Remarks by
FDIC Chairman Sheila C. Bair
To
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Thank you for that kind introduction.
It is wonderful to be back in Massachusetts
and an honor to talk to this distinguished group.

The past few years have been the most eventful for U.S. economic policy since the 1930s. And that, of course, is because our nation has suffered its most serious economic setback since the Great Depression. We knew that the crisis posed a grave threat to the U.S. economy. Our response has been historic in scope, and it has sparked a sorely needed debate over the appropriate roles for government and business in regulating and leading the economy.

What I would like to do this morning is outline the rationale for the new reforms, and explain how they intersect with the fundamental need for much greater responsibility and accountability on the part of government and corporate leaders.

Warren Buffett has said: “It takes 20 years to build a reputation and five minutes to ruin it. If you think about that, you'll do things differently.”

What we need are leaders who are willing to do things differently; leaders who are willing to do the hard work necessary to move our country forward. Leaders who aren’t interested in promoting their short term personal gains, but rather want to build their organizations for the long term for the benefit of this and future generations.

Accountability and responsibility

The financial crisis has revealed critical flaws in how our financial system operated and was regulated, as well as in our leadership culture. If there is an overarching theme of this crisis, it is a lack of accountability by managers, by regulators, by lenders, by borrowers -- by everyone. We see that at the failed banks – both large ones that the government bailed-out and smaller ones the FDIC has had to resolve.

We’ve seen disengaged managers; managers who were not hands-on, who would not take responsibility or find out what was going on inside of their organization. We’ve seen managers who didn’t look beyond their next quarter’s financial statements and who rewarded short term profit generation through high risk activities which sowed the seeds of their ultimate demise. They didn't do their homework, they didn't understand the risks their companies were taking, and they didn't work hard enough. Some were arrogant.

It's an important lesson for investors, shareholders and, of course boards, who ultimately are responsible for hiring the CEO, and making sure that the CEO and other senior managers are up to the job, and doing their job. At larger institutions, some managers assumed that their size protected them from regulatory or market sanctions – that they were so systemically important and interconnected that they were Too Big To Fail. And some of them proved to be right. Especially at the height of the financial crisis, we saw these large, systemically important institutions exempted from the type of supervisory sanctions that community banks face every day.

That is one of the reasons why we fought so hard to end Too Big To Fail. We now have a resolution process that will impose discipline on large institutions as well as the smaller ones. If they get into trouble, there will be accountability. There will be consequences for management, for corporate boards, for investors, and for creditors.

Too Big To Fail & Resolution Authority

The new Dodd-Frank financial reform act establishes a credible resolution authority for giant banks and non-bank financial institutions. It gives the FDIC, for the first time, a set of receivership powers to close and liquidate systemically-important financial firms that are failing. These new powers are similar to the existing FDIC receivership process for insured banks and thrifts.

Let me briefly describe the practical significance of these new powers. In the old world of Too Big To Fail, risk taking was subsidized. Systemically-important companies took on too much risk because the gains were private while the losses were socialized. Market discipline failed to rein in the excesses at these institutions because equity and debt holders -- who should rightly be at risk if things go wrong -- enjoyed an implicit government backstop.

This skewing of financial incentives inevitably led to a misallocation of capital and credit flows, which ultimately was harmful to the broader public good, as we have seen with the recent devastating losses of livelihoods, homes, and life savings. It was these poor incentives in place under Too Big To Fail that helped push risk out into the so-called shadow banking system, where regulation was the lightest. That’s where you saw most of the excesses in subprime and nontraditional mortgage lending, as well as holdings of mortgage-related derivative instruments.

So implementing the new resolution authority and ending Too Big To Fail is a game changer. It corrects the economic incentives, and protects the broader public good: market discipline will be restored; financial incentives will be better aligned; capital and credit will be allocated more efficiently; and taxpayers will no longer be on the hook when financial companies get it wrong.

Executive compensation

Another example of lack of accountability can be found in the misaligned compensation incentives, which were among the root causes of the financial crisis. Compensation was too-often based on deal volume or current earnings, and not enough attention was paid to risks that eventually caused problems down the road.

It is not appropriate for regulators to set or limit compensation. But it is very appropriate to undertake regulatory initiatives that encourage companies to structure compensation so that excessive risk taking is discouraged, long term profitability is rewarded, and most importantly, that meaningful financial penalties are imposed on employees whose risk taking ends up causing losses later on.

Fiscal responsibility

In Washington, we also need more accountability for our increasingly dire fiscal situation. We must mend our ways if we are to preserve financial stability in the years ahead. Excessive government borrowing poses a clear danger to our long-term financial stability, and assuaging it requires fiscal responsibility and leadership. Total U.S. public debt has doubled in just the past seven years to almost $14 trillion, or more than $100,000 for every U.S. household.

This explosive growth in federal borrowing is not only the result of the financial crisis, but also the unwillingness of our government over many years to make the hard choices necessary to rein in our long-term structural deficit. If it is not checked soon, this borrowing will at some point directly threaten financial stability by undermining the confidence that investors have in U.S. government obligations.

Actually fixing these problems will require a bipartisan national commitment to a comprehensive package of spending cuts and tax increases over many years. The plan released yesterday by the National Commission on Fiscal Responsibility and Reform offers such a plan. It proposes a combination of spending cuts, revenue-enhancing tax reforms, and cost containment in health care and entitlement programs that would produce nearly $4 trillion in deficit reduction over the next ten years.

While opinions differ as to exactly what combination of spending cuts and revenue increase will be necessary we can be sure that most of the needed changes will be unpopular, and will likely affect every interest group in some way or another. We will want to phase in these changes over time as the economy continues to recover from the effects of the financial crisis.

But only with a comprehensive package can we truly achieve the long-term budget discipline needed to preserve our nation’s credibility in global financial markets, and maintain a stable banking system to support the real economy. We must look beyond our narrow partisan interests, and show the world that we are prepared to act boldly to secure our economic future.

Leadership

I am very proud of the stability that the FDIC has provided throughout the crisis. No one lost a penny of insured deposits. And in fact, no one has ever lost a penny of insured deposits in the 77 years since the FDIC was created in 1933. As the crisis unfolded and other financial sectors were destabilizing, insured deposits remained stable and there were no disruptions.

As the leader of an organization, I always try to keep a focus on mission. Protecting insured deposits is a very important, tangible mission. It's one that the public understands and appreciates.

If you look at other organizations – whether private or public -- that have high morale, they have a clearly defined mission. The leadership at those organizations has to ensure that people stay focused on the mission and help them understand how their individual jobs relate to the mission. You need accountability. You need responsibility. You need people to take ownership of their jobs and connect that to the organization's broader mission.

One challenge I have is to tell our people how good they are. That their judgment is as good as that of the banks they are examining, and that it is their job to speak up about any concerns they have. That they have the right and the obligation to question and tell a bank's management about those concerns, whether they're not reserving enough against their loans, or that they're moving into a new line of business or a new geographic area in which they are unfamiliar.

Conclusion

We all know there are no easy shortcuts to rebuilding our financial infrastructure and reining in our long-term structural deficit. And it is always appealing to try to go back to old and familiar ways. But in American finance, those are the practices that pushed our economy to the brink of ruin.

Instead, we must move forward, make the tough choices, and accept that preserving stability is a prerequisite to making the financial system more efficient and more profitable. In the end, leadership means showing the resolve to identify emerging risks and taking concerted action to head them off.

In concluding, I don't want to leave you with the impression that all leadership in the financial sector should be faulted. There are several examples of senior management at financial institutions, large and small, who avoided the excessive risk taking that led to the crisis. So let us celebrate those who led their organizations effectively and resolve to foster a culture which rewards managers who are willing to forego short term profits in favor of long term stability and prosperity.

And as part of building that culture, let’s hope that we see a lot more women in the upper echelons of financial institution management, including – at long last – at the very top.

Thank you.

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