

Bair calls for end to too big to fail (April 3, 2009)

FDIC Chairman also fields "hot" questions at ABA meeting

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By Steve Cocheo, executive editor

The ongoing debate in Congress concerning the issue of systemic regulation has bankers and other players weighing their options, and choosing sides. FDIC Chairman Sheila Bair made it clear, in a speech to the ABA's May 30-April 1 Spring Government Relations Summit, where she stands on the central issue:

"We need to simply end 'Too Big to Fail'." This was greeted by massive applause by the substantially community-bank audience.

While avoiding inference that there are no well-managed large banks, Bair said that there is clearly no indication that bigger is necessarily better. She said that anyone who favors having a handful of huge banks and a single regulator overseeing them is "making a huge bet" that those institutions will make the right decisions at the right time, all the time.

Bair said it was critical that something better than ad hoc methods emerge from the debate over handling large nonbanks.

"The Lehman Brothers bankruptcy," she said, "was a very messy way to go."

The concept of making FDIC, rather than the Federal Reserve Board, the home for resolution of nonbank systemic risk candidates has been floated. Bair said her agency had both the experience and the ability to take on that role if Congress decides to add it to the agency's task list. She suggested during questions and answers that the agency would

likely establish a special unit to handle such issues, if Congress decided to assign that role to FDIC. She acknowledged and agreed with banker concerns about keeping the FDIC "separate from any systemic risk role.

"I'd like to work with the ABA on this, because I don't want to do anything that would dilute our brand," Bair said.

Prediction: Pain, with chance of angst

Bair opened her speech at the summit with some efforts to make a positive point or two, before she moved into less-pleasant and more-expected issues, plus the question period, which was predictably pointed. So she talked about cautious optimism, and some "glimmerings of hope."

For example, she acknowledged that the FDIC Temporary Loan Guaranty Program is backing around \$6.5 billion in debt, and has had no losses. But before too long, she had to get down to the nitty gritty: "As you know, there is still more pain to go."

Bair noted that the agency estimates that there is at least \$65 billion-worth of anticipated bank failures to deal with over the next five years. And the pace is accelerating. In 2008, 25 insured institutions failed, she recalled, and in 2009, 21 have already failed.

In another barometer of banking's times, Bair stated that a recent FDIC telephone conference, concerning the "legacy loans" program that the agency will oversee under the Obama Administration's banking cleanup package, drew interest from approximately 2,700 attendees.

With the balance in the Deposit Insurance Fund heading towards zero, she said, this underscores the need to hike revenue to the fund. Bankers are hoping that such measures as legislation introduced to increase FDIC's credit line at Treasury to \$100 billion from \$30 billion will enable FDIC to reduce the proposed emergency assessment to 10 cents, rather than 20.

Indications are that the Senate version of the legislation may come up for an anticipated approval shortly after Congress returns from its spring recess. While the passage of that legislation will be a factor in the FDIC Board's deliberations, Bair said that the board will likely not take final action on the proposal until late May. In part this will be to allow agency staff sufficient time to read and evaluate industry and public written comments on the proposal.

Bair noted that some bankers have gone so far as to suggest that the time has come for the taxpayer to kick something into the insurance fund. She advocated putting such thoughts aside, in spite of the expense that the emergency assessment, and the general increases in assessments, will cost banks.

“This industry has a long and proud history of funding the deposit insurance system,” said Bair. “Trying to keep deposit insurance privately funded will be better for you, for us, and for your depositors in the long run.”

Bair also addressed an attitude that has been voiced, that larger banks—frequently seen as more directly responsible, than smaller banks for the fund’s difficulties—should pay more for deposit insurance, proportionately, than smaller banks. She said that current law bars the agency from differentiating among banks, for deposit insurance purposes, based on bank size.

Regarding banks at the other end of the spectrum, de novos, Bair said, “we have definitely tightened up on deposit insurance applications.” While she said the agency wasn’t halting all approvals of such applications, it was going to subject new ones to a more “rigorous” process. She added that she hoped that anyone wishing to start a new bank would look at buying a failed institution from FDIC, rather than starting out for a wholly new charter.

In answering a banker’s question about how large institutions should be permitted to grow, in light of limits going back to the Riegle-Neal Act’s 10% national depositor cap, Bair declined to rise to the opportunity to pick some other number. She said the agency supports the 10% cap, and that, “like any insurance company, we are concerned about concentrated exposure.”

Bankers take their shots

Numerous other bankers stepped up to floor mikes to pose questions to the chairman. Most asked questions with an edge, or, at least, an agenda.

• Competition with high-rate deposit payers

A California banker objected to the way IndyMac Bank FSB was handled. He said the failed megathrift had been a stiff competitor, paying very high rates on deposits. After the California thrift had been taken over, the banker said, the high-rate stance continued. He said he believed FDIC should have put a stop to that.

"I don't like high-rate-paying banks—I just don't like them," said Bair, as a general view. She said IndyMac was an example of the costs posed for resolving high-paying institutions.

While that was her general attitude, Bair noted that her agency faced a "balancing act," in her words, in taking over the thrift. She said she believed that the high rates were continued only for depositors who had already contracted for those rates, not for new customers. She reminded the audience that FDIC was attempting to preserve the institution's franchise value so it could be sold at an opportune time.

• When FDIC runs your competition.

The same banker also objected to FDIC's decision to engage in massive loan modifications in order to avoid foreclosure in as many cases, in temporarily managing IndyMac, as possible.

The banker complained that FDIC's efforts "took foreclosure on a property off the table" when his staff negotiated with his bank's troubled residential mortgage borrowers, because of the perception that if IndyMac borrowers could avoid it, they could entertain hopes of doing so too.

Bair didn't show much sympathy on this point. She reminded the banker that FDIC was attempting to save as many homeowners as possible—the IndyMac effort became a strategy available on the agency's website for other lenders to emulate. Bair has opined for months that the home lending industry had to make program-level changes to avoid foreclosures, rather than piecemeal, deal by deal efforts. She also pointed out that avoiding foreclosure saves funds, and that FDIC must attempt to minimize its costs of resolution.

• Can't FDIC avoid tainting real estate markets further?

It was a meeting where bankers deeming themselves hurt by FDIC actions felt no compunction to take it to the chief of the agency that they felt hurt them.

One banker complained that FDIC was effectively dumping assets and properties acquired through failed-bank resolutions on open markets, thereby driving down values even further than the economy has already done.

Bair explained that the agency felt it was best to put assets back into the private sector as quickly as possible. She also pointed out that accountants looking at banks' holdings and appraisers re-appraising bank-held properties or properties securing bank loans should not be using FDIC-sold assets as a gauge for valuation. Such assets are sold as distress sales, she noted, and should not be considered comparative.

• Must we take the emergency assessment hit all at once?

A Georgia banker expressed his concern that the emergency assessment could wipe out earnings for 2009. He asked if there wasn't some accounting treatment that would enable banks to spread the costs of the proposed special charge over time.

"We explored that with the accountants," said Bair, "and it was a 'no-go'." However, she invited anyone with an accounting brainstorm that would serve this purpose to come forward.

• FDIC's take on fair-value accounting.

Bair was asked about the mark-to-market controversy. "I don't know that we can say it has had a direct impact on Deposit Insurance Fund losses," she answered. "But it is hard to mark to market when there is no market."

Bair declined to go where the questioner clearly hoped she would—calling for total repeal of the concept.

While she felt banks ought to have flexibility, she said, "there needs to be integrity in bank balance sheets. . . . Unless we strike the right balance, we won't have an exit strategy for the government." Investors, she said, had to have financials they could count on. BJ

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