Bair Cautions Banking Crisis Is Not Over

Joshua Zumbrun, 06.12.09, 5:20 PM ET

Sheila Bair, chairman of the Federal Deposit Insurance Corporation, said Friday that while the crisis that swept through the financial world last year has subsided somewhat, it was far from over and there would be "many more bank failures" ahead.

"I think there's still some challenges, I think we need to be realistic. There are still some troubled assets on the books and we still have an economy that's under significant stress," said Bair in a 90-minute interview with Forbes reporters and editors on Friday.

"We still don't know how deep the recession is going to be," she said, adding, "we'll still be well below what we were in the S&L days."

Her cautious comments come as investors have been increasingly cheered by news in the banking sector. Markets were reassured by the results of government "stress tests" that evaluated how the 19 largest banks would perform during a worsening recession. This week, 10 of the country's largest financial firms were approved to pay back the money they received from the government's TARP program. Most important, banks now find themselves able to raise private capital at levels not seen since the panic that ensued with the collapse of Lehman Brothers last September.

Still, Bair reminded, 21 insured institutions failed in the first three months of 2009, the most bank failures since 1992. The FDIC's list of problem banks grew to 305 from 252. Those 305 banks at risk of failure have some $220 billion in assets. The good news: The type of panicked runs that brought down Bear Stearns and Lehman Brothers, where the banks found themselves unable to obtain short-term financing and facing liquidity stress have likely passed.

"Hopefully there are no more events that create liquidity stresses on the banks," Bair said, knocking on a wooden conference room table, "and now we're having more good old-fashioned capital insolvencies."

Bair's focus is shifting toward the challenge of reforming banking regulation. Between bites of a sandwich that she never quite finished, she worried aloud about the current trend toward making the Federal Reserve banking's regulator-in-chief. She cautioned the Fed could find itself making "severe trade-offs" between the needs of consumers, businesses and the economy as a whole if pressed into service as America's top banking regulator.

"No other developed country gives their central bank the kind of power we give our central bank," Bair said.

"[The Fed] had authority to prescribe across-the-board lending standards for mortgages, and a lot of people said they should do that and they just didn't," Bair says as an example of where too many roles led to lapses. "Where does the consumer role go on your priority list? At some point it just doesn't get done. It just doesn't get the focus it should."

Bair instead repeated her support for a council of regulators including the Treasury, the Securities and Exchange Commission and CFTC, bank regulator (Bair says the roles of the Office of Thrift Supervision and Office of Comptroller of the Currency could be combined), the FDIC, the Federal Reserve and perhaps a new consumer regulator for financial products that has been proposed in Congress.

"It was our sense because the taxpayer is going to have significant exposure, the Treasury should have some leadership role," she said.

Most critical in her mind: getting regulatory authority from Congress for her agency to shutter financial institutions of all sizes.

The FDIC's oversight now extends just to depository banks, but not necessarily their parent companies. The result: During the financial meltdown the government had no orderly way to wind down complex financial institutions. Lehman Brothers, Bear Stearns and AIG, for example, could not be seized by the FDIC because they were not depository banks, leaving the federal government scrambling for solutions, with widely criticized results.

Bair says the authority to close institutions of any size would eliminate this "too big to fail" problem. If the mechanism were in place, everyone would know "large financial organizations can and will be resolved," she says.

Still, Bair said she does not think financial regulatory overhaul will happen anytime soon, as Congress shifts its focus from the financial meltdown to the Obama administration's health care agenda. "If that's the case, I don't know if that's necessarily bad," she said.

"I know some will say you have to act quickly while the window's there," Bair said. "Well, yes and no … I think there may be some merits to taking some time, taking a deep breath and thinking about it carefully. I don't know if it would be a terrible thing if more dramatic regulatory restructuring did not occur this year."

As for her future, "In two years I will be gone. My term is up and my primary objective is to serve out my term with my reputation intact and then get back to my family life," she said.