Remarks
by
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Good morning -- it is a pleasure to be with you here in Chicago.

I am pleased to participate in the upcoming panel moderated by Bill Fitzgerald. Skip Hove -- the FDIC's Vice Chair, a lifelong community banker and Bill's fellow Nebraskan -- tells me that Ellen and I are in good hands.

I am also pleased to be here with my colleague -- OTS Director and FDIC Board member Ellen Seidman. As Chairman, I can tell you firsthand how much Ellen brings to the Board. Intellectually alert and analytical, articulate, dynamic and opinionated -- she is a source of strength on our Board.

As I prepared for this convention, I could not help but reflect on how much has changed since I was a state regulator for thrift institutions in the 1980s. Even the smallest institution today must operate in a global financial marketplace. We have truly national financial institutions today -- institutions that operate throughout the United States.

And financial modernization is less and less about the promise of tomorrow and more and more about opportunities and the brutal reality of competition today.

We are also still enjoying a seven-year economic expansion, but this is no time for complacency. As of mid-year, there were only 64 commercial banks and 18 thrift institutions on the FDIC's problem list, compared to the almost 1,500 that were on the list in 1990. The Bank Insurance Fund has a record balance of $28.9 billion and the Savings Association Insurance Fund has a balance of $9.6 billion.

Today, 92 percent of the members of the Savings Association Insurance Fund are in the best capitalized and best managed category of institutions in our risk-based premium system. That means that 1,354 institutions pay no premiums into the SAIF for insurance coverage.

Today, 95 percent of the members of the Bank Insurance Fund are in the best or "1A" category. That means that 8,808 institutions pay no premiums into the BIF.

In recognition of the strong financial condition of the banking industry, the FDIC Board of Directors last week voted to maintain the current assessment rates for both funds during the first half of next year.

With that background on the funds, I want to talk with you briefly about three issues involving deposit insurance:The first issue deals with the FDIC's effort to refine the risk-based premium system. The second is the Savings Association Insurance Fund special reserve.

And the third is preparing computer systems for the Year 2000 date change.

Let's turn first to the refinement in premiums.

As you know, the reasoning behind our system of risk-based premiums is simple -- and fair: The greater the risk that an institution poses to the deposit insurance funds, the higher the premium it should have to pay. Of course, the smaller the risk an institution poses, the lower the premium it should have to pay.

Not only is this fair, there are also policy considerations to risk-adjusted deposit insurance premiums. Risk-based assessments provide a financial institution with a modest financial incentive to avoid taking on undue risk. And they thereby lessen the moral hazard that is created when we provide a safety net for our banking system.

How sensitive to risk should deposit insurance premiums be? As sensitive as practical.

I noted several weeks ago that, despite concerns about increasing risk in banking, there has been no increase in the percentage of institutions classified into the riskier categories of our premium system, and I announced that I have asked the FDIC staff to look into a number of possible explanations, including this one:

Are supervisors identifying institutions whose condition is good, but whose practices make them "outliers" in terms of underwriting, concentration of risk, or undisciplined growth?

If these institutions are being identified, they should be asked to pay -- through deposit insurance premiums -- for the risks they pose to the rest of you.

The FDIC is talking with the other regulators to find ways to refine existing procedures to assure that we consider risky practices fully and consistently.

Today I will update you on the preliminary approaches that the FDIC staff is exploring to reconcile risk-adjusted premiums and the greater risks that "outlier" institutions may be taking on.

Specifically, the FDIC is asking the question:

Are there any insured institutions rated 1 or 2 under the CAMELS rating system that warrant a rise in their premiums because their banking practices jeopardize their financial condition?

The FDIC would ask that question for the banks we supervise. And we would ask our colleagues at the other agencies -- the Office of Thrift Supervision, the Federal Reserve, and the Comptroller of the Currency -- that question for the institutions they supervise.

If the answer is "yes," we might reclassify the institution from an "A" to a "B" in our premium matrix, recommend further onsite review, or take no action, depending upon the unique situation at each individual institution. No premium increase would be made unless deficiencies in risk management had been discussed with the management of an institution.

We are also looking at ways to screen institutions so that we can zero in on those most in need of review. One possibility we are exploring is to look first at institutions that have composite CAMELS ratings of 1 or 2 -- and a management component rating of 3 or worse.

Today, there are 333 banks and savings institutions with those ratings out of 10,700 institutions we insure. Of the 333 institutions, 278 are banks and 55 are thrifts. Of the 55 thrifts, 36 are savings and loans and 19 are mutual savings banks.

If we were to use this screen, each one of these institutions would receive a closer look from its primary regulator. Based on what was found, we would decide whether premiums should be raised -- institution by institution. This fine-tuning of premiums would contribute to our common goal of avoiding an excess buildup of risk in the banking system.

I want to stress this morning that we have not made any decisions on these possibilities. Much would depend on the outcome of discussions with our colleagues at the other banking regulatory agencies, with whom we are beginning to discuss these approaches.

Of course, just as I am raising this possible approach with you today, we would inform you and your colleagues of our thinking as it continues to evolve. And we would give insured institutions advance notice of any changes we would make.

The earliest any changes could take place would be the spring of next year. Of course, we may not find any institution that we need to shift to another category. And we are prepared to accept that result.

The second issue I want to discuss with you briefly today is the SAIF special reserve -- a reserve that will total $1.05 billion as of the beginning of the year. We warned that creating this reserve could lead to an unnecessary rise in SAIF insurance premiums. As well as to a differential between BIF and SAIF premiums.

We saw with great clarity the destructive effects of a premium differential a couple of years ago. The FDIC supported repealing the special reserve. There was no opposition to repeal. But many issues were in play and time ran out.

Even though the SAIF special reserve probably will not have any immediate effect, we should still get rid of it. You can be assured that the FDIC will continue working to have it repealed. Of course, if the BIF and SAIF were merged -- as the FDIC has advocated and will continue to advocate -- the issue would be moot.

Finally, the third issue I want to touch upon this morning is Year 2000 readiness. The most recent assessments are encouraging. Nevertheless, there is more to be done: testing systems and contingency planning, the part of the process when problems are most likely to appear.

I want to make several points about banking, Y2K and the FDIC. If a bank or thrift institution should fail because of Year 2000 problems, insured deposits will be covered. No ifs, ands, or buts.

Because of the FDIC, depositors can place their money in an insured account with the assurance that their money is safe. When consumers see the FDIC symbol on your door, they can be confident that the full faith and credit of the U.S. government stand behind the insured money in the bank or thrift.

This is a message that we all should be giving the public. The FDIC has been making this point for months and we want to work with America's Community Bankers to get the message out to depositors.

I appreciate this opportunity to address you for the first time. There are tremendously exciting challenges ahead for all of us. I also am especially glad to address you at this convention where your current Chairman, Neal Mahoney, is a former banker from Hawaii and an individual who has led ACB during a critical period -- and where in the next day or so, a woman becomes Chair of America's Community Bankers for the first time.

I look forward to working closely with Lee Beard -- and with all of you.

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