CHAIRMAN DONALD E. POWELL
FEDERAL DEPOSIT INSURANCE CORPORATION
REMARKS TO
AN FDIC SYMPOSIUM ON
THE FUTURE OF FINANCIAL REGULATION: STRUCTURAL REFORM OR STATUS QUO?
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Good morning. It is wonderful to see you all here this morning - you honor us and the FDIC by your attendance.

We are here today to listen to the views of many of our stakeholders about a very important issue: the future of our country's system of financial regulation. We acknowledge there is no crisis surrounding this issue, and no groundswell for reform. Our discussions here today reflect FDIC's conviction that the absence of crisis is perhaps the best time to discuss an important issue like the one before us today - because it allows for the deliberation and careful thought needed to arrive at a sensible conclusion.

We also recognize that this issue has been studied many times since the current structure was created in 1933. Restructuring has become an almost mythical goal - long sought but never attained - for many banking policymakers. It is similar in many respects to the eternal quests for hair restoration treatments that work, a cheap and limitless power supply, and a simple 1040 tax form.

The fact that we have discussed the current system for so long without meaningful change may well indicate the system doesn't need revision. But history is also littered with examples of longtime efforts finally bearing fruit. It took 66 years for man to go from horse and buggy to the moon. It took 74 years to win the war against communism. It took 94 years to go from James Naismith's peach basket to the coming of Michael Jordan. And it took 45 years for the Texas A&M Aggies to win their first national championship. That was 1939, by the way. Some of us are still awaiting a repeat.

Last May, when I addressed the Federal Reserve Bank of Chicago's Conference on Bank Structure and Competition, the focus of my remarks was on how we could improve our efficiency and effectiveness as regulators. We suggested a discussion about how our regulatory structure could be improved. Today's symposium is one step in that direction. We hope each of you will come away with a new understanding and new insight into the issues surrounding reform.

Today I want to raise a fundamental question that has been raised many times before: Does the current regulatory arrangement make sense for today's financial system? In my view, there may be valid reasons to question the suitability of our current structure.

First, I am concerned about the increasing disconnect between the industry and our regulatory arrangements. It is clear that the marketplace is leading the way into new lines of business, new combinations and new products - whether on the retail or wholesale side of the business. Some would say we regulators have not kept up. We must keep up, however, in order to ensure that market innovations do not conflict with the public's basic interest in a safe, sound, and stable financial infrastructure.

Let me give you an example. The technological revolution of the past decade has led to astounding innovations in the hedging of risk and structured finance. In fact, Warren Buffet recently brought to the fore a number of concerns about derivatives that are certainly worthy of the regulators' attention. While the FDIC and others continue to monitor these issues and work on sound policy responses, I don't think anyone can argue that we are moving as fast as the industry in these areas. And this is just the tip of the iceberg. As the pace of change accelerates in the industry we regulate, I am not convinced the current regulatory structure - with its layers of checks, balances, and countervailing forces - is nimble enough to keep up.

Further, a fragmented financial regulatory system may not be well equipped to deal effectively with emerging problems, such as those that surfaced recently in large-scale corporate failures. While products and financial strategies continue to blur the lines between banking, insurance and securities products, the regulation remains largely fragmented. This concern was raised most recently by a U.S. Senate report on Enron's creative financing, urging greater cooperation between banking and securities regulators to ensure the regulatory gaps are filled. The incremental decision-making 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.

Second, market evolution and innovation have resulted in unprecedented convergence and consolidation in the financial services industry. Very large institutions have emerged, competing with smaller, more traditional banking companies. Complex new products, such as structured finance vehicles, are commonplace. With such dramatic change in the industry, we need to consider carefully whether our longstanding regulatory structure still fits the bill. Does convergence warrant a consolidated regulator? Does it warrant an enhanced umbrella regulator? I hope we explore these questions today.

Finally, and at a minimum, I think we need to consider whether we should make organizational changes to become more efficient, to reduce the cost of regulation, and to do a better job of protecting public confidence in the financial sector.

This is an old question. There have been numerous studies and legislative proposals to overhaul and consolidate the federal bank regulatory system. I believe we have benefited from these discussions - whether or not the proposals were actually implemented. For the most part, past studies on regulatory restructuring have focused on the federal banking agencies. Few studies have gone beyond this, although some proposals have included suggestions for the establishment of a national financial services committee that would include the SEC and CFTC, among others. Some have suggested consolidating the federal banking regulators into a single regulator. Others propose to streamline the regulatory process, either by limited consolidation of the federal banking regulators or by shifting certain functions within the bank regulatory agencies. In general, the proposals recognize the importance - and political realities - of the dual banking system. However, despite all the studies, we have seen little real progress in modifying our existing regulatory structure.

That may be okay. What is not okay is to leave the status quo unexamined simply because changing it would be hard, or would threaten this or that vested interest - including the FDIC's.

These efforts failed mainly due to the strengths inherent in our current system. Our financial markets are the most highly functioning in the world and they have served as a tremendous engine of growth. And our regulatory system has many appealing characteristics, including choices for the regulated firms, competition among regulators, different perspectives on policy matters, and so forth. A recent AEI conference on regulatory restructuring reminded us again of these facts, and they are important to remember. This means that any consideration of changes in the regulatory structure should be deliberate and measured. And it should adhere to the old admonition in the Hippocratic Oath: 'First, do no harm.'

We should not, however, use the strengths of the existing system to enshrine the status quo and prematurely end a reasonable discussion about how we can make improvements. The notion that the impressive functioning of our markets somehow hinges on maintaining an antiquated regulatory structure does not ring true to me. Again, I hope this is an issue we hear about in our discussions today.

It is important we get your views. Today's forum is part of our continuing initiative on the future of banking in America. Thus far we have held conferences on financial transparency and capital regulation. Today, we focus on our regulatory structure. The objective of our project is to examine and understand the underlying trends in the economy and the banking industry, and to determine what these trends suggest for the future. Our goal is to identify the policy issues that will confront regulators, bankers and banking consumers over the next decade.

Among the major elements of the study is an analysis of the prospects for different banking industry sectors - community banks, regional banks, and large, complex banking organizations. We are comparing different banking strategies, such as specialization and diversification. We also are looking at factors that will affect future banking trends: consolidation of the industry, the continuing effects of deregulation, advances in information technology and competition from a variety of non-bank financial institutions.

Finally, we are examining vital policy issues. In addition to today's topic on regulatory restructuring, we are looking at the advisability of permitting the ownership of banking organizations by non-financial enterprises, the challenges of supervising increasingly complex banking organizations, and the future of our systems of corporate governance and consumer protection.

As we proceed with this study, we need input from a wide audience. Today's symposium will allow us to hear the opinions of experts on the current regulatory structure, challenges and obstacles to reform, and alternatives for the future. Our meeting today is one of several we plan to host over the course of this year on various topics. When our study is completed, we will hold a conference in early 2004 to present our views and to invite others to present theirs.

As I mentioned earlier, the financial services industry has gone through profound changes in the past 20 years. Fifteen-hundred failures and more than 9,000 mergers have led to an unprecedented concentration of 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 have resulted in revenues that are more diversified and an industry that is less subject to the economic cycle. In short, two decades of unrelenting change have resulted in banks weathering the current downturn better than any of us expected.

So, despite its conservative reputation, banking has embraced change in a big way. While sometimes painful, this process of innovation and market evolution yielded benefits that were impossible to predict when the hard decisions were made. The banking industry is better able weather downturns and compete in a complex global economy. That is today's reality because bankers who led this effort were not prisoners of the past, they were not prisoners of the status quo, and they were not afraid to embrace change.

The government, on the other hand, has mostly followed the marketplace. The banking crisis brought on much-needed improvements in regulation and corporate governance. We again followed the industry's lead with the adoption of the Gramm-Leach-Bliley law. The financial regulatory structure - in my view - remains an item of unfinished business.

This brings me back to a fundamental principle. We've seen amazing dynamism and innovation in the marketplace over the last 20 years. Yet, the regulatory community is still mired in a confusing web of competing jurisdictions, overlapping responsibilities, and cumbersome procedures. I know we can do better.

Despite the strengths of our current regulatory system, and there are many, I believe we must consider the consequences of not adapting to this brave new world. Coordination difficulties, gaps in the seams among multiple regulators, confusion for the regulated firms, excessive costs, turf competition and delays in our policy response to new developments all have potential to undermine our attempts to maintain financial stability.

Other nations have responded to this challenge by choosing to simplify their systems of regulation. Led by the United Kingdom, many countries have reformed by consolidating their financial regulators. While there may be good reasons for the United States to avoid adopting these structures, I believe we have much to learn from them about the consequences of this consolidation - both positive and negative. I hope there will be an opportunity to explore this today.

In the past year we've seen the beginnings of a discussion among the regulators in this country about how we are organized. This has been gratifying. A discussion about how to make things better is, in my view, always warranted. The goal should be a regulatory structure that is better positioned to understand the market's evolution and one that can make better, faster decisions. Today we have the opportunity to bring our distinguished panelists and others into that discussion.

Let us make the most of this opportunity and explore alternatives for the future. I expect to learn a lot today and look forward to the discussions.

Thank you.

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