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Why Regulatory Restructuring? Why Now?
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Good afternoon. Thank you for inviting me to speak here today.

I've been in Washington, DC, for just over a year now. I've enjoyed getting to know this town a little bit, and getting to know you.

We've been busy at the FDIC. Over the past year, in addition to performing our core missions of bank supervision, deposit insurance and bank failure resolutions, we've been watching the economy and assessing its impact on the banking sector. We've also reorganized the Corporation - resulting in about $80 million a year in savings. We've selected a new management team and have set priorities rooted in our mission of supervising banks, insuring bank deposits and resolving failed institutions.

We have also tried to join the debate on the significant banking policy issues of the day, and that is important. My role is not to carve out my piece of turf and protect it at all costs. I'm here to ensure we regulators are asking the right questions and making the right decisions to ensure the safety and soundness of our financial system - and to support an industry that is vital to America's economic interests.

The banking industry has gone through profound changes in the past 20 years. The number of institutions has been reduced by about half. Fifteen hundred banks failed. There were more than 9,000 mergers. This led to an unprecedented concentration of banking assets in the largest banking organizations - not to mention better efficiency, more economies of scale and better choices for the credit customer. Industry assets increased threefold. Capital is up, earnings are at record levels. Innovations in credit products resulted in revenues that are more diversified and an industry that is less cyclical. In short, 20 years of change resulted in banks weathering this downturn better than any of us expected.

So, despite its conservative reputation, banking has embraced change in a big way. While clearly painful at times, this process of innovation and market evolution yielded benefits that were impossible to predict when the hard decisions were made. As a result, capital is allocated more efficiently in our society and we are all better off. And the banking industry is better able to compete in a complex global economy. That is today's reality.

How the government has responded to this market imperative has been a mixed bag. We managed to catch up with the industry somewhat with the adoption of the Gramm-Leach-Bliley legislation a couple of years ago. We've been less successful in addressing the question of our regulatory structure - and how we in government manage the financial safety net.

I keep coming back to a fundamental principle. We've seen amazing dynamism and innovation in banking over the last 20 years. Yet we keep in place a regulatory system rooted in an era that is truly gone with the wind. This perplexed me when I arrived on the scene a year ago - and it perplexes me today. Despite the convergence, efficiencies and economies of scale achieved by the industry, the regulatory community is still mired in a confusing web of competing jurisdictions, overlapping responsibilities, and cumbersome procedures. I know we can do better.

In the past six months we've seen the beginnings of a discussion between the regulators about how we're organized. This has been gratifying. I was pleased Under Secretary Fisher weighed in on the subject several weeks ago with a proposal for a joint rule-writing body separate from the supervision function. The Comptroller has been consistent in his press for a new funding mechanism. Both bring important issues to the table and they are proving - contrary to popular belief - that it is not altogether taboo to discuss this important subject.

Our concerns are not academic. Some of my friends argue the system works - meaning no major breakdowns have occurred. Therefore, a discussion about how to make things better isn't warranted. I disagree. Our goal should not be to design a system that works in theory, or to come up with a better organizational chart. Rather, our goal should be a regulatory structure that is better positioned to understand the market's evolution and one that can make better, faster decisions. If we fail to do this, we risk hampering needed innovations in the marketplace simply because the regulators do not grasp the issues or cannot agree on how to respond.

Why do we need to talk about our regulatory structure? Why does this matter?

I'll tell you why it matters to me. I gave a speech last week in Phoenix in which I affirmed my faith in the free market. No real surprise there. But I thought it important to stress that the marketplace will lead the financial industry into new lines of business, new combinations and new products - whether on the retail or wholesale side of the business. The regulators - on the other hand - should ensure that market innovations do not conflict with the public's basic interest in a safe, sound, and stable financial infrastructure.

I have three criticisms of our current system of financial regulation.

First, I am concerned we spend far too many resources on duplication of effort and turf competition. Choices are good - and we should preserve them where we can. But when a variety of choices leads to a variety of regulators, I'm not sure the benefits are worth the cost. The time we spend on coordinating our activities alone could be much better spent fulfilling our primary mission - protecting the safety and soundness of the financial system. I am reminded of what the first Chairman of Britain's Financial Services Authority said of their previous system of regulation:

"The weaknesses of the two-tier system are well understood. The system created duplication and dysfunctional turf wars between regulatory organizations. The system also created costly overlaps and resulted in a delayed response to problems."

He said that about a two-tier system. Imagine what he would conclude about our system - with its four banking regulators, its central bank, its deposit insurer, not to mention the securities regulator, commodities and futures regulator, and numerous state supervisors and self-regulatory organizations.

All too often, when we engage in turf warfare, the ultimate loser is the industry and the marketplace. The price is paid in lost opportunities and lost competitiveness. The commodity we already lack today - and will increasingly lack in the future - is time. We will no longer have the luxury of lengthy consideration, study, argument, debate, and delay. The industry - and the broader markets - will require answers from the regulators much faster than we can provide them today. In such a market, delay will be as good as denial. A nimble and efficient regulatory structure that evaluates emerging issues - and problems - and moves quickly to address them is going to be increasingly important.

My second concern is about cost. The President's 2003 budget estimates the cost of bank supervision and regulation alone at the FDIC, the OCC, the OTS and the Federal Reserve adds up to more than $1.2 billion. This escalates when you add in the cost of providing deposit insurance, central banking facilities and other components of the financial safety net. This cost - in economic terms - is about as burdensome as anything else we do. I know there is clear value in regulation. But I would remind you that anything beyond what we need is money that is not lent, not leveraged, and not providing fuel for our economy.

Consolidation and reorganization of the regulators would certainly result in savings. We looked at this issue earlier this year. We found that the FDIC, the OTS and the OCC alone spend at least $200 million to fund back-office operations. That is a back-of-the-envelope calculation, but still significant. A 20 percent reduction in that amount would save $40 million. I'd bet we could do much better. I continue to hope my fellow regulators will join me in an effort to pinpoint sensible back-office consolidations and make a better estimate of how much we can save in this area. No matter what decisions are made on the restructuring question, I believe this analysis would be useful to policymakers in Congress as they consider the restructuring question.

My third concern - and perhaps my strongest concern - is about the increasing disconnect between our structure and the industry we regulate. Banking, securities, and insurance firms all provide financial services products to consumers. But they are still largely distinct industries with fairly distinct roles in the economy. We can draw these lines with some certainty.

It is harder to draw these distinctions within the banking industry. Why should three banks on the same street, offering the same products and services to the same customer base, be regulated by three distinctly different federal regulatory entities? Take the case of, say, a Fed-member institution and a national bank. What redeeming features separate them that would justify a completely separate and costly federal regulatory structure? And to what extent does our structure improperly set the shape of the financial marketplace and inhibit innovation and evolution?

Look at our system today. The Office of the Comptroller of the Currency was created during the Civil War. The Federal Reserve was created after the financial panics that characterized the latter 19th and early 20th centuries. The FDIC was born in the Great Depression, and the Office of Thrift Supervision was established during the banking and thrift crisis just over a decade ago. The incremental decisionmaking that created our system was effective at dealing with the problems of the moment. But it left us with a system that - in the aggregate - seems crowded, costly, inefficient, and not really reflective of today's financial sector.

Those are my criticisms. What should we do?

I propose we take advantage of this time when there is no crisis and study the system as a whole. We should look at how the business of bank regulation has evolved, take a hard look at the industry we're regulating, and have a conversation about what sort of regulatory structure we need going forward.

I believe we should work together to recommend to Congress a new bank regulatory structure. The new structure should improve operating efficiencies, improve our responsiveness to consumers and the industry, and increase regulatory sensitivity to developments in the marketplace. The new structure should be independent, both in funding and in outlook, and should limit conflicts of interest wherever possible. We should preserve the dual banking system and the choices available to the marketplace today - while remaining flexible enough to sanction new choices as the financial market evolves. This is a tall order, but we have to start somewhere.

So, what makes sense? Here's my idea. We should design a regulatory system that looks like our modern marketplace. We should have three federal regulators. These entities would oversee the banking industry, the securities industry, and those companies that choose an optional federal insurance charter. We should establish an authoritative forum where the three regulators would meet, along with the Treasury and the Federal Reserve, on a regular basis. This body would sort through areas of overlap or sector-wide policy, and make decisions on systemic risk, permissible activities and product regulation.

This idea takes advantage of distinctions already drawn in both the economy and in current law. This structure allows us to provide a federal safety net to America's financial services industry that is streamlined and broad in scope, yet able to amass the technical expertise to deal with problems that arise in this or that sector of the financial marketplace.

A streamlined structure like this would certainly make the functional regulation idea envisioned in the Gramm-Leach-Bliley law more accessible and user-friendly. It would also ensure clear lines of authority and accountability. And the process would be efficient enough to ensure the timely delivery of policy and consumer protection decisions on a consistent basis across the entire financial sector.

I know that each of you can come up with 10 reasons why this won't work, or 10 issues I have not addressed in this high-level outline. My intent today is not to spell out exactly how a new system would work. Certainly, some folks in my own building will have a quibble or two with some of what I've said. My goal here today is to get you - and my colleagues in the other agencies - thinking about how a new and better structure would work, and how we can work together to achieve it.

This subject has a long history. By our count, this has been tried 25 times since the 1930s. Two former presidents and one vice president tried to restructure the bank regulatory system - and all failed. The Brookings Institution, and commissions full of luminaries, didn't make it happen. The result is a system that has remained largely untouched since the Great Depression.

We are entitled to study this history and acknowledge it. But I don't think we're entitled to perpetuate a system simply because it was handed down from our predecessors. It seems entirely appropriate - from time to time - to examine these issues and provide advice to Congress. It seems especially appropriate to do so now, given the dramatic changes in the entire financial sector over the last 20 years - and the remarkable lack of corresponding change in our system of bank regulation.

Last week I announced the FDIC would be conducting a major study over the next year on the future of banking in America. We will be working on this issue as part of that effort. We need your input, your views, your criticism. I hope you won't let the history of failure on this issue be an excuse for inaction. And I hope you will join us in developing a new and better structure for a new financial age.

Thank you.

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