**Remarks**
**By**
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**Before**
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**Community Bankers Conference**
**Of**
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Good morning. I'm glad to be with you so bright and early. 7:45 am is the very best time to have a serious talk. It's good to be here today with so many of my "own." Looking around the room, I see a number of colleagues from my days as a community banker. I'm glad to see your faces.

The theme of this conference is indeed timely. I've been thinking a lot lately about institutional change. It's never easy. But whether you are a bank or a government agency, it's unavoidable if you and I are going to survive and fulfill our missions.

Community banks and the FDIC are always challenged to remain relevant in today's evolving marketplace. Our world is being reshaped by globalization, consolidation, deregulation, and technology. When I entered banking more than 30 years ago, half the assets of the industry were held by the largest 102 institutions. Today, the 20 largest banks hold one-half - and they do a lot more than the traditional banking business.

That's a tremendous challenge to you as community bankers, and it's a tremendous challenge to us as regulators.

One thing that remains unchanged, though, is the overriding importance of maintaining trust - the trust of the customer, the trust of our communities and the trust of the marketplace.

For nearly 70 years, the FDIC has worked hard to maintain trust and confidence in the banking system and to guard the integrity of the deposit insurance funds.

To do that --- to maintain that trust -- the FDIC depends on several things. We need a foundation of good, reliable bank data. We need you - directors and officers who are engaged and reliable. You know the areas of your bank that are healthy and the areas that need work. And you should know more about your business than anyone else. You are in the best position to spot problems and deal with them early.

We rely on auditors to provide an independent view, to validate the numbers, and identify troublesome areas that may have escaped management's attention.

We rely on our examiners. They periodically visit your banks and make determinations about fundamental safety and soundness and compliance with consumer protection laws.

And - near and dear to my heart - we rely on capital. It is the lifeblood of a banking institution and is the ultimate protection from the unexpected.

Sun Tzu wrote in The Art of War that "The good fighters FIRST put themselves beyond the possibility of defeat." Good management can put you beyond defeat. And capital can put you beyond defeat, too. During the crisis in Texas, the banks that survived did so because of capital. It helped us weather the systemic problems in the industry, the shocks we didn't anticipate, and the bad decisions we made as managers. Good capital - equity, not debt - can cover a multitude of sins. This is true whether your problems are structural, managerial, or with your auditors. And it is one of the reasons the FDIC is able to say that the banking system is healthier today than in many previous recessions - because the aggregate capital levels in the industry are so high.

So as we talk today about the defenses of the banking system - and they are all important and interrelated - do not forget about the importance of capital.

But I want to focus my remarks today around two issues: the importance of reliable and timely bank data and the all-important auditing function. I would also like to tell you what we're doing at the FDIC to improve both these functions and why we believe it is in your interest to help us.

Let's start with data. As you well know, we collect bank information in various ways and we use it to calculate the risk to the insurance funds and make sound judgements about the future. And - when it is published - you use it to make sound business decisions. Reliable information can make the difference between a good loan and a bad one, or the difference between sound earnings and a struggle to stay alive.

Nowadays, we collect more information than we ever have before, and we analyze it more thoroughly. Advances in technology have certainly made it easier for us to manipulate and study information and this has led to tremendous benefits. On the FDIC's website you can access a variety of banking databases and print out the reports you need on the spot. And not only that, the Internet makes it possible for us to communicate and exchange information virtually instantaneously, no matter where we are located.

Yet…yet. We have a problem. In many respects the data collection and distribution channels we banking agencies use are outdated and more reflective of the typewriter and rotary-dial telephone era than this new age of high speed connections and real-time information flow. I am always amazed that I cannot find out - for instance - what deposit flows or bank earnings are doing until about 50-60 days after the end of the quarter. And you hear about it even later than that.

That is incredibly slow in today's world. Websites update stock prices every minute. The folks in the money-market fund industry know weekly how much money is coming into and out of their system. Amazon.com knows the books I'm interested in the minute I log on. Given this - and the thousand other ways timely information is being put to use - does it really make sense that the FDIC and the banking industry must wait more than two months to get the answers to basic questions? I don't think so.

And it isn't just about getting better data to help the FDIC do its job. It is about getting you better information, too. The faster we get it, the faster we can give it to you - and in a context you can use. And let me stress that as a former banker, I want us to find ways to collect this data from you without all the burdens inherent in the current system of call report collection and analysis.

I think we can do this. I want to create a system where good, reliable bank information is collected from you with less burden, and is made available to you in 'real time'. Think about what this would mean. With more timely data we can manage our funds better, understand bank risk better and provide analysis to you and the market in a dramatically shorter timeframe.

We will not achieve this vision tomorrow, but we are making progress. Let me tell you a little about what we're doing:

Together with our fellow banking agencies, we are working to modernize the Call Report process in three areas:

One, we want to make Call Reports easier to file;
Two, we want to make sure the data is better when we get it; and
Three, we want to give it to you as it is filed. That's what I mean by 'real time' data.
This is not a pipe dream - the technologies exist and we need to harness them. We are ready to do this, but we need your input and we need your help.

We are also working to establish a central data storage facility among the banking agencies. Centralization will permit all this information to be accessible to the industry, the regulators, and the public as appropriate. While this decision on where to centralize the data is the subject of interagency discussion, we think the FDIC is best-equipped to perform this vital industry function and we stand ready to make it happen. Our research and analysis capabilities are superb, and we are already in the business of data and risk analysis.

We are also working hard on the technology we need to get this project off the ground. The FDIC is leading the efforts of regulators around the world in developing an internet-based business reporting language. This language will function as a kind of seamless pipeline for business and technical information linking customer, vendor and banking needs across the country and around the world. We cannot underestimate the potential of this project given how connected business and banking relationships have become in the global economy.

Taken together, these initiatives will help us get better industry information, distribute it faster, and share it more broadly. And lest I forget, we are going to do it with less burden on you - the bankers.

Another benefit for you is that FDIC and the other banking agencies will be better equipped to make crucial policy decisions before costly failures that deplete the funds of your money. I believe it will lead us to a place where we are making policy and business decisions that are more 'proactive' and less 'reactive' because we - and you - will be working with timely data we can trust.

This is part of our vision at the FDIC, and we are eager to work with you to make this happen.

When it comes to financial information, having it is one thing. Trusting it is another. That brings me to another topic I want to discuss here today: The auditing function.

And I think it is important to say - as I did earlier - that the ultimate accountability for the success or failure of a banking enterprise rests on the directors and officers. They know more about the business than anyone else and they make all the key decisions - from the business plan to internal controls to general policies. But to the extent auditors are reviewing the actions of management and providing a critical independent assessment to the market, it is appropriate that we take an interest in their work. And we should always be looking for ways to ensure the rules and policies we articulate are clear and understandable.

Every institution with deposit insurance and more than $500 million in assets must be audited annually. Many smaller institutions decide to contract for these services, too. Auditors are supposed to express opinions on the fairness of institutions' financial statements and report any flaws in the bank's internal controls to the bank's audit committee or Board. When they decide that there is substantial doubt about an entity's ability to continue in business, the auditors must disclose this in their opinion.

Recent corporate failures like Enron and Global Crossing have brought our accounting rules under sharp scrutiny from the SEC, from the Congress and from the public. Appropriately so. We have depended on these rules - and the firms that apply them - to safeguard our economic system. Now we are all asking serious questions about the need for accounting reform.

Let me tell you why accounting reform matters to us and how the FDIC can help. First, we have some history on the matter. During the banking and thrift crisis of the late 1980s and the early 1990s, close to 3000 financial institutions failed at a cost - to the industry and the taxpayers - of almost $200 billion.

During this crisis, we had a number of differences with the auditors and - in several cases - we took action. As a result, many of these firms agreed to a series of reforms for their audits of federally insured institutions. It may be useful to look at these reforms as we consider today's accounting debate.

One reform involved requiring specific levels of training and experience for auditors working in insured institutions. For example, auditors in institutions of $500 million and over were required to have 1000 hours of relevant audit experience. In other settlements, the firms agreed to strengthen quality control, and overhaul their internal procedures. Another reform was that firms agreed to retain all working papers - as well as other documents - for at least six years.

These changes in the accounting practice for insured institutions were good for banks, good for the accountants and good for the FDIC. That is why we believe they could be very useful in informing our discussions today.

That is an important point. This is not just about history - whether it be the banking crisis or the recent failures we're all reading about in the newspapers. It is about learning from these experiences and formulating good public policy going forward as it relates to the accounting profession and the auditing function. That is our goal as we approach this issue.

We in the banking agencies are looking hard at whether we need more permanent, industry-wide solutions to the problems we're seeing today. I was pleased when SEC Chairman Harvey Pitt recently signaled a willingness "to engage in a dialogue with all parties willing to participate" on these complex accounting questions. We will participate. Here is what we're going to say to the SEC and what we are doing now:

We will provide the SEC with copies of our previous agreements with the accounting firms because this history - we believe - should help inform our actions today.

And we will be making additional recommendations for strengthening corporate audits. We will address issues of auditor independence and document destruction. And we will discuss our current authority to bar bad actors from insured depository institutions.

Let me spend a minute on each of these, starting with what we are doing.

First, auditor independence. We've seen this issue arise in enough bank failures to cause concern. Too many auditors are faced with conflicts of interest arising from providing multiple services to the same financial institution. As we've seen in recent corporate failures, the auditors became very connected to the business and their independent judgment may have been compromised as a result.

Bank regulators have a rule on the books that deals with independence standards for auditors. But we have the authority to adopt more stringent requirements in this area and we are looking into whether we should. One of the ideas we're discussing is whether accounting firms should be prohibited from providing both internal auditing and other consulting services to the same financial institutions they are auditing externally. We are not ready to implement this, but it is certainly something we are considering.

Another issue that's gotten a lot of attention recently is document destruction. This has posed a problem for the FDIC in a number of failed banks. It raises the question of whether or not we should recommend to the other banking agencies and the SEC a nationwide document retention requirement for the records and workpapers used during the audit of any insured depository institution. This would assist the regulators greatly in learning what happened in a failed institution.

Another question has to do with bad actors. They are present in every profession - auditors don't have a monopoly on this commodity. While we can bar auditors now for knowing or reckless misconduct, it is often more difficult to address situations involving less egregious misconduct. Congress gave us authority ten years ago to deal with this issue, but we haven't written the regulations to implement the law. This recent spate of failures may mean it is time to take a look at this statute. We will be reviewing this issue with our fellow regulators.

Along these same lines, we will be providing input to the SEC on some of the broader questions they are addressing. For example, the FDIC has considerable experience in evaluating the conduct of officers and directors of insured institutions. Our experience in this area should be of great use as the Commission weighs whether and how to bar unfit directors and officers from publicly traded companies.

Now, these are certainly complex questions. We will not answer them in a day, nor should we. And whatever we decide should be prudent and structurally sound for the long haul - not just a sop to the high emotions of the moment. But just as we are seeing the broader market learn and integrate the lessons of Enron and other corporate failures into the marketplace, we regulators should learn from these failures and take responsible steps to address these structural issues.

One last thing I'd like to address - before you head off to your coffee break - is the matter of how banks account for securitizations. This is a very important issue to us right now, since several recent bank failures have involved securitizations in one form or another. The complexities involved lead some institutions - those with weak internal controls or bad business plans - into very troubled waters. And sometimes into a very expensive receivership.

In 1997, the banking agencies adopted Generally Accepted Accounting Principles that brought us gain-on-sale accounting for securitization transactions - that is, the process of basing gains on volatile assumptions about future cash flows. When the assumptions are wrong - as often happens in a declining economy - these projected gains disappear, capital takes a hit, and sometimes the institution is left fighting for its life. This was clearly the case with the Superior failure and we have seen evidence of it elsewhere as well.

We have taken a giant step toward resolving this problem with the residual capital rule we adopted last year. By requiring dollar-for-dollar capital on these volatile assets, bank balance sheets are protected from undue volatility and we at the FDIC sleep better at night.

But as we look further into this issue, we - the FDIC and the other banking agencies - have begun to question whether the current accounting literature is sufficient in a number of other areas relating to securitizations - like, for example, how firms account for the accrued interest receivable on securitized assets.

Clearly, these are not questions that affect many people in this room. Banks that use these securitization tools are outside the profile of the typical community bank. But they matter to you from the standpoint that the deposit insurance funds - your money - are at risk if the accounting is not right. That's why we are looking at whether the bank regulators should issue specific guidance on various aspects of securitization accounting to make sure the capital reflected on banks' books is accurate and available to protect institutions from unforeseen risk.

Let me close by coming full circle. It is about getting back to basics. Good, timely information. Fair presentation of a bank's financial statements by the directors and officers. Reliable audits. Transparency. And capital, capital, capital.

I want to repeat something here I told our executives at a conference last month. We at the FDIC have to do our job better, and we have to do more. We have to always be on top of our game. This means being an organization that learns from our mistakes. That knows exactly what is happening in the banking system, and why it is happening. And an organization that recognizes problems and knows how to solve them.

I'm not just talking about doing a better job of tracking and understanding the industry through better and more timely data collection and analysis. I'm also talking about knowing how to see in today's data the outline of future prosperity or peril, about knowing how to find the answers, and about having the courage to act.

And we will do it. You have my word on that.

Thank you.

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