, they could live with the premium differential for the three years it would take the SAIF to capitalize.

Simply put, I agree with Jonathan Fiechter, acting director of the Office of Thrift Supervision, that the SAIF problem is a FICO problem.

Keep in mind that the assessment base available to SAIF to meet FICO obligations has been shrinking, although the shrinkage has slowed considerably in the last year.

Why?

The law created two types of institutions whose SAIF assessments cannot be used to meet FICO interest payments -- so-called Oakar and Sasser institutions -- and over time the number of these institutions has grown. Together, Oakar and Sasser institutions represent 30 percent of the SAIF assessment base. The remaining 70 percent of the assessment base is responsible for the FICO obligation.

Over the last two years, the rate of shrinkage in the assessment base available to meet the FICO obligation has slowed. The base shrank by only 1.8 percent in the first three quarters of 1994, compared to the record high rate of 7.6 percent in 1990. The current experience explains why FDIC economists project a 2 percent per year shrinkage rate going forward.

The FDIC research and statistics division has stress-tested SAIF under a variety of conditions, including the growth or shrinkage of thrift deposits, the percentage of thrift industry deposits held by Oakar and Sasser institutions, and projected thrift failures measured by assets.

Here are some of the economists' findings:

If the deposit base shrinks 2 percent per year, the FICO bonds can be serviced well into the second decade of the twenty-first century. If the base shrinks substantially more, then servicing the FICO bonds could be a problem earlier, perhaps before the Year 2000.

If the Oakar and Sasser portion of SAIF continues to grow, it will become increasingly difficult to make FICO interest payments from current SAIF assessment revenues. This would be true regardless of a BIF-SAIF premium differential.

In contrast, if thrift deposits were to grow dramatically, it would not significantly change the time it takes for SAIF to capitalize. Changes in troubled assets and interest rates would have far greater effect on the condition of the SAIF than changes in the growth of the deposit base would.

If a 20 basis point -- to use a round number -- differential exists between BIF and SAIF assessment rates and we return to the interest rates and asset quality conditions of the early 1990s, it is projected that assets at failed SAIF-member institutions could increase as much as $2 billion over five years.

While these are not insignificant numbers, they are still manageable for the SAIF at current 85 percent recovery rates on failed assets.

The FDIC research division expects to release the results of its analysis this week.
In setting a 1.25 target, congress recognized that $1.8 billion is not enough to ensure a sound SAIF -- one with a large cushion to absorb the costs of thrift failures. The failure of a single large institution or an economic downturn leading to higher than anticipated losses could render the fund insolvent.

This is true regardless of whether there is a BIF-SAIF premium differential.
It is clear that the SAIF's problem is not a premium differential between SAIF and BIF. The SAIF's problem is meeting its FICO obligation -- regardless of whether a differential exists.

What is to be done?

A number of proposals have been advanced.

One 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. The FDIC's goal is recapitalization of the SAIF as soon as feasible.

Another proposal is to use Treasury funds appropriated for the RTC to remove the FICO obligation. This could be done by changing an interpretation of the Congressional Budget Office and by legislation.

A third proposal is for BIF and SAIF to share the obligation 50/50.

Finally, there has been talk of merging the funds.

One does not need a crystal ball to see that bankers have a vital interest in assuring that a reasonable and fair solution emerges to the FICO problem. I urge you to be a part of the dialogue.

Some elements of the banking industry believe that if they ignore the problem, it will go away. That mentality is wrong-headed.

It reminds me of the general in the civil war who inspired his troops by ignoring enemy fire. The general's last words were: "Don't worry, lads, those fellows couldn't hit the broad side of a barn at this . . ." There sadly his words ended.

No -- recognize your exposure.

The FDIC's proposals on BIF and SAIF premiums are out for public comment. I urge all of you to give us your views. All comments will be considered carefully and thoroughly before the Board takes final action.

The health and stability of the financial industry is in the interest of all who are a part of it -- participants as well as regulators -- banks as well as thrifts. Nothing else contributes more to that stability than sound insurance funds.

Thank you.

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