Remarks by
FDIC Chairman Sheila Bair
to the
Independent Community Bankers
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Let me start with a few comments about the challenges we're facing, and the actions we're taking to preserve and strengthen the banking system.

There is no question that this is one of the most difficult periods we've had to deal with since the FDIC was created 75 years ago.

I want to assure you that the FDIC will continue working with other federal agencies, with Congress, and with the industry to get the nation's financial system back on track. Our job is to protect insured depositors, and to preserve the stability of our banking system.

Financial innovations come and go. But FDIC-insured institutions will always play an indispensable role in our economy.

In today's economy, deposit insurance is more valuable than ever. While many sources of bank funding have dried up, deposits have not. In fact they're growing. Insured deposits grew 11 percent last year.

Well-managed banks (especially community banks) that rely primarily on insured deposit funding should be able to weather the storm. They will be a key source of lending to help the economy recover.

Insured deposits are a reliable source of funding because people know their money is absolutely safe. No one has ever lost a penny on 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 consumers and businesses. Maintaining a stable banking system and preserving the availability of credit are absolutely critical to getting the U.S. economy back on track.

Assessment hike

As you know, 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 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 (17 so far this year).

We currently expect that bank failures will cost about $65 billion over the next five years. 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.

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 good 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. Credit Unions are now paying 80 basis points. It should also be noted that for 1991 – 1994, banks paid on average 21 – 24 basis points.

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.

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.

We want your input

We'll consider all comments about the assessment. And we'll continue to evaluate all options at our disposal.

We've already had extensive discussions with the ICBA and community bankers across the country about the assessments. Last Friday, we hosted Cam Fine and several of your members at a roundtable discussion with the bank regulatory agencies in Washington. We agreed that it was time for a frank and direct talk between a group of community bankers and their supervisors about the challenges you're facing.

We want to know what it will take for you to continue lending to creditworthy borrowers in your communities. We heard a lot of good ideas that we're considering.

Above all else, two-way communication with your examiner is absolutely critical. And don't be afraid to pick up the phone or send us an email back in Washington.

New community bank panel

We're very serious about the FDIC's broader role in helping industry and consumers take steps to secure America's economic recovery. So on Monday, we created a new, senior level office devoted to community bank outreach.

It's headed by Paul Nash, who is my new deputy for external affairs. Some of you may know him. He was Sen. Tim Johnson's counsel. Among his initial tasks will be setting up a special advisory committee on issues unique to community banking.

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 more room and more flexibility on the assessment.

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 covering all projected losses, with industry funds.

TLGP income & the DIF

We also hope to get extra revenue from our temporary liquidity guarantee program (TLGP). We've taken in over $5 billion so far on the debt program. 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.

And earlier this week, we 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 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 this 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.

Still, credit remains tight. That's why the FDIC Board voted on Tuesday to extend the debt program through October 31.

Fee outlook

Over the coming weeks, we'll be monitoring the impact of the new surcharge on the fund, 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 to make a sound decision.

It should be emphasized that even as proposed, over 70% of the special assessment will be paid by banks with assets over $10 billion. The TLGP surcharge will shift the burden to large banks even more. We will carefully consider ICBA's suggestion to use assets, not domestic deposits, for the assessment base.

Working together, I am confident that we can find a way to equitably distribute the burden, and hopefully reduce the special assessment to single digits assuming Congress acts.

Too big to fail debate

Now, let me say a few words about the too big to fail debate.

Yesterday I testified before the Senate Banking Committee about needed changes to our financial regulatory system. I said that while a new systemic risk regulator may be a good idea, what we really need to do is end too big to fail.

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 for 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 similar to the one for FDIC insured banks. 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. 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.

Message to Main Street bankers: keep on lending

Let me end on a positive note. Community bankers are vitally important to our country and our economy. You are a significant source of credit for consumers and small businesses in good times and bad. The FDIC has a very unique perspective on community banking. (Most of the institutions we supervise have assets totaling less than $1 billion.)

We understand your business. Many of our examiners live and raise families in the same communities that you serve so they understand how important you are to the local economy. We're encouraging them to keep using sound judgment in reviewing loan portfolios and determining the current fair value of assets, which can be tough in today's economy.

We continue to emphasize the need to review all aspects of a loan's structure. We've made clear that examiners should not classify performing loans solely because the value of any underlying collateral has declined, particularly when other indicators are healthy.

Striking the right balance can be tough. So we encourage close communication between bankers and your regulators.

We applaud you for lending to Main Street, while others have cutback. At the end of fourth quarter 2008, growth in loans outstanding varied greatly by size of institution. The largest institutions (those with assets over $100 billion) reported a decline of 3.4 percent. But the smallest (those with assets under $1 billion) posted an increase of 1.5 percent.

That tells the story.

Your ability and willingness to lend -- even in the midst of a financial crisis -- demonstrates how devoted you are to our financial system, and to the broader economy.

Community banks control just over 10 percent of industry total assets. But your significance is huge in small towns and rural communities. Of the 9,800 banking offices located in communities with populations under 10,000, more than two-thirds are community banks. In these markets, the local bank is often the essential provider of banking services and credit.

As you are aware, we have been encouraging the banks we supervise to keep making loans to creditworthy borrowers. And it's because Main Street Americans are depending on the ICBA's members to support their working capital and their dreams to expand. So please, stay active in your market. Make loans available to worthy customers. And serve your communities that are counting on you.

Conclusion

Obviously, these are very challenging times for you and for all financial institutions. And it's likely that the pressure will remain for some time to come. Still, I believe that the long term outlook for FDIC-insured banks and thrifts is very good.

Most institutions remain in sound financial condition. 98 percent are well capitalized (according to regulatory rules). And most continue to lend money in a difficult business environment where other private credit has virtually shut down.

There will be more challenges ahead before recovery takes hold. There are no quick fixes. But as recovery comes, and I know it will, America's community banks will provide the credit to make it happen. And ultimately, we'll emerge with a stronger and better financial system. Thank you.

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