Remarks by
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Thank you and good afternoon.

I want to start with a fact that is sometimes overlooked in public discussion: The money in the Bank Insurance Fund (BIF) belongs to the banking industry. The FDIC manages the Fund in trust. The Fund is the product of premium assessments on banks and investment income from those assessments. We at the FDIC 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. You -- the banking industry -- have paid for it.

In the last several years, you have paid -- by any standard -- a high price. From 1991 through 1994, you paid from $5 to $6 billion a year in assessments. Given this extraordinary inflow of assessment income -- and record earnings in banking, rather than continued record losses as some people predicted -- the BIF will reach $1.25 in reserves for every $100 in deposits sometime around mid-year. At recapitalization, the FDIC will have a $25 billion reserve to deal with unforeseen losses. Not too many years ago, we thought that the fund would not hit the Congressionally-mandated 1.25 ratio until the year 2002.

As a result of the very fast recapitalization of the Bank Insurance Fund, relief from the burden of historically high premiums is in sight for almost all banks -- and for nine-out-of- ten banks, that relief is substantial. As you know, on Tuesday, the FDIC Board agreed to propose for comment a new premium rate schedule. Under that schedule, the best capitalized banks in the system -- 9,780 banks out of 10,778 BIF-insured institutions, or 91 percent of the total -- would see their assessment rates reduced from the current 23 basis points to 4 basis points. That is an 83 percent reduction.
The next largest group -- those institutions that are well- capitalized but reflect somewhat greater supervisory risk -- would see their premiums drop from 23 basis points to 7 basis points. These BIF-insured institutions number 639 -- about 6 percent of the total.

In fact, eight of our nine assessment groups -- a range that runs from best-capitalized, best managed to worst-capitalized, worst-managed -- would experience some premium reduction. Only the worst-capitalized, worst-managed institutions -- those in the lowest group -- would see their assessments stay the same. Today, they number 33 out of

10,778 institutions. Every other bank would see a reduction in rates.

We estimate that -- as a result of lower assessment costs -- industry expenses will drop by more than $4.5 billion per year and industry profits -- after taxes -- will rise more than $3 billion a year.

Let me be clear, this is no "windfall" for the industry -- quite the contrary! In the last four years, the need to recapitalize the Bank Insurance Fund has made extraordinary demands on your operating income. When the recapitalization of BIF is accomplished, there will be no need to impose such extraordinary costs.

Insurance losses are projected to be $130 million during the second half of 1995, and operating expenses are projected to be approximately $260 million. Investment income is expected to approach $500 million for the second half of the year, and it alone should suffice to cover these obligations in that period.

That being the case, why did we propose a 4 basis point premium for the best banks? What is the magic in 4 basis points?

There is no magic, but there is some reason, to set the rate somewhere near 4 basis points for the best banks.

For about half of our existence, the effective assessment rate for FDIC insurance was less than 4 basis points. Experience showed that this was not enough. In the period 1981-93, the Bank Insurance Fund's losses averaged 16 basis points.

Add to this experience several prudential concerns going forward: one, banks face increasing competition; two, rapid financial innovation increases risk-taking; and, three, interest rates and other prices are increasingly variable, in part due to the globalization of markets. Given these concerns, it is unlikely that the loss experience in the banking industry will revert to that which we knew before 1980. Indeed, the average yearly loss as a percentage of deposits may be greater than the 60-year average, with large changes from year to year.

We believe that we need an average assessment rate of 4 to 5 basis points to maintain the BIF reserve ratio at 1.25. When you take into account the higher premiums for riskier institutions, we would experience an average assessment rate of 4.5 basis points -- which would produce approximately $1.1 billion of annual revenue in the short run.

Prudence also requires us to be able to change assessment rates as conditions change. The FDIC Board now has the discretion to set deposit insurance assessment rates semi- annually. We are proposing to increase or decrease the assessment schedule -- across the board -- by up to 5 basis points without going through an additional notice and comment rulemaking process.

Prudential concerns -- and the law -- require us to take into account potential risks to the

Bank Insurance Fund from those institutions that are less well-managed and less well-capitalized than the best. As you know, Congress instructed the FDIC to set our insurance premiums to reflect the risk that individual banks pose to the insurance fund. Strong banks should not subsidize weak ones. Risk-based premiums are a way to maintain a strong insurance fund that is prepared to handle losses. It is also a way to influence behavior by rewarding well-run institutions and encouraging weak ones to improve. As the Fund nears recapitalization, we must decide just how great the spread in premiums should be to reflect the risks of less well-capitalized and less well-managed institutions and to motivate the managements of those institutions to improve their financial conditions.

Today, there is an 8-basis-point spread between the premiums the best banks pay and the premiums the worst banks pay. As you know, there are 9 gradations in that range.

Bankers and banking scholars have criticized the 8 point spread for being too narrow. In fact, when the FDIC Board proposed the current risk-based premium system for comment in 1992, it asked whether the 8-basis-point system should be widened. Three-out-of-four commenters on this issue favored a wider spread. At that time, the health of the banking industry did not permit a wider spread.

We are now proposing to widen the range to 27 basis points -- a range from 4 basis points for the best banks to 31 basis points for the worst banks. Note that 31 basis points is no greater than the premium that the least well-capitalized and least-well managed banks pay now.

Today, well-capitalized banks pay 23, 26, or 29 basis points in premiums, depending upon the supervisory risks they present; adequately capitalized banks pay 26, 29, or 30 basis points; and under-capitalized banks pay 29, 30, or 31 basis points.

Under our proposal, well-capitalized banks would pay 4 basis points, 7 basis points, or 21 basis points, depending upon the risks they present; adequately-capitalized banks would pay 7 basis points, 14 basis points, or 28 basis points; and undercapitalized banks would pay 14 basis points, 28 basis points or 31 basis points. These premiums are large enough to be a real incentive for banks to improve their condition. We crafted the proposal carefully so that the risk-based premiums would not cause more problems than they would resolve. All in all, this range would allow the FDIC to function more like an insurance company. You probably noted that the further away from the best-capitalized, best-managed institutions you go, the larger the differences between the rates become, with a compression of rates in the two lowest categories. That approach makes sense: the empirical evidence shows that the less capital and managerial direction an institution has, the more likely it is to fail and to cost the BIF money. It is a matter of actuarial fairness.

I want to discuss one other area of Bank Insurance Fund financing with you: investment income. In the last several years, with the emphasis on assessment income, the important contribution of investment income to the growth of the Fund has been forgotten. In fact, in the years 1934 to 1993, income from investments and other sources totalled about 40 percent, while income from assessments totalled about 60 percent. In the period 1981 through 1989, investment income totalled $14.5 billion, while assessment income totalled just $13 billion. The Fund enjoyed almost $2 billion in investment income in 1985 alone. In light of the events of the late 1980s and early 1990s, the Fund's investment income insulated the U.S. taxpayer from the costs of bank failures. As interest rates rise and the Fund becomes more liquid, our investment income is likely to grow.

Before I close, I want to discuss one other issue with you briefly: replenishing the Savings Association Insurance Fund (SAIF). As you know, the FDIC Board on Tuesday also proposed retaining the existing assessment rate schedule for SAIF.

A substantial premium differential between BIF-insured and SAIF-insured institutions is likely to have an impact -- and FDIC Board members know that. The law, however, requires the FDIC to set BIF and SAIF premium rates independently -- and that is what we are doing. Media reports yesterday accurately described reaction in the thrift industry.

I want to stress that the problem will not just go away. The SAIF now has under $2 billion in reserves. It needs approximately $7 billion to be fully capitalized. While the thrift industry is now relatively healthy, keep in mind that the law requires future thrift resolutions to be borne by the SAIF.

Also keep in mind that almost half of the revenue flowing into SAIF is dedicated to paying off obligations left over from an attempt to clean-up the thrift industry before the creation of the Resolution Trust Corporation (RTC). That draw on the SAIF -- to service bonds issued by the Financing Corporation, known as "FICO" bonds -- is about $780 million a year. If you have ever tried to fill a bucket with a big hole in the side, you see the problem here. This draw on SAIF is the major reason the SAIF is not likely to be recapitalized until 2002.

The insurance system for the savings and loan industry may no longer be broken, but it still needs fixing.

In medieval Europe, merchants sometimes adopted a style of living considerably below the style they could afford. The reason was not the habit of thrift -- the reason was to avoid drawing the attention of the count, the duke, and the king to the merchant's wealth -- that is, to avoid being taxed. Governments in all places and at all time have needs that must be funded.

Banking has repeatedly reported record earnings. Banking has an insurance fund projected to reach $25 billion in a matter of months. Banking is looking at a proposed 83 percent reduction in insurance premiums, which, as I noted before, can translate into more than $3 billion in after tax profit.

Other people -- especially your counterparts in the thrift industry -- are not unaware of your good fortune.

If I were a banker, I would not close my eyes to the SAIF problems and hope they magically disappear. I would involve myself in working with all the interested parties to make sure that the inevitable solution is both effective and fair.

In closing, every new Chairman of the Federal Deposit Insurance Corporation looks forward to addressing the New York State Bankers for the first time. The insurance of bank obligations began here with the first state-sponsored insurance plan in 1829. The creation of the New York plan was a recognition by bankers here that they may have been in different boats, but they were all afloat on the same lake, and that whatever affected one affected all. It took more than a century -- and a banking catastrophe -- for bankers throughout the rest of the country to come to the same conclusion -- but New Yorkers then, like New Yorkers now, took pride in being first.

For the last four years, FDIC insurance premiums have been major operating expenses for the industry. For the best banks, that will soon no longer be true. These banks will be able to compete more effectively in the domestic and global financial marketplaces -- and that will benefit U.S. businesses, the U.S. economy and all of us.

I am sure that New York banks will be among the first to take advantage of the new competitive opportunities that will arise. As you take advantage of these opportunities, I urge you to make use of controls that will allow you to monitor and limit, where necessary, your risks. The FDIC wants to work with you to assure the health of your institutions, the continued soundness of the Bank Insurance Fund, and the strength of the financial system.

New Yorkers always seem to take advantage of business opportunities. There was a little story in the newspaper not too long ago about a teacher in a grammar school upstate who told the class that "Anybody in this room could grow up and become President of the United States. You all have a chance."

Half the students in the class tried to sell the teacher an option on theirs.

Thank you -- it has been a pleasure.

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