FEDERAL DEPOSIT INSURANCE CORPORATION, Washington, DC 20429

SHEILA C. BAIR
CHAIRMAN

October 2, 2009

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

Dear Chairman Frank:

Thank you for your letter regarding specific consumer protection actions and initiatives undertaken by the Federal Deposit Insurance Corporation over the past ten years. I appreciate the opportunity to respond.

As the nation's federal deposit insurer, maintaining consumer confidence and trust in the nation's banking system is a core function. Consumers have confidence in the banking system when banks treat them fairly, and when they can rely on mechanisms both within the industry and those established by government agencies to protect their interests. The FDIC does not consider a bank safe and sound if the bank does not treat its customers fairly. The Deposit Insurance Fund is there to make sure that consumers do not lose their insured deposits, but equally important to consumer confidence is ensuring that consumer protections are enforced on a routine basis, in good times and bad.

It is clear that regulatory gaps in the financial system played a role in exacerbating the current financial crisis. However, the FDIC has continued to take a leadership role in protecting consumers. Whether taking enforcement actions, fostering a dedicated cadre of consumer protection ("compliance") examiners, developing new consumer protection guidance, or serving as a vocal advocate on consumer protection issues, our track record demonstrates that consumer protection at the FDIC has not taken a back seat to any other concerns.

Requesting Additional Consumer Protection Authority

On a number of occasions – most recently in March of this year – in testimony before the House Committee on Financial Services and in the Senate, we have asked for additional rulemaking authority to increase consumer protection (see Attachment A). For example, in June 2007, I said the following before your Committee:

> [R]egulators need to set rules for market participation. Moreover, price competition does not work if consumers do not understand the true cost of financial products. Through appropriate rulemaking, regulators can establish consumer protection against abuses that are strong and consistent across industry and regulatory lines. In addition, there should be meaningful enforcement authority and sufficient resources devoted to that authority. To achieve these goals, I would recommend that Congress consider the following reforms:
>
> - The creation of national standards for subprime mortgage lending by all lenders which could be done by statute or through HOEPA rulemaking;
> - Expand rulemaking authority to all federal banking regulators to address unfair and deceptive practices; and
> - Permit state Attorneys General and supervisory authorities to enforce TILA and the FTC Act against non-bank financial providers. . . .

The FDIC raised some of the earliest alarms about consumer protection problems adversely affecting both consumers and the economy as a whole. In congressional testimony and speeches, the FDIC raised concerns about the need for stronger consumer protections and highlighted the clear connection between consumer protection and safety and soundness. We urged stronger underwriting standards for nontraditional mortgage products, and argued that they were unsuitable for many borrowers.

In addition, in comments submitted to other financial regulatory agencies, the FDIC has strongly advocated for regulatory changes that would protect consumers and strengthen our financial system (see Attachment B). In comment letters we submitted on proposed rules regarding credit cards, mortgages, and other issues, we requested that the relevant agencies:

- Ban yield spread premiums and allow brokers to be fairly compensated by alternative means;
- Restrict marketing of high fee credit cards to consumers as credit repair products;
- Require banks to only pay overdrafts if consumers have affirmatively selected to participate in overdraft coverage;
- Prohibit underwriting based solely on initial teaser rates for all nontraditional mortgages and ban prepayment penalties outright for higher cost loans; and
- Affirmatively require lenders to consider a borrower's debt-to-income ratio in determining repayment ability.

Enforcing Consumer Protection Laws

Bank examination for consumer compliance has been a long-standing part of our supervisory process. Based on our supervisory and enforcement authority, we mandate corrective action, assess substantial penalties, and require consumer reimbursement when we find violations of law, breaches of fiduciary duty, or mismanagement in banks' consumer protection responsibilities.

Over the past 10 years, the FDIC has conducted 34,364 consumer compliance and Community Reinvestment Act (CRA) exams and has taken over 1,500 formal and informal enforcement actions to address consumer protection violations or problems (see Attachment C). Enforcement actions generally are based on examination findings, but can also arise through complaints to our Consumer Response Center or third party referrals. For example, in 2008, the FDIC took 182 consumer protection enforcement actions against the banks we supervise. Illustrating the intersection between consumer protection and safety and soundness, some of these enforcement actions jointly addressed safety and soundness and consumer protection problems.

While the FDIC does not have rulemaking authority for unfair or deceptive acts or practices (UDAP), we have been able to aggressively pursue case-by-case enforcement actions that resulted in substantial penalties and restitution to consumers. For example, in four recent significant cases where UDAP violations were found, our enforcement actions resulted in over $165 million in penalties and restitution (see Attachment C). We have taken action relating to credit cards, overdraft protection programs, automatic teller machines (ATM) usage of debit cards, rewards accounts, and other lending practices.[1] Since 2005, we have cited 75 institutions for violations of UDAP regarding overdraft lines of credit and overdraft balances.

In 2008, the FDIC and the Federal Trade Commission won a major settlement against CompuCredit, a credit card company, for misleading subprime credit card users. As a result, CompuCredit is correcting its practices and providing $114 million in cash and credits to consumers who were improperly assessed fees as a result of inadequate and misleading disclosures. The FDIC also took groundbreaking enforcement actions against three banks that used this same firm's services. The banks have settled with the FDIC, are correcting their practices, and are substantially improving their compliance management systems and their oversight of third-party service providers. In addition, the FDIC assessed civil money penalties in excess of $5 million (see Attachment C for other examples of significant FDIC enforcement actions).

The FDIC also has consistently ensured that consumers receive restitution when Truth-in-Lending discrepancies such as inaccurate finance charges are found and has achieved those results quickly. Over the last 10 years, we have required more than 900 institutions to make restitution to consumers ranging from a few dollars each to several thousand dollars.

Fair Lending Referrals

We have been, and continue to be, committed to addressing discrimination. In 2001, the FDIC established a Fair Lending Examination Specialist Program with examiners dedicated to providing expert fair lending consultation to compliance examiners. Over the past 10 years, the FDIC has made 213 referrals of pattern or practice

[1] In March 2007, the FDIC issued additional guidance to its compliance examiners specifically about Overdraft protection programs and accessing balance information through ATMs, and over the phone or internet (see Attachment E).

fair lending violations to the Department of Justice (DOJ) (see Attachment C). Some of the less significant cases have been referred back to the FDIC for administrative resolution, and we have requested that significant cases involving discriminatory mortgage pricing be referred back to the FDIC in order to speed resolution. For example, at our request, the DOJ returned to the FDIC a case involving First Mariner Bank, and we were able to settle both UDAP and Equal Credit Opportunity Act violations in a $1 million consent order representing $950,000 in restitution to consumers and a $50,000 civil money penalty. We also look for ways to make our consumer protection program more effective, such as by enhancing fair lending examinations through the use of residential pricing data and denial data.

Taking Action Against Third Parties and Coordinating with Other Regulators

In addition to taking action to protect consumers at FDIC-supervised institutions that we have traditionally examined, we use our available authority over institution-affiliated parties to take enforcement action against third parties. For example, we used this authority against a non-bank credit card company, as described in the CompuCredit example. Where the FDIC does not have enforcement authority over third parties, we have worked with other regulators to ensure that proper enforcement actions are taken. One such example is a 2004 case with Commerce Bank & Trust Company and its affiliate 1-800-East-West Mortgage Company. When an examination of the bank identified significant problems in the entire mortgage process with its affiliate, the FDIC worked with the Division of Banks of the Commonwealth of Massachusetts to issue a joint Cease and Desist Order against the Bank and its affiliate. In this case, we also worked with the Department of Housing and Urban Development to settle RESPA violations involving kickbacks for business referrals. In 2008, the FDIC issued guidance that put banks on notice that they will be held accountable for managing activities conducted through third parties. It also made clear that, under appropriate circumstances, we will use our authority to take action against third parties.

Dedicated Examiner Workforce Focused Exclusively on Consumer Protection

The FDIC has established a robust compliance examination program dedicated to consumer protection. Since 2006, our compliance examination staff has increased by more than 40 percent through a combination of entry level and mid-career, experienced staff positions. I want to emphasize that our compliance examiners focus solely on examining banks for consumer protection issues. They are consumer compliance experts by choice and are trained to examine, provide technical assistance on improvements, and cite consumer protection violations. Our 431 consumer compliance examiners have great pride about the work that they do. Their energy and expertise make our consumer protection program effective and strong and they stand ready to enforce the consumer protections laws that Congress puts in place for the future.

Inextricable Relationship Between Consumer Protection and Safety and Soundness

While our consumer compliance examiners are dedicated to consumer protection supervision, we strengthen our compliance program by having compliance examiners and safety and soundness examiners share information and work together, when appropriate. For example, we have launched Joint Examination Teams (JET teams) where examiners from both consumer compliance and safety and soundness examine institutions offering certain products that are of concern to both disciplines. Through this approach, the FDIC was successful in eliminating payday lending partnerships at FDIC-supervised banks. In addition, JET teams have identified unfair or deceptive acts or practices by third-party vendors pertaining to subprime credit cards.

Between 2005 and 2006, the FDIC investigated over a dozen banks that had partnered with payday lenders. Based on the FDIC's consumer protection and safety and soundness concerns, including a concern about inadequate consideration of the consumer's ability to repay the loans, the FDIC achieved the result that these banks are no longer engaged in these payday loan partnerships. In addition, to monitor future payday lending, the FDIC entered into a written agreement with one of the large payday lenders, which agreed to provide advance notice before entering into a payday lending agreement with an FDIC-supervised bank. We also worked closely with the Department of Defense on its rule to protect service members and their families from payday loans and other problematic credit products.

At the FDIC, compliance examination findings are incorporated into both safety and soundness examinations and Community Reinvestment Act (CRA) performance evaluations. When significant issues are found, especially those relating to discrimination and UDAP, banks' overall composite ratings and their public CRA ratings are directly impacted and often downgraded. In addition, our compliance examination findings have a profound impact on whether or not the FDIC will approve an institution's applications to open additional branches or make other changes to its corporate structure. The failure of a bank to properly handle consumer compliance issues or effectively reinvest in the community is always taken into consideration in the application process along with safety and soundness issues.

The FDIC has long believed that consumer protection and safety and soundness are two sides of the same coin. We do not hesitate in taking appropriate supervisory action to address consumer protection-related violations. Our examination process requires that significant consumer compliance violations are evaluated first at the Regional Office level and then referred to senior officials in Washington, D.C. who focus solely on enforcing consumer protection laws. The Washington consumer compliance office, in conjunction with the Legal Division, reviews the violations and determines the appropriate enforcement actions and corrective measures which may include restitution to consumers.

Responding to Consumer Complaints

In addition to supervising the banking system, the FDIC is an invaluable resource to consumers who are having difficulty dealing with their financial institutions (see

Attachment G). Since 2005, the FDIC's Consumer Response Center has received more than 100,000 complaints and questions from consumers about consumer protection matters. The FDIC has been instrumental in helping these individuals resolve their banking issues.

Beyond assisting consumers, our Consumer Response Center is an integral part of the examination process. One of the first things that an examiner does to prepare for a consumer compliance exam is to review consumer complaints. The Center provides examiners a report outlining complaints received against particular banks. When a potential violation or other supervisory concern is identified, the Consumer Response Center works closely with the examination function to assure appropriate follow-up action is taken.

As an example, earlier this year, the FDIC resolved significant issues arising out of complaints from consumers whose credit card convenience checks were not honored by the issuing bank. We required the bank to improve its process for determining customer eligibility for convenience checks and to ensure that the checks are honored consistently with the bank's consumer disclosures. The bank paid a $250,000 Civil Money Penalty for this unfair practice and refunded $160 per dishonored check to an estimated 10,000 affected customers.

Vocal Advocate and Thought Leader for Consumer Protection

I am proud of the leadership role that the FDIC has taken in the consumer protection arena. By encouraging banks to offer responsible products, conducting research on emerging consumer protection issues, and bringing together leaders to foster economic inclusion for all Americans, the FDIC seeks to protect consumers and to empower them to make best use of the American financial system.

Foreclosure Prevention and Loan Modifications

When the housing market was devastated by foreclosures, early on we advocated for long-term sustainable foreclosure prevention programs. Our experience managing foreclosures at IndyMac Bank led us to develop an effective loan modification protocol which served as the model for the Administration's loan modification program. We also designed the "Mod In a Box" which we placed on our website to give all lenders the ability to create streamlined and sustainable loan modifications in an effort to address the growing number of foreclosures throughout the United States.

Small Dollar Loan Program

Through our small-dollar loan pilot program, we have encouraged banks to offer affordable alternatives to high cost payday loans. The pilot is a two year case study designed to identify and amplify models for banks to offer affordable and profitable small dollar loans. After six quarters of results, the 31 banks in the pilot have made nearly 24,000 loans with a balance of more than $28 million. Interestingly, loans made by banks in the pilot are no more likely to default than loans to the general population, and participating bankers report that the loans represent an important cornerstone for profitability.

Financial Literacy

Since 2001, the FDIC's award-winning Money Smart financial education program has helped participants enhance their money management skills by learning the benefits of saving money, effectively managing credit, and avoiding predatory financial practices. Money Smart is available in seven languages and has reached more than 2.4 million individuals. Findings from a longitudinal survey of consumers show that Money Smart can positively influence how people manage their finances, as those who took the Money Smart course were more likely to open deposit accounts, save money, use and adhere to a budget, and have increased confidence in their financial abilities when contacted 6 to 12 months after completing the course.

Overdraft Study

Because little data was available regarding overdraft protection programs, we began a study in 2006 and, in November 2008, we issued our "FDIC Study of Bank Overdraft Programs." This was a two-part study that gathered empirical data on the types, characteristics, and use of overdraft programs operated by FDIC-supervised banks. Our objective was to provide data that would assist policymakers and inform the public of the features and costs related to overdraft programs.

Economic Inclusion

The FDIC's Advisory Committee on Economic Inclusion (ComE-IN) was formed in 2006 to provide advice and recommendations to the FDIC in improving access to the financial mainstream for the 10 million unbanked households and the millions more underbanked households that use alternative financial service providers, often at a very high cost. The Committee is comprised of a diverse mix of academics, bankers, consumer advocates, and government officials to ensure a wide range of views. To date, this Committee has tackled some of the most challenging issues facing underserved consumers, including subprime mortgages and foreclosure prevention, asset building and prize-linked savings strategies, and access to affordable small dollar credit. Advice provided by this Committee has helped shape many aspects of the FDIC's response to issues facing consumers, including the use of CRA ratings and other incentives for banks to provide better access to the financial mainstream, increasing consumer-focused research, and conducting our pilot program for banks offering small dollar loans.

In addition, the Alliance of Economic Inclusion (AEI) was created in June 2006 to work with financial institutions and other partners to bring those currently unbanked and underserved into the financial mainstream. The AEI focuses on expanding banking services in underserved markets, including low- and moderate-income neighborhoods, minority communities and rural areas.

Access to Mortgage Credit

In July 2008, the FDIC hosted a forum to discuss potential solutions to the serious disruption in mortgage credit access that occurred as a result of the burgeoning economic crisis. We convened a distinguished set of experts, including the Secretary of the Treasury, the Chairman of the Federal Reserve, bank CEOs, rating agency officials, investors, academics, and others to discuss how the market for low- and moderate-income (LMI) mortgages could be rejuvenated. As a result of this forum, we issued best practices for lending to LMI consumers for banks and others. Among other findings, these best practices addressed the importance of strong due diligence, mitigating moral hazard or having "skin" in the game, and aligning compensation related to mortgage transactions with loan performance.

Leveraging CRA for Consumer Protection

The FDIC has had a strong commitment to the statutory objectives of the CRA – to expand credit to low- and moderate-income communities and address redlining. Our dedication to CRA is demonstrated through our examination program and the guidance we have issued to banks and examiners. The FDIC's compliance examiners conduct CRA examinations in conjunction with our consumer compliance examinations, which include a strong fair lending component.

As a matter of policy, we emphasize to our examination force that bank CRA ratings must reflect full consideration of consumer protection violations and any discriminatory practices in CRA ratings. As a result, we have consistently linked our rigorous fair lending oversight and UDAP enforcement initiatives to CRA ratings of institutions. Recent examples of CRA downgrades resulting from our consideration of these violations include Columbus Bank and Trust, Republic Bank, and Advanta (see Attachment C).

The FDIC has shown leadership by leveraging CRA to encourage solutions to emerging consumer and community credit needs. For example, in June 2007, we issued guidance (Financial Institution Letter 50-2007) to encourage financial institutions to offer small-dollar credit products and to promote these products to their customers. The guidance informed banks that such loans would be considered favorably under the CRA if they were affordable, safe and sound, consistent with all applicable federal and state laws, and served low- and moderate-income customers.

As you know, we were early advocates for considering loan modification and foreclosure prevention initiatives more fully in CRA evaluations. The focus on effective loan modifications continues to require strong industry encouragement and practical tools for implementation, such as our FDIC foreclosure prevention tool kit, updated on September 16, 2009.

In addition, we have taken a leadership role in working with the other Federal regulators to promote additional interagency guidance to ensure that financial institution responses to these two emerging issues are fully considered during CRA examinations. Guidance on favorable consideration of small loans and loan modifications, for example, has been incorporated into Interagency Questions and Answers.

The FDIC also continues to explore using positive CRA consideration as an incentive for banks to offer products that build wealth and provide for financial security. The FDIC has pursued new initiatives to promote broader access to banking services by traditionally underserved populations and to ensure adequate consumer protection in the provision of these services, including conducting significant surveys and forums on serving the unbanked.

Conclusion

We believe that our record demonstrates our deep commitment to consumer protection. With the advent of the Consumer Financial Protection Agency (CFPA) and the prospect of strong rules applicable to all consumer financial providers, services and products, the FDIC is eager to leverage our dedicated, experienced compliance examination and enforcement staff and other resources to support the CFPA's consumer protection mission.

The enclosed attachments provide more detailed information that we hope is helpful to you. Please let me know if you have questions or need additional information.

Sincerely,

[redacted]

Sheila C. Bair

Enclosures:

Attachment A – FDIC requests for new or enhanced authorities
Attachment B – FDIC comment letters on proposed regulations
Attachment C – Formal and informal enforcement actions
Attachment D – Final rules
Attachment E – New/revised examination procedures (CD also provided)
Attachment F – Formal guidance and policies (financial institution letters)
Attachment G – Consumer complaint program
Attachment H – Consumer outreach and financial education
Attachment I – Reviews, audits, and assessments

Attachment A
Requests for Additional Authority to Protect Consumers:
Testimony Before Congress and Related Correspondence

March 20, 2009
Testimony by Martin C. Gruenberg, Vice Chairman, Federal Deposit Insurance Corporation "Federal and State Enforcement of Consumer and Investor Protection Laws" before the House Committee on Financial Services
Pages 16 through 18
Excerpt:

> **In order to further strengthen the use of the FTC Act's rulemaking provisions, the FDIC has recommended that Congress consider granting Section 5 rulemaking authority to all federal banking regulators. By limiting FTC rulemaking authority to the FRB, OTS and NCUA, current law excludes participation by the primary federal supervisors of about 7,000 banks. The FDIC's perspective -- as deposit insurer and as supervisor for the largest number of banks, many of whom are small community banks -- would provide valuable input and expertise to the rulemaking process. [page 17]**

March 19, 2009
Testimony by Sheila C. Bair, Chairman, Federal Deposit Insurance Corporation "Modernizing Bank Supervision and Regulation" before the Senate Committee on Banking, Housing and Urban Affairs

Excerpts:

> **Under the Federal Trade Commission (FTC) Act, only the Federal Reserve Board has authority to issue regulations applicable to banks regarding unfair or deceptive acts or practices...the FTC Act does not give the FDIC authority to write rules that apply to the approximately 5,000 entities it supervises – the bulk of state banks-nor to the OCC for their 1700 national banks ... [I]n order to strengthen the use of the FTC Act's rulemaking provisions, the FDIC has recommended that Congress consider granting Section 5 rulemaking authority to all federal banking regulators...the FDIC's perspective – as deposit insurer and as supervisor for the largest number of banks, many of whom are small community banks -- would provide valuable input and expertise to the rulemaking process.**

April 17, 2008
Testimony by Martin C. Gruenberg, Vice Chairman, Federal Deposit Insurance Corporation "The Credit Cardholders' Bill of Rights: Providing New Protections for Consumers" before the House Committee on Financial Services
Pages 8 through 10.
Excerpts:

> **While improved disclosures are important, it is doubtful whether even improved disclosures can mitigate the harmful effect of some of the most questionable**

practices. Action by Congress may expedite solutions to some of the most troubling practices. [page 8]

****

Last year, the House of Representatives passed legislation, H.R. 3526, to amend the FTC Act to grant banking agency the authority to prescribe regulations governing unfair or deceptive acts or practices with respect to the institutions each such agency supervises. The authority in H.R. 3526 would be a helpful addition to our present enforcement authority, and would enable us to improve our ability to address egregious and pervasive practices on an industry-wide basis. Including the perspectives of the supervisor of some of the nation's largest banks and the perspectives of the supervisor of the largest number of banks as well as the deposit insurer would provide valuable input and expertise to the rulemaking process. [page 9]

Response to follow-up questions from Rep. Barrett (May 5, 2008 letter to Chairman Frank) [attached]

April 15, 2008
Robert W. Mooney, Deputy Director, Division of Supervision and Consumer Protection, Federal Deposit Insurance Corporation
"Financial Literacy and Education: The Effectiveness of Governmental and Private Sector Initiatives"
Pages 2 through 3
Excerpt:

The FDIC has called for national standards to address many of the problems and abuses that are now coming to light in the subprime mortgage market. These standards should impose underwriting based on the borrower's ability to repay the true cost of the loan, especially among the non-bank lenders currently operating with little or no regulatory oversight. Such standards also should address misleading or confusing marketing that prevents borrowers from properly evaluating loan products. [page 2]

April 9, 2008
Sheila C. Bair, Chairman, Federal Deposit Insurance Corporation
"Using FHA for Housing Stabilization and Homeownership Retention"
Page 6
Excerpt:

I would emphasize that there is a particular urgency for Congress to act on legislation to establish national licensing standards for non-bank mortgage participants. [page 6]

February 13, 2008
Sandra L. Thompson, Director, Division of Supervision and Consumer Protection, Federal Deposit Insurance Corporation "The Community Reinvestment Act: Thirty Years of Accomplishments, But Challenges Remain" before the House Financial Services Committee.
Excerpt:

> **These patterns raise questions about what should constitute a bank's assessment area and whether only lending within the assessment area should be considered. They also raise questions about whether continuing to cover only banks and thrifts under CRA is achieving the goals established by CRA thirty years ago – that is, to work towards meeting the credit needs of entire communities.** [page 23]

December 6, 2007
Sheila C. Bair, Chairman, Federal Deposit Insurance Corporation "Accelerating Loan Modifications, Improving foreclosure Prevention and Enhancing Enforcement" before the House Financial Services Committee
Excerpts:

> **" Between now and the end of 2008, subprime hybrid ARMs representing hundreds of billions of dollars in outstanding mortgage debt will undergo payment resets...these foreclosures will inflict financial harm on individual borrowers and their communities...the FDIC advocates a systematic approach to loan restructuring."**

October 24, 2007
Sheila C. Bair, Chairman, Federal Deposit Insurance Corporation
"Legislative Proposals on Reforming Mortgage Practices" before House Financial Services Committee
Pages 3 through 4
Excerpt:

> **Legislative action by this Committee and rulemaking by the Federal Reserve Board under the Home Ownership and Equity Protection Act (HOEPA) hold out promise that mortgage originations will return to the standards and fundamentals that have served us well for many years.**
>
> **In my June testimony before this Committee, I listed several elements that should be included in national standards for mortgage lending.** [page 3]

September 5, 2007
Sheila C. Bair, Chairman, Federal Deposit Insurance Corporation, "Recent Events in the Credit and Mortgage Markets and Possible Implications for U.S. Consumers" before the House Financial Services Committee
Excerpt:

The FDIC "supports the exercise of authority by the Federal Reserve under HOEPA to establish a national standard."

June 13, 2007
Sheila C. Bair, Chairman, Federal Deposit Insurance Corporation
"Improving Federal Consumer Protection in Financial Services"
Pages 9 through 10, 17 through 28
Excerpts:

> **Through appropriate rulemaking, regulators can establish consumer protections against abuses that are strong and consistent across industry and regulatory lines. In addition, there should be meaningful enforcement authority and sufficient resources devoted to that authority. To achieve these goals, I would recommend that Congress consider the following reforms:**
>
> - **The creation of national standards for subprime mortgage lending by all lenders which could be done by statute or through HOEPA rulemaking;**
> - **Expand rulemaking authority to all federal banking regulators to address unfair and deceptive practices; ...** [page 17]

Response to follow-up questions from Rep. Waters (July 20, 2007 letter to Ms. Waters): [attached]

June 7, 2007
Sheila C. Bair, Chairman, Federal Deposit Insurance Corporation
"Improving Credit Card Consumer Protection: Recent Industry and Regulatory Initiatives"
Pages 7, 9 through 10, 21
Excerpt:

> **The Federal Reserve Board has the authority to promulgate regulations defining unfair and deceptive acts or practices of banks, while the Office of Thrift Supervision and the National Credit Union Administration enjoy similar rulemaking authority for thrift institutions and credit unions, respectively. Other Federal banking agencies, including the FDIC, may use their enforcement authority pursuant to the FDI Act to address unfair and deceptive acts and practices engaged in by their supervised institutions, but they have no rulemaking authority.** [page 9-10]

LA09-1454

September 23, 2009

FDIC
SEP 24 2009
OFFICE OF LEGISLATIVE AFFAIRS

The Honorable Sheila C. Bair
Chairman
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429

Dear Chairman Bair:

RE: Consumer Protection Initiatives

During the course of the debate regarding the Consumer Financial Protection Agency (CFPA) two main arguments have been made by federal regulators and many in industry against the centralization of consumer protection functions. We are told that the federal agencies do not want to lose their consumer protection authority because that authority is integrally linked with evaluating an institution's overall safety and soundness. We are also told that the federal agencies are not only capable of, but willing to, take action to protect consumers.

The first argument ignores the fact that in troubled times, a regulator tasked with safety and soundness responsibilities *and* consumer protection responsibilities will almost certainly focus its efforts on the former at the expense of the latter, and consumers will suffer. Indeed, had more focus been placed on consumer protection functions earlier in this decade, much of the current crisis may well have been avoided.

The second argument is of particular interest to many of my colleagues and me. It would greatly inform the debate over the CFPA if my colleagues and I had a better understanding of the specific consumer protection actions your agency has undertaken during the last 10 years. In particular, please identify any final rules or regulations adopted, formal enforcement actions taken (including written agreements and cease and desist orders), informal enforcement actions taken (including board resolutions adopted and MOUs entered into), new inspection protocols or procedures adopted, formal policies adopted or regulatory guidance issued, or any other actions taken by your agency that related directly to consumer protection functions. Additionally, to the extent you have undertaken any reviews, audits, or assessments of any of these initiatives, please provide a summary of the results. To the extent your agency sought to take additional actions but found it did not have the authority to do so, please identify what specific new authorities you requested of Congress.

As you know, we are on a very short timeframe, but this information is of great importance to the Committee. Your responses are appreciated by Friday, October 2, 2009.

[redacted]

Chairman

FEDERAL DEPOSIT INSURANCE CORPORATION, Washington, DC 20429

SHEILA C. BAIR
CHAIRMAN

October 9, 2009

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

Dear Congressman Bachus:

Thank you for your letter about the role of the Federal Deposit Insurance Corporation in the Capital Purchase Program (CPP) of the Department of the Treasury's Troubled Asset Relief Program's (TARP) and the consideration of [redacted] application for a CPP subscription. I share your concern about the TARP CPP decision-making process and the program's participation rate among community banks. As [redacted] is an open and operating institution, I cannot comment on any specifics relative to this institution.

As you noted, community banks continue to perceive the TARP program as a financial stability initiative targeted for large institutions, and program participation rates confirm this perception. Although all qualifying, domestically owned banks among the 25 largest institutions have received TARP subscriptions, few smaller institutions have participated. As of September 15, 2009, only 680 institutions of the 7,257 holding companies and small independent banks in the United States have received TARP subscriptions. Thus, more than 93 percent of U.S. banking institutions, which are predominantly comprised of community institutions, did not participate in the TARP program.

We have heard many other concerns voiced about the program, such as the high cost of TARP capital for Subchapter S corporations, the tier 1 capital ineligibility of TARP subscriptions for mutual institutions, and the high closing costs on TARP subscriptions for smaller institutions. In addition, the approval process for TARP has been viewed by the industry as protracted and opaque. The FDIC believes the TARP program could be revised to enhance greater participation by viable community banks. We look forward to working with the Treasury Department, other banking agencies, and Congress to make this program accessible to community banks.

Thank you again for contacting me about this important matter. If you have further questions or comments, please contact me at 202-898-6974 or Paul Nash, Deputy for External Affairs, at 202-898-6962.

Sincerely,

[redacted]

Sheila C. Bair

LA09-148

BARNEY FRANK, MA, CHAIRMAN

U. S. House of Representatives
Committee on Financial Services
2129 Rayburn House Office Building
Washington, DC 20515

SPENCER BACHUS, AL, RANKING MEMBER

September 17, 2009

FDIC
SEP 17 2009
OFFICE OF LEGISLATIVE AFFAIRS

VIA FACSIMILE

The Honorable Sheila Bair
Chairman
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429

Dear Chairman Bair:

I am writing to you today to express my concern with the lack of transparency in the consideration of Capital Purchase Program (CPP) applications by smaller institutions. While the Treasury Department is generally responsible for establishing the parameters of the CPP, it is clear that the decision of the functional federal regulator is generally the controlling factor in determining whether an institution will receive federal assistance. What is not clear is how the Federal Deposit Insurance Corporation (FDIC) and other functional regulators arrive at their decisions.

While I have heard from a number of small institutions that have been frustrated by the delays and lack of communication regarding their CPP applications, one bank in particular typifies the experience of smaller institutions in this opaque process. [redacted] first applied for CPP assistance on November 13th, 2008 but due to Treasury's delay in releasing guidelines for privately-held banks, their first application was merely a placeholder. A final application was submitted to the FDIC on December 4th, 2008. More than seven months later, on July 6th, 2009, the bank received a phone call from the FDIC indicating that [redacted] would not be receiving a positive recommendation from the regulator, effectively denying the healthy bank its request for assistance. The FDIC staffer recommended that the bank withdraw its application and on July 7th [redacted] formally requested that their application be withdrawn.

No reason was given for the FDIC's decision to withhold a positive recommendation on [redacted] application. Given that there were some 98 CPP approvals from May-July 2009, [redacted] had a reasonable expectation during that period that the FDIC's delay could still produce a favorable result.

A *Washington Post* story from September 11, 2009 suggests that the government is currently contemplating a new capital injection plan for community banks[1]. Should that be the case, I would hope that the FDIC and its fellow regulators will strive for a greater degree of transparency than has been the case with the Capital Purchase Program. The

[1] *Washington Post*, "TARP: Treasury Looks to Shift Rescue's Focus to Small Businesses and Community Banks"

FDIC, in consultation with the Treasury Department and the other functional regulators, should establish some basic transparency guidelines for the CPP program so that the more than 200 institutions awaiting a decision from their regulator have some idea of what metrics will lead to a favorable recommendation.

Should you have further questions regarding this matter, please contact me or my staff.

Sincerely,

[redacted]

SPENCER BACHUS
Ranking Member

cc: The Honorable Timothy Geithner, Secretary of the Treasury

FEDERAL DEPOSIT INSURANCE CORPORATION, Washington, DC 20429

SHEILA C. BAIR
CHAIRMAN

October 9, 2009

Honorable Carl Levin
United States Senate
Washington, D.C. 20515

Dear Senator Levin:

Thank you for your letter expressing concern that the Federal Deposit Insurance Corporation might impose an additional special assessment this year on insured depository institutions.

As we discussed last week, the FDIC imposed a special assessment earlier this year only after serious consideration of our responsibility to maintain the Deposit Insurance Fund (DIF) without imposing undue burden on the banking industry. We recognize that assessments are a significant expense, particularly during a recession when bank earnings are under pressure. We also recognize that assessments reduce the capital and funding that allow banks to lend in their communities. FDIC staff recently updated projections affecting the DIF and determined that additional resources would be necessary to meet the FDIC's liquidity needs. We are currently seeking comment on a proposed alternative to imposing further special assessments on the industry this year.

On September 29, 2009, the FDIC issued a notice of proposed rulemaking that would require all insured depository institutions to prepay their estimated regular quarterly risk-based assessments for the fourth quarter of 2009, and for all of 2010, 2011, and 2012. Unlike a special assessment, which would immediately affect bank earnings, requiring prepaid assessments allows each institution to record the entire amount of its prepaid assessment as a prepaid expense (an asset) as of December 30, 2009. An institution's income and earnings would not be affected until its regular risk-based assessment becomes due each quarter. Additionally, FDIC staff believes that most of the prepaid assessment paid under this proposal would be drawn from available cash and excess reserves, which should not significantly affect depository institutions' current lending activities.

Nevertheless, the FDIC recognizes that prepaying assessments could prove difficult for some institutions. As a result, the proposal would allow the FDIC to exercise its discretion as supervisor and insurer to exempt an institution from the prepayment requirement if the FDIC determines that the prepayment would adversely affect the safety and soundness of the institution. In addition, an insured depository institution could apply to the FDIC for an exemption from the prepaid requirement if the prepayment

CARL LEVIN
MICHIGAN

LA09-1425

United States Senate

WASHINGTON, DC 20510-2202

September 15, 2009

FDIC
SEP 22 2009
OF LEGISLATIVE AFFAIRS

The Honorable Sheila C. Bair
Chairman
Federal Deposit Insurance Corporation
550 17th St., NW
Washington, DC 20429

Dear Chairman Bair:

I would like to express my concerns with the FDIC imposing another massive special assessment, which, if implemented, could weaken many of our community banks.

I was encouraged by your New York Times Op-Ed of September 1, 2009, in which you highlighted the importance of maintaining strong and effective community banks. As I am sure you would agree, community banks have long been an important and vital resource for the residents and local businesses they serve.

While most community lenders were not caught up in the exotic excesses of their larger peers, the ongoing economic crisis has still had a tremendous impact on them. The impact has been particularly acute in states like Michigan, which are experiencing high unemployment and substantial declines in property values. Adding yet another major financial obligation during this crisis could further deplete the capital of these small financial institutions, making it difficult for them to extend the credit needed to turn our economy around.

Congress has already given the FDIC the tools it needs to ensure the integrity of the insurance fund in these challenging times. Congress included a provision in the Helping Families Save Their Homes Act (P.L.111-22) that authorizes the FDIC to borrow up to $100 billion from the Treasury. If additional funds are needed for the insurance fund, the FDIC should consider utilizing this access to the Treasury funds.

In the wake of the worst financial crisis our country has experienced in decades, I commend your leadership and commitment to maintaining a stable, solvent insurance fund for the protection of our hard-earned deposits. Your task has been particularly difficult, given the challenges posed by the 92 bank failures that have already occurred this year and the losses that are expected in the near future.

However, imposing a second major special assessment could impose significant financial hardship on community banks and their communities. I encourage you and the Board of

Directors to consider alternate methods of ensuring the security of the deposit insurance fund, including accessing the Treasury facility that Congress has already provided.

Further, if the FDIC is to impose another special assessment, it should consider ways to alleviate some of that burden, including by allowing smaller banks and banks in economically distressed areas additional time to pay.

Thank you for your consideration. I look forward to hearing from you on this matter.

Sincerely,

[redacted]

Carl Levin

cc: The Honorable Timothy Geithner
Secretary of the Department of the Treasury

FEDERAL DEPOSIT INSURANCE CORPORATION, Washington, DC 20429

SHEILA C. BAIR
CHAIRMAN

October 26, 2009

Honorable Carolyn McCarthy
House of Representatives
Washington, D.C. 20515

Dear Congresswoman McCarthy:

Thank you for your letter concerning the sale of Guaranty Bank to the BBVA Group. I appreciate the opportunity to respond to the issues you raised regarding this transaction.

A Loss Sharing agreement was entered into by the Federal Deposit Insurance Corporation and Compass Bank, Birmingham, Alabama, as part of the whole bank Purchase and Assumption dated August 21, 2009.

Both Compass Bank, a state chartered bank, and Compass Bancshares, its immediate bank holding company, are U.S. domestic entities wholly owned by BBVA USA Bancshares, Inc., Houston, Texas, whose ultimate parent is Banco Bilbao Vizcaya Argentaria SA, headquartered in Spain. Compass Bank is chartered in Alabama and is assessed insurance premiums by the FDIC. There are 50 foreign owned banks throughout the U.S. that also pay insurance assessments and are community lenders.

The Loss Sharing agreement specific to this transaction is between the FDIC and the domestically chartered subsidiary bank, Compass Bank, rather than with either the domestic bank holding companies or the foreign parent. There is no agreement that uniformly provides U.S. banks with European government assistance to purchase European banks. However, the Loss Sharing agreement on selected assets in the Guaranty Bank Purchase and Assumption by Compass Bank was individually negotiated between the FDIC and the assuming bank's management. Such an agreement also might be negotiated, under similar circumstances, between any U.S. banks making European bank acquisitions and respective European governments or agencies.

Finally, the Loss Sharing agreement entered into between the FDIC and Compass Bank involves approximately $11 billion of Guaranty Bank's assets. Although Loss Sharing agreements are not intended to directly create U.S. jobs or maximize bank profits, these agreements are designed to mitigate losses to the FDIC and to the banking system in general from bank failures, and as a result should strengthen industry capital, aid in stabilizing the U.S. financial system, and preserve as many affected jobs as possible. As with all of our closed bank transactions, this sale was based on a competitive bidding process; and it was the best offer available for these assets. As customary, we accepted it pursuant to our least cost statutory mandate. Moreover, by entering into this federal assistance agreement at the subsidiary bank level, capital will be preserved or created first at the state chartered bank before any profits can be up-streamed to either the domestic or foreign bank holding companies.

I hope this information is helpful. If you have further questions or comments, please do not hesitate to contact me at (202) 898-6974 or Paul Nash, Deputy for External Affairs, at (202) 898-6962.

Sincerely,

[redacted]

Sheila C. Bair

Sep. 11. 2009 4:54PM

No. 4574 P. 1

LA09-1372

CARDLYN McCARTHY
4TH DISTRICT, NEW YORK

WASHINGTON OFFICE:
2346 RAYBURN HOUSE OFFICE BUILDING
WASHINGTON, DC 20515
(202) 225-5516
FAX: (202) 225-5758

DISTRICT OFFICE:
300 GARDEN CITY PLAZA, SUITE 200
GARDEN CITY, NY 11530
(516) 739-3008
FAX: (516) 739-2973

CONGRESS OF THE UNITED STATES
HOUSE OF REPRESENTATIVES
WASHINGTON, DC 20515-3204

COMMITTEES:
EDUCATION AND LABOR

SUBCOMMITTEES:
CHAIRWOMAN,
HEALTHY FAMILIES AND COMMUNITIES
HEALTH, EMPLOYMENT, LABOR, AND PENSIONS

FINANCIAL SERVICES

SUBCOMMITTEES:
CAPITAL MARKETS, INSURANCE AND
GOVERNMENT SPONSORED ENTERPRISES
FINANCIAL INSTITUTIONS AND
CONSUMER CREDIT

E-MAIL:
http://www.house.gov/writerep/

WEBSITE:
http://carolynmccarthy.house.gov

September 11, 2009

FDIC
SEP 11 2009
OFFICE OF LEGISLATIVE AFFAIRS

Ms. Sheila C. Bair
Chairwoman
Federal Deposit Insurance Corporation
550 Seventeenth Street, NW
Washington D.C. 20429

Dear Chairwoman Bair,

The FDIC announced on August 21, 2009 the sale of Guaranty Bank to BBVA Group, a large Spanish bank holding company. The failure of Guaranty Bank- which in published reports was the 10th largest bank failure in U.S. History- is expected to cost the FDIC Insurance Fund approximately $3 billion.

The FDIC Board's decision to award Guaranty to BBVA over other U.S. bidders is surprising because it effectively means that U.S. taxpayer funds are being used to help a European bank expand its operations in the United States. The FDIC Insurance Fund's assets come from fees assessed on U.S. banks, many of which are currently being assisted with taxpayer dollars in the form of TARP funds.

There have been various news articles regarding the details surrounding this sale, and I believe it is important for Congress and U.S. taxpayers to understand what it means for the future of the U.S. financial system. The sale of Guaranty Bank to BBVA means that the FDIC has essentially decided to underwrite the expansion of a foreign bank's operations in the U.S. using taxpayer funds.

Specifically, I would appreciate response to the following questions:

- Will the FDIC be entering into a loss share agreement with BBVA, given that BBVA is a foreign entity?
- Has the Spanish government and the European Union committed to the FDIC that U.S. banks will be able to acquire troubled European banks with assistance, as the FDIC has assisted BBVA?
- How will the BBVA purchase of Guaranty Bank help in creating jobs and stabilize the U.S. financial system, when their profits will not be staying here in the US?

Being a time sensitive matter, I look forward to your kind and prompt response to my inquires.

Sincerely,

[redacted]

CAROLYN MCCARTHY
Member of Congress

Office of the Comptroller of the Currency
Board of Governors of the Federal Reserve System
Federal Deposit Insurance Corporation
Office of Thrift Supervision
National Credit Union Administration

August 14, 2009

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

Dear Mr. Chairman:

Thank you for your letter of June 3, 2009, regarding potential safety and soundness concerns arising from the increased use of appraisal management companies (AMCs) by mortgage lenders, including federally regulated financial institutions. The Office of the Comptroller of the Currency, Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, Office of Thrift Supervision, and National Credit Union Administration (collectively, the Agencies) view appraisals as an integral part of a regulated institution's residential mortgage loan underwriting process and, therefore, have extensive regulations, guidelines, policies, and procedures in place to ensure the quality and reliability of appraisals.

Your letter requests a description of steps that our examiners take to address safety and soundness concerns arising from the increased use of AMCs and to ensure the accuracy and reliability of appraisals. The requirements for appraiser independence and competency have been cornerstones of the Agencies' regulatory framework since the adoption of the appraisal regulations in 1990. Over the years, the Agencies have issued additional guidance to emphasize the importance of reliable appraisals in an institution's real estate lending activities, including the separation and protection of appraisers from coercion and other undue influence from the institution's loan production, investment, and collection functions, as well as from the borrower. The *Interagency Appraisal and Evaluation Guidelines* (Guidelines) state that an institution's board of directors is responsible for reviewing and adopting policies and procedures that establish and maintain an effective, independent real estate appraisal program.

If a regulated financial institution chooses to use the appraisal management services of an AMC, the institution is not relieved of its responsibility to maintain a safe and sound appraisal program and to ensure appraiser independence. In such a case, the Agencies expect the institution's appraisal program to include risk management practices that monitor the AMC's performance, ensure that an appraiser is selected and engaged based on his or her competency to perform the particular appraisal assignment, and ensure that the AMC is protected from coercion and other undue influence from the institution's loan production, investment, and collection functions. The regulated institution remains responsible for compliance with applicable laws and regulations, which requires the exercise of appropriate oversight of its appraisal program. If an institution engages another party to perform such services, the Agencies expect the institution to consider the legal, reputational and operational risks posed by the arrangement and have appropriate policies and procedures to manage such risks.

As part of an examination of a regulated institution's real estate lending activity, the Agencies' examiners review an institution's real estate appraisal and evaluation policies and procedures. Examiners also review the steps taken by an institution to ensure that the individuals who perform appraisals are qualified and not subject to conflicts of interest. Further, when analyzing individual transactions, examiners review an institution's individual appraisals, including those obtained under third party arrangements, for compliance with regulations and supervisory guidance. An institution's failure to comply with the Agencies' appraisal regulations, policies, or guidelines is cited in the examination report, and deficiencies require corrective action.

These examiner directives are reflected in the existing Guidelines. The Agencies recently requested public comment on proposed updates to the Guidelines.[1] These updates reflect revisions to the Uniform Standards of Professional Appraisal Practice, the evolution of collateral valuation practices, and the addition of the National Credit Union Administration, which was not a party to the existing Guidelines. Some commenters have requested that the Agencies provide more explicit guidance on the use of AMCs. The Agencies are considering whether to incorporate a discussion on AMCs in the final guidelines and will consider your letter as part of that review.

---

[1] Proposed Interagency Appraisal and Evaluation Guidelines, 73 Fed. Reg. 69,647 (Nov. 19, 2008).

We hope this information responds to your concerns, and thank you again for your letter.

Sincerely,

[redacted]

John C. Dugan
Comptroller of the Currency

[redacted]

Ben S. Bernanke, Chairman
Board of Governors of the
Federal Reserve System

[redacted]

Sheila C. Bair, Chairman
Federal Deposit Insurance Corporation

[redacted]

John E. Bowman, Acting Director
Office of Thrift Supervision

[redacted]

Michael E. Fryzel, Chairman
National Credit Union Administration

LA09-~~[illegible]~~ 910

United States Senate

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS

WASHINGTON, DC 20510-6075

June 3, 2009

The Honorable Ben Bernanke
Chairman
Board of Governors of the
Federal Reserve System
20th and Constitution Avenue, NW
Washington, DC 20551

The Honorable Sheila C. Bair
Chairman
Federal Deposit Insurance
Corporation
550 17th Street, NW
Washington, DC 20429

The Honorable John Dugan
Comptroller of the Currency
Office of the Comptroller of the Currency
Administrator of National Banks
Washington, DC 20219

Mr. John E. Bowman
Acting Director
Office of Thrift Supervision
1700 G Street, NW
Washington, DC 20552

The Honorable Michael E. Fryzel
Chairman
National Credit Union Administration
1775 Duke Street
Alexandria, VA 22314-3428

Dear Sir/Madam:

A significant contributing factor to the mortgage crisis we are currently experiencing was faulty appraisals that helped fuel inflated home values and mortgage balances. Many buyers who were provided inflated appraisals are now holding mortgages that are "underwater," resulting in historically high levels of delinquencies and foreclosures. In light of this problem, I would like to bring to your attention information about the use of Appraisal Management Companies ("AMCs") by the institutions you regulate and their potential effects on their safety and soundness. In particular, many appraisers, including many of my constituents, are concerned that use of AMCs may compromise the quality and reliability of appraisals used to support residential mortgage lending. Their concerns are heightened by the implementation of the Home Valuation Code of Conduct, entered into by Fannie Mae and Freddie Mac as part of a settlement with the New York State Attorney General.

It is my understanding that with the Home Valuation Code of Conduct in effect, the percentage of residential appraisals conducted through AMCs has increased from roughly 20 percent to about 60 percent in less than one year. Concerns have been expressed to me about potential safety and soundness implications of this increased usage. Specifically, we have received reports of out-of-market appraisers being used by AMCs in an effort to maximize profits; continued inappropriate influence of appraisers by loan officers and loan production staff in situations where the bank has outsourced the appraisal function to an AMC; and widespread concerns about AMCs capturing a portion of the appraiser's fee without any disclosure to the consumer, potentially jeopardizing the quality and reliability of appraisals for which the appraiser has not received customary, market-based fee.

Please describe the steps your examiners are taking to address these concerns and to ensure the accuracy and reliability of the appraisals.

Sincerely,

[redacted]

CHRISTOPHER J. DODD
Chairman

LA09-1340

FEDERAL DEPOSIT INSURANCE CORPORATION, Washington, DC 20429

SHEILA C. BAIR
CHAIRMAN

November 13, 2009

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

Dear Mr. Chairman:

Thank you for the opportunity to testify before the Senate Banking Committee at the July 23 hearing "Establishing a Framework for Systemic Risk Regulation."

Enclosed are my responses to the follow up questions you provided from Senator Bunning, Senator Crapo, Senator Menendez, Senator Reed, Senator Shelby, and Senator Vitter. If you have further questions or comments, please do not hesitate to contact me at (202) 898-6974 or Paul Nash, Deputy for External Affairs, at (202) 898-6962.

Sincerely,

[redacted]

Sheila C. Bair

Enclosure

Response to questions from the Honorable Jim Bunning
by Sheila C. Bair, Chairman,
Federal Deposit Insurance Corporation

Q1. Many proposals call for a risk regulator that is separate from the normal safety and soundness regulator of banks and other firms. The idea is that the risk regulator will set rules that the other regulators will enforce. That sounds a lot like the current system we have today, where different regulators read and enforce the same rules different ways. Under such a risk regulator, how would you make sure the rules were being enforced the same across the board?

A1. The significant size and growth of unsupervised financial activities outside the traditional banking system -- in what is termed the shadow financial system -- has made it all the more difficult for regulators or market participants to understand the real dynamics of either bank credit markets or public capital markets. The existence of one regulatory framework for insured institutions and a much less effective regulatory scheme for non-bank entities created the conditions for arbitrage that permitted the development of risky and harmful products and services outside regulated entities.

We have proposed a Systemic Risk Council composed of the principal prudential regulators for banking, financial markets, consumer protection, and Treasury to look broadly across all of the financial sectors to adopt a "macro-prudential" approach to regulation. The point of looking more broadly at the financial system is that reasonable business decisions by individual financial firms may, in aggregate, pose a systemic risk. This failure of composition problem cannot be solved by simply making each financial instrument or practice safe.

Rules and restrictions promulgated by the proposed Systemic Risk Council would be uniform with respect to institutions, products, practices, services and markets that create potential systemic risks. Again, a distinction should be drawn between the direct supervision of systemically-significant financial firms and the macro-prudential oversight and regulation of developing risks that may pose systemic risks to the U.S. financial system. The former appropriately calls for the identification of a prudential supervisor for any potential systemically significant holding companies or similar conglomerates. Entities that are already subject to a prudential supervisor, such as insured depository institutions and financial holding companies, should retain those supervisory relationships. In addition, for systemic entities not already subject to a federal prudential supervisor, this Council should be empowered to require that they submit to such oversight, presumably as a financial holding company under the Federal Reserve -- without subjecting them to the activities restrictions applicable to these companies.

We need to combine the current micro-prudential approach with a macro-prudential approach through the Council. The current system focuses only on individual financial instruments or practices. Each agency is responsible for enforcing these regulations only for their institutions. In addition, there are separate regulatory schemes used by the SEC and the CFTC as well as the state level regulation of insurance companies. The macro-prudential oversight of system-wide risks requires the integration of insights from a number of different regulatory perspectives -- banks, securities firms, holding companies, and perhaps others. Thus, the FDIC supports the creation of a Council to oversee systemic risk issues, develop needed prudential policies, and mitigate developing systemic risks.

Q2. Before we can regulate systemic risk, we have to know what it is. But no one seems to have a definition. How do you define systemic risk?

A2. We would anticipate that the Systemic Risk Council, in conjunction with the Federal Reserve would develop definitions for systemic risk. Also, mergers, failures, and changing business models could change what firms would be considered systemically important from year-to-year.

Q3. Assuming a regulator could spot systemic risk, what exactly is the regulator supposed 6to do about it? What powers would they need to have?

A3. The failure of some large banks and non-banks revealed that the U.S. banking agencies should have been more aggressive in their efforts to mitigate excessive risk concentrations in banks and their affiliates, and that the agencies' powers to oversee systemically important non-banks require strengthening.

As discussed in my testimony, the FDIC endorses the creation of a Council to oversee systemic risk issues, develop needed prudential policies, and mitigate developing systemic risks. For example, the Council could ensure capital standards are strong and consistent across significant classes of financial services firms including non-banks and GSEs. Prior to the current crisis, systemic risk was not routinely part of the ongoing supervisory process. The FDIC believes that the creation of a Council would provide a continuous mechanism for measuring and reacting to systemic risk across the financial system. The powers of such a Council would ultimately have to be developed through a dialogue between the banking agencies and Congress, and empower the Council to ensure appropriate oversight of unsupervised non-banks that present systemic risk. Such non-banks should be required to submit to such oversight, presumably as a financial holding company under the Federal Reserve.

Q4. How do you propose we identify firms that pose systemic risks?

A4. The proposed Systemic Risk Council could establish what practices, instruments, or characteristics (concentrations of risk or size) that might be considered risky, but should not identify any set of firms as systemic. We have concerns about formally designating certain institutions as a special class. We recognize that there may be very large interconnected financial entities that are not yet subject to federal consolidated supervision, although most of them are already subject to such supervision as a result of converting to banks or financial holding companies in response to the crisis. Any recognition of an institution as systemically important, however, risks invoking the moral hazard that accompanies institutions that are considered too big to fail. That is one reason why, most importantly, a robust resolution mechanism, in addition to enhanced supervision, is important for very large financial organizations.

Q5. Any risk regulator would have access to valuable information about the business of many firms. There would be a lot of people who would pay good money to get that information. How do we protect that information from being used improperly, such as theft or an employee leaving the regulator and using his knowledge to make money?

A5. The FDIC, as deposit insurer and supervisor of over 5,000 banks, prides itself on maintaining confidentiality with our stakeholders. We have a corporate culture that demands strict confidentiality with regard to bank and personal information. Our staff is trained extensively on the use, protection, and disclosure of non-public information as well as expectations for the ethical conduct. Disclosure of non-public information is not tolerated and any potential gaps are dealt with swiftly and disclosed to affected parties. The FDIC's Office of Inspector General has a robust process for dealing with improper disclosures of information both during and post-employment with FDIC.

These ethical principles are supported by criminal statutes which provide that federal officers and employees are prohibited from the disclosure of confidential information generally (18 U.S.C. 1905) and from the disclosure of information from a bank examination report (18 U.S.C. 1906).

All former federal officers and employees are subject to the post-employment restrictions (18 U.S.C. 207), which prohibit former government officers and employees from knowingly making a communication or appearance on behalf of any other person, with the intent to influence, before any officer or employee of any federal agency or court in connection with a particular matter in which the employee personally and substantially participated, which involved a specific party at the time of the participation and representation, and in which the U.S. is a party or has a direct and substantial interest.

In addition, an officer or employee of the FDIC who serves as a senior examiner of an insured depository institution for at least 2 months during the last 12 months of that individual's employment with the FDIC may not, within 1 year after the termination date of his or her employment with the FDIC, knowingly accept compensation as an employee, officer, director, or consultant from the insured depository institution; or any company (including a bank holding company or savings and loan holding company) that controls such institution. (12 U.S.C. 1820(k).

Response to questions from the Honorable Mike Crapo
by Sheila C. Bair, Chairman,
Federal Deposit Insurance Corporation

Q1. I appreciate the FDIC's desire to provide clarity around the process of private investors investing in failed banks that have been taken over by the FDIC. We need to make sure that the final rule doesn't deter private capital from entering the banking system, leaving the FDIC's insurance fund and, ultimately, the taxpayers with the final bill. Are you open to modifying some of the proposed requirements, such as the 15% capital requirement?

A1. The Federal Deposit Insurance Corporation is aware of the need for additional capital in the banking system and the potential contribution that private equity capital could make to meet this need. At the same time, the FDIC is sensitive to the need for all investments in insured depository institutions, regardless of the source, to be consistent with protecting the Deposit Insurance Fund and the safety and soundness of insured institutions.

In light of the increased number of bank and thrift failures and the consequent increase in interest by potential private capital investors, the FDIC published for comment on July 9, 2009, a Proposed Statement of Policy on Qualifications for Failed Bank Acquisitions (Proposed Policy Statement). The Proposed Policy Statement provided guidance to private capital investors interested in acquiring the deposit liabilities, or the liabilities and assets, of failed insured depository institutions. It included specific questions on the important issues surrounding non-traditional investors in insured financial institutions including the level of capital required for the institution that would be owned by these new entrants into the banking system and whether these owners can be a source of strength. We sought public and industry comment to assist us in evaluating the policies to apply in deciding whether a non-traditional investor may bid on a failed institution.

On August 26, 2009, the FDIC's Board of Directors voted to adopt the Final Statement of Policy on Qualifications for Failed Bank Acquisitions (Final Policy Statement), which was published in the *Federal Register* on September 2, 2009. The Final Policy Statement takes into account the comments presented by the many interested parties who submitted comments. Although the final minimum capital commitment has been adjusted from 15 percent Tier 1 leverage to 10 percent Tier 1 common equity, key elements of the earlier proposed statement remain in place: cross support, prohibitions on insider lending, limitations on sales of acquired shares in the first three years, a prohibition on bidding by excessively opaque and complex business structures, and minimum disclosure requirements.

Importantly, the Final Policy Statement specifies that it does not apply to investors who do not hold more than 5 percent of the total voting powers and who are not engaged in concerted actions with other investors. It also includes relief for investors if the insured institution maintains a Uniform Financial Institution composite rating of 1 or 2 for 7 consecutive years. The FDIC Board is given the authority to make exceptions to its application in special circumstances. The Final Policy Statement also clearly excludes partnerships between private capital investors and bank or thrift holding companies that have a strong majority interest in the acquired banks or thrifts.

In adopting the Final Policy Statement, the FDIC sought to strike a balance between the interests of private investors and the need to provide adequate safeguards for the insured depository institutions involved. We believe the Final Policy Statement will encourage safe and sound investments and make the bidding more competitive and robust. In turn, this will limit the FDIC's losses, protect taxpayers, and speed the resolution process. As a result, the Final Policy Statement will aid the FDIC in carrying out its mission.

Response to questions from the Honorable Robert Menendez
by Sheila C. Bair, Chairman,
Federal Deposit Insurance Corporation

Q1. A recent media article (New York Times, June 14th) states there have been strong disagreements between the FDIC and the OCC over whether the proposal to impose new insurance fees on banks is unfair to the largest banks, with the FDIC arguing that the largest banks contributed to the current crisis and should have to pay more. Can you elaborate on your rationale for requiring big banks to pay more than community banks?

A1. The *New York Times* article referred to the emergency special assessment, adopted on May 22, 2009, which imposes a 5-basis point special assessment rate on each insured depository institution's assets minus Tier 1 capital as of June 30, 2009.

The Federal Deposit Insurance Reform Act of 2005 requires the FDIC to establish and implement a restoration plan if the reserve ratio falls below 1.15 percent of insured deposits. On October 7, 2008, the FDIC established a Restoration Plan for the Deposit Insurance Fund. The Restoration Plan was amended on February 27, 2009, and quarterly base assessment rates were set at a range of 12 to 45 basis points beginning in the second quarter of 2009. However, given the FDIC's estimated losses from projected institution failures, these assessment rates were determined not to be sufficient to return the fund reserve ratio to 1.15 percent. On May 22, 2009, therefore, the FDIC Board of Directors adopted a final rule establishing a 5 basis point special assessment on each insured depository institution's assets minus Tier 1 capital as of June 30, 2009. The special assessment is necessary to strengthen the Deposit Insurance Fund and promote confidence in the deposit insurance system.

The adoption of the final rule on the special assessment followed a request for comment that generated over 14,000 responses. The final rule implemented several changes to the FDIC's special assessment interim rule, including a reduction in the rate used to calculate the special assessment and a change in the base used to calculate the special assessment.

The assessment formula is the same for all insured institutions -- big and small. However, it produces higher assessments for institutions that rely more on non-deposit liabilities. These institutions do tend to be the larger institutions. The FDIC considers this appropriate as in the event of the failure of institutions with significant amounts of secured debt, the FDIC's loss is often increased without any compensation in the form of increased assessment revenue.

The amount of the special assessment for any institution, however, will not exceed 10 basis points times the institution's assessment base for the second quarter 2009 risk-based assessment. We believe that the special assessment formula provides incentives for institutions to hold long-term unsecured debt, and for smaller institutions to hold high levels of Tier 1 capital—both good things in the FDIC's view.

Response to questions from the Honorable Jack Reed by Sheila C. Bair, Chairman, Federal Deposit Insurance Corporation

Q1. You discussed regulatory arbitrage in your written statements and emphasized the benefits of a Council to minimize such opportunities. Can you elaborate on this? Should standards be set by individual regulators, the Council, or both? Can a Council operate effectively in emergency situations?

A1. One type of regulatory arbitrage is regulatory capital arbitrage. It is made possible when there are different capital requirements for organizations that have similar risks. For instance, banks must hold 10 percent total risk-based capital and a 5 percent leverage ratio to be considered well capitalized, while large broker-dealers (investment banks) were allowed to operate with as little as 3 percent risk based capital. Thus for similar assets, a bank would have to hold $5 for every $100 of assets, a broker dealer would only be required to hold $3 of capital for every $100 of the same assets. Obviously, it would be more advantageous for broker dealers to accumulate these assets, as their capital requirement was 40 percent smaller than for a comparable bank.

The creation of a Systemic Risk Council with authority to harmonize capital requirements across all financial firms would mitigate this type of regulatory capital arbitrage. Although the capital rules would vary somewhat according to industry, the authority vested in the Council would prevent the types of disparities in capital requirements we have recently witnessed.

Some have suggested that a council approach would be less effective than having this authority vested in a single agency because of the perception that a deliberative council such as this would need additional time to address emergency situations that might arise from time to time. Certainly, some additional thought and effort will be needed to address any dissenting views in council deliberations, but a vote by Council members would achieve a final decision. A Council will provide for an appropriate system of checks and balances to ensure that appropriate decisions are made that reflect the various interests of public and private stakeholders. In this regard, it should be noted that the board structure at the FDIC, with the participation of outside directors, is not very different than the way the council would operate. In the case of the FDIC, quick decisions have been made with respect to systemic issues and emergency bank resolutions on many occasions. Based on our experience with a board structure, we believe that decisions could be made quickly by a deliberative council while still providing the benefit of arriving at consensus decisions.

Q2. What do you see as the key differences in viewpoints with respect to the role and authority of a Systemic Risk Council? For example, it seems like one key question is whether the Council or the Federal Reserve will set capital, liquidity, and

risk management standards. Another key question seems to be who should be the Chair of the Council, the Secretary of the Treasury or a different Senate-appointed Chair. Please share your views on these issues.

A2. The Systemic Risk Council should have the authority to impose higher capital and other standards on financial firms notwithstanding existing federal or state law and it should be able to overrule or force actions on behalf of other regulatory entities to raise capital or other requirements. Primary regulators would be charged with enforcing the requirements set by the Council. However, if the primary regulators fail to act, the Council should have the authority to do so. The standards set by the Council would be designed to provide incentives to reduce or eliminate potential systemic risks created by the size or complexity of individual entities, concentrations of risk or market practices, and other interconnections between entities and markets.

The Council would be uniquely positioned to provide the critical linkage between the primary federal regulators and the need to take a macro-prudential view and focus on emerging systemic risk across the financial system. The Council would assimilate information on economic conditions and the condition of supervised financial companies to assess potential risk to the entire financial system. The Council could then direct specific regulatory agencies to undertake systemic risk monitoring activities or impose recommended regulatory measures to mitigate systemic risk.

The Administration proposal includes eight members on the Council: the Secretary of the Treasury (as Chairman); the Chairman of the Federal Reserve Board; the Director of the National Bank Supervisor; the Director of the Consumer Financial Protection Agency; the Chairman of the Securities and Exchange Commission; the Chairman of the Commodities Futures Trading Commission; the Chairman of the FDIC; and the Director of the Federal Housing Finance Agency.

In designing the role of the Council, it will be important to preserve the longstanding principle that bank regulation and supervision are best conducted by independent agencies. For example, while the OCC is an organization within the Treasury Department, there are statutory safeguards to prevent undue involvement of the Treasury in regulation and supervision of National Banks. Given the role of the Treasury in the Council contemplated in the Administration's plan, careful attention should be given to the establishment of appropriate safeguards to preserve the political independence of financial regulation.

Moreover, while the FDIC does not have a specific recommendation regarding what agencies should compose the Council, we would suggest that the Council include an odd number of members in order to avoid deadlocks. One way to address this issue that would be consistent with the importance of preserving the political independence of the regulatory process would be for the Treasury Chair to be a non-voting member, or the Council could be headed by someone appointed by the President and confirmed by the Senate.

Q3. What are the other unresolved aspects of establishing a framework for systemic risk regulation?

A3. With an enhanced Council with decision-making powers to raise capital and other key standards for systemically related firms or activities, we are in general agreement with the Treasury plan for systemic risk regulation, or the Council could be headed by a Presidential appointee.

Q4. How should Tier 1 firms be identified? Which regulator(s) should have this responsibility?

A4. As discussed in my testimony, the FDIC endorses the creation of a Council to oversee systemic risk issues, develop needed prudential policies and mitigate developing systemic risks. Prior to the current crisis, systemic risk was not routinely part of the ongoing supervisory process. The FDIC believes that the creation of a Council would provide a continuous mechanism for measuring and reacting to systemic risk across the financial system. The powers of such a Council would ultimately have to be developed through a dialogue between the banking agencies and Congress, and empower the Council to oversee unsupervised non-banks that present systemic risk. Such non-banks should be required to submit to such oversight, presumably as a financial holding company under the Federal Reserve. The Council could establish what practices, instruments, or characteristics (concentrations of risk or size) that might be considered risky, but would not identify any set of firms as systemic.

We have concerns about formally designating certain institutions as a special class. Any recognition of an institution as systemically important, however, risks invoking the moral hazard that accompanies institutions that are considered too big to fail. That is why, most importantly, a robust resolution mechanism, in addition to enhanced supervision, is important for very large financial organizations.

Q5. One key part of the discussion at the hearing is whether the Federal Reserve, or any agency, can effectively operate with two or more goals or missions. Can the Federal Reserve effectively conduct monetary policy, macro-prudential regulation, and consumer protection?

A5. The Federal Reserve has been the primary federal regulator for state chartered member institutions since its inception and has been the bank holding company supervisor since 1956. With the creation of the Consumer Financial Protection Agency and the Systemic Risk Council, the Federal Reserve should be able to continue its monetary policy role as well as remain the prudential primary federal regulator for state chartered member institutions and bank holding companies.

Q6. Under the Administration's plan, there would be heightened supervision and consolidation of all large, interconnected financial firms, including likely requiring more firms to become financial holding companies. Can you comment on whether this plan adequately addresses the too-big-to-fail problem? Is it problematic, as some say, to identify specific firms that are systemically significant, even if you provide disincentives to becoming so large, as the Administration's plan does?

A6. The creation of a systemic risk regulatory framework for bank holding companies and systemically important firms will address some of the problems posed by too-big-to-fail firms. In addition, we should develop incentives to reduce the size of very large financial firms.

However, even if risk-management practices improve dramatically and we introduce effective macro-prudential supervision, the odds are that a large systemically significant firm will become troubled or fail at some time in the future. The current crisis has clearly demonstrated the need for a single resolution mechanism for financial firms that will preserve stability while imposing the losses on shareholders and creditors and replacing senior management to encourage market discipline. A timely, orderly resolution process that could be applied to both banks and non-bank financial institutions, and their holding companies, would prevent instability and contagion and promote fairness. It would enable the financial markets to continue to function smoothly, while providing for an orderly transfer or unwinding of the firm's operations. The resolution process would ensure that there is the necessary liquidity to complete transactions that are in process at the time of failure, thus addressing the potential for systemic risk without creating the expectation of a bailout.

Under a new resolution regime, Congress should raise the bar higher than existing law and eliminate the possibility of open assistance for individual failing entities. The new resolution powers should result in the shareholders and unsecured creditors taking losses prior to the government, and consideration also should be given to imposing some haircut on secured creditors to promote market discipline and limit costs potentially borne by the government.

Response to questions from the Honorable Richard Shelby
by Sheila C. Bair, Chairman,
Federal Deposit Insurance Corporation

Too Big To Fail

Chairman Bair, the Obama Administration's proposal would have regulators designate certain firms as systemically important. These firms would be classified as Tier 1 Financial Holding Companies and would be subject to a separate regulatory regime.

Q1. If some firms are designated as systemically important, would this signal to market participants that the government will not allow these firms to fail? If so, how would this worsen our too big to fail problem?

A1. We have concerns about formally designating certain institutions as a special class. Any recognition of an institution as systemically important risks invoking the moral hazard that accompanies institutions that are considered too-big-to-fail. That is why, most importantly, a robust resolution mechanism, in addition to enhanced supervision, is important for very large financial organizations. A vigorous systemic risk regulatory regime, along with resolution authority for bank holding companies and systemically risky financial firms would go far toward eliminating too-big-to-fail.

Government Replacing Management?

In your testimony, while discussing the need for a systemic risk regulator to provide a resolution regime, you state that "losses would be borne by the stockholders and bondholders of the holding company, and senior management would be replaced."

Q2. Could you expand upon how the senior management would be replaced? Would the systemic risk regulator decide who needed to be replaced and who would replace them?

A2. When the FDIC takes over a large insured bank and establishes a bridge bank, the normal business practice is to replace certain top officials in the bank, usually the CEO, plus any other senior officials whose activities were tied to the cause of the bank failure. The resolution authority would decide who to replace based on why the firm failed.

"Highly credible mechanism" for orderly resolution

Chairman Bair, in your testimony you suggest that we must re-design our system to allow the market to determine winners and losers, "and when firms– through their own mismanagement and excessive risk taking– are no longer viable, they should fail." You also suggest that the solution must involve a "highly credible mechanism" for orderly resolution of failed institutions similar to that which exists for FDIC-insured banks.

Q3. Do you believe that our current bankruptcy system is inadequate, or do you believe that we must create a new resolution regime simply to fight the perception that we will not allow a systemically important institution to fail?

A3. In the United States, liquidation and rehabilitation of most failing corporations are governed by the federal bankruptcy code and administered primarily in the federal bankruptcy courts. Separate treatment, however, is afforded to banks, which are resolved under the Federal Deposit Insurance Act and administered by the FDIC.[1] The justifications for this separate treatment are banks' importance to the aggregate economy, and the serious adverse affect of their insolvency on others.

Bankruptcy focuses on returning value to creditors and is not geared to protecting the stability of the financial system. When a firm is placed into bankruptcy, an automatic stay is placed on most creditor claims to allow management time to develop a reorganization plan. This can create liquidity problems for creditors -- especially when a financial institution is involved -- who must wait to receive their funds. Bankruptcy cannot prevent a meltdown of the financial system when a systemically important financial firm is troubled or failing.

Financial firms -- especially large and complex financial firms -- are highly interconnected and operate through financial commitments. Most obtain a significant share of their funding from wholesale markets using short-term instruments. They provide key credit and liquidity intermediation functions. Like banks, financial firms (holding companies and their affiliates) can be vulnerable to "runs" if their short-term liabilities come due and cannot be rolled over. For these firms, bankruptcy can trigger a rush to the door, since counterparties to derivatives contracts -- which are exempt from the automatic stay placed on other contracts -- will exercise their rights to immediately terminate contracts, net out their exposures, and sell any supporting collateral.

The statutory right to invoke close-out netting and settlement was intended to reduce the risks of market disruption. Because financial firms play a central role in the intermediation of credit and liquidity, tying up these functions in the bankruptcy process would be particularly destabilizing. However, during periods of economic instability this rush-to-the-door can overwhelm the market and even depress market prices for the underlying assets. This can further destabilize the markets and affect other financial firms as they are forced to adjust their balance sheets.

By contrast, the powers that are available to the FDIC under its special resolution authority prevent the immediate close-out netting and settlement of financial contracts of an insured depository institution if the FDIC, within 24 hours after its appointment as receiver, decides to transfer the contracts to another bank or to an FDIC-operated bridge bank. As a result, the potential for instability or contagion caused by the immediate close-out netting and settlement of qualified financial contracts can be tempered by transferring them to a more stable counterparty or by having the bridge bank guarantee to continue to perform on the contracts. The FDIC's resolution powers clearly add stability in contrast to a bankruptcy proceeding.

---

[1] Another exception would be the liquidation or rehabilitation of insurance companies, which are handled under state law.

For any new resolution regime to be truly "credible," it must provide for the orderly wind-down of large, systemically important financial firms in a manner that is clear, comprehensive, and capable of conclusion. Thus, it is not simply a matter of "perception," although the new resolution regime must be recognized by firms, investors, creditors, and the public as a mechanism in which systemically important institutions will in fact fail.

<u>Firms subject to new resolution regime</u>

Chairman Bair, in your testimony, you continuously refer to "systemically significant entities," and you also advocate for much broader resolution authority.

Q4. Could you indicate how a "systemically significant entity" would be defined? Will the list of systemically significant institutions change year-to-year? Do you envision it including non-financial companies such as GM?

Would all financial and "systemically significant entities" be subject to this new resolution regime? If not, how would the market determine whether the company would be subject to a traditional bankruptcy or the new resolution regime?

Why do we need a systemic risk regulator if we are going to allow institutions to become "systemically important"?

A4. We would anticipate that the Systemic Risk Council, in conjunction with the Federal Reserve would develop definitions for systemic risk. Also, mergers, failures, and changing business models could change what firms would be considered systemically important from year-to-year.

While not commenting on any specific company, non-financial firms that become major financial system participants should have their financial activities come under the same regulatory scrutiny as any other major financial system participant.

<u>Better deal for the Taxpayer</u>

Q1. Chairman Bair, you advocate in your testimony for a new resolution mechanism designed to handle systemically significant institutions. Could you please cite specific examples of how this new resolution regime would have worked to achieve a better outcome for the taxpayer during this past crisis?

A1. A proposed new resolution regime modeled after the FDIC's existing authorities has a number of characteristics that would reduce the costs associated with the failure of a systemically significant institution.

First and foremost, the existence of a transparent resolution scheme and processes will make clear to market participants that there will be an imposition of losses according to an established claims priority where stockholders and creditors, not the government, are in the first loss position. This will provide a significant measure of cost savings by imposing market discipline on institutions so that they are less likely to get to the point where they would have otherwise been considered too-big-to-fail.

Also, the proposed resolution regime would allow the continuation of any systemically significant operations, but only as a means to achieve a final resolution of the entity. A bridge mechanism, applicable to the parent company and all affiliated entities, would allow the government to preserve systemically significant functions. Also, for institutions involved in derivatives contracts, the new resolution regime would provide an orderly unwinding of counterparty positions as compared to the rush to the door that can occur during a bankruptcy. In contrast, since counterparties to derivatives contracts are exempt from the automatic stay placed on other contracts under the Bankruptcy Code, they will exercise their rights to immediately terminate contracts, net out their exposures, and sell any supporting collateral, which serves to increase the loss to the failed institution.

In addition, the proposed resolution regime enables losses to be imposed on market players who should appropriately bear the risk, including shareholders and unsecured debt investors. This creates a buffer that can reduce potential losses that could be borne by taxpayers.

Further, when the institution and its assets are sold, this approach creates the possibility of multiple bidders for the financial organization and its assets, which can improve pricing and reduce losses to the receivership.

The current financial crisis led to illiquidity and the potential insolvency of a number of systemically significant financial institutions during 2008. Where government assistance was provided on an open-institution basis, the government exposed itself to significant loss that would otherwise have been mitigated by these authorities proposed for the resolution of systemically significant institutions. A new resolution regime for firms such as Lehman or AIG would ensure that shareholders, management, and creditors take losses and would bar an open institution bail-out, as with AIG. The powers of a receiver for a financial firm would include the ability to require counterparties to perform under their contracts and the ability to repudiate or terminate contracts that impose continuing losses. It also would have the power to terminate employment contracts and eliminate many bonuses.

Response to questions from the Honorable David Vitter
by Sheila C. Bair, Chairman,
Federal Deposit Insurance Corporation

Chairwoman Bair, you recently released a proposal which, I believe, asks private equity to maintain a 15% Tier-1 capital ratio while well capitalized banks only maintain a 5% ratio and newly established banks an 8% ratio. In May, the FDIC announced the successful purchase of BankUnited which allowed almost $1 billion of private investment come in and successfully take over the bank's management. By all reports this has been a successful arrangement for both the FDIC and private investment company. Although I understand your policy concerns, I think that the current proposal goes too far in several respects. I am concerned that the FDIC's proposed policy deters private capital from entering the banking system, leaving the FDIC's insurance fund and, ultimately, the taxpayers with the final bill. With bank failures mounting this year, I would have liked see more private investment able to participate in cleaning up these troubled banks.

Q1. What can the FDIC do to ensure that more private equity comes in to stem the tide of bank failures?

A1. On August 26, 2009, the FDIC's Board of Directors voted to adopt the Final Statement of Policy on Qualifications for Failed Bank Acquisitions (Final Policy Statement), which was published in the *Federal Register* on September 2, 2009. The Final Policy Statement takes into account the comments presented by the many interested parties who submitted comments. Although the final minimum capital commitment has been adjusted from 15 percent Tier 1 leverage to 10 percent Tier 1 common equity, key elements of the earlier proposed statement remain in place: cross support, prohibitions on insider lending, limitations on sales of acquired shares in the first three years, a prohibition on bidding by excessively opaque and complex business structures, and minimum disclosure requirements.

Importantly, the Final Policy Statement specifies that it does not apply to investors who do not hold more than 5 percent of the total voting powers and who are not engaged in concerted actions with other investors. It also includes relief for investors if the insured institution maintains a Uniform Financial Institution composite rating of 1 or 2 for 7 consecutive years. The FDIC Board is given the authority to make exceptions to its application in special circumstances. The Final Policy Statement also clearly excludes partnerships between private capital investors and bank or thrift holding companies that have a strong majority interest in the acquired banks or thrifts.

In adopting the Final Policy Statement, the FDIC sought to strike a balance between the interests of private investors and the need to provide adequate safeguards for the insured depository institutions involved. We believe the Final Policy Statement will encourage safe and sound investments and make the bidding more competitive and robust. In turn, this will limit the FDIC's losses, protect taxpayers, and speed the resolution process. As a result, the Final Policy Statement will aid the FDIC in carrying out its mission.

Q2. Are you concerned that without attracting private capital, the FDIC's deposit insurance fund and, ultimately, taxpayers will foot the entire bill for the looming bank failures?

A2. We do not see a taxpayer exposure as a result of upcoming bank failures. Our latest publicly released information shows that the FDIC ended the second quarter of 2009 with a DIF balance of $10.4 billion and an additional $32 billion reserve for expected future failure losses. Updates to these numbers show the FDIC estimates that it ended the third quarter of 2009 with a negative fund balance. The contingent loss reserve for expected future losses from failures has grown, however.

To date, the FDIC has required a special assessment to rebuild the DIF and we recently issued a notice of proposed rulemaking to require the prepayment of assessments for three years. Current projections are that assessment income will exceed expected losses from bank failures over the next several years. However, there is a timing problem as the bulk of bank failures are expected to occur in 2009 and 2010, while most assessment income will be booked in later years. Therefore, although the prepayment of assessments will not immediately rebuild the fund balance, it will provide the FDIC with the liquidity needed to fund projected bank failures. Further, even if it became necessary for the FDIC to borrow from the U.S. Treasury, any potential borrowing would be repaid by insured depository institutions.

Q3. If private equity does come in, what could the savings be to the deposit insurance fund?

A3. If, as expected, the FDIC increases the overall number of potential bidders for failed financial institutions by including more private equity firms, it would increase competition and potentially improve the quality of the bids.

Q4. Do you agree with the Secretary's assessment that the FDIC was created to address resolving small banks and thrifts and does not have the appropriate resources to deal with the failure of a major bank?

A4. The FDIC has substantial experience resolving large, complex, internationally active insured depository institutions. Continental Illinois National Bank and Trust, which required FDIC assistance in 1984 was the seventh largest commercial bank in the country at the time. More recently, in September 2008, the FDIC dealt with the failure of Washington Mutual Bank which had total assets of $307 billion. This was the fifth largest bank in the country at that time.

This experience with conservatorships and receiverships has significant parallels for systemically important holding companies and for other types of financial companies, enabling the FDIC to take advantage of its experience in acting as receiver for thousands of insured depository institutions. Also, much of the Administration's special resolution authority proposal is based on the FDIC's current statutory authority. Therefore, expanding the FDIC's activities to systemically significant institutions will be consistent in many respects to its current scope of activities.

Q5. If there are limits on the FDIC's expertise and resources would keep the FDIC from resolving the biggest banks in the country, what are they?

A5. We believe the FDIC is prepared to handle the resolution of an insured depository institution of any size and complexity. Our testimony outlines limitations of our current resolution authority and recommends, on page 7, principles to guide Congress in adopting a process that ensures an orderly and comprehensive resolution mechanism for systemically important financial firms.

Q6. What are the impediments, if any, that the FDIC would face in resolving the depository institutions associated with Bank of America or Citi?

A6. Although I cannot comment on supervisory matters involving open institutions, any large depository institution can pose special challenges. They typically have extensive foreign operations, higher-than-normal levels of uninsured deposits, expansive branch networks that can span multiple time zones and usually are heavily involved in derivative financial instruments. Further, the largest insured depository institutions are owned by holding companies that own other related entities. These holding companies manage operations by business line with little regard to the legal entities involved. The intertwined nature of the operations of a large bank holding company will present its own set of challenges. This is one reason it is important for the FDIC to have receivership authority over the entire financial services holding company, not just the insured depository institution.

LA09-1340

United States Senate

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS
WASHINGTON, DC 20510-6075

August 26, 2009

FDIC
SEP - 1 2009
OFFICE OF LEGISLATIVE AFFAIRS

The Honorable Sheila Bair
Chairman
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429

Dear Chairman Bair:

Thank you for testifying before the Committee on Banking, Housing, and Urban Affairs on July 23, 2009. In order to complete the hearing record, we would appreciate your answers to the enclosed questions as soon as possible.

Please repeat the question, then your answer, single spacing both question and answer. Please do not use all capitals.

Send your reply to Ms. Dawn L. Ratliff, the Committee's Chief Clerk. She will transmit copies to the appropriate offices, including the committee's publications office. Due to current procedures regarding Senate mail, it is recommended that you send replies via e-mail in a MS Word, WordPerfect or .pdf attachment to Dawn_Ratliff@banking.senate.gov.

If you have any questions about this letter, please contact Ms. Ratliff at (202)224-3043.

Sincerely,

[redacted]

CHRISTOPHER J. DODD
Chairman

CJD/dr

Questions for the Hearing on "Establishing a Framework for Systemic Risk Regulation"
July 23, 2009

Questions for The Honorable Sheila Bair, Chairman, Federal Deposit Insurance Corporation, from Senator Bunning:

1. Many proposals call for a risk regulator that is separate from the normal safety and soundness regulator of banks and other firms. The idea is that the risk regulator will set rules that the other regulators will enforce. That sounds a lot like the current system we have today, where different regulators read and enforce the same rules different ways. Under such a risk regulator, how would you make sure the rules were being enforced the same across the board?

2. Before we can regulate systemic risk, we have to know what it is. But no one seems to have a definition. How do you define systemic risk?

3. Assuming a regulator could spot systemic risk, what exactly is the regulator supposed to do about it? What powers would they need to have?

4. How do you propose we identify firms that pose systemic risks?

5. Any risk regulator would have access to valuable information about the business of many firms. There would be a lot of people who would pay good money to get that information. How do we protect that information from being used improperly, such as theft or an employee leaving the regulator and using his knowledge to make money?

Questions for the Hearing on "Establishing a Framework for Systemic Risk Regulation"
July 23, 2009

Questions for The Honorable Sheila Bair, Chairman, Federal Deposit Insurance Corporation, from Senator Crapo:

I appreciate the FDIC's desire to provide clarity around the process of private investors investing in failed banks that have been taken over by the FDIC. We need to make sure that the final rule doesn't deter private capital from entering the banking system, leaving the FDIC's insurance fund and, ultimately, the taxpayers with the final bill. Are you open to modifying some of the proposed requirements, such as the 15% capital requirement?

Questions for the Hearing on "Establishing a Framework for Systemic Risk Regulation"
July 23, 2009

Questions for The Honorable Sheila Bair, Chairman, Federal Deposit Insurance Corporation, from Senator Menendez:

A recent media article (New York Times, June 14th) states there have been strong disagreements between the FDIC and the OCC over whether the proposal to impose new insurance fees on banks is unfair to the largest banks, with the FDIC arguing that the largest banks contributed to the current crisis and should have to pay more. Can you elaborate on your rationale for requiring big banks to pay more than community banks?

Questions for the Hearing on "Establishing a Framework for Systemic Risk Regulation"
July 23, 2009

Questions for The Honorable Sheila Bair, Chairman, Federal Deposit Insurance Corporation, from Senator Reed:

You discussed regulatory arbitrage in your written statements and emphasized the benefits of a Council to minimize such opportunities. Can you elaborate on this? Should standards be set by individual regulators, the Council, or both? Can a Council operate effectively in emergency situations?

What do you see as the key differences in viewpoints with respect to the role and authority of a Systemic Risk Council? For example, it seems like one key question is whether the Council or the Federal Reserve will set capital, liquidity, and risk management standards. Another key question seems to be who should be the Chair of the Council, the Secretary of the Treasury or a different Senate-appointed Chair. Please share your views on these issues.

What are the other unresolved aspects of establishing a framework for systemic risk regulation?

How should Tier 1 firms be identified? Which regulator(s) should have this responsibility?

One key part of the discussion at the hearing is whether the Federal Reserve, or any agency, can effectively operate with two or more goals or missions. Can the Federal Reserve effectively conduct monetary policy, macro-prudential regulation, and consumer protection?

Under the Administration's plan, there would be heightened supervision and consolidation of all large, interconnected financial firms, including likely requiring more firms to become financial holding companies. Can you comment on whether this plan adequately addresses the too-big-to-fail problem? Is it problematic, as some say, to identify specific firms that are systemically significant, even if you provide disincentives to becoming so large, as the Administration's plan does?

Questions for the Hearing on "Establishing a Framework for Systemic Risk Regulation"
July 23, 2009

Questions for The Honorable Sheila Bair, Chairman, Federal Deposit Insurance Corporation, from Ranking Member Shelby:

Too Big To Fail

Chairman Bair, the Obama Administration's proposal would have regulators designate certain firms as systemically important. These firms would be classified as Tier 1 Financial Holding Companies and would be subject to a separate regulatory regime.

- If some firms are designated as systemically important, would this signal to market participants that the government will not allow these firms to fail?
- If so, how would this worsen our too big to fail problem?

Government Replacing Management?

In your testimony, while discussing the need for a systemic risk regulator to provide a resolution regime, you state that "losses would be borne by the stockholders and bondholders of the holding company, and senior management would be replaced."

- Could you expand upon how the senior management would be replaced? Would the systemic risk regulator decide who needed to be replaced and who would replace them?

"Highly credible mechanism" for orderly resolution

Chairman Bair, in your testimony you suggest that we must re-design our system to allow the market to determine winners and losers, "and when firms– through their own mismanagement and excessive risk taking– are no longer viable, they should fail." You also suggest that the solution must involve a "highly credible mechanism" for orderly resolution of failed institutions similar to that which exists for FDIC-insured banks.

- Do you believe that our current bankruptcy system is inadequate, or do you believe that we must create a new resolution regime simply to fight the perception that we will not allow a systemically important institution to fail?

Questions for the Hearing on "Establishing a Framework for Systemic Risk Regulation"
July 23, 2009

Firms subject to new resolution regime
Chairman Bair, in your testimony, you continuously refer to "systemically significant entities," and you also advocate for much broader resolution authority.

- Could you indicate how a "systemically significant entity" would be defined? Will the list of systemically significant institutions change year-to-year? Do you envision it including non-financial companies such as GM?

- Would all financial and "systemically significant entities" be subject to this new resolution regime? If not, how would the market determine whether the company would be subject to a traditional bankruptcy or the new resolution regime?

- Why do we need a systemic risk regulator if we are going to allow institutions to become "systemically important"?

Better deal for the Taxpayer
Chairman Bair, you advocate in your testimony for a new resolution mechanism designed to handle systemically significant institutions.

- Could you please cite specific examples of how this new resolution regime would have worked to achieve a better outcome for the taxpayer during this past crisis?

Questions for the Hearing on "Establishing a Framework for Systemic Risk Regulation"
July 23, 2009

Questions for The Honorable Sheila Bair, Chairman, Federal Deposit Insurance Corporation, from Senator Vitter:

Chairwoman Bair, you recently released a proposal which, I believe, asks private equity to maintain a 15% Tier-1 capital ratio while well capitalized banks only maintain a 5% ratio and newly established banks an 8% ratio. In May the FDIC announced the successful purchase of BankUnited which allowed almost $1 billion of private investment come in and successfully take over the bank's management. By all reports this has been a successful arrangement for both the FDIC and private investment company. Although I understand your policy concerns, I think that the current proposal goes too far in several respects. I am concerned that the FDIC's proposed policy deters private capital from entering the banking system, leaving the FDIC's insurance fund and, ultimately, the taxpayers with the final bill. With bank failures mounting this year, I would have liked see more private investment able to participate in cleaning up these troubled banks.

- o What can the FDIC do to ensure that more private equity comes in to stem the tide of bank failures?
- o Are you concerned that without attracting private capital, the FDIC's deposit insurance fund and, ultimately, taxpayers will foot the entire bill for the looming bank failures?
- o If private equity does come in, what could the savings be to the deposit insurance fund?

On May 20, 2009, the Senate Committee on Banking, Housing, and Urban Affairs the Committee heard testimony from United States Treasury Secretary Timothy Geithner about the Troubled Asset Relief Program. Twice, the Secretary stated his belief that the FDIC was created specifically to deal with small banks and thrifts. And, as it is currently constituted, the FDIC cannot be counted on to resolve a major bank.

Secretary Geithner said, "Well, the great virtue of the model put in place by the Congress for small banks in the country, which the FDIC administer, is it gives the government the ability to come in more quickly and a much greater set of options for unwinding, cleaning up, separating the band from the good, putting the good back into the market. It gives the FDIC the authority to guarantee temporarily, to put capital in, to do other steps that, again, help facilitate a quicker, more surgical separation to let the government get out more quickly."

Later in the hearing the Secretary again noted that the FDIC was designed to strictly handle the smaller banks and thrifts in the nation's banking system when he responded, "the proposal we have made and we will make for resolution authority will be based on and modeled on what the Congress designed for the FDIC, what was designed for small banks and thrifts, not for a crisis like this, has not caught up to the dramatic evolution in the structure of our system."

As you are well aware, provisions of S. 896, the Helping Families Save Their Homes Act, dramatically expand the FDIC's ability to borrow from the U.S. Treasury. The newly enacted

Questions for the Hearing on "Establishing a Framework for Systemic Risk Regulation"
July 23, 2009

law, signed last week by President Obama, permanently expands FDIC's current borrowing authority from $30 billion to $100 billion. The Congress included these provisions in order to

ensure that the FDIC had the appropriate resources to deal with the current challenges in the nation's banking system.

- Do you agree with the Secretary's assessment that the FDIC was created to address resolving small banks and thrifts and does not have the appropriate resources to deal with the failure of a major bank?
- If there are limits on the FDIC's expertise and resources would keep the FDIC from resolving the biggest banks in the country, what are they?
- What are the impediments, if any, would the FDIC would face in resolving the depository institutions associated with Bank of America or Citi?

OC09-1430

STATE OF WASHINGTON

OFFICE OF THE GOVERNOR

Olympia, Washington 98504

November 16, 2009

The Honorable Sheila C. Bair, Chairman
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429

Dear Chairman Bair:

Thank you for your efforts to maintain stability and public confidence in the nation's financial system during these extraordinary times. Your contributions to the public policy debate about how our nation must reform its financial regulatory house is appreciated, particularly your thoughtful and consistent support for preserving a viable dual-charter banking system. Like you, I am concerned that concentration of regulatory power in a single federal regulator would severely prejudice the community banks that are the lending lifeblood for our nation's "main streets."

At this time of economic uncertainty, when our economy is struggling to recover and we seek ways to improve access to critically needed credit for businesses and consumers, we must do all we can to support – and fairly implement – prudent financial regulatory policies and processes that support economic growth. As I travel my home state of Washington, I hear directly from community bankers, small businesses and consumers who are concerned about what are seen to be mixed policy and regulatory messages and disparate treatment coming from the "other Washington." At a minimum, they suggest a belief that our regulatory systems are unfairly weighted against "Main Street" and in favor of "Wall Street."

As Chairman Frank and Congressman Minnick of the House Financial Services Committee highlight in their October 29, 2009, letter to you and to other federal financial regulators (copy enclosed), our nation's community bankers were not significant contributors to the sub-prime lending debacle that triggered the series of financial events that contributed to the credit and economic crisis we find ourselves facing today. I share many of the concerns expressed in the Congressmen's letter and wonder if we might all benefit from field staff being allowed to exercise their training and judgment without undue pressure by any one Regional Office to produce results significantly more negative than those otherwise recommended by field examiners. Furthermore, I agree with their message that "[a] self-fulfilling prophecy of community bank failures, shrinking credit availability and a slower economic recovery can all result from a regulatory over-reaction to the current crisis."

I look forward to your response to Chairman Frank and Congressman Minnick; and to supplement their observations, you should know that it is regularly expressed to me that federal policies have rewarded irresponsible behaviors by the "too big to fail" institutions and continue to provide these same institutions with a competitive advantage over traditional "main street" community banks. The perception is that the government will always be there to bail out the large institutions, affording them the ability to borrow on more favorable terms than their "main street' competitors.

Similarly, it has been suggested to me that the various FDIC regions do not all adhere to, nor do they consistently apply, the same standards, with the San Francisco and Atlanta regions being singled out as taking more aggressive approaches to the community banks in their regions than do their counterparts around the nation. On this point, I would ask for your assurances that FDIC has systems in place to minimize the likelihood that different standards or disparate treatment is applied to institutions by region, and that, rather, banks across the nation are to receive equal treatment irrespective of where they are located.

On a positive note, we are seeing some signs of investor willingness to infuse much needed capital into our banks. The FDIC recognized the need for some regulatory flexibility as to private-equity investors seeking to buy failing banks in the final guidelines adopted on August 26, 2009. The guidelines were an effort to strike a balance between the clear need for banks to attract capital and the fundamental principles supporting prudent banking practices.

With respect to these August 26 guidelines, what can you share as to the experience since their adoption? Has private equity stepped forward? If not, are there reasons you discern as to why that is the case and is any consideration being given to what additional, responsible steps need to be taken by regulators to facilitate safe and sound appropriate capital investment? Recent experience suggests to me that there is more we can do to overcome potential equity investors' concern that their applications will receive fair and timely consideration by the appropriate regulators and any insights you can provide are welcome.

We must continue to support the viability of a safe and sound dual-charter banking system and the community banks that serve communities across our nation. I commend your continuing support for the community banking system in the regulatory reform discussions and I look forward to hearing from you as to how we can smooth out the regulatory bumps along the road to an improved, responsive and responsible financial regulatory system and economic recovery.

Sincerely,

[redacted]
Governor

Enclosure

U.S. House of Representatives
Committee on Financial Services
2129 Rayburn House Office Building
Washington, DC 20515

October 29 2009

The Honorable Ben S. Bernanke
Chairman
Board of Governors
Of the Federal Reserve System
20th and Constitution Avenue, NW
Washington, DC 20551

The Honorable Sheila C. Bair
Chairman
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429

The Honorable John Dugan
Comptroller of the Currency
Office of the Comptroller of the Currency
250 E Street, SW
Washington, DC 20219

The Honorable Debbie Matz
Chairman
National Credit Union Administration
1775 Duke Street
Alexandria, VA 22314-3428

The Honorable John E. Bowman
Acting Director
Office of Thrift Supervision
1700 G Street, NW
Washington, DC 20552

Dear Chairman Bernanke, Chairman Bair, Comptroller Dugan, Chairman Matz and Acting Director Bowman:

It is now recognized that the vast majority of problem sub-prime loans were originated by non-bank lenders. Yet, it is the already highly regulated traditional depository banks that are feeling the greatest regulatory pressure as a result of the current economic crisis. In particular, one of the biggest challenges faced by community banks (but shared by all banks) is how to respond to the calls from Congress to increase lending to stimulate the economy and to work with troubled borrowers on foreclosure mitigation, while dealing with increasingly stringent directives from regulators that can preclude banks from doing just that.

Community banks became strong and viable players in the financial services industry because they fill an important need, and it would be short-sighted to weaken that role through over-zealous regulatory actions - actions based not on wrong-doing or poor management practices at these banks, but on changes in the economic environment and toughening regulatory standards.

It is critical now more than ever that regulatory personnel out in the field apply a measured approach to examinations that is directed by agency leadership rather than subject to arbitrary decisions in the field. Examiners that are now being inappropriately tougher in their analysis of asset quality and are consistently requiring downgrades of loans whenever there is any doubt about the loans condition are acting counter to the kind of balanced approach required in the current economy.

Worsening conditions in many markets have strained the ability of some borrowers to pay on their loans, which often leads regulators to insist that a bank make a capital call on the borrower, impose harmful amortization schedules or obtain additional collateral. These steps can set in motion a "death spiral" based on fire-sale prices for assets to raise cash, a drop in the comparable sales figures the appraisers use, which results in market devaluations of other assets. These actions are directly counter to the message from Congress calling for banks to work with borrowers to help them through these difficult times and to make credit available.

While there is no question that regulatory gaps and other regulatory short-comings were a significant contributor to the economic crisis, those gaps were largely within the non-bank lending market and Wall Street banks.

We call on regulators to show some temperance in their regulation of traditional banks. Not to jeopardize core safety and soundness principles, but to show some restraint in the immediate enforcement of new rules that may prove to be excessive at a time when community banks are least able to respond. A self-fulfilling prophecy of community bank failures, shrinking credit availability and a slower economic recovery can all result from a regulatory over-reaction to the current crisis.

Here are some examples of problem areas that have been brought to our attention by constituents:

1. "Unofficial" Capital Requirements—the official regulatory standard for being "Well capitalized" is basically 5% for Tier One Capital and 10% for Total Risk Base Capital. Some bankers indicate that individual examiners have in some cases unofficially moved these numbers to as high as 8-9% and 12% respectively. The impact is that many community banks have to restrict their growth (lending activity) in order to shrink their balance sheets and meet these standards. Restricting lending activity, especially to small businesses—is counter productive to helping the economy recover.

2. In many cases the traditional "CAMELS" rating exercise for banks appears to have become an "A" –asset quality –exam. We have always understood that weakness in asset quality in an institution could be mitigated by strength in other areas such as Capital, core earnings and liquidity. Examiners now seem to say if asset quality is bad all the other components are also unsatisfactory.

3. Valuation of assets—Banks are being forced to write assets, loans and Other Real Estate Owned, down to current "market" value. The problem is that there is virtually no market for some of these assets (developed lots for example) *at present*, leading to artificially low prices for those assets that have to be sold under duress. However, many of these markets are expected to recover in the future, and the forced writedowns to "fire-sale" values now are making the banks' capital crunch artificially and unnecessarily worse.

4. Discouragement of the use of short term borrowings from Federal Reserve, Federal Home Loan Bank, or CDARS reciprocal CD's, etc. Regulators seem to be re-establishing their old aversion to a bank funding its operations with anything but deposits. The pressure in this area is often applied by lowering liquidity grades on exams for those banks that do make use of what the examiners deem "excessive" borrowing. This "message" is in turn causing some institutions artificially to constrict lending in order to reduce their amount of borrowings to please the regulator

These are just a few examples, but the overall message is clear. While our regulators need to uphold proper safety and soundness standards in this difficult economy, unnecessarily aggressive decisions made in the field by individual examiners or teams intended to require banks to hold or acquire capital in excess of the official regulatory standard for being "well capitalized" must be avoided, to prevent more banks from failing unnecessarily. We are calling upon you to take the long view, use their wisdom and experience to guide their field staff toward a more appropriate application of the core principles of safety and soundness regulation in order to enable our banks to assist fully in our economic recovery.

[redacted]

BARNEY FRANK

[redacted]

WALT MINNICK

FEDERAL DEPOSIT INSURANCE CORPORATION, Washington, DC 20429

SHEILA C. BAIR
CHAIRMAN

November 26, 2008

Honorable Dianne Feinstein
United States Senate
Washington, D.C. 20510

Dear Senator Feinstein:

Thank you for your letter expressing support for the Federal Deposit Insurance Corporation's efforts to promote a more systematic approach to modifying problem mortgage loans.

As you point out in your letter, foreclosure represents an increasingly self-defeating response to the problem of delinquent mortgage loans. In the present environment, this approach only adds to an overhang of excess vacant homes that has been estimated to exceed one million units nationally. To help us get ahead of this problem, we need a program that encourages mortgage lenders and servicers to modify loans on a sustainable basis, and that does so efficiently on a large scale.

As you are aware, the FDIC has initiated a systematic loan modification program at IndyMac Federal Bank, where it is conservator. This program identifies loans with high monthly payments relative to income and makes offers to borrowers to reduce the monthly payment to as low as 31 percent of monthly income. Modifications are undertaken according to a standard protocol based on interest rate reductions, extensions of term, and principal forbearance. Like any mortgage servicer, the FDIC must undertake a net present value, or NPV, test for every modified loan to ensure that this strategy will maximize the returns for the Deposit Insurance Fund or the investors that own the troubled mortgages. The FDIC also takes steps to verify the occupancy status and current income of the borrower.

Based on this experience, the FDIC discussed with the Treasury Department implementation of a partial loss guaranty program, as authorized under the Emergency Economic Stabilization Act (EESA), that would provide financial incentives for a wide range of mortgage servicers to modify high-cost mortgage loans according to the IndyMac standard. One of the advantages of this approach is the ability to modify loans that have been securitized, leaving them in place under private management. While those discussions have not led to adoption of the program by Treasury under the authority provided by the EESA, we believe that the rapid implementation of such a guaranty program would be the best way to achieve a significant impact on the distressed housing market.

I believe that this approach offers a way forward to improve the affordability of mortgage loans for distressed households, reducing the number of unnecessary foreclosures, and helping to stabilize U.S. housing markets. But given the immense scale of the challenge before us, our approach can make a dent in the problem only if it is implemented in a comprehensive manner. It will not be without costs. But we feel that to the extent that declining home prices and mortgage credit distress are at the heart of the present crisis, this program will more directly address it. Under this proposal, there is hope that we will finally stop falling behind this problem and begin to stabilize our housing markets and our financial system.

I appreciate your interest in this issue and support of our efforts to address it. If you have further questions or comments, please do not hesitate to contact me at (202) 898-6974 or Eric Spitler, Director of Legislative Affairs, at (202) 898-3837.

Sincerely,

[redacted]

Sheila C. Bair

Thank you

This is very frustrating

We are not tackling the core problem.

LA08-541

DIANNE FEINSTEIN
CALIFORNIA

United States Senate

WASHINGTON, DC 20510-0504

October 30, 2008

FDIC
OCT 30 2008
OFFICE OF LEGISLATIVE AFFAIRS

The Honorable Sheila C. Bair
Chairman
Federal Deposit Insurance Corporation
550 17th Street N.W.
Washington, D.C. 20429

Dear Chairman Bair:

I write to express my strong support for your efforts to prevent foreclosures and expedite loan modifications through federal loan guarantees and standardized procedures for mortgage workout agreements. These are prudent and cost-effective steps to improve assistance for homeowners while also limiting foreclosures and stabilizing home values.

Foreclosures have had a devastating impact on our national economy, and the damage in my state has been particularly severe. California has the third highest foreclosure rate in the Nation, with one in every [illegible] homes in foreclosure—more than twice the national average of one foreclosure per every 475 homes. At this rate, more than 300,000 foreclosures may be filed on California properties this year, a roughly 75 percent increase over 2007. Six of the top ten high foreclosure U.S. metropolitan areas are in California and local communities are struggling to cope with the economic fallout.

It is critical that a portion of the funds provided in the recently enacted economic rescue legislation be immediately directed towards addressing the foreclosure problem. Utilizing the Federal Deposit Insurance Corporation model to standardize procedures for mortgage workout agreements based upon an appropriate debt-to-income ratio for borrowers will help expedite loan modifications. Moreover, I believe that providing federal loan guarantees will help incentivize lenders to offer more loan modifications to qualified borrowers while ensuring that taxpayer dollars are used efficiently.

Foreclosures are not in the best interest of anyone. Neighborhoods are devastated when homes are repossessed or left vacant, property values decline, local economies suffer, and crime often increases in blighted areas. Lenders must manage the costly foreclosure process and are left with the burden of reselling properties in a distressed market. Homeowners are forced to give up on the American dream, and in some cases tenants are forced out of homes they have been renting.

I know that you recognize the importance of this issue and I appreciate all of your hard work in developing practical solutions to assist struggling homeowners. Please keep my office closely advised of your progress. If I can be of any assistance, please do not hesitate to call me. I look forward to discussing further steps that can be taken to reduce foreclosures.

Thank you very much for your time and consideration.

Sincerely,

[redacted]

Dianne Feinstein
United States Senator

cc: The Honorable Henry Paulson, Jr., Secretary of the Treasury

DF:at

FEDERAL DEPOSIT INSURANCE CORPORATION, Washington, DC 20429

SHEILA C. BAIR
CHAIRMAN

October 9, 2009

Honorable Michael N. Castle
House of Representatives
Washington, D.C. 20515

Dear Congressman Castle:

Thank you for soliciting the Federal Deposit Insurance Corporation's comments on subtitle D of the Discussion Draft of the Consumer Financial Protection Agency Act of 2009.

Subtitle D seeks to eliminate the potential for regulatory arbitrage that exists because of federal preemption of certain state laws. We support that goal. We also support creating a strong floor for consumer protection, rather than a ceiling, by allowing more protective state consumer laws to apply to all providers of financial products and services operating within a state. While we are still studying the language of subtitle D and other options that have been suggested, we believe that the fundamental approach should significantly improve consumer protection.

We appreciate the opportunity to comment. Please do not hesitate to contact me at (202) 898-6974 or Paul Nash, Deputy for External Affairs, at (202) 898-6962.

Sincerely,

[redacted]

Sheila C. Bair

FEDERAL DEPOSIT INSURANCE CORPORATION, Washington, DC 20429

SHEILA C. BAIR
CHAIRMAN

October 15, 2009

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

Dear Mr. Chairman:

In our roles as Chairman, Vice Chairman, and appointed Director of the Federal Deposit Insurance Corporation, we are responsible for ensuring public confidence in the U.S. banking system by protecting depositors and taking action as appropriate to mitigate the risks and potential costs associated with the federal government's guarantee of insured deposits. We are deeply concerned that recent proposals to consolidate the supervisory powers of the four federal banking agencies into a single agency would not only fail to address the underlying causes of the financial crisis, but would weaken our dual banking system, lead to further consolidation in the banking industry, and undermine the FDIC's ability to perform critical functions necessary to protect depositors and mitigate risks to taxpayers.

The financial crisis had its roots in an unsustainable credit bubble driven by a confluence of factors. These factors included a prolonged period of low short-term interest rates that encouraged the financial system to fund long-term assets with short-term credit, inadequate regulatory standards for mortgage loan originations, regulatory gaps between banks and the non-bank financial sector, an explosion of derivatives activity that concentrated risks while it obscured them from view, arbitrage of different capital requirements among bank and non-bank institutions, and the lack of effective resolution options for large complex institutions.

There is little controversy about the important role these factors played in creating the conditions for the financial crisis. In contrast, we are not aware of any serious suggestion that the ability of state banks to convert to a federal charter, or vice versa, played such a role. Moreover, we believe the costs and potential for harmful consequences of a four agency supervisory consolidation are substantial and real.

There is little doubt that consolidation of supervisory authority in a single agency would endanger the dual banking system in the U.S. Supervisory consolidation in a single federal chartering authority would over time result in continued diminution and de-emphasis of the role of state banks and state regulation. This would be unfortunate, because the dual banking system has fostered a vibrant community banking industry that has supported economic growth and job creation, especially in rural areas, while state regulation has played an important role in identifying and addressing issues affecting consumers.

Moreover, and of great concern to us, the loss of the FDIC's supervisory function would compromise our ability to work as Congress intended to ensure that the statutory intent of Prompt Corrective Action is carried out. In addition to supervising state nonmember banks, our examinations are the eyes and ears by which the FDIC, in its role as deposit insurer, understands, assesses, and addresses risks at banks of all sizes and charter types.

A vibrant examination and supervision program plays a critical role in supporting the FDIC's ability to execute its insurance mission, and carry out its responsibilities as backup supervisor for all insured institutions. As a backup supervisor, the FDIC has played an active role during this crisis in numerous troubled bank situations where we were not the primary federal regulator. Our examiners' involvement has promoted earlier and more cost-effective resolutions. Supervisory input is an important element to the FDIC's risk-based deposit insurance premium, our overall assessment of industry-wide risks for deposit insurance purposes, and the development of policies to address those risks.

It is of great concern to us that the consolidation of supervisory authority in a single agency would weaken the system of checks and balances within the U.S. regulatory system. With our perspective as deposit insurer, the FDIC adds a needed conservative voice to safety and soundness regulation. For example, in single-regulator systems such as exist in many parts of the world, untested "advanced approaches" to allow large banks to set their own capital requirements using internal models were put into place without meaningful input from deposit insurers who had financial accountability for the results. In the U.S., in contrast, the FDIC's voice moved the outcome to a more gradual and prudential implementation of Basel II. Without the FDIC's strong role in the process, the U.S. would have implemented the advanced approaches earlier and with fewer safeguards, our large banks would have entered the crisis with less capital, and the problems would have been even more costly to address.

It is noteworthy that the strongest advocates of single regulator models have tended to be large financial institutions. We are concerned that a single regulator would inevitably come to view the largest institutions as its most important constituents since of necessity they would dominate the attention of the regulator. While the views of these institutions are important and worthy of consideration, we believe there is a substantial risk that over time a single regulator could be unduly swayed by the particular interests of these institutions. This in term could lead to further industry consolidation, even though there is a clear consensus that we need less concentration in the financial sector, not more.

What is needed are better approaches to fill regulatory gaps such as a strong Systemic Risk Council would provide: a strong rule-writing agency for consumer protection to address regulatory gaps and risk in the non-bank sector, better resolution tools to end the too-big-to-fail problem, and other specific capital and regulatory reforms.

As always, it remains the FDIC's privilege to work with you and your staff on the many important issues surrounding regulatory reform. We look forward to continuing these discussions going forward.

Sincerely,

[redacted] [redacted] [redacted]

Sheila C. Bair
Chairman

Martin J. Gruenberg
Vice Chairman

Thomas J. Curry
Director

FEDERAL DEPOSIT INSURANCE CORPORATION, Washington, DC 20429

SHEILA C. BAIR
CHAIRMAN

November 18, 2009

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

Dear Mr. Chairman:

I am pleased that Representatives Brad Miller and Dennis Moore have offered an amendment to address the imbalance under existing law in which the new resolution fund could suffer a loss in the resolution of a systemically significant financial firm while secured creditors receive full payment.

This amendment is a worthy addition to your proposed legislation because it supports your goals of preventing future taxpayer bail-outs and restoring market discipline to our largest financial companies. Fundamental to your legislation are the bans on government assistance to specific financial firms and the creation of a credible resolution process to close them and impose the losses on shareholders and creditors.

The Miller/Moore amendment supports these goals by requiring secured creditors to take losses of up to 20 percent of their secured claim before any losses could be imposed on the new resolution fund. This would apply only in the rare circumstance where losses were so severe that all other creditors have been wiped out. However, this amendment will help achieve your goal of enhancing market discipline because it will mean that secured creditors, alike with every other creditor, will need to evaluate the solvency of our largest financial firms. This amendment will ensure that the largest firms are not immunized from their bad decisions by relying on short-term financing so long as they have collateral to pledge.

For these reasons, I urge you to support the amendment of Representatives Miller and Moore in furtherance of our shared goal of returning market discipline to our financial system.

Sincerely,

[redacted]

Sheila C. Bair

FEDERAL DEPOSIT INSURANCE CORPORATION, Washington, DC 20429

SHEILA C. BAIR
CHAIRMAN

December 7, 2009

Honorable Louise M. Slaughter
Chairwoman
Committee on Rules
House of Representatives
Washington, D.C. 20515

Dear Madam Chairwoman:

I write in support of Congressman Hank Johnson's proposed amendment to Section 1105 of H.R. 4173, the Wall Street Reform and Consumer Protection Act of 2009.

The Federal Deposit Insurance Corporation supports allowing for judicial review of the Financial Services Oversight Council's extraordinary orders to mitigate systemic risk under Section 1105. However, the FDIC is concerned the judicial review provisions could be read more broadly than intended and inadvertently interfere with the ability of the FDIC and other bank regulatory agencies to take normal supervisory actions under existing law unrelated to the Section 1105 authority.

Congressman Johnson's amendment is technical in nature, but the FDIC feels strongly that it is a necessary clarification to Section 1105. Thus, I urge the Committee to make Representative Johnson's amendment to Section 1105 in order.

Thank you in advance for your consideration. Please let me know if you have any questions. If you have further questions or comments, please contact me at (202) 898-6974 or Paul Nash, Deputy for External Affairs, at (202) 898-6962.

Sincerely,

[redacted]

Sheila C. Bair