Remarks
By
Sheila C. Bair, Chairman,
Federal Deposit Insurance Corporation;
Before the
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Thank you. I'm very pleased to be here today.

As you know, I am new to the FDIC, having served as Chairman just under a month. I'm extremely honored to be appointed to this position. Having worked in the financial services field for much of my career – both in government and the private sector – I've always held the FDIC in the highest regard. As deposit insurer of the almost 8,800 banks and savings associations and federal supervisor of over 5,200 banks, the FDIC is vitally important to the stability of our nation's economy. Our deposit insurance system is, indeed, a model for nations around the world.

Economic and Banking Conditions in New York

I know that you are as pleased as I am that the banking industry in the nation and in New York, in particular, remain strong. Economic activity in New York continues to expand. The state has experienced employment growth for over two years, led by the financial sector. We have observed continued health among New York-based insured institutions, which have reported improvement in already strong asset quality. On the other hand, we've also noticed, as we have across the country, continuing pressure on net interest margins owing, in part, to the flattened yield curve.

Background on Deposit Insurance Reform

Today, I'd like to discuss one of the many critical issues facing the FDIC today, implementation of deposit insurance reform.

On February 8th of this year, President Bush signed into law the Federal Deposit Insurance Reform Act of 2005, a law containing sweeping improvements for our federal deposit insurance system. Securing enactment of this legislation was a long, multi-year process and I thank my predecessors, former Chairmen Don Powell and Donna Tanoue, and Vice Chairman Marty Gruenberg, for their efforts toward passage of this comprehensive law.

Federal deposit insurance was created during a period of economic crisis to stabilize the economy by protecting depositors. It has been remarkably effective in achieving its goals over the years and has served us very well. So why was a reform package needed?

For two main reasons: First, to provide the FDIC with greater flexibility in managing the fund in order to maintain stability and public confidence in the banking system. Integrity of the fund has been a continuing goal for the FDIC since its inception. The old system provided for a potentially severe assessment "shock" once the designated reserve ratio (DRR) moved below 1.25 percent. We now have considerably greater latitude to maintain the fund at prudent levels and spread the assessment burden more evenly over time.

The second major goal of reform was to make assessments more risk sensitive so that the assessment burden falls more fairly across insured institutions. The legislation also gives us the ability to recognize past contributions by institutions in building up the fund.

Congress gave us nine months to implement the provisions of the reform legislation. That means we have until November 5th of this year to adopt most of the final regulations. That's a lot to do in a short time. I would like to review with you where we stand in our efforts to implement reform.

Funds Merger

As its first order of business, the FDIC merged the Bank Insurance Fund (BIF) and the Savings Association Insurance Fund (SAIF) into the new Deposit Insurance Fund, or DIF. The merger of the funds took effect on March 31st.

Coverage Limits

Next, the FDIC Board adopted interim final regulations that implement the substantive changes to the FDIC's insurance coverage rules, effective April 1. As you know, the biggest change was to increase coverage for certain retirement plan deposits to $250,000. The basic insurance limit for other depositors – individuals, joint accountholders, businesses, government entities and trusts – remains at $100,000, but may be adjusted for inflation in future years.

One-Time Assessment Credits

On May 9th, the FDIC Board approved three notices of proposed rulemaking. The most important of these proposed a system for distributing and using the $4.7 billion one-time assessment credit that Congress provided. Congress created this credit to recognize the contributions that institutions made to build the deposit insurance funds following the bank and thrift crises of the late 80s and early 90s. The Reform Act requires that the credit be distributed among "eligible insured depository institutions" and their successors. Eligible institutions, generally speaking, are those that were in existence on December 31, 1996, and had paid a deposit insurance assessment before then. By the way, any bank can find its preliminary estimated one-time assessment credit amount through a search tool on the FDIC's website.

Dividends

The second proposal approved May 9th by the Board concerns the allocation of future dividends from the fund. We proposed a two-year interim rule, but I must tell you that the prospect of a dividend within the next two years appears remote. The FDIC will undertake a more comprehensive rulemaking for dividends next year.

Operational Changes

The third and final proposal approved on May 9th involves procedural and operational improvements to the assessment system, such as determining and collecting assessments after, rather than before, each quarter ends, which will allow us to use more current supervisory information and capital data.

The comment period for these three proposed rules was extended from July 17 to August 16 to allow for overlap with the comment period on the assessment proposal I will discuss next. We look forward to the industry's thoughtful input on the proposals.

Institutions Will Pay, But New System Will Be Fairer

The Reform Act also provides us with the opportunity to make improvements to the risk-based assessment system. Just last week, on July 11th, the Board considered and approved for public comment a proposed rule governing deposit insurance assessments. Because this proposed rule is new, I would like to spend a few minutes discussing it with you, but before I do, I'm going to tell you something you may not be happy to hear. We will be charging you for deposit insurance beginning next year. Some may view that as bad news, however, the good news is that without reform, the FDIC would have had less flexibility to manage the fund and would have been charging higher assessments right now.

The proposals that I'm going to discuss, combined with the proposal we made in May on the one-time assessment credit, should, however, help ensure two things: First, the premiums that you pay will take into account the contributions you made to build the funds, and, second, the safer you are, the less you will pay for deposit insurance; the more risk you take on, the more you will pay. Having riskier banks pay more than safer ones is both fair and consistent with sound insurance principles. In essence, these changes should make the assessment system both fairer and more risk sensitive.

Introduction to New Risk-Based Assessment System

There are two major parts to the proposal the FDIC Board approved on July 11th. The first would more closely tie what banks pay for deposit insurance to the risks they pose. The second major proposal is for a base assessment rate schedule. The base rate schedule includes the rates that we think could be sustained over time, and that appropriately account for risk, but could be adjusted up or down from time to time depending upon revenue needs of the fund.

As you may know, 95 percent of institutions are now in a single insurance category, the 1A risk category. Under the proposal, these institutions would pay differing rates in the future, depending upon their risks. The proposal differs somewhat depending upon an institution's size. We propose one method for smaller institutions in this category—those with less than $10 billion in assets—and another for larger institutions—those with at least $10 billion in assets.

Small Bank Method

For smaller institutions in the 1A category (which we propose to rename Risk Category I) rates would depend upon a combination of financial ratios and supervisory factors. You may have read in the press that the way we plan to do this is complex. Inevitably, when we're differentiating on the basis of risk, there is going to be some complexity. But while the derivation of the method is complicated, the ideas behind it are intuitive and the application straightforward.

Higher earnings and capital would tend to lead to lower rates. Higher past-due and non-performing loans, charge-offs, volatile liabilities and CAMELS component ratings would tend to raise rates.

Institutions under $10 billion can quickly get an idea of what their assessment rates might be by multiplying a few financial ratios and a weighted average of their CAMELS component ratings by some fixed multipliers and doing some addition. We plan to put a pricing calculator on our website in the next few days that will let a bank calculate its premium rate under our proposed method and simulate the effect of a change in a financial ratio on its premium.

We've tried to strike the right balance in the system for smaller banks between risk sensitivity, on the one hand, with fairness and transparency, on the other. But if there are ways to make our approach more fair and transparent, I would be greatly interested in your comments. I urge you to read our proposal and give us your thoughts.

Large Bank Method

For well-managed, well-capitalized institutions over $10 billion, rates would again depend upon financial ratios and supervisory factors, but, as asset size increased, financial ratios gradually would be replaced by market factors, specifically, long-term debt issuer ratings, which are usually available for these larger institutions, but not for smaller ones. For institutions with $30 billion or more in assets, financial ratios would be phased out entirely.

Financial ratios would affect premiums similar to the way they would for smaller banks. Lower CAMELS component ratings and better long-term debt issuer ratings would tend to lead to lower rates, while higher CAMELS component ratings and lower long-term debt issuer ratings would tend to raise rates. In addition, the FDIC would review

additional information on banks with over $10 billion in assets to determine whether small rate adjustments were appropriate.

Request for Comment on Integration

Despite the similarities between the small and large bank methods that I've described, there are differences, and I am particularly interested in your comments on whether the final rule should reflect a more integrated approach. For example, while both methods rely upon CAMELS component ratings and financial ratios, these measures are combined to determine assessment rates in different ways. I would be very interested in knowing your views on using the same approach in combining these risk measures. For example, for small banks, the FDIC could assign equal weight to the CAMELS component ratings and a combination of the six financial ratios to determine an assessment rate. As institution asset size increases, the weight assigned to financial ratios could be replaced by debt issuer ratings. This approach is more similar to the large bank proposal, and could allow for a smoother transition as a bank moves from one method to the next.

I would also be interested in hearing from you on our proposal to use incremental pricing for small banks in between the minimum and maximum rates and buckets for large banks. An advantage of using incremental pricing is that small changes in financial ratios or a CAMELS component rating would result in small changes in assessment rates. For large banks, the use of buckets would allow for potentially larger increases or decreases in assessment rates as an institution moved up or down one bucket, depending on its overall risk characteristics. The FDIC would also have the ability to determine whether any change in one of the risk measures warranted a change in an assessment rate. Again, I would be very interested in your comments on this aspect of our proposal.

Proposed Base Rate Schedule and New Banks

As I mentioned earlier, the proposed rule approved on July 11th would also adopt a new base schedule of rates that the FDIC Board could adjust uniformly up or down, depending upon the revenue needs of the insurance fund, to determine actual rates. The 95 percent of all banks that are well capitalized and well managed will no longer be charged the same rate. We have proposed that under the base rate schedule, these banks would be charged a rate between minimum of two and a maximum of four basis points. Initially, in this risk category, roughly 45 percent of small banks and 45 percent of large banks (other than new ones) would be charged the minimum rate and roughly five percent of banks (other than new ones) would be charged the maximum rate.

New banks in Risk Category I—those in business for less than seven years—would be charged the maximum rate applicable to that category. New banks tend to fail at a higher rate than established institutions and their financial data is much more difficult to interpret.

Actual Rates for 2007

The rates we've proposed would be the base rates for well-managed, well capitalized banks, but the FDIC has not yet determined actual rates for 2007. As I said, base rates could be adjusted up or down to determine actual rates. We will wait until later in the year to set actual rates, but you should be aware that, most likely, assessment rates will need to be higher than the base rate schedule initially.

Because most institutions will have one-time assessment credits that they can use to offset most or all of their premiums during 2007, assessment income will be limited initially. If the Board was to adopt the base rate schedule for 2007 and insured deposits grew at the pace they did in 2005, which was 7.5 percent, the reserve ratio could be below 1.15 percent, the lower bound of the allowable range, within the second year of the new system. Therefore, depending on whether insured deposits continue to grow at a breakneck pace, as they have for over a year, and depending upon the FDIC Board's tolerance for lower reserve ratios, rates could well be substantially above the base rates we have proposed. For example, if insured deposit growth is projected to continue at its pace over the last year of seven to eight percent and the Board wanted to raise the reserve ratio to its level at year-end 2005 of 1.25 percent within one year, the minimum rate would need to be 12 basis points, 10 higher than the proposed base minimum. To bring the reserve ratio back to 1.25 percent in two years, the minimum rate would need to be seven basis points, or five higher than the proposed base rate.

Designated Reserve Ratio, Logo, and Advertising Requirements

The proposed rules approved on July 11th would also set the designated reserve ratio (the DRR) at 1.25 percent, the same level as the current DRR, change the official FDIC sign, and for the first time, require both banks and savings associations to use the same sign and rules for advertising FDIC membership.

Conclusion

We have now proposed all of the rules required by the legislation. Our guiding principle in implementing reform has been to retain the best of the old system and to improve what needed to be improved. We encourage the industry and the public to weigh in on our proposals. They are critically important, and I hope that you find them to be fair and reasonable, but if there are ways to improve them, we want to know your views.

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