Remarks by

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I grew up in Smyrna and Murfreesboro, where I witnessed first hand the contribution that banks can make to strengthening the community -- particularly where they work hand-in-hand with local leaders. In small towns, the bankers make things happen -- those things being growth, development, and prosperity.

It tells us something that banks in Murfreesboro are involved in a "Main Street Program" -- a public-private partnership to rebuild the core of the town around one of only six remaining ante-bellum courthouses in Tennessee.

The program sponsors a $5 million low-interest loan pool with local banks -- and to date it has financed 35 of 103 renovations in the program -- not bad for a town of 44,000 people. One of the town's bankers serves on the program's board of directors.

It also tells us something that one thrift in Murfreesboro not only finances housing, working with Habitat for Humanity, its employees have built housing, too. One bank in Murfreesboro sponsors a hotline to help students with their homework. Another banker is working to finance a cultural arts facility for the town. It has been my experience that bankers in Tennessee take the extra step to serve their communities.

It has also been my personal experience that bankers in Tennessee take the extra step to serve their customers. 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. 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.

So -- as always -- it is a personal, as well as a professional, pleasure to be with Tennessee bankers.

The late C. C. Hope -- banker, industry leader, director of the Federal Deposit Insurance Corporation and a good friend to many of us here today -- once told a marvelous story to illustrate the meaning of tenacity.

During the Civil War, or as we say down here, "The War Between the States," the Union ran a prisoner-of-war camp in the wilds of northern Michigan. No one escaped from the camp -- ever. In 1863, one of the prisoners began taunting the guards at every opportunity with the words: "General Bragg sure whupped <u>you boys</u> at Chickamauga" -- the battle having recently occurred.

This went on for several weeks.

The Union colonel who ran the camp tried to ignore the taunting, but it soon had the effect of raising the morale of the prisoners while lowering the morale of the guards -- the last thing in the world the colonel wanted -- so he called the Confederate in and gave him a choice.

If he took the oath of loyalty to the Union, he would be released and transported South.

If he did not, he would spend the duration of the war in solitary confinement.

The Confederate thought hard for a moment and replied: "I'll take the oath."

The Union colonel smiled and administered it.

When it was over, he said to the former-Confederate: "That wasn't so bad, was it?"

"No, sir," was the reply, "it wasn't."

"Permission to speak freely, sir," the former-Confederate requested.

"Permission granted," the Union colonel said kindly.

"Ain't it sad," said the former Confederate, "how General Bragg whupped our boys at Chickamauga?"

I am one of those people who considers tenacity a virtue. So -- at the risk of sounding like that Confederate soldier -- I want to discuss an issue I have raised a few times before. I came here today to talk with you about the problem of the Savings Association Insurance Fund (SAIF), which, as you know, is managed by the FDIC.

Some people have taken the position that no problem exists. That conclusion rests on optimistic assumptions -- too optimistic in the view of a bank regulator who, after all, is paid to worry about the future.

Some bankers have taken the position that there is a problem -- but it cannot be addressed until the banks get lower deposit insurance premiums. I support significantly lower insurance premiums for banks, but that is a separate issue and will be considered by the FDIC Board following its normal administrative procedures for reviewing the 3,200 comments we have received on the Board's proposals.

In the meantime, the clock is ticking on the SAIF problem. Bankers are not insulated from that problem because it is an FDIC problem.

Stated simply the problem is this: Although the Bank Insurance Fund (BIF) is in good condition and its prospects appear favorable, SAIF is not in good condition and its prospects are not favorable. There are three parts to this problem.

Part one: The SAIF is significantly underfunded. At year-end 1994, the SAIF had a balance of $1.9 billion, or 28 cents in reserves for every $100 in insured deposits. Under current conditions and reasonably optimistic assumptions, the SAIF would not reach $1.25 in reserves for every $100 in deposits until at least the year 2002.

Part two: SAIF assessments have been -- and continue to be -- diverted to purposes other than the fund. Of the $9.3 billion in SAIF assessment revenue received from 1989 to 1994, a total of $7 billion has been diverted to pay off obligations from thrift failures in the 1980s.

Without these diversions, the SAIF would have reached the reserve target of 1.25 in 1994 -- before the BIF hit the target, in fact. Most of the money was diverted to pay interest on bonds issued by the Financing Corporation, or FICO. The FICO claim will remain as an impediment to SAIF funding for 24 years to come. SAIF assessment revenue currently amounts to just over $1.7 billion a year and FICO interest payments run $779 million a year, or about 45 percent of all SAIF assessments annually.

Part three of the SAIF problem: The SAIF will assume responsibility for resolving failed thrifts after June 30 of this year. Given the underfunding of SAIF, significant insurance losses in the near-term could render the SAIF insolvent and put the taxpayer at risk. One large or several sizable thrift failures could bankrupt the fund. Although such losses are not currently predicted, they are possible.

The outlook for the SAIF is further complicated by the fact that the law limits SAIF assessments that can be used for FICO payments to assessments on insured institutions that are both savings associations and SAIF members. Because assessment revenue from institutions that do not meet both tests cannot be used to meet debt service on FICO bonds, more than 32 percent of SAIF-insured deposits were unavailable to meet FICO payments in 1994.

At current assessment rates, an assessment base of $325 billion is required to generate revenue sufficient to service the FICO interest payments. The base available to FICO at year-end 1994 stood at $486 billion. The difference of $161 billion can be thought of as a cushion which protects against a default on the FICO bonds. If there is minimal shrinkage in the FICO assessment base -- 2 percent -- a FICO shortfall occurs in 2002. If shrinkage increases -- for whatever reason, including efforts by thrift institutions to leave the SAIF -- the shortfall could occur as early as 1996 or 1997.

If the SAIF were to approach insolvency, the erosion of the SAIF assessment base would likely accelerate. Strong institutions would want to distance themselves from a demonstrably weak insurance fund. If assessments were increased, the incentive to leave would be even greater than it is now.

What happens if the SAIF becomes insolvent?

Deposit insurance is a fundamental part of the financial industry safety net. Deposit insurance is designed -- not to isolate individual institutions from the rigors of competition -- but to stabilize markets and protect the system in general. As part of this larger safety net, the deposit insurance system not only protects individual depositors but serves to buttress the banking and thrift industries during times of stress by substantially eliminating the incentives for depositors to engage in runs on banks.

The deposit insurance system and the other components of the financial industry safety net rest ultimately on confidence -- on the belief that the full faith and credit of the government support the safety net. Confidence in government's backing for the safety net was a major reason that the financial troubles of the 1980s and early 1990s did not lead to widespread panic and economic disarray.

That confidence could be damaged if government is perceived as no longer willing to support one or more components of the safety net. That confidence can be shaken, if government is seen as willing to deal only half-heartedly with a problem. Indeed, the FICO bond arrangement that is now so much a part of the SAIF's problem was an element of earlier solutions to the S&L crisis that did not go far enough -- putting off until tomorrow what should have been addressed yesterday. If the FICO bonds run into trouble or default, confidence in the ability of government to solve financial problems in the future will be lessened -- and solutions, therefore, will be more costly for all of us. If default occurs on the FICO bonds, the immediate effect would be that investors holding the bonds would sustain losses.

The more widespread effect could include downward pressure on the prices of securities issued by government-sponsored enterprises such as Fannie Mae, Freddie Mac, Farmer Mac, and Sallie Mae, as well as upward pressure on the interest rates on these obligations. A default could also add to the cost of bank capital if the obligations of government-sponsored enterprises were to carry higher risk weights under risk-based capital standards.

As we have seen again and again, the government's early, half-hearted efforts in addressing the S&L crisis, such as the inadequate $10 billion authorized in 1987 to recapitalize the Federal Savings and Loan Insurance Corporation, or FSLIC, invariably ended up costing more than a comprehensive solution to a problem would have cost.

The current difficulties of the SAIF pose the danger of such an approach.

As I noted earlier, the SAIF problem has three parts: the fund's undercapitalized condition; the drain of the FICO interest obligation; and the looming transfer of responsibility for resolving failed thrifts to the SAIF -- that is to say, the FDIC -- after June 30. Because they have immediate consequences, the last two problems might seem to warrant higher priorities than the first.

This conclusion is incorrect.

Experience with underfunded state deposit insurance funds in Maryland, Ohio, and Rhode Island, and with the underfunded FSLIC, shows that permitting an insurance fund to limp along in an undercapitalized condition is an invitation to much greater difficulties. Regulators and legislators in the past have become paralyzed when large or visible institutions insured by a grossly weakened fund began to falter. Fear of runs on deposits has inhibited action. Because of an insurance fund's weak financial condition, failed institutions have been handled in a manner that minimizes or defers cash outlays, but ultimately increases costs.

Stronger institutions look for greener pastures untainted by the collapsing regulatory edifice. The failure to take corrective actions allows the problems to worsen. Consequently, all three of the difficulties facing the SAIF -- its undercapitalized condition, and the resulting BIF-SAIF premium disparity, which could lead to a weaker SAIF because of fleeing members; the drain of the FICO interest obligation; and the need to resolve thrift failures after June 30 -- demand consideration in a solution.

The SAIF, the BIF, and the FDIC are distinguishable to only a small segment of the population. To most, only one acronym -- "FDIC" -- makes a difference.

Bank customers and thrift customers do not know the difference between BIF and SAIF. Indeed, Congress insisted that the SAIF become "FDIC-insured" precisely to assure confidence in its future.

The failure of the SAIF would undermine the confidence Americans have in the FDIC as a source of stability for the financial system and would call into question the government safety net for financial institutions. Bankers benefit from this safety net and, therefore, have a direct stake in the effort to find a solution to the SAIF's weak condition.

It is only natural for bankers to approach a solution to the SAIF's problem with the same question that Pandora asked herself, before she opened the box that has since been linked to her name. That question was: "What's in it for me?"

We remember that all the evils in creation flew from the box when Pandora threw back the lid.

Not many of us remember, however, that, according to mythology, the box contained one last item: hope.

For bankers -- for everyone, in fact -- a solution to the SAIF problem holds forth the hope that we can get the financial crises of the 1980s finally behind us and that we can get on with the business of assuring a stable financial system for the future.

Thank you for inviting me. It is great to be back in Tennessee!

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