

**The Remarks of  
FDIC Chairman Sheila C. Bair  
to the  
American Bankers Association  
Government Relations Summit,  
Washington DC  
April 1, 2009**

Good morning and thanks for inviting me to speak.

It's been a tough 18 months since the financial crisis began. And despite a few bumps in the road, government and industry together have taken extraordinary steps to prevent our financial system from collapsing.

But the sense that "we're all in this together" and share the same goals, has gained momentum in recent weeks. You saw it last week during a conference call with bankers that we held to talk over the details of our new Legacy Loan Program. Some 2,700 people were on the call.

There was a lot give and take, and many questions. It was a very constructive discussion. There were many good ideas and suggestions. Everybody on the call wanted to get this critical program up and running. And to get it right. We need to build on that spirit of cooperation and mutual interest, and to redouble our efforts to repair the financial system and get the economy back on track.

Let me start with a few comments about the current challenges we're facing, and the actions we've been taking. I want to assure you that the FDIC will continue working with other federal agencies, with Congress, and the White House. Our main job is protecting FDIC insured depositors, and to preserve the stability of our banking system.

Financial innovations come, and they go. But FDIC-insured institutions will always play an indispensable role in our economy. While many sources of bank funding have dried up, deposits have not. In fact they're growing. Insured deposits grew 11 percent last year. They remain a stable source of funding because depositors know that their money is safe. No one has ever lost a penny of an insured deposit.

All of the government measures that have been put in place in recent months are designed to ensure that credit flows on sound terms to both consumers and businesses. Well-managed banks that rely primarily on insured deposit funding should be able to weather this storm. And they will be a key source of lending to help the economy recover.

I see some glimmers of hope. I'm cautiously optimistic that the industry is getting on a better footing. Many banks are making money. So I see our efforts beginning to pay off. But to be honest, there's still more pain to go.

## **Assessment hike**

The FDIC's Board of Directors recently made a series of very difficult decisions to bolster our nation's deposit insurance system. Raising assessment rates is never pleasant. The new assessments are a significant burden, especially during a financial crisis and a recession when bank earnings we know are under pressure.

It would have been far better if we'd had the opportunity to build up the fund before conditions worsened. But we didn't.

The reality is that the deposit insurance fund has declined significantly. And it is likely to fall further, despite what we've done so far. Deteriorating economic and industry conditions resulted in 25 bank failures last year (21 so far this year).

We currently expect that bank failures will cost about \$65 billion over the next five years. Much of that is front-loaded this year and next. That's on top of \$18 billion last year.

So without additional revenue beyond the regular assessments, current projections indicate that the fund balance will approach zero later this year. To be sure, we won't run out of money. We're 100 percent backed by the full faith and credit of the United States Government. No depositor has ever lost a penny on an insured deposit. And that is NOT going to change.

### **Some ask: Why not get help from taxpayers?**

This industry has a long and proud history of funding the deposit insurance system. All of you have benefited from industry-funded status. Turning to taxpayer funding could open up a whole new debate about the degree of government involvement in the affairs of insured banks. And it would paint all banks with the "bailout" brush. So even though this increase comes at a difficult time, I strongly believe that keeping deposit insurance industry-funded will be better for you, and your customers when this crisis is over.

I also think deposit insurance is a bargain. Even with higher fees, deposits are cheaper than alternative funding sources. Last quarter, for example, domestic deposit interest expenses were 1.65 percent, which compared to 2.40 percent for other funding.

Others ask: Why not put the burden on weaker, higher-risk banks. In fact, the new risk-based rules we finalized in February will charge higher-risk banks significantly more. But there's only so much you can impose on weaker banks before it becomes self-defeating. After all, in any insurance system, premiums paid by healthier members are supposed to help cover the losses of weaker members.

Still others ask: Why shouldn't the big banks pay a greater share of the premiums? Under current law, for risk based assessments, we can't discriminate because of size. We're seeking comments on whether we should use total assets or some other base for

the special assessment ... which would have consequences for how the burden is distributed. We're also asking whether we should take into account assistance given to systemically important institutions in setting the special assessment.

The FDIC Board did not reach these decisions lightly. We certainly don't like imposing large assessments when the industry and the economy are struggling. That's why we stretched out the time for rebuilding the fund. But we believe that this step is necessary to maintain public confidence in the FDIC and the banking system.

### **Assessment cutback**

As many of you know, we hope to trim back the special assessment. We told Congress that an increase in our borrowing authority to \$100 billion (plus emergency authority to go above that) should give us much more flexibility on the assessment.

The current borrowing authority provides a thin margin of error to handle any unforeseen contingencies. An increase in borrowing authority is long overdue. The last increase came back in 1991. Since then the industry has tripled in size.

I'm optimistic that Congress will soon act on the borrowing authority increase. This should give us the breathing room we need to reduce the special assessment, while continuing to cover all projected losses with industry funds.

### **TLGP income & the DIF**

We also hope to get extra revenue from our temporary liquidity guarantee program. We've taken in \$6.5 billion for the debt guarantee program so far. And we haven't had any losses. If this money isn't needed to cover defaults, it will go into the insurance fund and could help reduce future insurance assessments.

We've also started imposing a surcharge for new guaranteed debt that will go immediately into the insurance fund. The largest insured banks and their holding companies are the main buyers of the debt guarantees. So it's only fair that these larger banks pay more for the guarantees to ease pressure on smaller banks.

Putting the new surcharges directly into the deposit insurance fund benefits everybody because they could help lower the special assessment.

We're comfortable with the risk we're taking with the guarantee program. But as the program's name says, we see this as a temporary way of helping ease the credit market freeze. It's not a permanent substitute for private market-based financing.

Credit remains tight. That's why we've extended the debt program through October 31.

Over the coming weeks, we'll be monitoring the impact of the new surcharge on fund revenue, as well as the progress in Congress on increasing our borrowing authority.

At the same time, we'll keep evaluating the condition of the industry, projected failures, and estimated insurance losses while we review the comments on the special assessment. As a result, I don't expect the FDIC Board to take final action on the assessment before late May, so that we have the most up-to-date information for our decision.

## **LLP program**

Last week we announced another new program (the Legacy Loan Program) designed to help cleanse bank balance sheets and thaw credit markets. While the idea of having the government purchase assets from banks has been proposed before, the problem of determining a fair price for the assets has prevented the idea from moving forward.

The concern has been that a price set by the government might result in overpaying for the assets. To address this concern, the Treasury will join with private investors to buy these assets by creating public-private investment funds (PPIFs). This combination taps the expertise of the private sector and the discipline from the financial markets to determine a market-based price for assets that have been hard to value.

I want to emphasize that all banks will be able to participate in this program, large and small. Our initial focus will be on the higher risk assets, particularly the mortgages and commercial real estate legacy loans. But we'd like comment on asset categories and where we should put our focus first.

The pricing, the investment and the management will be based on the government and private sector partnership, with the Treasury and private investors providing the equity capital. The FDIC will be assisting with financing by guaranteeing public private investment fund (PPIF) debt, or perhaps through notes either publicly issued, or notes going back to the selling banks. So that's another area where we'd like some comment.

As for the investors, we want to reach a very broad range: individuals, mutual funds, pension plans, insurance companies, and other long-term investors. And we do appreciate input from you on how to ensure that the investor participation is as broad as possible.

So, I'd ask all of you to put your thinking caps on. Go to our website to see the list of questions we want answered. And give your best thoughts and comments by April 10 (when the comment period ends) so we can finalize the program and proceed with the first bid.

I thank the ABA for already giving us some excellent input. And thank you to any of you here today who participated in last week's call. We think this program has a very good chance of succeeding. We're going to be doing it on a very measured, and a very transparent approach. It's a good structure and a good plan.

I'm optimistic that it will help many banks clean their balance sheets, and attract new private capital and give them an exit strategy from Treasury's capital purchase program.

### **Regulatory reform (too big to fail)**

Another issue we need to tackle sooner than later is how deal with large too-big-to-fail institutions that get into trouble. My view is: creating a new systemic risk regulator is no panacea. We really need to simply end too big to fail.

A strong case can be made. It's now obvious that just being bigger isn't necessarily better. I don't mean to imply that there are no well-managed big banks. But when you have a handful of giants, with global reach, and a single regulator ... you're making a huge bet that a few banks and their regulator ... over a long period of time ... will always make the right decisions at the right time.

So, instead of hoping that these risks will be competently managed ... we also need a "fail-safe" system where if any one large institution fails, the system carries on without breaking down. We need to reduce systemic risk by limiting the size, complexity, and concentration of our financial institutions.

We need to create regulatory and economic disincentives aimed at limiting the size and number of systemically important financial firms. For example, we need to impose higher capital requirements on them in recognition of their systemic importance, to make sure they have adequate capital buffers in times of stress.

We also need to impose greater market discipline by creating a legal mechanism for the orderly resolution of a large troubled institution.

The ad-hoc response to the banking crisis is because we don't have a playbook for taking over an entire complex financial organization. As we saw in the case of Lehman Brothers, bankruptcy is a very messy way to go.

As you know, the FDIC has that authority but only for insured depository institutions. The FDIC has the experience and manpower to handle the task of taking over a large a nonbank institution. We need a special receivership process that is outside bankruptcy, patterned after the one we use for insured banks and thrifts.

To protect taxpayers, a new resolution regime should be funded by fees charged to systemically important firms, and would apply to any institution that puts the system at risk. These fees should be imposed on a sliding scale, so the greater the risk, the higher the fees.

In a new regime, roles and responsibilities must be clearly spelled out to prevent conflicts of interest. For example, Congress gave the FDIC backup supervisory authority and the power to self-appoint as receiver when banks get into trouble. I hope Congress

acts soon. Nobody wants to go through another banking crisis like this one, and another ad hoc response.

## **Conclusion**

These are truly extraordinary times for the American economy and for our banking system. We're dealing with one of the greatest economic challenges we've seen in many years. Getting through a recession triggered by a credit crisis puts us in uncharted waters to be sure.

People want the quick fix. And if you're looking for the quick fix, you're not going to get it. It's going to take time. People need to be patient.

By nature I'm an optimist. I know we're going to dig out of this. I know our country has seen even tougher times than these. And I know if we make bold decisions, if we keep focused and flexible, and keep our heads ... I know we can turn this crisis around.

I know we can turn it into an opportunity to make things better, and clear the way for renewed prosperity in the months ahead. Thank you very much.

Last Updated 4/1/2009