JOHN P. DUCREST
COMMISSIONER, LOUISIANA DEPARTMENT OF FINANCIAL INSTITUTIONS
GRADUATE SCHOOL OF BANKING AT LOUISIANA STATE UNIVERSITY
MAY 29, 2012

Thank you Don for allowing me to come visit today with you, Ernie, and the Presidents of the Bank Simm Banks. It is truly a pleasure to be back here at the GSB. It was 20 years ago this year that I entered the freshman class. It was great experience for me and it allowed me to look at banking from different perspectives. I can't help but to think bank 18 years ago when I was going through the Bank Simm exercise. I was the president our bank. Everything was going great. Our numbers looked good, we had a good balance sheet, etc. Our chief investment officer was a straight A student. Then, all at once, everything crashed. Somehow, he had not read the limitations on investments correctly and convinced our group to put a tremendous amount of dollars into FFS. Unfortunately, there was a limitation on FFS which was only a fraction of our position. The penalty for excess sales was severe. I was told at that time, I believe, it was the largest penalty ever assessed in Bank Simm. As President, I should have monitored his investments more closely, but I guess it was a late night the night before, studying of course, and I did not catch it. I did have what I think was a very creative solution. When we were required to have our shareholder meeting to present our year-end results, we elected to have our fiscal year end be Sept 30 since our large violation was in the 4th quarter. At third quarter, we were doing great. We footnoted for our shareholders a significant subsequent event dealing with a regulatory violation that may impact our 4th quarter results. I think we got some points for creativity, but still suffered the consequences of our actions.

Anyway, I need to lead off with a disclaimer that the views I am expressing today are my own and do not necessarily reflect the views of the other Financial Stability Oversight Council members or the Council as a body. Also, nothing I will say today will be based on any nonpublic information that I have received as a participant in FSOC.

I began my career as a bank examiner in 1985. I worked my way up in the organization and was appointed Commissioner in 2004. Having been and examiner, as well as servings as the examiner-in-charge, of many examinations of community banks, I have a great appreciation and understanding of banking at the local level. I fully understand the role a community bank plays and the positive impact it can have on its community. I was also Commissioner when Hurricanes Katrina and Rita struck Louisiana and I experienced firsthand the importance of a functioning banking system. In that context it was really about people's livelihoods, ensuring access to cash to meet every day needs. And, it was also about these community banks leading the way back through their rebuilding of their branch networks. And, it was also about these same banks looking after the needs of their employees. It was all about creating stability on the local level. I cannot say that I ever really gave the stability of our **broader** financial system much thought. Unfortunately, I'm not sure many in the federal government were considering it either until 2007.

The financial crisis exposed tremendous risk in the financial system, which shook confidence and nearly brought our financial system to its knees. This story has been written about many times, so I do not need to walk you through all of the events. The mere mention of the conservation of Fannie and Freddie, of Bear Stearns, the virtual overnight conversion of Goldman and Morgan Stanley to Bank Holding companies, the Lehman Brothers bankruptcy, of Countrywide, Citigroup, Bank of American, Merrill Lynch, and the conservation of AIG will undoubtedly create images in your mind of the news surrounding that time.

The financial regulatory system as it was structured at that time was ill-prepared to manage this crisis, lacking the necessary tools and more importantly, the knowledge of the risks and operations of the largest financial firms. We also lacked the ability to monitor and contain non-bank firms that were able to take large risks but had no prudential standards or supervision over certain parts of their operations. Consequently, when the system started to crumble, the federal government had to resort to ad hoc measures just to keep the system functioning. Sometimes these measures were creative and sometimes they were done out of desperation.

We could probably have a lengthy debate if the actions taken were the right ones or if they were implemented at the proper time. I have my own views on those topics. However, the fact is that Ben Bernanke, Sheila Bair, Hank Paulson, Tim Geithner, and many others were the principals in the room and made the decisions they felt they needed to make. Even in hindsight, we should not pretend the choices and decisions were easy. As leaders in your organization, you will undoubtedly be the one in the room faced with a tough choice, which may later be criticized by those with the luxury of not having to make the decision you made in real time.

Congress chose to address the issues around the financial crisis with the Dodd-Frank Wall Street Reform and Consumer Protection Act. The law was signed by President Obama on July 21, 2010. Title I of the Act lays out a framework to address financial stability. Here are the key provisions of the Title:

1. Establishment of the Financial Stability Oversight Council – the FSOC. The FSOC is permanently chaired by the Secretary of the Treasury. There are ten voting members of the Council and they are the Secretary of the Treasury, the Chairman of the Federal Reserve, the Chairman of the FDIC, the Comptroller of the Currency, the Chairman of the SEC, the Chairman of the CFTC, the Chairman of the NCUA, the Director of the FHFA, the Director of the CFPB, and an independent member with insurance expertise that is appointed by the President There are also five non-voting members, who include three state financial regulators. I represent state bank regulators on the FSOC.

2. It creates an ability to designate non-bank financial firms as systemically important. These firms are subject to bank-like prudential standards and Federal Reserve supervision.

3. It provides for enhanced prudential standards for bank holding companies above $50 billion in assets.

4. It establishs the Office of Financial Research, which was granted very broad data collection powers from across the financial sector.

The purpose of the FSOC is to identify risks to the financial system, promote market discipline, and respond to emerging threats. Looking back, it is odd to think that no one in the federal government had this responsibility. Certainly, no agency was going to admit it when everything fell apart.

During the creation of the Title I, there was extensive debate if this should be the responsibility of a single agency, most likely the Federal Reserve, or a broader group of participants. This was largely a choice between single accountability and requiring a greater level of coordination and information sharing. I believe the approach chosen will, over the long term, provide a much stronger mechanism for understanding and addressing systemic risks to our country. By forcing the various regulators who operate quite well within their silos of supervision to regularly get together, in person, and discuss these risks will make the entire system more robust and hopefully quicker to react to future systemic challenges.

The Council has met 17 times since the passage of the Act. While general minutes of the meetings are published, the details and deliberations are confidential. In the two meetings I have attended, I have found the dialogue to be open and witnessed an overall commitment to making the Council effective. I am optimistic that the regulatory system will be better informed and coordinated under the FSOC. However, we cannot and should not eliminate risk from the system and we will not prevent future financial crises. From 1763 to present, there have been 30 banking panics or systemic banking crises. If you expand the definition to include stock market crashes, financial bubbles, currency crises, and sovereign defaults, the number grows to 39. One could argue that over 249 years, we are not doing too badly. However, we have all witnessed how destructive these events can be to individuals, businesses, and governments. It is in our national interest to ensure a financial system that can withstand the storm, minimize the damage, and serve as a foundation for recovery.

While the United States is in the process of recovery, there are significant risks in Europe that we read about in the press every day. In a global economy, we benefit from a stable Europe. What does a Greek crisis mean to the banks I supervise in Louisiana? That one event, nothing. However, as we experienced in this country, there can be a significant amount of contagion, triggering subsequent events. What we all need to think about is what else that leads to and what new risks emerge. Consider the following:

1. What will happen to other countries in Europe?

2. What direct exposure do U.S. banks have to European government debt, as well as bank debt?

3. What happens to U.S. exports if the crisis in Europe extends over a protracted period of time?

4. How does the crisis in Europe impact the suppliers of the exporters, which a variety of banks finance?

5. How does negative press and global uncertainty impact consumer sentiment in the U.S.?

6. To what extent does financial instability re-occur in the U.S.?
7. What opportunities may this present for our institutions and the customers they serve?

I do not ask these questions to be alarmist. These questions, and many others, are things every business should be considering as we evaluate risks in the economy and chart our future. These are the same type of questions we deal with through the FSOC.

The other issue dominating the financial press is J.P. Morgan. They disclosed a $2 billion plus loss on what they are describing as a hedging strategy. With a strong capital base and restored earnings power, this is not a solvency or financial stability issue. This does, however, get to a key part of Dodd-Frank, the so-called Volcker Rule. Among other things, the Volcker Rule bans proprietary trading in banks and bank holding companies. The federal agencies proposed a very burdensome and complicated rule that no one – not even Paul Volcker – liked. The ongoing question being debated is whether JP Morgan's activity violated the intent of the Volcker Rule. Banks take risks and they hedge those risks. Among the toughest issues to define is what is hedging. Since the large banks successfully argued that they should be allowed to hedge not only specific instruments, but should also be allowed to hedge overall portfolio risks, the question of what is hedging and what is proprietary trading gets extremely complex When is it really a hedge and when is it speculation which is masked like a hedge? This will be a healthy debate. All of the regulators that touch some part of this activity are looking at what occurred. Congress is already scheduling hearings that will include testimony by J.P. Morgan. Since we have an actual event, which does not appear too damaging, this will be an opportunity for Congress, the agencies, and others to evaluate if the activity should be permitted in a depository institution. Without question, this was a step backwards for the large banks and their ongoing attack of the Dodd-Frank Act.

I know there is a lot of industry anxiety over Dodd-Frank. I understand the burden issues of community banks and the concern about a trickling-down effect of provision of Dodd-Frank. However, when people talk about "repealing Dodd-Frank," that would include all the work that has been done and is being done around financial stability, which is focused on the largest systemically important firms. I believe in a diverse banking system. I believe in the need for institutions of all sizes and types. However, I am a bank supervisor in a community banking state. While there are many things we can and should do to promote the long-term viability of community banking, one of the most important is to address the problem of "too big to fail." We need to restore equity to the system. The Dodd-Frank Act does many things to address TBTF. However, as we have just witnessed at J.P. Morgan, this soon after the crisis, these institutions pose particular risks to the country and no matter how many conditions are placed on them, potentially the only way to effectively solve the problem of TBTF is to actually address their size and the activities they engage in with insured deposits. Some are calling for even greater levels of capital and liquidity requirements beyond the levels in Dodd-Frank for these largest firms. This will either force them to have substantial capital protections or to reduce their size. Others are advocating to simply impose overall size limitations on firms so that they cannot be above a certain asset size. Another approach argued by others is to restore partially some of the limitations of the Glass Steagall Act that were removed in the recent past. Again, I think the activity that has come to light at J.P. Morgan may have positive benefits to the overall system if we can learn from this issue and make further improvements in the toolkit that is authorized to address TBTF.

With that I will close my formal comments, thank you for your attention, and would be glad to answer any questions.