

NATIONAL PRESS CLUB LUNCHEON WITH SHEILA BAIR

SUBJECT: REFLECTIONS OF FDIC CHAIRMANSHIP

MODERATOR: MARK HAMRICK, PRESIDENT, NATIONAL PRESS CLUB

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MARK HAMRICK: (Sounds gavel.) Good afternoon, and welcome to the National Press Club. I'm Mark Hamrick, I'm a broadcast journalist with the Associated Press, and I'm the 104th president of the National Press Club. We are the world's leading professional organization for journalists committed to our profession's future through our programming, events such as this, while also working to foster a free press worldwide. For more information about the National Press Club, I'd ask that you please visit our website at www.press.org. And to donate to programs offered to the public through our Eric Friedheim National Journalism Library, you could find information on the website as well.

So on behalf of our members worldwide, I'd like to welcome our speaker today, as well as those of you attending today's event at our head table. Our head table does include guests of our speaker as well as working journalists who are club members, and we'd like to note that members of the general public are here today as well. So it's not necessarily evidence of a lack of journalistic objectivity if you happen to hear applause today. I'd also like to welcome our C-SPAN and Public Radio audiences. Our luncheons are featured on our member-produced weekly Podcast from the National Press Club and that's available for free download on iTunes. You can also follow the action on Twitter using the hash tag #NPlunch. After our guest speech concludes, we'll have Q&A and I'll ask as many questions as time permits.

Now it is time to introduce our head table guests, and I'd ask each of you here to stand up briefly as your name is announced. So we begin from your right. Skip Kaltenheuser, he is a Financial News writer, also for the International Bar Association

who went to law school with our guest speaker today; Ron Orol, the banking reporter with Dow Jones Market Watch; Mark Schoeff, Jr., a reporter for Investment News, and he's also the chair of our NPC publications committee. Jennifer Schonberger is a staff writer with Kiplinger's Personal Finance. She's also a new member of the club, and we're thankful for that. Richard Brown is our guest speaker's chief economist; Lorraine Woellert is a reporter covering housing and financial services policy for Bloomberg News. Scott Cooper is here, and among the other things that he does, he is husband of our guest speaker today.

Skip over the podium for a moment, Alison Fitzgerald is Vice Chair of the NPC's Speakers Committee, and she is a reporter for Bloomberg News. Skip over our guest for a moment, Lee Perryman, works for the Associated Press, and he's the Speakers Committee member who organized today's event, did a fantastic job. Thanks so much, Lee. Jose Villarreal is our guest speaker's Chief of Staff, welcome; Joe Adler is a reporter for American Banker and Source Media; Tim Ahmann is Editor-in-Charge and Washington Economics editor for Thomson Reuters; Darren Gersh is bureau chief with the Nightly Business Report; and Jim Parenti is Associate Dean of Georgetown University. And now you can give your round of applause for our head table guests. (Applause)

Our guest speaker today is the 19th Chairman of the Federal Deposit Insurance Corporation. Her term ends on July 8th, just two weeks from today. And I'm told that this is the last major speech that she will give. We're grateful that she's using the National Press Club to do that. She is often described as outspoken, aggressive, forceful, direct, candid, compassionate, optimistic and realistic, yet generally wary of politics. Appointed by President Bush in 2006, her start that the FDIC was generally uneventful, and then came the financial crisis that pushed her onto center stage.

In 2008 and 2009, *Forbes* magazine named her the second most powerful woman in the world; in 2008, she topped the *Wall Street Journal's* 50 Women to Watch list. In 2009, she was named one of *Time* magazine's 100 Most Influential People and received the John F. Kennedy Profile in Courage award and the Hubert H. Humphrey Civil Rights award. And in 2010, she was featured on the cover of *Time* magazine as 'one of the new sheriffs' of Wall Street. She is a Kansas native who grew up in the small town of Independence. It just so happens that's 12 miles up the road from my home town of Coffeerville. Our high schools were arch rivals in sports and everything else, but that's another story.

Our guest speaker worked as a bank teller in college; later in the 1970s she was an instructor at the University of Arkansas Law School and staff member. And then the U.S. Department of Health, Education and Welfare. In 1981, she was recruited by Senator Bob Dole to work on his Washington staff where she was deputy counsel and counsel and research director for his presidential campaign. She ended the decade as an attorney with the New York Stock Exchange.

In 1990, she ran for public and congressional seat in Kansas and lost by fewer than a thousand votes, drawing attention during her campaign by riding a bicycle around the district. She served as Commissioner and Acting Chairman of the Commodities Futures Trading Commission, Senior Vice President for Government Relations of the NYSE, and Assistant Treasury Secretary for financial institutions. Before joining the FDIC, she taught about financial regulation at the University of Massachusetts.

Our guest speaker did play a key role in managing the reaction to the 2008 financial meltdown and was praised for foresight in issuing warnings about the danger of Wall Street investments in sub-prime loans. Working to bolster public confidence and system stability, she implemented programs that provided temporary liquidity measures and guarantees to unfreeze credit markets and increase deposit insurance limits. And during her tenure, the FDIC closed the most banks since the savings and loan crisis.

She led the FDIC resolution strategies to sell failing banks to healthier institutions, curbing prospective deposits insurance fund losses. And under her leadership, the FDIC ranked third in the best places to work in government for 2009. It received an unqualified, or clean, 2010 audit from the GAO, which her office calls remarkable considering demands on the agency for rapid expansion and the loss exposure involving over 350 failed banks, representing over \$640 billion in assets.

This year, our guest speaker was inducted into the University of Kansas Women's Hall of Fame and received the Distinguished Kansan Award from the Native Sons and Daughters of Kansas. She also received several honors for published work on financial issues and has written two children's books on financial themes. She received a bachelor's degree from the University of Kansas. She also got her J. D. from the University of Kansas School of Law. She and her husband Scott have two children.

We thank her in accepting our invitation today to speak and to offer some parting remarks as she completes her remarkable tenure. Please offer a warm National Press Club welcome to FDIC Chairman, Sheila Bair. (Applause)

MS. BAIR: Thank you, that was a very, very nice introduction. You know, I spoke recently to my daughter's elementary school and the principal introduced me and we went through a lot of that, especially being number two in the *Forbes* ranking of the Most Powerful Women in the World in 2008 and 2009. And so I got up and I started making my spiel on talking about banks and savings and compounding interest and all the things I like to talk to young people about. And I started to take questions. A little hand went up, the first question was, "Well, who was number one?" So they're tough to impress these days. It was Angela Merkel, if you all were wondering. And I did drop to 15 this year behind Lady Gaga. I think it's because the banks are healing, unfortunately not as much as I would like, but things are getting better so I'm going to ascribe that to good news as to why I've fallen in my power status.

Before I would like to begin the speech, I'd like to thank some of the staff who are here with me, Rich Brown in particular, our chief economist who's also been drafted

repeatedly as chief speech writer. He has done some wonderful work and had a big hand in this speech today, and I do want to thank you for this and all the wonderful work you've done over the past five years. Rich, thank you very much.

And Andrew Gray, who many of you know, our head of public affairs, is out here somewhere, who has been with me the whole five years and done such a fabulous job. And his deputy, Michelle Heller. Thank you wherever you all are out here. And Jesse Villarreal, my chief of staff, who I drafted from-- he worked for me during my Treasury days and again has been at my side through what has been an incredible experience.

And finally, of course, my husband, Scott Cooper, who has just been supportive of everything including covering a lot of home obligations when I was not there as much as I wanted to be. And also I might say helping with speech writing. On more than one occasion, I've had him review, and he's a wonderful editor as well.

I'm deeply honored, and thank you for inviting me here to be at the National Press Club to deliver my last speech as FDIC chairman. As I prepare to close out my term, I cannot help reflect on the challenges we have faced over the past five years, and some of the lessons learned we've learned in the process. Our nation has suffered its most serious financial crisis and economic downturn since the Great Depression. The aftereffects will be felt for many years to come. There are many causes of this crisis, some of which I will address in my remarks today. But in my opinion, the overarching lesson of the crisis is the pervasive short-term thinking that helped to bring it about. Short-termism, it's a serious and growing problem in both business and government. I would like to devote my remarks to explaining what I mean by this and discussing how I think it plays into the policy challenges arising from the crisis.

What is short-termism and why does it arise? Short-termism refers to the long observed tendency which we all share to one degree or another to unduly discount outcomes that occur far into the future. Myopic decision making is a familiar concept. The emerging field of behavioral economics delves further into patterns of inconsistency and economic decision making. Investors systematically over-value short-term payoffs and pass up investment opportunities that could leave them much better off in the longer term. Too much short-term thinking can be very costly. It is a market failure that leads to under investment in valuable projects with long payoff periods.

Part of our tendency towards short-termism appears to be biological. While the mathematical side of our brain makes careful calculations of risk and reward over time, the more primal emotional parts of our brain tend to focus on the here and now. But which part of the brain do you think becomes active when research subjects are presented with real life decisions involving risk and reward? You guessed it: it's the more primitive system which understands greed and fear, but it's less focused on long-term consequences.

Short-termism also grows out of the institutional rules that govern our behavior. When executive compensation varies according to current year earnings or stock prices, it

creates incentives to maximize short-term results even at the expense of longer-term considerations. And short-term incentives tend to feed on each other through the chain of accountability. If an investment fund earns fees based on volume and if volume varies, as it often does with current performance, then the path of least resistance is to compensate fund managers based on current results.

But ask yourself if this investment fund is part of your 401(k), wouldn't you prefer that your fund manager be compensated at least in part based on long-term performance?

I probably don't need to tell you that short-termism also holds sway in the realm of politics. The virtue of our electoral process is that the incumbents face market discipline at regular intervals. But the drawback is that those facing reelection have little incentive to take a longer view of the issues than their constituents do. If the voting public doesn't regard the runaway federal debt as their highest concern, then elected leaders probably won't, either.

It's a particular challenge under our system to find leaders who will commit to projects that will pay off long after they have left office. Americans are naturally cautious when it comes to the ability of government to direct capital to long-term investments with uncertain outcomes. And yet, we can easily think of many examples where far-sighted government investments have yielded large returns for generations to come.

Think of the set aside of land for national parks that permanently preserve the beauty and grandeur of our natural landscape. Government investments have linked our country to the interstate highway system and the internet. As a nation, we have made investments that have allowed us to defend the peace, to explore the moon, eradicate disease and decode the human genome. But while we can clearly see the wisdom of those investments in retrospect, there are many areas of our national life, both public and private, where short-termism appears to be on the rise.

The average holding period of an equity share traded on the New York Stock Exchange fell from seven years in 1940 to just seven months by 2007. The average tenure of departing CEOs declined by nearly 30 percent between 1995 and 2009. Not surprisingly, CEO turnover was found to be highest among companies whose stock price performance lagged their industry.

One powerful force behind the rise in short-termism is also technology. We may simply have more latitude to express our innate short-term preferences than we once did. For example, a well developed consumer debt market provides more options for households to act on their inclination to borrow from the future to meet short-term needs. As we know, credit cards can be either extremely useful or highly destructive tools depending on how they're used. Well developed capital markets have expanded the opportunities for financial companies to earn returns from transaction fees and trading activities, as opposed to the patient work of lending and long-term investing.

The term patient capital seems quaint in the era of hedge funds and high frequency trading. Finally, unless you have been too busy updating your Facebook status, you have probably already inferred that short-termism is also driven by informational factors. In a 24 hour news cycle, we are constantly bombarded with information that compels action, not patience. Given the built in pressures faced by corporate executives and investment managers, the constant flow of information only heightens their obsession with short-term performance at the expense of longer-term goals.

At this point, you may be asking what all this has to do with the financial crisis, and the answer is plenty. As has been the case with most previous crises, a central cause of this crisis was excessive debt and leverage across our financial system. In the decade leading up to 2006, when U.S. home prices reached their peak, total U.S. mortgage debt increased by 180 percent, and average U.S. home prices rose by almost 190 percent. Rising home prices prompted mortgage lenders to focus on temporarily inflated collateral values while they relaxed underwriting standards that traditionally insured that the borrower could repay the loan over time.

Most of the sub prime loans made at the height of the boom imposed a large upward adjustment in the interest rate and monthly payment after two or three years, frequently making the loans unaffordable. As long as home prices kept rising, these borrowers could usually refinance. But after prices leveled off and then began falling, sub prime borrowers defaulted in record numbers. The reason that lenders were willing to make these risky loans, and the reason that securities issuers were willing to fund them, is that they knew they would be paid up front. Mortgage investors and the homeowners themselves would end up bearing the long-term consequences.

Arrangements like this gave rise to the acronym IBGYBG, meaning I'll be gone, you'll be gone, a watch word for short-termism in the mortgage industry during the boom. Homeowners, too, responded to rising home prices, flexible terms and tax advantages of mortgage debt to raise their home equity, cashing out to the tune of more than a half a trillion dollars per year at the peak of the boom.

Meanwhile, financial institutions frequently sought to maximize their balance sheet leverage. They sometimes moved assets to shadowy, off-balance sheet structures where regulation and capital requirements were less stringent. That strategy worked brilliantly until the eventual collapse of investor confidence and market liquidity forced these assets back onto the balance sheet where there was not enough capital on hand to support them. Leading financial companies proved adept at creating innovative new loan structures and funding strategies in the years leading up to the crisis. But all too often, these innovations left participants with badly misaligned economic incentives.

The compensation of loan officers, portfolio managers and bank CEOs was typically based on current year loan volume, earnings or stock price with little regard for the risks that were building up in the system. Most damaging of all, some of the largest and most complex financial companies were made exempt from the discipline of the

marketplace because their size, complexity and interconnectedness made them too big to fail under the resolution processes in place at the time.

The expectation that the largest financial companies enjoyed the implicit backing of the federal government allowed the managers of those companies to book short-term profits while ignoring the build up of TL risk inherent in the complex mortgage instruments they held. And the financial market chaos that followed the September 2008 bankruptcy of Lehman Brothers, the expectation of government support for systemically important financial institutions, or SIFIs, became a reality.

Government assistance to financial institutions took on a variety of forms, amounting to a total commitment of almost \$14 trillion by the spring of 2009. Direct assistance to the largest financial institutions eased the short-term crisis of confidence in the inter-bank market, and our financial system began to function again. But policymakers failed to effectively attack the root cause of the problem, which was the enormous backlog of unaffordable and under water mortgage loans that continues to slow the recovery of our housing market and our economy.

Bailouts result in a host of adverse consequences for our financial system over the long-term. They undermine market discipline and promote risk taking. They inhibit the restructuring of troubled financial companies and the recognition of losses. They keep substandard management in place and preserve a suboptimal allocation of capital. They are inherently unfair to well run banks.

The bailouts of 2008 tainted the reputation of the entire banking industry and tilted the competitive balance in favor of some mega banks. In the first quarter of this year, the cost of funding earnings assets is only about half as high for banks with more than \$100 billion in assets as it was for community banks with assets under \$1 billion. Bailouts violate the principles of limited government on which our free enterprise system is founded.

That's why the FDIC was so determined to press for a more robust and more effective SIFI resolution framework as the centerpiece of the Dodd-Frank Financial Reform Legislation that was enacted last summer. Titles I and II in Dodd-Frank authorized the creation of just such a resolution framework that can make the SIFIs resolvable in a future crisis. This starts with the authority to designate large banking organizations and certain non-bank companies as SIFIs and then subject them to heightened oversight and higher capital requirements in relation to the risk they pose for the financial system.

These companies will also be required to maintain liquidation plans, or living wills, that show how they could be resolved in a crisis without a bailout and without blowing up the financial system. Far from being an assault on the free market, these provisions are designed to restore the discipline of the marketplace to the mega banks to end their ability to take risk at the expense of the public and to eliminate the competitive advantage they enjoy over smaller institutions.

Some of the rhetoric in the financial reform debate has been either shortsighted or simply inaccurate. As part of the reforms we advocated, an ordered liquidation authority for SIFIs, like the authority we have used for years to resolve FDIC insured institutions. This OLA is expressly designed to facilitate the failure of one of these companies without a bailout, which is expressly prohibited by the new law. But what is the sound bite I keep hearing about this provision? Bailouts as far as the eye can see. We need to spread the word as to what the SIFI resolution framework is really all about and what is at stake if we don't see that the new authority is fully implemented before the next crisis.

The resolution plans required of the SIFIs under Dodd-Frank will be critically important to obtaining the information we need to carry out an orderly resolution that places losses on shareholders and debt holder, which is where they belong. The FDIC and the Federal Reserve are going to need to stick to their guns and insist that these companies simplify their structure if necessary to insure that they can be resolved without a bailout in some future crisis.

That debate will most likely take place when markets are calm and the possibility of crisis seems remote. Once again, people are going to ask, "Why now? Why are we putting such onerous demands on private sector financial institutions?" And it will be needed to be explained that the alternative is to risk another financial crisis that could some day throw millions of people out of work and wreck our public finances.

Short-termism is also alive and well in the ongoing debate over bank capital requirements. Some banking industry representatives are claiming that higher capital requirements will raise the cost of credit and could derail the economic expansion. This is a terrific example of the sort of static short-term thinking that got us into this mess in the first place. There is a lot of recent research that shows higher capital requirements in the range that we are talking about will have a very modest effect on the cost of credit. It will create a large net improvement in long-term economic growth by having more capital, lessen the frequency and severity of financial crises.

If your time horizon is anything longer than six months or so, I think that's a pretty good tradeoff. The fact is that capital requirements U.S. banks now face are mostly the same as those that were in existence before the crisis. The reason banks are not lending more now is the combination of risk aversion on their part and reduced borrower demand. They have plenty of capacity to lend. Large banks have been raising capital since the crisis started and most either already meet the new Basel III standards or are well positioned to do so solely through retained earnings. The banks that need more time will benefit from the extended phase in periods designed to insure seamless transition to the new standards including any SIFI surcharge.

Another Dodd-Frank mandate is a rule requiring issuers of mortgage-backed securities to retain 5 percent of the credit risk of the pool. Risk retention is necessary to give issuers a long-term interest in the performance of the underlying mortgages. But given the controversy that has surrounded this rule, I have to say I regret that Congress

also carved out an exception for ultra safe mortgages as defined by the regulatory agencies. Everyone, it seems, believes that their mortgage should receive this qualifying residential mortgage, or QRM status, and thus be exempt from the small premium in their mortgage rate that will result from risk retention.

The connection they're not making is that this small extra cost is the price we must pay in the short-term to put a little equity behind these mortgages to insure that incentives are properly aligned and to avoid a costly repeat of the mortgage crisis in the future.

We also need solid, long-term thinking on other important national policy issues. Too often the response is sub par economic growth has been another tax credit or a cut in interest rates that feels good for a while but does nothing to enhance the long-term performance of our economy. Deep political divisions appear to have sapped our will to make the type of long-term investments in education and public infrastructure that will pay dividends over many years. Programs of national service, like the Civilian Conservation Corps, once provided jobs skills to young people in need as they worked to conserve and develop our natural resources. We still see the CCC's handiwork in national parks and forests throughout the country.

The sense of pride and purpose instilled by programs like this is certainly greater than costly stimulus programs designed to put a few extra dollars into consumer pockets, much of which is used to purchase foreign-made goods. We need to get serious about entitlement reform that will make our system of old age insurance and healthcare sustainable over the long run as longevity rises and the baby boomers retire.

The longer and healthier life that most of us will lead compared to previous generations is a wonderful and much under appreciated historical development. But with this blessing comes the need to make some choices that involve short-term sacrifices. We have to work longer, pay more into the system and perhaps impose means tests on benefits or more likely all three. Similarly, our loophole ridden tax system which favors debt financing over equity and hold building over other long-term investments, is badly in need of an overhaul. Closing the loopholes will result in a more efficient allocation of capital and allow us to reduce marginal tax rates while raising more revenue that can be used to help pay down our national debt.

But some of us are going to have to give something up in the short-term in order to secure those long-term advantages. Where will the focus be when this question is debated in Congress, reported in newspapers and ranted about in the blogs? In a world obsessed with instant gratification and lightning round debates, we are in dire need of leadership, both public and private, that will champion patience and sacrifice now in return for a brighter and more stable future for us and our progeny.

The media plays a critical role in all of this. You report the facts so others can make informed decisions. And you know better than anyone that getting a story factually correct requires going beyond the sound bites to verify the accuracy of claims. There is

no shortage of rhetoric for you to investigate. Your efforts to dig down to the truth of the story will help the public get beyond the sound bite of the day and think about the long-term consequences of the policy choices and the personal choices that all of us must make.

Fortunately, there are signs that the mood of the public is already changing direction, at least in terms of their personal decision making. Total household debt is down by almost 5 percent from pre-crisis levels while the personal savings rate has risen to its highest level in 15 years.

Speaking to you today in this historic venue, I am reminded of some advice I received when I took the job as FDIC chairman five years ago. It came from one of my predecessors, the late Bill Seidman, whom I'm sure many of you knew well. "The FDIC's foremost responsibility is to maintain public confidence in the banking system," he said. "We are the ultimate guarantor of the people's money." Today, we insure some \$6.4 trillion on deposits in thousands of banks across America. And while literally thousands of FDIC insured institutions have failed over the years, nobody has ever lost a penny in insured deposits.

Bill emphasized to me that one of the keys to public confidence is transparency. As you would expect, much of what the FDIC does in bank supervision and bank closings is confidential as it pertains obviously to individual institutions. But the FDIC chairman needs to be visible to the public, accessible to journalists and fully engaged in the policy debates of our time. So I took this advice to heart, and as many of you know I have tried my best to reach out to the media, to talk with reporters and to be a reliable source for the information that you need to tell stories with accuracy and perspective.

And I think it has been a constructive relationship that has served the public interest. Even at the height of the crisis, easily the worst since the 1930s, you didn't see massive runs on banks. Working together, we averted a panic. People left their money and their insured deposits. It was a good example of how Americans can still be counted on to make wise choices that benefit themselves and their country when they're armed with the facts and encouraged to consider the long view. Thank you very much.
(Applause)

MR. HAMRICK: Thank you very much. So now we will engage in that give and take that you just mentioned about with the news media. We have a lot of questions from our audience, but some of them were specifically stemming from the speech. Some of them were handed to me before we came in. We have an interesting mix here this afternoon. We have a lot of very focused financial journalists who can really get in on the nuance and the micro aspect of things. We have members, I'm sure, of the general public, we have some international visitors here. And I think one of the great things about your ability is to speak directly and in a way that's understandable that's not always shared by regulator or politicians.

So let's start sort of with the big picture. I mean, here we are several years out of the financial crisis, and you talked about some of the lingering effects. Mr. Bernanke talked about the risks this week with some of the problems that are particularly persistent, seem to be continuing and may raise the risk of the slowdown that we seem to be experiencing at the moment persists. What anxiety level do you think is appropriate for the public and our policymakers right now as we look out to the risks that we see that seem to be percolating over the horizon on any number of different fronts?

MS. BAIR: Well, I think these are risks, but they're subject to our control and influence if we take some action and make some decisions. I think with the housing market, we still have a loan level problem. These loans either need to be restructured whether it makes economic sense where the distressed borrower can make an economically viable payment. Or if not, there needs to be relocation assistance or some other mechanism to clear the market, because clearly the foreclosure process is breaking down.

Our fiscal situation, again, it's a big risk for the financial system if this doesn't get resolved, but that's within our control, Congress's control, the administration's control. They need to make some tough decisions, but they can do it.

It's the same problem in Europe. Perhaps that Greek debt needs to be restructured and people just need to understand that they're holding it, that they're going to have to take some losses. But those are tough decisions people do not want to make. But it's not getting resolved and you just need to bite the bullet sometime, realize there's a loss there, take it and move on.

So, I don't think they should be anxious because I think most of these problems are now ones we're aware of and there are ways to approach them and solve them. But it takes political courage to do that. So citizens and voters, I would be worried more about the leadership capacity, the will to take action as opposed to these problems in and of themselves because there are solutions if people are willing to undertake them.

MR. HAMRICK: So you went down a bit of a laundry list there in terms of the risks in the near term. You mentioned about the modification process. And I remember when we were in your office, it seems like early 2009 and we were sort of saying boy, it'd be great if we could get into that process and essentially try to resolve the housing crisis and the foreclosure crisis as soon as possible. Is it fair to say as a whole that the government's reaction to that has been wholly inadequate?

MS. BAIR: Well, I wouldn't say wholly inadequate. I think it could have been better, I still think it can be better. I think the housing market, look, two things. We need to understand that the housing market became too big of a part of our economy and some resources have to be reallocated. That notwithstanding, it still remains a big part of our economy and it needs to clear and turn before we're really going to get on a more solid economic footing. So I think this requires very senior level attention. We do have a dysfunctional foreclosure market now. We need to come to grips with that. We need to

streamline the modification process, these servicers need to have more staff, better quality controls, tell the borrower where they stand. Make a decision, do they qualify for a modification? Fine, do it. If not, then explore other alternatives. But I think the industry, this is another problem, misaligned incentives, where because the banks don't own a lot of these loans, they don't have the direct economic incentive to mitigate the loss through effective servicing so that's a problem. That's why the government needs to step in more assertively, because this is a market breakdown. But I think it needs much more senior level attention and focus and resources. I'm not sure that's happening right now.

MR. HAMRICK: Why is that?

MS. BAIR: I don't know.

MR. HAMRICK: Because we think back several years ago where it seemed as if the hope was that we could contain the crisis by focusing on the housing market. And yet here we are and you talk to the foreclosure experts and they don't really-- they can cite a data point and say that is hopeful, right? But nobody is really willing to say, "I see the end," anywhere in the near future. Is it because there's a sense of intervention fatigue in the public and there's not political will in the leadership to try to make the selling point that that is something that needs to be done?

MS. BAIR: Yes, to some extent, I think, and it gets back, perhaps, to the short-termism theme. Unless we can see a quick, easy fix, we don't do anything. And so during the crisis, a lot of capital was infused very quickly into a lot of large institutions. That was easy to do; write a big check, get the capital in. And I was part of that decision making, I don't regret it, it stabilized the system. But it didn't fix the long-term problem, which were the mortgages. It's harder to go in there and fix these mortgages. And I think that's why we lack the political will. If it's not right in front of us and easy to do, we just don't seem to get it done.

MR. HAMRICK: And then you referenced the Greek crisis. Mr. Bernanke was asked this week essentially what is the risk to our banking system, if indeed sort of a worst case scenario there plays out, and obviously those political processes are yet to be resolved. So what do you think the risk is, first of all, let's say to the banking system and then to the broader economy with respect to the Greek situation?

MS. BAIR: Well again, I think that is a problem that's solvable if Europe can muster the political will to make the hard choices to stabilize that situation. I think if it gets out of control, it could be pretty ugly there and here. There's not a lot of direct exposure, but certainly to Greek debt, but there's a lot of direct exposure to European banks. There's obviously a lot of interrelationships between our banking system and theirs. This is another reason I might say why I'm so frustrated on the whole debate about capital right now. We have been arguing for a long time against something called the Basel II advanced approaches, which was implemented in Europe in the early 2000s and led to really quite precipitous declines in capital levels there. It basically allows banks to

set their own risk weights on their assets for capital purposes using their own internal models.

So we have been pushing hard to try to get a leverage ratio, which would serve as a binding constraint on capital being too low to get the ratios higher, the quality of capital better, but also some objective parameters on the use of these advanced approaches to staunch this decline and get the capital levels up in Europe.

But instead, I find myself and others defending trying to have a stable capital base here where I wish the U.S. political will would be to engage Europe and say, "Your banks need to de-leverage more. They need higher capital cushions." And this is complicating, I think, their ability to solve the Greek debt situation, is because many of their banks are too highly leveraged.

MR. HAMRICK: So you're headed for discussions on this very subject in the near term, right?

MS. BAIR: That's right.

MR. HAMRICK: And is it fair to say that you are among those that are trying to set the highest bar for the capital requirements?

MS. BAIR: We are trying to set a high bar. I think we are trying to set a bar that we think is achievable on an international basis because, again, we can always do what we think we need to do here in the U.S. The Fed has the authority to set capital levels wherever they feel they need to be for large banking organizations. But I think, again, the bigger challenge is to make sure we have an accord that will get the capital levels up in Europe. I've publicly said I think a 300 basis point surcharge so you have a 10 percent tangible common equity ratio for the largest financial institutions is something that we can and should do, and I think it is achievable.

MR. HAMRICK: So here's a direct follow-up to your speech. One person asks why do you use the euphemism short-termism instead of greed? When financial institutions, a bit of speechifying here, act solely with profit with complete disregard for the consequences of their actions, it's historically been referred to as greed and not short-termism. Good point?

MS. BAIR: Right. Well, it is a good point. But I think it goes beyond greed because I think our political process now is also suffering from short-termism. I don't think that's greed, I think that is perhaps more concern about your immediate reelection prospects than the longer-term consequences for the country. If you're worried about keeping your job, maybe you could somehow turn that into greed analysis, but that may be a bit of a stretch. So I do think it goes beyond that. Greed is certainly a good example of short-term thinking, but there are other factors at play and so that's why I use-- not so much as a euphemism, just because I thought it would be more all-encompassing.

MR. HAMRICK: Certainly more congenial and the spirit that we like to promote here at the National Press Club. First quarter data from your agency showed a rare year over year decline in revenue, the first since 1983. Is zero interest rate policy hurting banks' profitability and is that impeding the lending environment? And by extension, should interest rates then be raised to help assist?

MS. BAIR: Well, that is an interesting debate and I certainly hear that from a lot of bankers, that a gradual-- an increase in interest rates, incremental increase in interest rates, could make lending more profitable and therefore provide more incentives for lending. So I think it's certainly an argument the Federal Reserve Board is very aware of. There are counter said argument in terms of economic impact, but maybe it's time to think about it a little more. What we have been doing is not giving us the impetus we were hoping for, so maybe it's something to think about a bit more.

MR. HAMRICK: Then a variation on that question, couple weeks ago, J. P. Morgan CEO Jamie Diamond asked Fed Chair Ben Bernanke whether regulators understand the full impact of sort of the forthcoming regulatory environment. And it is a common criticism from some quarters that people say, well over-regulation, making us less able to compete. Is there any validity to that concern, that criticism?

MS. BAIR: Well, I think going back to capital, I think we have done a lot of cost benefit analysis on this already. And the overwhelming weight of the literature on this shows the 10 percent that I've been calling for is actually in the moderate range of what many of these studies would justify based on a cost benefit analysis comparing the payoffs in terms of system stability and reducing the severity of the next crises with any incremental impact in lending costs.

So I think on that score, we've done a very good job. I think some of this extends more from the interplay of the derivatives regulation, the Volker Rule, and I think on that score that is going to be more of a phased in approach. And perhaps under the auspices of the FSOC, the Financial Stability Oversight Council, we could do some analysis of the interrelationship of these rules. That's not to say we shouldn't more forward with vigor, we should. But I think understanding the interrelationships to make sure the rules are working together will achieve the intended outcomes, makes some sense.

So I think by itself, sure, analysis to understand interrelationships is good, but I wouldn't want that to be interpreted as a reason for not engaging in reforms that we know are needed, and certainly on capital it's been studied a lot already.

MR. HAMRICK: So someone's asking about another downside. No one's asking about the upside. So as you look at the implementation of efforts of Dodd-Frank, where do you see the greatest pitfalls in its potential derailment?

MS. BAIR: Boy, that's a really good question. I do think the derivatives oversight is very important and that's not an area where my agency has the lead. It's with the SEC and the CFTC. But I think it's extremely important and I hope very much that

Congress gives those agencies the money they need to implement some very important and needed reforms, and derivatives transparency and oversight. The CDS market, in particular, I think, continues to be far too opaque for purposes of assuring system stability. And it was a key driver during the crisis, so I would hope that those funds would be available to implement those rules because I think they're very important.

I think just more generally again, maintaining the political will, it is-- I've been quoted saying this before-- there's just a lot of amnesia right now and a lot of pushback on things that are so obviously needed like higher capital. And one of the things I hope to do when I leave is try to engage the public more generally on some of those issues and try to explain to them in terms everyone can understand why it's important; why they need to be engaged, why they need to be paying attention to what their elected officials are doing this for. Because this crisis hurt us all terribly and I don't want to ever see it repeated.

MR. HAMRICK: One of the responses was to take some of the traditional brokerage houses and make them commercial banks. And we also have situations where in the breadth of these enterprises they're seeking return on investment by essentially taking depositor's money and investing it in the financial market. So does that mean there's increased financial risk there?

MS. BAIR: Well, I think that's a lot of what the Volker Rule is trying to address. We don't want insured deposits to be done for proprietary trading and it's supposed to be in insured banks and the Volker Rule strengthens those prohibitions just on insured banks, but in bank holding companies as well, which I think is important given the fact that a number of major investment banks have now become bank holding companies and have larger depository institutions. So, I think again with the Volker Rule, the tools are there to make sure insured deposits are not used for proprietary trading. And again, just another area where we need to have very vigorous and robust implementation.

Some have suggested going farther in separating out the investment banks and the commercial banks. I don't see that getting traction here in the U.S., though I have suggested as part of these resolution plans that the regulators will be requiring very large financial organizations that perhaps part of those can show greater legal and financial autonomy between the investment bank and the commercial banks to reinforce the Volker restrictions.

MR. HAMRICK: So with regard to Dodd-Frank, someone's saying now that there does seem to be so much political pushback and I might ask you a question about that specifically in just a moment. Does the debate about the lack of job creation and the status of the recovery have the potential to overtake implementation?

MS. BAIR: Well, there again I would just implore the media to really drill down. When people are just starting to blame financial regulators for our broader economic problems, I mean I'm sorry, but that just is-- most of these rules haven't even been finalized yet, they haven't had any impact. It seems to me this is an effort to blame the regulators for something that has nothing to do with what we're doing and it's completely

outside of our control. And in point of fact, what the regulators are trying to do now is provide for a more stable system so when you get into the next inevitable downturn, we won't have this severe impact on the real economy that we had in this most recent crisis.

So these financial reforms promote a healthy, long-term, sustainable, growing economy. They help redirect financial services towards supporting the real economy through the traditional function of credit intermediation. An example, again, the capital rules. The higher capital charges are much more significant on the trading book assets than they are on the banking book where the loans are kept. So the capital incentives will be for lending vis-à-vis trading and other market activities.

So, again, what the financial regulators are doing supports a healthy, vibrant, sustainable economy, not the other way around. And again, when you hear this, I just hope will scratch below the surface.

MR. HAMRICK: With banks, some banks anyway, too big to fail, complex schemes, complex, unravel and cases involving Wall Street billionaires sometimes seemingly difficult to prosecute, how will some of these larger banks ever regain the confidence of the American public? And if not, is that really a problem?

MS. BAIR: Well, I think it is and this is why I would hope more responsible members of the industry would work with the regulators as opposed to against us and rein in their trade groups and their paid lobbyists here. Because I think it's in their interests. I mean, what kind of horrible reputational damage that's been done by the industry from these bailouts? It is in their interests to have a more stable system, to having rules that constrain the excessive risk taking that weed out the bad player in the industry. It's in their interests as much as ours. And the vehemence and intensity of cynicism and anger towards the banking sector continues to be quite problematic. And so I wish the industry would see it as in their interests to work with regulators to get this fixed.

MR. HAMRICK: There was some speculation after President Obama was elected that you might be tapped as Treasury Secretary, and you were critical of some of the policies of both the Bush and Obama Administrations in the crisis, particularly regarding housing and relief for under water borrowers. Do you think they've listened closely enough to your views, and what advice would you offer your successor or any other independent regulators in terms of speaking up in such a way?

MS. BAIR: Well, I'm not a part of the administration. I'm the head of an independent agency. I was appointed in the previous administration, and so I don't think it's their obligation to-- I'm not an advisor to the President and it's not his obligation to listen to me or give any credence to my views. I speak out when I see risks to the banking system and I see continuing risks to the banking system and hopeful that I'll have some input on broader public policy decision making.

But, you know, the President has the right to choose who advises him and I'm sure he has confidence in those who are advising him. And there are frustrations we've had,

again, on the intensity of effort on the housing problems. But, I wish him well and I wish his administration well.

MR. HAMRICK: That was, again, a very cordial statement in keeping with the spirit of the National Press Club. I asked someone else here recently on another subject who was in, let's say, comparable position. What kind of grade they would give the current administration with regard to, let's say, management of the financial crisis and now in the current situation, let's just say, for the administration as a whole. What kind of a letter grade would you give? As one who's been in the academic sector before?

MS. BAIR: You really think I'm going to answer that? (Laughter)

MR. HAMRICK: Well, I took a shot anyway. You want us to drill down, right?

MS. BAIR: That's right. You know, and it's a good question and I'm not going to answer it because I don't want to-- look, I'm trying to speak in on policy and I don't want anything that I say or positions I may articulate to look like they're pro or con any particular candidate or any particular political party. I try to avoid that impression. And I'm afraid if I start grading the President or any other elected official, I'm going to get into that, so I'm going to take a pass.

MR. HAMRICK: I've got a couple of weeks where you might consider taking another approach. The SEC has passed rules that require money market funds to invest in assets with high credit ratings. But because interest rates are so low in the U.S., the money market fund managers have sought investments in European banks debt which have exposure to Greece. Are you worried the money market funds will obviously be hit if this situation continues to unravel?

MS. BAIR: Well, I worry that the people understand where their money is put and if they have money in money market funds, as I said before, they should do some checking. And the SEC has improved disclosure rules, and some are invested in Treasury securities. They don't have exposure to European banks, but others do. So I think first and foremost, people should check and understand where their money is and if that's consistent with their comfort level.

I think longer term, I supported a floating NAV. I think, unfortunately, folks do think of this money as somehow guaranteed and again that was reinforced by the crisis when the government stepped in after the reserve fund broke the bucks. So I think making it float as other mutual funds do will help provide better clarity and understanding among those who have money in money market funds about the safety, or the relative risk of their investment. And I do think this underscores that this is a problem we, meaning the FSOC and the SEC with the SEC's leadership solve sooner than later.

MR. HAMRICK: One of the most dramatic events that occurred during the crisis was the failure of Lehman Brothers. In retrospect, do you think more should have

been done to save it to the extent that the government then bailed out AIG? And did it take the experience of Lehman to lead to the AIG decision?

MS. BAIR: No, I don't think more should have been done to save it. I think we needed better tools and I think it was-- even looking back at that situation, I think the original problem probably was with Bear Sterns. I think that created expectations. You know, we were-- I'll quickly say we were far removed from the Lehman bankruptcy. It was an investment bank, it had a couple of very small insured banks that are actually still solvent and operating within the bankruptcy. And so, we didn't have direct involvement in that.

But I do think it surprised me when I saw the market reaction because the place was so sick for so long, I thought everybody just understood. And they didn't, and I wonder if part of that was because of the bailout expectation. Bear Sterns had had a government assisted deal done for it and even though its shareholders took some loss, they still were kept alive and everybody else was protected.

So, you know, hindsight is always 20/20, but going forward this is why we've just pushed so hard for resolution authority. One of the other problems with the Lehman bankruptcy, or bankruptcy in general, is the way derivatives contracts are treated. And so with our process, we can actually require derivatives counterparties to continue to perform. In a bankruptcy, they have a right to close out the positions and pull their collateral out. That led to a lot of the disruption with the Lehman bankruptcy. So I think perhaps the best lesson learned is how to fix that going forward, which is what we tried to do with providing broader powers for what we call title II, FDIC style resolution authorities that provide some continuity of operations that you just don't get in bankruptcy.

MR. HAMRICK: One question, someone says efforts among Republicans now to water down some of the reforms, as one who is a member of the GOP yourself, are you particularly disappointed about that?

MS. BAIR: About efforts to water down?

MR. HAMRICK: Yes, to water down reforms in particular?

MS. BAIR: Well, you know, I've been disappointed, yes, with some Republicans, I've been disappointed with some Democrats, too. Regulators will never be glamorous people, we'll probably never be popular people and it's easy to beat up on us. And so we get pushback and it's not just coming from the Republicans. On this risk retention rule, there's a lot of Democrats pushing back as well. So, I am disappointed in a lot of people. We were really so harshly criticized going up to the crisis for laxity and being asleep at the switch and all that, and some of that was justified. But now that we're trying to fix it, there is a lot of amnesia setting in.

So I just hope that Congress will let us exercise the judgment and authorities that were given to us under Dodd-Frank. This is what they pay regulators to do, to make these kinds of decisions. And this is why they set bank regulatory agencies and the SEC and the CFTC, up as independent agencies so they can make these decisions which sometimes will be politically unpopular. And I just hope at the end of the day, members of both parties will let the agencies do their work.

MR. HAMRICK: So you're at the National Press Club and earlier you mentioned, not to, let's say, pay too much attention to the need for sound bites, which was a particularly painful thing for our fellow broadcast journalists to hear. But in all seriousness, as one who has run for Congress in the relatively gentle shadow of the Kansas press, as well as having now been subjected essentially to international scrutiny, how do you feel like you've been treated by the news media?

MS. BAIR: I think pretty fairly overall, I do. There have been a couple of times where I had some real issues, but for the most part, I think we've been treated fairly. And I think in situations where we felt our story didn't accurately or fairly present to all the perspectives, including ours, we found the press to be responsive to that. So I think overall, we have had a good relationship. I hope you feel the same way. We have put a high emphasis on transparency. I think it's very important for the public to understand what it is they FDIC does, because it hits them directly. It's their insured money in those banks.

So I want them to understand what we do. And I think that's one of the reasons why we fared pretty well in public opinion as well, because I think they understand what we do, they appreciate what we do. And if I do say so myself, in tribute to all our 8,000 staff, we've done it pretty well.

MR. HAMRICK: So, you referenced public opinion there, and that played into, let's say, either the fortunate or unfortunate aspect that you weren't successful in your congressional run back in Kansas back in the day, depending on how you view fate. Bob Dole has been quoted, I think, as saying that maybe one thing that played into that is you were a single woman running for office. It just so happens your husband is very close to the podium today, and so that is very visible that you are married now. So would that mean that the political landscape might have shifted over the years and you might be a more viable political candidate in the future?

MS. BAIR: Well, you know, Scott and I were dating during that campaign and he's a Democrat so he would come out and visit me and we would hide him, actually. This shows how much love this man has for me and I have for him. We had a big bear costume that we would use in parades and so he'd put the bear costume on so nobody could see who it was and he'd be throwing out candy. It was back with the Care Bears, you know, so it had a Bear Care sash on it and the kids loved it. So thank you, dear.

And I don't know, I don't think I really want to run for anything again. The reason is, I'll tell you, I loved campaigning, I loved interacting with voters. I hated the

fundraising. I spent about half of my time on the phone asking people for money. And that was the singularly most degrading thing I ever had to do. And I think it's a shame, what we put members of Congress through to do this. I don't know what the answer is, but the money has really overcome this process. And I think also deters other people who might otherwise want to serve from even getting into it.

MR. HAMRICK: Well, we're almost out of time. And before we ask the last question, we have a couple of housekeeping matters to take care of. First of all, I'd like to remind you about some of our upcoming luncheon speakers. On June 30th, Gary Sinise, the Oscar-nominated actor, will announce the formation of a special foundation to help causes around the military. On July 1st, Mr. Charles Bolden, the administrator for NASA, will discuss the nation's future in space and plans to extend a human presence beyond low Earth orbit. We also know that the retiring astronaut, Mark Kelly, will be at our head table that day. And Ted Leonsis, who just made a couple of interesting draft picks for the Washington Wizards, and of course the majority owner as well of the Washington Capitals, will be here on July 13th. So in terms of would-be formalities, next up I'd like to present you with our highly sought after National Press Club coffee mug as a token of today's event, thank you.

MS. BAIR: That's great, thanks very much.

MR. HAMRICK: And finally, a last question for our speaker. You're planning to write a book after you leave office. We're wondering whether it will take us behind the scenes of all the critical decision making in the financial crisis, will it be a tell all? Or is there an angle or a message to average people that you'd like to get across in the book?

MS. BAIR: Well, it will not be a tell all. Look, I think everybody worked very hard in this crisis with the best of motives and there were certainly different perspectives and philosophies and I think it's important for those to be explained to the readership, and that's really what I'm trying to accomplish. And also, just [00:58:15] for some of the things have happened after the crisis and some of the problems we still need to work through and some of the reforms that it's very important to enact. So I hope very much with this book I'd engage the general population. Some of these issues that have traditionally been just the domain of banking regulators, because it's really important for people to understand this is relevant to them, it impacts them and it's important to them and they need to be engaged.

MR. HAMRICK: Thank you. How about a round of applause for our guest speaker today? (Applause) I'd like to thank our National Press Club staff including our library and broadcast center for helping to organize today's event. And there's a reminder that you can find out more about what goes on here at the National Press Club on our website. You can also get a copy of today's program from www.press.org. Thank you and we're adjourned. (Sounds gavel.)

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