Remarks by
FDIC Chairman Sheila C. Bair
to the
ICBA National Convention,
San Diego, CA
March 22, 2011

It is always a pleasure to address the annual meeting of the ICBA. I have addressed your meeting every year of my five year term at the FDIC, and I've always had an affinity for this group. You are fiercely independent in your core mission of defending the interests of the nation's community bankers.

As you know, I am also tenacious in defending the interests of the FDIC as it pursues its vital public mission of depositor protection and financial stability. Like me, you are frequently direct and pointed in your communications. You pride yourselves in your professionalism, and you influence opinion through reasoned public debate. Like me, you stay focused on your objectives. And you are never confused about who you represent. That has been a key to your considerable effectiveness in Washington.

You may not be aware of this, but my experience with community banking extends back into my early childhood. In fact one of those experiences helped prepare me for the Chairmanship of the FDIC. When I was in grade school, I loved accompanying my father to Citizens Bank in Independence Kansas each Friday afternoon when he would deposit the week's earnings from his medical practice. As I would stand with him in the teller line waiting for our turn at the window, I would always stare in fascination at the big, shiny steel door of the bank's vault. It had a huge, round metal handle with prongs like the steering wheel of a ship. I imagined that behind that door stood tall stacks of crisp green bills and piles of gleaming coins.

One Friday afternoon, as we entered the bank, I noticed that the vault door was open a crack. My heart raced. Someone had forgotten to close the door! Now was my chance to sneak a peak at the treasures within. As my father was pre-occupied in conversation with a friend, I slipped away from him and edged furtively to the vault door in rapt anticipation. But when I reached the vault and peeked expectantly into the small slit of an opening, I had the surprise of my life -- no crisp greenbacks, no bags of shiny coins -- just rows and rows of little metal drawers with numbers on them. "There's no money in the bank, there's no money in the bank" I shouted, racing back to my father to forewarn him that someone had been absconding with his and other bank depositors' hard-earned cash.

As you might imagine, this created quite a stir among the long line of customers waiting to deposit their week's earnings. The bank's President came rushing out of his office to find out what was causing all the commotion. After giving me a few somewhat forceful pats on the head, he assured me that everyone's money was quite safe. He then invited me and my father into his office for a quick tutorial on reserve banking. I didn't understand much of it, except for the idea that most of the depositors' money was loaned out to others to help them buy things like cars and homes, which I thought was nice.

So this was my first introduction to the community banking model, as well as the importance of depositor confidence. Ironic that a six-year-old who nearly instigated a bank run that day would later become Chairman of the Federal Deposit Insurance Corporation.

We have had quite a ride over these past five years. When I first came to the FDIC in June of 2006, I thought that my main challenges would be dealing with the Wal-Mart ILC application and implementing our new authorities under the Federal Deposit Insurance Reform Act to begin assessing risk based premiums on all banks.

To be honest, back then, I didn't really know where I stood on the issue of commercial ownership of banks. But I came quickly to understand that the Wal-Mart application, if approved, had the potential to radically transform the structure of the banking industry. This was a step that needed to be decided by Congress, not by the FDIC. This application risked embroiling the FDIC in a never-ending controversy which would divert it from its core public mission.

So we imposed a moratorium on ILC applications to give Congress time to act, and Wal-Mart eventually withdrew its application, making the issue somewhat moot. Dodd-Frank has now closed the so-called ILC loophole to bank holding company rules. So I am glad we imposed the moratorium, and I think that the end result was the right one.

Though community banks were obviously pleased by our early decision on the Wal-Mart application, you were a bit more mixed on our decision to move ahead with a new risk-based pricing system that would begin charging all banks something for their deposit insurance.

As most of you will recall, prior to 2006, the FDIC was essentially prohibited from charging CAMELS 1 or 2 banks for deposit insurance so long as the reserve ratio stayed above 1.25. This was a nice deal for the more than 95 percent of the industry which had the requisite high CAMELS rating. The downside, however, was that a number of new banks had been chartered which never had to pay anything for deposit insurance, an inherently unfair situation for older banks which had paid dearly to cover losses from the last bank and thrift crisis.

Another significant downside was that if the fund were to dip below 1.25, everyone would be whacked with a 23 basis-point assessment. When the deposit insurance reform law said we could start charging a premium to every institution, it also gave us the ability to manage the fund within a range. This would allow us to build reserves in the good times and provide a cushion against the need for pro-cyclical premium hikes during downturns. In addition, the law gave older banks a credit in recognition of past assessments, so the brunt of the initial assessment would fall on so-called "free riders."

I remember well the strongly-worded comment letters and tense meetings with newer banks, many of whom followed non-traditional strategies through internet deposits or affiliations with investment banks. They were not happy with us, and I recall many saying we had no need to build the fund because of the health of the industry and lack of bank failures.

Yes, they assumed, the good times would go on forever, so why in the world did we need more money? The rest, as they say, is history. We went ahead with the new assessment rate schedule, which was my first major rulemaking just two weeks into my tenure.

But as it turned out, it was too little, too late. As the crisis hit, bank failures mounted, and so did losses to the Deposit Insurance Fund. The low point was the fourth quarter of 2009, when the fund dipped to a negative balance of $20.8 billion. But the fund, like the banking industry, is healing, and I anticipate that it will achieve a positive balance before the end of the year.

So where are we now? Community banks' return on assets in 2010 was 0.33 percent, and 4 out of every 5 community banks operated at a profit. Noncurrent loans stood at 3.5 percent, with a net charge-off rate of 1.27 percent. This is a major improvement from the fourth quarter of 2009, when ROA was a negative 0.65 percent, and more than one in three community banks were unprofitable.

However, the current situation still pales in comparison to the robust earnings enjoyed by most banks during the so-called "golden age of banking" prior to the crisis. Now, as the industry is beginning to recover from the setbacks of the past few years, you are moving forward to a future which holds much promise but also considerable uncertainty.

As with previous crises, there has been significant consolidation over the past few years, and nearly 300 community banks have failed. As I've discussed with you many times before, we at the FDIC have a keen appreciation for the unique role community banks play, not only in their local markets but also through the contributions they make to the national economy.

Quarter after quarter, throughout the crisis and ensuing recession, we saw you maintain and even modestly grow your loan balances as the largest institutions were pulling back dramatically. Small businesses, in particular, come to you for credit because you understand the local economy and you understand their particular credit needs. In the wake of the most severe recession since the 1930s, we need a thriving community banking sector to support the credit needs of local households and businesses.

I know that you have many concerns about the future of community banking and how it will be affected by the changes that are taking place as regulators implement Dodd-Frank. Yours is already one of the most heavily regulated industries in America. Congress just passed a 2,000 page bill mandating scores of new regulations. You are understandably wary of how the new law will be implemented, and even if you are not the target of its many reforms, you are concerned that there could be collateral damage to your industry.

I am not going to claim that we have always seen things the same way on every issue. We have not, and we should not. Our respective jobs are quite different. But I will say this: We at the FDIC are committed to a future regulatory structure that will support a vibrant, competitive community banking sector, that will assure a level playing field between large and small banks, and most importantly, that will put an end to the pernicious doctrine of too big to fail.

Throughout this crisis, we have consciously pursued policies to protect community banks and their customers from the fall out of the financial crisis—a crisis that was not of your making, to mute the impact of deposit insurance fund losses while maintaining the integrity of industry funding, to preserve continuation of community banking services in areas impacted by failing institutions, and to assure that financial reform measures take into account the potential impact on smaller banks.

We were early and strong advocates for interagency guidance addressing high-risk mortgages. We were among the first to see the dangers of these unaffordable mortgages to the broader banking sector -- indeed to the entire economy. We supported strong guidance in 2006 to tighten standards on so-called pick-a-pay loans, and successfully pushed for extending those standards to subprime hybrid loans in early 2007.

While commercial real estate lending was not the cause of the crisis, we could see in 2006 that poorly managed commercial real estate concentrations were becoming a growing threat to the deposit insurance fund. So we also supported heightened supervisory standards for CRE concentrations.

I know we disagreed on that guidance, but looking back it is clear that weak banks with high levels of CRE concentrations – especially construction and development concentrations – represent the lion's share of small bank failures. So this was not a case of overzealous regulation.

At the same time, going forward, I believe that supervisory policies need to reflect the reality that most community banks are specialty CRE lenders and that examiners need to focus on assuring quality underwriting standards and effective management of those concentrations. Though hundreds of small banks have become troubled or failed because of CRE concentrations, thousands more have successfully managed those portfolios. We need to learn from the success stories and promote broader adoption of proven risk-management tools for banks concentrated in CRE.

As the crisis unfolded, we worked with our fellow regulators and the Treasury Department to promote public confidence and system stability. Foreseeing the risk of increased failures from growing problems in the housing sector, we launched in 2008 an intensive public education campaign about deposit insurance. We used the occasion of our 75th anniversary to re-acquaint the general public about the FDIC's strong record in protecting insured bank deposits. Here again, our objective was to assure the stability of insured deposits, the lifeblood of community banks, and in that we were successful.

However, as conditions deteriorated in the summer and fall of 2008, we witnessed growing volatility in uninsured deposits and a troubling trend of business accounts "fleeing" community banks for larger institutions perceived as too big to fail. For this reason, when we were asked by the Treasury Department and the Federal Reserve Board to develop a debt guarantee program which would have primarily benefited larger institutions, we also proposed an unlimited temporary guarantee for non-interest bearing transaction accounts. This program proved enormously successful in stabilizing these accounts and averting liquidity stress or failures in otherwise healthy community banks.

Throughout the crisis, we were determined not to turn to taxpayer borrowing but rather to manage our losses and liquidity needs through our industry-funded resources. In retrospect, given the understandable public backlash to TARP and the taxpayer bailouts, I am more convinced than ever that this was the right decision. At the same time, we used strategies to soften the impact of additional assessments on a distressed banking sector.

We worked with you to bolster public confidence in our resources by convincing Congress to substantially raise our borrowing line, ameliorating the need for a large special assessment. We also successfully secured legislation to make clear that any losses on the FDIC's debt guarantee program would be assessed on those holding companies availing themselves of that program, not insured banks.

We required prepayment of three years worth of premiums to make sure that our cash resources were adequate to cover bank failures, while allowing you to expense those premiums gradually over time.

And finally, we deployed resolution strategies to sell failing banks to other insured depositories, while providing credit support on futures losses from failed banks' troubled loans. This strategy has saved us $40 billion over losses we would have incurred if we had liquidated those banks. But perhaps more importantly, this strategy provided continuation of banking services in local areas served by the failed banks, frequently through the acquisition of a failed community bank by a healthy one. Now, the system is on the mend. Bank failures peaked last year at 157. Profitability is returning, loan quality is improving, and borrower demand is starting to pick up somewhat with an improving economy.

Unfortunately, many of the obvious problems that led to this crisis -- excess leverage, unregulated credit derivatives, skewed incentives from securitization, too big to fail -- have yet to be fixed. And increasingly, regulators are being called to task for doing too much too fast, just as a few years go we were being pilloried for being asleep at the switch.

Do not misunderstand. Accountability and oversight are a good thing for the regulatory process. As a market-oriented Republican, I wholeheartedly concur that our regulations should be tightly focused on fixing what went wrong. But we must not lose sight of the fact that A lot went wrong and it does need to be fixed. Which brings me back to Dodd-Frank.

Dodd-Frank is not a perfect law. There are many things in it that I would like to change. But, on balance, it is a good law and one which I think will strengthen, not weaken, communtiy banks. Let's start with the basics.

If Dodd-Frank had not been enacted, deposit insurance limits would have reverted to $100,000. The transaction account guarantee would have expired. The too big to fail doctrine would have remained intact. A public still uncertain about the strength of smaller banks would have pulled their newly uninsured deposits and fled to the large, too big to fail institutions. This would have led to more small bank failures and higher costs for the deposit insurance fund.

So you would have lost large deposit accounts, and it is likely that your deposit insurance premiums would have gone up. But none of that happened.

Dodd-Frank made permanent the $250,000 deposit insurance limit and provided a two-year extension of the transaction account guarantee. It attacked the doctrine of too big to fail by extending the FDIC's resolution process to large, systemically-important financial institutions. It subjected all financial institutions, large and small, bank and non-bank, to our resolution process, which imposes losses where they belong -- on shareholders and creditors -- not on taxpayers.

It also required that large financial entities have capital cushions at least as strong as those that apply to community banks. And it changed the assessment base so that instead of your premiums going up, they will be reduced by about 30 percent later this year. Why did this happen? You.

Instead of stridently opposing even the most modest of reforms, the ICBA stayed engaged. You maintained a constructive dialogue with the key sponsors of the legislation. You gave voice to the views of community banks, and Congress listened. Most of the other financial trade groups tried to stop reform. It didn't matter. A bill was going to pass. The ICBA realized the inevitability of the process. You kept a seat at the table, and you had an impact on the outcome.

I know you have many concerns about this legislation. I understand your concerns. It is a massive law, and you would be foolish not to take an active interest in the new regulations as they are developed. We are proceeding to implement the provisions of Dodd-Frank as transparently and expeditiously as possible.

We are going beyond the normal steps that we use in the rulemaking process. We are holding roundtables to discuss issues, and documenting meetings between senior FDIC officials and outside parties that are related to Dodd-Frank implementation. In addition, we continue to discuss issues related to Dodd-Frank during the visits by the state banking delegations to the FDIC and at meetings of our Advisory Committee on Community Banking.

So you will continue to have many venues to provide feedback to us as implementation moves forward. And I want you to know that we're paying close attention to the potential impact of the law on community banks.

On March 10, we sent a letter to Federal Reserve Chairman Bernanke commenting on the proposed rule on debit-card interchange fees. We are extremely concerned that community banks may not actually receive the benefit of the interchange fee limit exemption explicitly provided by Congress. In the comment letter, we urged the Board to use its authority under the Electronic Fund Transfer Act to address the practical implications of the proposal. The proposed rule assumes the creation of a two-tiered interchange structure, and failure to maintain a two-tiered structure could result in a loss of income for community banks, and higher banking costs for your customers.

We also urged the Board to expand its survey methodology to gain information on the costs incurred by issuers of all asset sizes; to include costs associated with anti-fraud protection; and to revise its fee cap proposal as appropriate.

Your concerns about the potential impact of the interchange fee provision are well-founded, and we are working hard to assure that you receive the protection promised by the law. At the same time, I would ask you to maintain an open-mind about the potential positive benefits of the new consumer protection agency. Many of the fears I have heard expressed about this new agency are not well-founded.

On the contrary, I believe that this agency holds the promise of doing tremendous good by simplifying consumer rules and disclosures, reducing compliance costs for you and making products easier to understand for your customers. I also think this agency can help level your competitive playing field by applying much-needed regulation and enforcement to non-bank mortgage originators and other providers of consumer credit.

Banking has come a long way since the days when I used to accompany my father to Citizen's Bank every Friday afternoon. We have just come through the worst financial crisis and most severe recession since the 1930s. I know these are uncertain times for you, when the economic environment remains difficult, and the regulatory outlook seems unclear.

I ask you to continue our dialogue, and to work with us to get the details right on the regulatory reforms now underway. It is my hope and belief that public dissatisfaction with impersonal, model-driven banking will bring more customers back to those institutions which bank the old-fashioned way – to banks who know their customers and tend to their individual banking needs – to banks run by hands-on executives willing to take some time to explain to a six-year-old why all the depositors' money isn't sitting in the vault.

Community banking is the foundation of our economy. The future belongs to you, and it depends on you. That is why I am asking you to support the reforms that are needed to restore financial stability and lay the foundation for a stronger U.S. economy in the years ahead. Thank you.

Last Updated 12/7/2011