FEDERAL DEPOSIT INSURANCE CORPORATION, Washington, DC 20429

SHEILA C. BAIR
CHAIRMAN

April 30, 2010

Honorable Christopher J. Dodd
Chairman
Committee on Banking, Housing, and Urban Affairs
United States Senate
Washington, D.C. 20510

Honorable Blanche L. Lincoln
Chairman
Committee on Agriculture, Nutrition and Forestry
United States Senate
Washington, D.C. 20510

Dear Chairman Dodd and Chairman Lincoln:

Thank you for reaching out to the Federal Deposit Insurance Corporation for our views on Title VII of the "Wall Street Transparency and Accountability Act" contained in S. 3217, the "Restoring American Financial Stability Act of 2010." At the outset, I would like to express my strong support for enhanced regulation of "over-the-counter" (OTC) derivatives and the provisions of the bill which would require centralized clearing and exchange trading of standardized products. If this requirement is applied rigorously it will mean that most OTC contracts will be centrally cleared, a desirable improvement from the bilateral clearing processes used now. I would also like to express my wholehearted endorsement of the ultimate intent of the bill, to protect the deposit insurance fund from high risk behavior.

I would like to share some concerns with respect to section 716 of S. 3217, which would require most derivatives activities to be conducted outside of banks and bank holding companies. If enacted, this provision would require that some $294 trillion in notional amount of derivatives be moved outside of banks or from bank holding companies that own insured depository institutions, presumably to nonbank financial firms such as hedge funds and futures commission merchants, or to foreign banking organizations beyond the reach of federal regulation. I would note that credit derivatives – the riskiest – held by banks and bank holding companies (when measured by notional amount) total $25.5 trillion, or slightly less than nine percent of the total derivatives held by these entities.

At the same time, it needs to be pointed out that the vast majority of banks that use OTC derivatives confine their activity to hedging interest rate risk with straightforward interest rate derivatives. Given the continuing uncertainty surrounding future movements in interest rates and the detrimental effects that these could have on unhedged banks, I encourage you to adopt an approach that would allow banks to easily hedge with OTC derivatives. Moreover, I believe that directing standardized OTC products toward exchanges or other central clearing facilities would accomplish the stabilization of the OTC market that we seek to enhance, and would still allow banks to continue the important market-making functions that they currently perform.

In addition, I urge you to carefully consider the underlying premise of this provision - that the best way to protect the deposit insurance fund is to push higher risk activities into the so-called shadow sector. To be sure, there are certain activities, such as speculative derivatives trading, that should have no place in banks or bank holding companies. We believe the Volcker rule addresses that issue and indeed would be happy to work with you on a total ban on speculative trading, at least in the CDS market. At the same time, other types of derivatives such as customized interest rate swaps and even some CDS do have legitimate and important functions as risk management tools, and insured banks play an essential role in providing market-making functions for these products

Banks are not perfect, but we do believe that insured banks as a whole performed better during this crisis because they are subject to higher capital requirements in both the amount and quality of capital. Insured banks also are subject to ongoing prudential supervision by their primary banking regulators, as well as a second pair of eyes through the FDIC's back up supervisory role, which we are strengthening as a lesson of the crisis. If all derivatives market-making activities were moved outside of bank holding companies, most of the activity would no doubt continue, but in less regulated and more highly leveraged venues. Even pushing the activity into a bank holding company affiliate would reduce the amount and quality of capital required to be held against this activity. It would also be beyond the scrutiny of the FDIC because we do not have the same comprehensive backup authority over the affiliates of banks as we do with the banks themselves. Such affiliates would have to rely on less stable sources of liquidity, which – as we saw during the past crisis – would be destabilizing to the banking organization in times of financial distress, which in turn would put additional pressure on the insured bank to provide stability. By concentrating the activity in an affiliate of the insured bank, we could end up with less and lower quality capital, less information and oversight for the FDIC, and potentially less support for the insured bank in a time of crisis. Thus, one unintended outcome of this provision would be weakened, not strengthened, protection of the insured bank and the Deposit Insurance Fund, which I know is not the result any of us want

A central lesson of this crisis is that it is difficult to insulate insured banks from risk taking conducted by their nonbanking affiliated entities. When the crisis hit, the shadow sector collapsed, leaving insured banks as the only source of stability. Far from serving as a source of strength, bank holding companies and their affiliates had to draw stability from their insured deposit franchises. We must be careful not to reduce even further the availability of support to insured banks from their holding companies. As a result, we believe policies going forward should recognize the damage regulatory arbitrage caused our economy and craft policies that focus on the quality and strength of regulation as opposed to the business model used to support it.

The FDIC is pleased to continue working with you on this important issue to assure that the final outcome serves all of our goals for a safer and more stable financial sector. We hope that a compromise can be achieved by perhaps moving some derivatives activity into affiliates, so long as capital standards remain as strict as they are for insured depositories and banks continue to be able to fully utilize derivatives for appropriate hedging activities.

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Please do not hesitate to contact me at [redacted] or have your staff contact Paul Nash, Deputy Director for External Affairs, at [redacted]

Sincerely,

[redacted]

Sheila C. Bair

FEDERAL DEPOSIT INSURANCE CORPORATION, Washington, DC 20429

SHEILA C. BAIR
CHAIRMAN

May 7, 2010

Honorable Susan M. Collins
Ranking Minority Member
Committee on Homeland Security and Governmental Affairs
United States Senate
Washington, D.C. 20510

Dear Senator Collins:

I am writing to express my strong support for your amendment number 3879 to ensure strong capital requirements for our nation's financial institutions. This amendment is a critical element to ensure that U.S. financial institutions hold sufficient capital to absorb losses during future periods of financial stress. With new resolution authority, taxpayers will no longer bail out large financial institutions. This makes it imperative that they have sufficient capital to stand on their own in times of adversity.

During the crisis, FDIC-insured subsidiary banks became the source of strength both to the holding companies and holding company affiliates. Far from being a source of strength to banks as Congress intended, holding companies became a source of weakness requiring federal support. If, in the future, bank holding companies are to become sources of financial stability for insured banks, then they cannot operate under consolidated capital requirements that are numerically lower and qualitatively less stringent than those applying to insured banks. This amendment would address this issue by requiring bank holding companies to operate under capital standards at least as stringent as those applying to banks.

The crisis also demonstrated the dangers of excessive leverage undertaken by large nonbanks outside of the scope of federal bank regulation. Notable examples included the excessive leverage of the largest investment banks during the run-up to the crisis, and the extremely high leverage of Fannie Mae and Freddie Mac. To remedy this and prevent regulatory gaps and arbitrage, large nonbank financial institutions deemed to be systemic must be held to the same, or higher, capital standards as those applying to banks and bank holding companies. Again, the amendment accomplishes this goal simply and directly.

Finally, and more broadly, the crisis identified the dangers of a regulatory mindset focused exclusively on the soundness of individual banks without reference to the "big picture." For example, an individual overnight repo may be safe, but widespread financing of illiquid securities with overnight repos left the system vulnerable to a liquidity crisis. A financial system-wide view requires regulators, working in conjunction with the new Financial Services Oversight Panel, to develop capital regulations to address the risks of activities that affect the broader financial system, beyond the bank that is engaging in the activity.

We at the FDIC remain committed to working with you towards a stronger financial system. This amendment will be an important step in accomplishing this goal.

If you have further questions or comments, please do not hesitate to contact me at
(b)(2) [redacted] or Paul Nash, Deputy for External Affairs, at [redacted] (b)(2)

Sincerely,

[redacted]

Sheila C. Bair

FEDERAL DEPOSIT INSURANCE CORPORATION, Washington, DC 20429

OFFICE OF THE CHAIRMAN

May 11, 2010

Honorable Christopher J. Dodd
Chairman
Committee on Banking, Housing, and Urban Affairs
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

I write in strong support of a provision within the Dodd-Lincoln derivatives substitute amendment that prohibits derivatives and securities clearinghouses from accessing the Federal Reserve discount window. This provision is in conflict with Section 806(b) of the Wall Street Transparency and Accountability Act that could provide discount window access to clearinghouses and other designated financial market utilities. While I support eliminating discount window access for clearinghouses, I support preserving their access to broadly-based assistance provided under Section 13(3).

Clearinghouse access to this potentially routine government liquidity would constitute an unprecedented expansion of the discount window to entities other than insured depository institutions. Such an expansion, over time, could increase risk by enabling clearinghouses to rely on government liquidity instead of more prudent and market-based risk management practices. Giving a clearinghouse the ability to access "one-off" support through discount window lending could significantly increase moral hazard and the likelihood that a clearinghouse might require a bailout in the future.

While some insured depository institutions may come within the definition of "financial market utilities" as used in the bill, they already have access to the discount window. Further expanding access is in direct conflict with a central goal of the legislation: to protect the American public by lowering the risk of future taxpayer bailouts.

Accordingly, I would propose deleting section 806(b), which authorizes the Federal Reserve Board to enable Federal Reserve Banks to provided discount window borrowing privileges to "designated financial market utilities" (i.e., clearing facilities), but retaining robust clearinghouse oversight. In an extreme and extraordinary circumstance, the Federal Reserve should have adequate authority under Section 13(3) to make assistance generally available to clearinghouses.

If you have questions or comments, please do not hesitate to contact me at [redacted] (b)(2)
(b)(2) [redacted] or Paul Nash, Deputy for External Affairs, at [redacted] (b)(2)

Sincerely,

[redacted]

Sheila C. Bair

FEDERAL DEPOSIT INSURANCE CORPORATION, Washington, DC 20429

SHEILA C. BAIR
CHAIRMAN

May 17, 2010

Honorable Carl Levin
Chairman
Permanent Subcommittee on Investigations
Committee on Homeland Security and Governmental Affairs
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

I am writing to express my strong support for the amendment to S. 3217 that you are co-sponsoring with Senator Kaufman and Senator Reed on back-up examination and enforcement authority for the Federal Deposit Insurance Corporation. I also would like to express my appreciation for the diligent efforts of the Permanent Subcommittee on Investigations to examine the causes of the financial crisis and remedies to help prevent a recurrence of the mistakes that led to the current crisis.

The amendment would provide vital improvements to the FDIC's back-up examination and enforcement authority to protect the Deposit Insurance Fund and help facilitate the orderly liquidation of large systemically important financial companies. This enhanced examination and enforcement authority is a key element in ending the too-big-to-fail doctrine.

S. 3217, the *Restoring American Financial Stability Act of 2010* would give the FDIC the important responsibility of providing for the orderly liquidation of large systemically important financial organizations (defined as covered financial companies under the Act). The ability to close these large, complex companies and place them into receivership in a manner similar to banks is essential to ending too-big-to-fail.

In order to plan for the potential failure of such a company, the FDIC needs back-up examination authority. The FDIC's access to timely information on the condition of these large companies is especially important in light of the recently adopted Shelby-Dodd amendment to Title II of S. 3217. Under that amendment, the FDIC will be required initially to fund its liquidation operations and activities through a line of credit with Treasury, the amount of which is dependent on the value of the assets of the company to be resolved. As a result, the FDIC will need timely access to information about the condition of a troubled company, through an examination if need be, to determine the value of the company's assets and to otherwise prepare for its resolution. We note that the Treasury's 2009 White Paper on financial regulatory reform, "A New Foundation: Rebuilding Financial Supervision and Regulation," recommended that the FDIC have holding company backup authority; and H.R. 4173, the Wall Street Reform and

Consumer Protection Act of 2009, which passed the House on December 11, 2009, also expands the FDIC's authority in this area. The Levin-Kaufman amendment provides the FDIC back-up examination authority of the large financial companies supervised by the Federal Reserve as well as depository institution holding companies generally.

As you know, the FDIC is the primary federal regulator for nearly 5,000 state-chartered depository institutions that are not members of the Federal Reserve System. In addition to its role as primary federal regulator for most state-chartered depository institutions, the FDIC has back-up authority to examine the other 3,000 FDIC-insured institutions and take enforcement actions in a case where the primary regulator does not act to correct a violation or deficiency in a timely manner.

The Levin-Kaufman amendment addresses regulatory gaps examined by the Subcommittee during its hearing on the failure of Washington Mutual (WaMu). Current law and an implementing agreement with the other three primary federal banking regulators have prevented FDIC supervision staff from obtaining timely access to information on the condition of FDIC-insured institutions at critical times. In the case of WaMu, the FDIC was not able to fully participate in examinations, and the FDIC's access to critical information on the mortgage operations that eventually led to WaMu's failure was restricted.

The Levin-Kaufman amendment would go a long way toward preventing a recurrence of such events. The amendment would streamline the FDIC's exercise of its back-up examination authority by giving the FDIC Chairperson, in addition to the Board of the FDIC, the ability to authorize a back-up examination of a depository institution. Because the operations and conditions of a depository institution and its holding company are inexorably intertwined, the amendment would give the FDIC back-up authority to examine a depository institution's holding company as well.

The Levin-Kaufman amendment would further enhance the FDIC's ability to obtain needed information on the condition of a depository institution, holding company, or nonbank financial company. The amendment would allow the FDIC to obtain the information directly from these entities, whenever readily available information from other regulators is inadequate.

Importantly, the Levin-Kaufman amendment would streamline the process for exercising the FDIC's back-up enforcement authority. The amendment would give the FDIC Chairperson, in addition to the Board of the FDIC, the ability to authorize an enforcement action against a depository institution or depository institution holding company whenever the primary regulator fails to take an enforcement action recommended by the FDIC within 60 days. By allowing the Chairperson to act, the Levin-Kaufman amendment ensures that the FDIC can act quickly to prevent losses to the Deposit Insurance Fund and ensure the orderly liquidation of a covered financial company.

The Levin-Kaufman amendment provides the FDIC important tools to protect the Deposit Insurance Fund and, in the event of a failure, promote financial stability through orderly liquidation of systemically important financial company, while ending too-big-to-fail. I applaud your leadership on this important amendment and your work to ensure the soundness of the financial system.

If you have further questions or comments, please do not hesitate to contact me at
(b)(2) [redacted] or Paul Nash, Deputy for External Affairs, at [redacted]. (b)(2)

Sincerely,

[redacted]

Sheila C. Bair

cc: Senator Dodd
Senator Shelby

FEDERAL DEPOSIT INSURANCE CORPORATION, Washington, DC 20429

SHEILA C. BAIR
CHAIRMAN

June 17, 2010

Honorable Luis V. Gutierrez
Chairman
Subcommittee on Financial Institutions and Consumer Credit
Committee on Financial Services
House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman:

I am writing in response to your request for my views on your proposal for a pre-funded working capital reserve (ex ante fund) for the orderly liquidation of systemically important financial institutions. My public support for an ex ante fund is long held and well documented.

Foremost among the needed financial reforms is a new legal and regulatory framework to resolve the failure of a large interconnected financial firm similar to the regime long in place for insured banks and thrifts. Such a liquidation regime would provide the government with the tools to ensure the orderly winding down of these institutions, without disrupting the broader economy, while imposing the losses on shareholders, bondholders, and other creditors. It also would bring sorely lacking market discipline to our largest institutions. A key element for such a regime – as it is for banks – is adequate working capital to be used by the receiver to provide temporary financing to maintain operations as the institution is broken up and sold off.

The House passed bill, as well as the bill approved by the Senate Banking Committee, would impose assessments on large, interconnected non-bank financial institutions to build a working capital fund "up front." The Senate passed bill would instead require the FDIC to borrow from a line of credit established by the Treasury Department and assess the industry "ex post" to repay the Treasury Department for any shortfall. Ex post assessments could, I believe, result in either pro-cyclical assessments during an economic crisis, or multi-year delays in repayment. In contrast, an ex ante fund would provide the FDIC with the ability to charge regular assessments in "good times," providing more predictability to covered financial companies and better capacity to manage their expenses. The ex ante fund also would give the FDIC the authority to impose risk-based assessments on all large, interconnected firms, requiring the riskiest firms to pay the most. To avoid double charging banks that already pay deposit insurance premiums, your proposal appropriately bases the assessments on assets held outside of insured depositories.

As I have previously stated, I believe an ex ante fund provides better protection for taxpayers than a system borrowing all funds from the Treasury Department when needed and then repaying the borrowings through after-the-fact industry assessments. Even though it is contemplated that the funds will be fully repaid by the industry, the immediate temporary use of government funds would undoubtedly be viewed by the public as a government bailout. With the ex ante fund, any temporary use of government assistance would occur only if and when the industry funding is depleted. Finally, your proposal provides further protection for taxpayers by requiring the FDIC to recoup any costs associated with the resolution through additional post-failure industry assessments.

I appreciate that some believe an ex ante assessment could be viewed as a "bailout fund" and thus it is preferable to establish a Treasury line of credit. To address those concerns, I would only ask that one analyze the strong record of the FDIC in protecting the Deposit Insurance Fund (DIF). For over 75 years, the FDIC has maintained the DIF scrupulously in conformance with its statutory mandate – to protect insured depositors. The FDIC would be equally as scrupulous in protecting the integrity of an ex ante resolution fund, consistent with the express terms of this legislation.

Your proposal also places the budgetary burden of the new systemic risk regulatory regime where it belongs – on the entire non-bank financial sector. Resolution of insured banks will continue to be funded through the DIF. Over the decades, insured banks have paid heavily into the DIF to maintain the integrity of industry funding of deposit insurance, and this has been particularly true during the recent crisis. At the same time, as the financial crisis hit, the shadow sector collapsed into the regulated banking sector, reaping substantial benefits from the stabilization measures that were instituted. The burden of nonbank resolution authority should fall on nonbanks, and the FDIC is vigorously opposed to any proposal that meets pay-go requirements on the back of the Deposit Insurance Fund. The new resolution authority -- like many other parts of this bill – is necessitated by instability created by the explosive growth of the shadow sector, and the shadow sector should pay for its costs. Since the current financial crisis began in 2008 the commercial banking sector has already paid in more than $65 billion to stabilize the financial sector through assessments to recapitalize the DIF. Commercial banks are projected to pay almost another $80 billion under the current DIF recapitalization plan by 2016.

Thank you for considering my views.

Sincerely,

[redacted]

Sheila C. Bair

FEDERAL DEPOSIT INSURANCE CORPORATION, Washington, DC 20429

SHEILA C. BAIR
CHAIRMAN

June 22, 2010

Honorable Susan Collins
United States Senate
Washington, D.C. 20510

Dear Senator Collins:

I am writing to express my continued support for your amendment to strengthen the capital regulation of the U.S. banking system and systemically important nonbank financial institutions.

The amendment ensures that our largest financial institutions, including those that benefited the most from federal support during the crisis, will adhere to capital requirements at least as stringent as those applying to thousands of community banks nationwide. The amendment requires bank holding companies' capital requirements to be at least as stringent as those of banks, ensuring they can serve as a source of strength to their subsidiary banks rather than a source of weakness as we saw too often during the crisis. Requiring large nonbank firms regulated by the Federal Reserve to adhere to capital requirements as strict as those faced by banks addresses the problem of regulatory capital arbitrage that fueled risk-taking in the years before the crisis.

One of the implications of the amendment has attracted a great deal of attention. Specifically, trust preferred securities, which are not permitted as tier 1 capital for insured banks, would not be permitted as tier 1 capital for bank holding companies. I view this as an important and necessary change.

Over the past several years, the capital bases at the largest financial institutions have become diluted with trust preferred securities and other debt instruments that "look" like capital in good times, but that fail to absorb losses when called upon. Institutions became very savvy at exploiting legal, accounting, and regulatory rules to create and issue well over a hundred billion dollars in trust preferred securities in the boom years of the 1990s and 2000s. Trust preferred securities proved highly attractive to investors insofar as they legally commit bank holding companies to pay dividends or risk going into default. (In fact, the tax code treats them as debt, making the interest deductible to the bank holding company.) The ease of issuing these debt-like instruments as "capital" fueled growth at many weaker institutions, allowing them to increase leverage and risk taking.

However, as the crisis hit, these securities became a significant burden on troubled bank holding companies, making them a drain -- not a source of strength – for their subsidiary banks. The market had no confidence in trust preferred securities as loss-absorbing capital and notably, the regulators did not give credit for trust preferred securities in conducting the stress tests of capital adequacy in 2009.

Another significant problem is that investors interested in recapitalizing bank holding companies have been discouraged by their inability to persuade holders of trust preferred securities to convert their shares into common equity. Because holders of trust preferred securities have legal rights to cumulative dividends, they have little incentive to subordinate their position to facilitate the infusion of fresh equity capital. This leaves potential acquirers frustrated and unable to complete an open bank transaction, making it more likely the banking organization will fail, exposing the Deposit Insurance Fund to losses that could have otherwise been avoided. The increased leverage facilitated by trust preferred securities, combined with the impediments they pose to recapitalization, will cost the Deposit Insurance Fund billions in resolution costs which must, of course, be borne by the all insured banks through increased deposit insurance assessments.

Your amendment takes aim at the financial engineering that went on in the boom years, and serves as the most concrete and meaningful legislative proposal that I have seen to improve the quality of capital at U.S. banking organizations. Contrary to the argument that your amendment would reduce credit availability, it will actually encourage renewed lending by placing the banking system on a sounder footing with real, tangible common equity. Ask any securities analyst or market participant whether or not they put much value in trust preferred securities during the crisis - the answer is a resounding no. The market believes trust preferred securities are debt – the regulators and Congress should follow suit. The end result of your amendment would be to replace weak, risky debt-like instruments with growth sustaining, true capital.

We appreciate that concerns have been raised by some in the financial services industry that banking organizations should not be required to raise capital as they seek to repair their balance sheets and provide credit support for the recovering economy. The amendments you have agreed to provide ample relief and transition time for financial institutions to adjust to these new requirements. There will always be some industry resistance to increasing capital requirements. In bad times, there will be those who argue that increased capital will constrain lending; in good times, they will argue that increased capital is unnecessary given low delinquency default rates on their loans and other assets. The process of deleveraging will be difficult whenever it occurs, but occur it must. With greater capital cushions, much of the financial crisis could have been averted. Large financial entities would have been constrained in their risk taking and better able to withstand losses, ameliorating the need for costly bailouts.

We have a great opportunity to return to the basic business of banking and away from the financial games that caused significant hardship, the loss of millions of jobs, and significant losses to the Deposit Insurance Fund. The FDIC remains committed to working with you towards accomplishing this goal and we applaud your strong leadership.

Sincerely,

[redacted]

Sheila C. Bair

FEDERAL DEPOSIT INSURANCE CORPORATION, Washington, DC 20429

SHEILA C. BAIR
CHAIRMAN

June 25, 2010

Honorable Hank Johnson
House of Representatives
Washington, D.C. 20515

Dear Congressman Johnson:

Thank you for your letter concerning options available to underserved consumers in need of small-dollar emergency credit. We share your concerns. Expanding the availability of mainstream financial services in general and of affordable small-dollar loans in particular is a significant priority at the Federal Deposit Insurance Corporation.

The FDIC has issued guidelines to encourage banks to offer affordable small-dollar credit products, conducted a pilot program to demonstrate the feasibility of banks offering these products, and continues to explore strategies to scale small-dollar lending across the financial mainstream. As the enclosed report prepared by my staff indicates, we also have pursued initiatives to increase underserved consumers' access to savings and financial literacy as an option to potentially avoid costly forms of emergency credit.

As the enclosed material describes in more detail, the FDIC's small-dollar loan pilot program had 28 banks located in 27 states that provided loans up to $2,500 at annual percentage rates of less than 36 percent. These loans had low or no fees and loan terms of at least 90 days to give consumers time to repay. The FDIC's Advisory Committee on Economic Inclusion (ComE-IN) is meeting on Thursday, June 24 to review how lessons learned from the pilot and other strategies can be used to encourage more banks to offer safe, affordable and feasible small-dollar loans. We contacted your staff to invite them to the meeting or to view it live via Webcast at http://www.vodium.com/goto/fdic/advisorycommittee.asp.

Through these steps and by working with other interested groups, the FDIC looks forward to the day when affordable small-dollar loans become a staple product at all banks. If you have further questions or comments, please do not hesitate to contact me at [redacted] (b)(2)
(b)(2) or Paul Nash, Deputy for External Affairs, at [redacted]

Sincerely,

[redacted]

Sheila C. Bair

Enclosures

Response to an Inquiry by
The Honorable Hank Johnson

The following information is provided by the Federal Deposit Insurance Corporation

Like all of us, underserved consumers need to cash their paychecks, pay bills, and save for the future with products that are safe, affordable, and easy to understand.[1] They also need access to reasonably-priced credit to buy a car or a home, pay for their children's education, and, of particular relevance to your inquiry, to meet unexpected financial emergencies. As you point out, there is a great demand for small-dollar credit to cover emergencies; but all too often, consumers turn to high-cost products to meet their needs. For example, outside sources estimate payday loan volume to be in excess of $40 billion annually and overdraft fees at more than $38 billion per year.[2] Annual percentage rates (APRs) for these products can top several hundred, or even thousand, percent.

The FDIC believes that banks already have the tools and infrastructure to create small-dollar emergency credit products that are affordable for consumers and beneficial for banks. To that end, we have taken a number of steps to help stimulate an increase in bank offerings of reasonably-priced, safe and sound alternatives to high-cost emergency credit. We also believe that enhancing opportunities to save and bolstering financial literacy can help underserved consumers better manage economic disruptions, and perhaps avoid using short-term credit altogether. We have taken a multi-pronged approach to addressing the issues raised in your letter. Our efforts relate to savings and financial literacy, and our overall economic inclusion initiatives are described in detail below. The efforts are concentrated in the six following key areas:

- Use of our Advisory Committee on Economic Inclusion to stimulate discussion and obtain information about the issues you raise;
- Our small-dollar loan guidelines and pilot program;
- Development of safe, low-cost transactional and savings account templates;
- Ongoing financial literacy education and outreach through the FDIC's *Money Smart* initiative;
- Coalition building through the Alliance for Economic Inclusion; and
- FDIC surveys on underbanked and unbanked, and other economic inclusion research.

[1] "Underserved" refers to "unbanked" and "underbanked" populations. "Unbanked" generally means consumers do not have a checking or savings account with a mainstream financial institution. "Underbanked" generally refers to consumers that have a bank account, but also use non-bank, alternative financial services and products and providers, such as money orders, check cashing services, payday loans, rent-to-own agreements, pawn shops, or refund anticipation loans.
[2] The payday loan estimate is from "Economic Impact of the Payday Lending Industry," HIS Global Insight (USA) Consulting Services Group, May 2009, which in turn cites an April 17, 2008 report from Stephens, Inc., "Industry Report: Payday Loan Industry" as the source for the estimate. The overdraft estimate is from "Bank Overdraft Fees to Total $38.5 billion," CNNMoney.com, August 10, 2009, which in turn cites an August 2009 report from Moebs Services as the source for the estimate.

Advisory Committee on Economic Inclusion

Upon the approval of the FDIC's Board of Directors, Chairman Bair established the FDIC Advisory Committee on Economic Inclusion (the Committee) in 2006 and extended its two-year charter in 2008. The Committee is comprised of representatives from banks, academics, consumer and community groups, and government agencies. The purpose of the Committee is to provide advice and recommendations to the FDIC regarding expanding access to banking services by underserved populations.

In April 2010, the Committee adopted a strategic plan. As reflected in that plan, the Committee's objectives are to (1) lower the level of underserved households and (2) increase the supply of financial products and services targeted to underserved households. The Committee has outlined project initiatives to help meet its objectives. Initiatives are concentrated in, but are not limited to, the following program areas: Transactional Accounts, Savings, Affordable Credit, Financial Literacy, Incentives, and Safe Mortgages. A copy of the Committee's strategic plan is enclosed.

Small-Dollar Loan Guidelines

In June 2007, the FDIC issued the Affordable Small-Dollar Loan Guidelines (the guidelines), to encourage financial institutions to offer small-dollar credit products that are affordable, yet safe and sound and consistent with all applicable federal and state laws. The guidelines explore several aspects of loan product development, including affordable prices, reasonable loan terms, streamlined underwriting, and the benefits of linking saving and financial education to short-term loan products.

In response to your question about the supervisory treatment of small-dollar loans, the guidelines state "Safe and sound small-dollar lending programs that comply with consumer protection laws will not be criticized by FDIC examiners. Importantly, the FDIC recognizes that the Community Reinvestment Act (CRA) provides a valuable incentive to offer affordable small-dollar loans. Institutions that provide such products consistent with these guidelines will receive favorable CRA consideration as outlined in the CRA section below." A copy of the guidelines is enclosed.

Small-Dollar Loan Pilot Program

In February 2008, the FDIC launched a two-year case study known as the FDIC Small-Dollar Loan Pilot (the pilot) to determine the feasibility of banks offering small-dollar loans as an alternative to high-cost emergency credit sources, such as payday loans or fee-based overdraft programs. Twenty-eight banks participated with total assets ranging from $27 million to $10 billion, with almost 450 branches in 27 states.

The pilot concluded as of the fourth quarter 2009. During the pilot, banks made 34,400 loans with a principal balance of $40.2 million. Defaults on loans originated under the pilot are in line with the default rates for consumer loans generally. Perhaps most importantly, the pilot shows that banks can offer affordable small-dollar loans in a manner that suits their business plans and is fair to consumers.

The pilot has resulted in a model, or template, of product elements that can produce a safe, affordable, and feasible small-dollar loan. Product elements include loan amounts of $2,500 or less, loan terms of at least 90 days or more, APRs of 36 percent or less, low or no fees, streamlined but solid underwriting and optional savings and financial education components.

The template is replicable in that it is simple and requires no particular technology or other major infrastructure investment. Moreover, adoption of the template could help banks better adhere to existing regulatory guidance regarding offering alternatives to fee-based overdraft protection programs.[3] Specifically, this guidance suggests that banks should "monitor excessive consumer usage (of overdrafts), which may indicate a need for alternative credit arrangements or other services, and inform consumers of these available options" that could include small-dollar credit products.

Best practices and elements of success emerged from the pilot and underpin the template. In particular, a dominant business model emerged: most pilot bankers indicated that small-dollar loans were a useful business strategy for developing or retaining long-term relationships with consumers. In terms of overall programmatic success, bankers reported that long-term support from a bank's board of directors and senior management was most important. The most prominent product element bankers linked to the success of their program was a loan term longer than just a few pay cycles to give consumers time to repay.

Going forward, the FDIC is working with the banking industry, consumer, community, and philanthropic groups, other government agencies, innovators in small-dollar lending, and others to research and pursue strategies that could prove useful in expanding the supply of small-dollar loans. Among other things, these strategies include:

- Highlighting the facts about the pilot and other successful small-dollar loan models.
- Studying the creation of pools of nonprofit or government funds to serve as "guarantees" for small-dollar loans.
- Encouraging broad-based partnerships among banks, nonprofit organizations, and community groups to work together in designing and delivering small-dollar loans.
- Studying the feasibility of safe and innovative emerging small-dollar loan technologies and business models.
- Considering ways that regulators can encourage banks to offer safe and affordable small-dollar loan products and that these products can receive favorable CRA consideration.

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[3] "Overdraft Protection Programs, Joint Agency Guidance" Financial Institution Letter, February 18, 2005, http://www.fdic.gov/news/news/financial/2005/fil1105.html.

The FDIC released the results from the first year of the pilot in July 2009. A copy of the report is enclosed. Final results of the pilot program will be discussed at the next Committee meeting on June 24, 2010 and released shortly thereafter.

Safe, Low-Cost Account Templates

On May 7, 2010, the FDIC published, for a 30-day comment period, proposed templates describing potential features for safe, low-cost transactional and basic savings account products for low- and moderate-income (LMI) consumers. The templates provide a roadmap for basic account elements to encourage insured financial institutions to make safe, low-cost transactional and basic savings account products more widely available to LMI consumers. Expanded access to safe and affordable bank accounts could provide more underserved consumers with the option of tapping savings for emergencies, rather than relying on high-cost forms of credit.

The guiding principles in developing these templates are that these financial products have low and transparent fees; are simple to use; include easily understandable terms and conditions; are FDIC-insured and subject to consumer protection laws, regulations and guidelines; and represent sustainable product offerings for financial institutions.

Financial Literacy: the Money Smart Initiative

The FDIC initiated a national financial education campaign in 2001 by launching *Money Smart*, a comprehensive financial education curriculum designed to help individuals outside the financial mainstream develop financial skills and positive banking relationships. Over 2.4 million consumers have been reached with Money Smart and over 1,600 organizations are part of the FDIC's Money Smart Alliance. Money Smart is available in seven languages, comes in adult and young adult versions, and is available for consumers to complete independently online or through a MP3 player.

A 2007 study of the effectiveness of Money Smart showed that financial education can improve an individual's overall financial well-being and reduce reliance on costly credit. For example, two-thirds of Money Smart graduates reported an increase in savings after completing the course, while more than one-half reported a decrease in debt. A copy of a report describing the study is enclosed.

The FDIC continues to form alliances with public, private, and non-profit entities to promote financial education and encourage linkages between financial education and access to mainstream banking services.

Alliance for Economic Inclusion

The Alliance for Economic Inclusion (AEI) is the FDIC's national initiative to establish coalitions of financial institutions, local policymakers, community-based and consumer organizations, and other partners in 14 markets across the country to bring unbanked and underserved populations into the financial mainstream. The focus of AEI is on expanding basic retail financial services to underserved populations, including savings accounts, affordable remittance products, small-dollar loan programs, targeted financial education programs, and asset-building programs. The number of AEI members nationwide is 967, and 35 banks offer or are developing small-dollar loan programs.[4]

FDIC Unbanked and Underbanked Surveys and Other Economic Inclusion Research

Section 7 of the Federal Deposit Insurance Reform Conforming Amendments Act of 2005 (Pub. L. 109-173) requires the FDIC to conduct ongoing surveys "on efforts by insured institutions to bring those individuals and families who have rarely, if ever, held a checking account, a savings account, or other type of transaction or check cashing account at an insured depository institution into the conventional finance system." The Act further requires the FDIC to provide a "fair estimate of the size and worth of the 'unbanked' market in the United States."

To satisfy the congressional mandate, the FDIC designed two complementary national surveys: a survey of FDIC-insured depository institutions (bank survey) and a survey of households (household survey). The bank survey focused on collecting data related to banks' efforts to serve unbanked and underbanked populations. The bank survey results were released to the public in February 2009, and among its key findings was that while 73 percent of banks are aware of significant underserved populations in their market area, less than 18 percent identify expanding services to these consumers as a priority in their business strategy.

The household survey was conducted in January 2009 as a supplement to the U.S. Census Bureau's Current Population Survey, and the results were released to the public in December 2009. The household survey sought to estimate the size of the unbanked and underbanked markets and to identify the factors that inhibit their participation in the mainstream banking system. The household survey estimated that 7.7 percent of U.S. households are unbanked, while 17.9 percent of U.S. households are underbanked. Certain racial and ethnic groups are more likely to be underserved than the population as a whole. Almost 54 percent of black households, 44.5 percent of American Indian/Alaskan households, and 43.3 percent of Hispanic households are underserved.

The results of these surveys provide new and valuable information to policymakers, the banking industry, and other organizations interested in expanding safe and affordable financial access to underserved populations. The surveys will be repeated in 2011. Copies of the executive summaries for both surveys are enclosed. Additional data for the household survey is available in an interactive format on www.economicinclusion.gov, a website established by the FDIC to highlight our efforts to expand access to the financial mainstream.

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[4] Some of the AEI member banks offering small-dollar loans also participated in the small-dollar loan pilot discussed above.

In addition to the surveys, the FDIC provides research, data, and other resources for consumers, banks, policymakers and others regarding issues related to consumer protection, underserved populations, and the use of alternative financial services. These research materials also are available on www.economicinclusion.gov.

Enclosures

FEDERAL DEPOSIT INSURANCE CORPORATION, Washington, DC 20429

SHEILA C. BAIR
CHAIRMAN

June 29, 2010

Honorable Chris Dodd
Chairman
Committee on Banking
United States Senate
Washington, D.C. 20510

Honorable Barney Frank
Chairman
Committee on Financial Services
House of Representatives
Washington, D.C. 20515

Honorable Richard Shelby
Ranking Minority Member
Committee on Banking
United States Senate
Washington, D.C. 20510

Honorable Spencer Bachus
Ranking Minority Member
Committee on Financial Services
House of Representatives
Washington, D.C. 20515

Dear Chairmen Dodd and Frank and Ranking Members Shelby and Bachus:

Thank you for your interest in our views regarding increasing the Deposit Insurance Fund (DIF) ratio to 1.35.

Federal deposit insurance promotes public confidence in our nation's banking system by providing a safe place for consumers' funds. Deposit insurance has provided much needed stability throughout this crisis. Moreover, insured deposits provide banks with a stable and cost-effective source of funds for lending in their communities. Importantly, the DIF is funded by the insured banking industry.

A key measure of the strength of the insurance fund is the reserve ratio, which is the amount in the DIF as a percentage of the industry's estimated insured deposits. Current law requires us to maintain a reserve ratio of at least 1.15 percent. One of the lessons learned from the current crisis is that a minimum reserve ratio of 1.15 is insufficient to avoid the need for pro-cyclical assessments in times of stress. One of my first priorities when I assumed the Chairmanship of the FDIC in June of 2006 was to begin building our reserves. Regrettably, there was insufficient time before the crisis hit. Indeed, we started this crisis with a DIF reserve ratio of 1.22 percent (as of December 31, 2007). Beginning in mid-2008, as bank failures increased and the insurance fund incurred losses, the Fund balance and reserve ratio dropped precipitously. The reserve ratio became negative in the third quarter of 2009 and hit a low of negative 0.39 percent as of December 31, 2009. To date, we have collected more than $65 billion in assessments, and are projected to collect another $80 billion by 2016 to restore the fund.

Given this experience, we believe it is clear that as the economy strengthens and the banking system heals, the reserve ratio needs to be increased. In fact, our Board has acted through regulation to target the reserve ratio at 1.25 percent, and a further increase to 1.35 percent is consistent with our view that the Fund should build up in good economic times and be allowed to fall in poor economic times, while maintaining relatively steady premiums throughout the economic cycle, thereby reducing the procyclicality of the assessment system.

Please let me know if you have any questions or would like to discuss further.

Sincerely,

[redacted]

Sheila C. Bair