

TABLE VI-A. Derivatives, All FDIC-Insured Commercial Banks and State-Chartered Savings Banks

(dollar figures in millions; notional amounts unless otherwise indicated)	4th Quarter 2007	3rd Quarter 2007	2nd Quarter 2007	1st Quarter 2007	4th Quarter 2006	%Change 06:4-07:4	Asset Size Distribution			
							Less than \$100 Million	\$100 Million to \$1 Billion	\$1 Billion to \$10 Billion	Greater than \$10 Billion
ALL DERIVATIVE HOLDERS										
Number of institutions reporting derivatives	1,042	1,025	1,058	1,056	1,014	2.8	67	632	264	79
Total assets of institutions reporting derivatives	\$9,826,802	\$9,460,260	\$9,147,067	\$8,871,745	\$8,834,288	11.2	\$4,954	\$275,039	\$821,793	\$8,725,016
Total deposits of institutions reporting derivatives	6,324,177	6,031,920	5,900,355	5,750,636	5,751,266	10.0	3,969	216,148	588,151	5,515,908
Total derivatives	164,780,773	173,284,358	153,678,084	144,098,922	132,182,732	24.7	94	17,670	101,276	164,661,733
Derivative Contracts by Underlying Risk Exposure										
Interest rate	129,587,559	138,789,177	123,340,595	116,751,425	107,434,665	20.6	75	17,256	83,520	129,486,707
Foreign exchange*	17,174,474	16,696,567	15,117,713	14,167,853	12,564,160	36.7	8	30	5,170	17,169,265
Equity	2,533,531	2,783,712	2,491,034	2,173,375	2,270,942	11.6	11	186	12,162	2,521,172
Commodity & other (excluding credit derivatives)	1,073,116	1,025,685	951,725	840,505	893,310	20.1	0	0	207	1,072,908
Credit	14,412,094	13,989,217	11,777,017	10,165,765	9,019,655	59.8	0	198	216	14,411,679
Total	164,780,773	173,284,358	153,678,084	144,098,922	132,182,732	24.7	94	17,670	101,276	164,661,733
Derivative Contracts by Transaction Type										
Swaps	103,100,934	111,410,085	95,320,189	88,006,970	81,339,865	26.8	19	10,639	59,484	103,030,791
Futures & forwards	18,967,549	17,202,716	16,198,687	15,307,497	14,881,758	27.5	18	1,621	16,017	18,949,894
Purchased options	13,784,021	14,562,615	14,298,899	14,737,699	12,944,893	6.5	5	3,109	20,357	13,760,550
Written options	13,956,210	15,033,429	14,773,476	14,601,673	13,332,489	4.7	44	2,088	4,884	13,949,194
Total	149,808,714	158,208,844	140,591,251	132,653,840	122,499,005	22.3	86	17,457	100,742	149,690,429
Fair Value of Derivative Contracts										
Interest rate contracts	33,902	30,716	20,001	24,423	23,275	45.7	0	45	58	33,799
Foreign exchange contracts	6,569	3,119	5,661	74,088	5,324	23.4	0	0	-7	6,576
Equity contracts	-18,947	-20,872	-24,473	-18,499	-17,845	6.2	0	10	59	-19,016
Commodity & other (excluding credit derivatives)	1,422	1,664	1,946	22,530	2,658	-46.5	0	0	0	1,421
Credit derivatives as guarantor	-212,447	-104,120	-22,960	9,032	31,583	-772.7	0	0	-16	-212,431
Credit derivatives as beneficiary	222,426	110,905	23,824	-9,668	-32,745	-779.3	0	0	7	222,419
Derivative Contracts by Maturity**										
Interest rate contracts										
< 1 year	39,085,024	48,917,897	39,403,807	32,457,730	29,551,704	32.3	11	2,067	23,077	39,059,868
1-5 years	37,222,439	36,310,944	33,846,133	33,802,189	31,385,640	18.6	9	10,311	27,112	37,185,007
> 5 years	27,722,186	27,875,202	24,588,177	24,684,533	23,273,618	19.1	12	2,552	27,038	27,692,583
Foreign exchange contracts										
< 1 year	11,592,113	10,094,603	8,948,450	8,372,488	7,690,210	50.7	0	7	3,801	11,588,305
1-5 years	1,604,898	1,831,220	1,667,700	1,571,241	1,415,846	13.4	0	4	17	1,604,878
> 5 years	618,960	718,390	676,071	624,415	592,897	4.4	0	5	10	618,945
Equity contracts										
< 1 year	473,413	464,820	442,652	397,237	341,346	38.7	0	22	148	473,242
1-5 years	297,419	330,227	283,520	236,563	220,856	34.7	5	74	400	296,940
> 5 years	70,485	95,900	62,916	74,332	44,858	57.1	0	1	37	70,447
Commodity & other contracts										
< 1 year	288,125	278,442	280,133	271,647	235,107	22.6	0	0	158	287,967
1-5 years	337,075	308,298	261,410	200,458	272,314	23.8	0	0	27	337,048
> 5 years	26,387	27,617	27,273	23,931	21,581	22.3	0	0	0	26,387
Risk-Based Capital: Credit Equivalent Amount										
Total current exposure to tier 1 capital (%)	45.6	38.0	30.7	28.3	29.2		0.2	0.4	1.9	52.8
Total potential future exposure to tier 1 capital (%)	109.8	115.1	113.4	106.8	97.7		0.1	0.4	0.9	127.5
Total exposure (credit equivalent amount) to tier 1 capital (%)	155.4	153.1	144.1	135.1	126.9		0.3	0.8	2.7	180.3
Credit losses on derivatives***	156.0	125.0	6.0	-3.0	-25.0	-724.0		1.0	0.0	155.0
HELD FOR TRADING										
Number of institutions reporting derivatives	166	159	167	156	147	12.9	11	45	57	53
Total assets of institutions reporting derivatives	8,307,238	7,977,733	7,640,639	7,388,068	7,223,404	15.0	760	22,358	250,499	8,033,621
Total deposits of institutions reporting derivatives	5,354,783	5,083,233	4,917,948	4,770,665	4,712,089	13.6	599	17,483	175,641	5,161,060
Derivative Contracts by Underlying Risk Exposure										
Interest rate	127,126,919	136,068,953	120,820,791	114,003,913	104,692,154	21.4	9	304	30,489	127,096,117
Foreign exchange	16,483,269	15,489,462	13,683,371	12,769,131	11,788,161	39.8	0	12	4,486	16,478,771
Equity	2,515,242	2,767,663	2,474,617	2,168,932	2,266,778	11.0	0	1	347	2,514,894
Commodity & other	1,072,230	1,024,998	951,236	840,237	893,087	20.1	0	0	148	1,072,082
Total	147,197,659	155,351,076	137,930,014	129,782,212	119,640,180	23.0	9	317	35,470	147,161,864
Trading Revenues: Cash & Derivative Instruments										
Interest rate	-5,658	1,364	2,939	2,405	1,151	-591.6	0	0	13	-5,671
Foreign exchange	1,873	2,005	1,265	1,830	1,613	16.1	0	0	9	1,864
Equity	211	-92	1,020	1,732	1,214	-82.6	0	0	0	211
Commodity & other (including credit derivatives)	-6,400	-1,017	907	1,053	-111	5,665.8	0	0	1	-6,401
Total trading revenues	-9,974	2,260	6,131	7,020	3,866	-358.0	0	0	23	-9,997
Share of Revenue										
Trading revenues to gross revenues (%)	-7.2	1.5	4.1	4.9	3.0		0.0	0.0	0.7	-7.4
Trading revenues to net operating revenues (%)	-233.9	12.6	27.0	33.0	19.6		0.0	-0.4	7.3	-256.0
HELD FOR PURPOSES OTHER THAN TRADING										
Number of institutions reporting derivatives	959	949	971	969	935	2.6	56	591	237	75
Total assets of institutions reporting derivatives	9,651,581	9,300,460	8,967,342	8,637,459	8,604,674	12.2	4,160	254,949	749,334	8,643,139
Total deposits of institutions reporting derivatives	6,204,217	5,923,372	5,776,699	5,582,898	5,589,964	11.0	3,336	200,320	536,933	5,463,628
Derivative Contracts by Underlying Risk Exposure										
Interest rate	2,460,640	2,720,224	2,519,804	2,747,512	2,742,511	-10.3	66	16,952	53,031	2,390,591
Foreign exchange	131,240	120,808	124,526	119,405	111,928	17.3	0	4	366	130,870
Equity	18,289	16,048	16,417	4,443	4,164	339.2	11	185	11,815	6,279
Commodity & other	886	687	489	268	223	297.3	0	0	59	826
Total notional amount	2,611,055	2,857,768	2,661,237	2,871,628	2,858,826	-8.7	77	17,140	65,272	2,528,566

All line items are reported on a quarterly basis.

*Include spot foreign exchange contracts. All other references to foreign exchange contracts in which notional values or fair values are reported exclude spot foreign exchange contracts.

** Derivative contracts subject to the risk-based capital requirements for derivatives.

*** The reporting of credit losses on derivatives is applicable to all banks filing the FFIEC 031 report form and to those banks filing the FFIEC 041 report form that have \$300 million or more in total assets.

TABLE VII-A. Servicing, Securitization, and Asset Sales Activities (All FDIC-Insured Commercial Banks and State-Chartered Savings Banks)

(dollar figures in millions)	4th Quarter 2007	3rd Quarter 2007	2nd Quarter 2007	1st Quarter 2007	4th Quarter 2006	%Change 06:4-07:4	Asset Size Distribution						
							Less than \$100 Million	\$100 Million to \$1 Billion	\$1 Billion to \$10 Billion	Greater than \$10 Billion			
Assets Sold and Securitized with Servicing Retained or with Recourse or Other Seller-Provided Credit Enhancements													
Number of institutions reporting securitization activities							14	49	20	41			
Outstanding Principal Balance by Asset Type													
1-4 family residential loans	\$1,129,377	\$1,111,554	\$1,119,076	\$1,088,151	\$739,041	52.8	\$44	\$326	\$9,074	\$1,119,933			
Home equity loans	9,353	9,894	10,640	9,339	8,905	5.0	0	0	232	9,120			
Credit card receivables	389,502	379,662	372,481	367,796	362,467	7.5	0	2,939	11,713	374,850			
Auto loans	9,019	10,433	12,547	14,132	16,263	-44.5	0	0	291	8,728			
Other consumer loans	28,542	29,386	27,396	27,737	28,673	-0.5	0	7	0	28,536			
Commercial and industrial loans	14,148	15,862	13,193	12,039	10,543	34.2	0	39	5,322	8,787			
All other loans, leases, and other assets*	193,875	184,941	162,434	150,404	144,582	34.1	1	79	681	193,115			
Total securitized and sold	1,773,817	1,741,732	1,717,767	1,669,598	1,310,475	35.4	45	3,389	27,313	1,743,069			
Maximum Credit Exposure by Asset Type													
1-4 family residential loans	6,891	6,856	6,502	6,047	6,580	4.7	17	4	35	6,836			
Home equity loans	2,000	2,336	2,402	2,354	2,332	-14.2	0	0	10	1,990			
Credit card receivables	19,196	19,120	18,711	17,685	19,182	0.1	0	167	601	18,428			
Auto loans	380	426	555	628	724	-47.5	0	0	12	368			
Other consumer loans	1,379	2,114	1,768	1,861	1,882	-26.7	0	0	0	1,379			
Commercial and industrial loans	282	399	314	311	348	-19.0	0	0	71	211			
All other loans, leases, and other assets	3,733	4,578	1,053	1,052	964	287.2	1	26	42	3,663			
Total credit exposure	33,860	35,829	31,304	29,937	32,013	5.8	18	197	771	32,875			
Total unused liquidity commitments provided to institution's own securitizations	4,686	5,095	5,667	6,116	6,503	-27.9	0	0	0	4,686			
Securitized Loans, Leases, and Other Assets 30-89 Days Past Due (%)													
1-4 family residential loans	2.7	2.7	2.6	2.1	3.0		2.7	0.0	10.3	2.6			
Home equity loans	0.8	0.7	0.6	0.7	0.7		0.0	0.0	2.4	0.8			
Credit card receivables	2.2	2.1	1.9	1.9	2.0		0.0	1.2	1.6	2.2			
Auto loans	2.5	2.0	1.7	1.5	1.7		0.0	0.0	1.1	2.5			
Other consumer loans	3.1	2.8	2.8	2.4	3.0		0.0	0.0	0.0	3.1			
Commercial and industrial loans	1.0	1.0	0.5	0.7	0.7		0.0	0.0	2.3	0.2			
All other loans, leases, and other assets	0.1	0.1	0.1	0.1	0.2		0.0	0.0	0.2	0.1			
Total loans, leases, and other assets	2.3	2.3	2.1	1.9	2.4		2.6	1.1	4.6	2.2			
Securitized Loans, Leases, and Other Assets 90 Days or More Past Due (%)													
1-4 family residential loans	1.5	1.2	1.3	1.1	1.2		0.3	0.0	23.8	1.4			
Home equity loans	0.5	0.4	0.3	0.4	0.5		0.0	0.0	1.1	0.5			
Credit card receivables	1.9	1.7	1.6	1.8	1.7		0.0	1.1	1.3	1.9			
Auto loans	0.3	0.2	0.2	0.2	0.3		0.0	0.0	0.1	0.4			
Other consumer loans	2.4	2.1	2.1	2.0	2.1		0.0	0.0	0.0	2.4			
Commercial and industrial loans	0.9	0.7	0.6	0.6	0.7		0.0	0.0	2.0	0.3			
All other loans, leases, and other assets	0.1	0.1	0.2	0.1	0.2		0.0	1.9	0.0	0.1			
Total loans, leases, and other assets	1.5	1.2	1.2	1.2	1.2		0.3	1.0	8.9	1.4			
Securitized Loans, Leases, and Other Assets Charged-Off (net, YTD, annualized, %)													
1-4 family residential loans	0.1	0.0	0.0	0.0	0.0		0.0	0.0	3.1	0.0			
Home equity loans	0.2	0.1	0.1	0.1	0.3		0.0	0.0	1.6	0.2			
Credit card receivables	4.4	3.3	2.2	1.1	3.8		0.0	3.3	3.0	4.5			
Auto loans	1.2	0.8	0.5	0.3	0.7		0.0	0.0	0.5	1.2			
Other consumer loans	1.3	1.1	0.7	0.4	1.5		0.0	0.0	0.0	1.3			
Commercial and industrial loans	2.0	1.3	0.7	0.4	1.3		0.0	0.0	4.2	0.7			
All other loans, leases, and other assets	0.0	0.0	0.0	0.0	0.0		0.0	0.0	0.0	0.0			
Total loans, leases, and other assets	1.1	0.8	0.5	0.3	1.1		0.0	2.9	3.1	1.0			
Seller's Interests in Institution's Own Securitizations - Carried as Loans													
Home equity loans	347	494	651	671	869	-60.1	0	0	0	347			
Credit card receivables	86,748	77,451	73,405	61,569	75,225	15.3	0	251	4,699	81,798			
Commercial and industrial loans	7,671	6,018	2,843	2,863	2,596	195.5	0	0	816	6,855			
Seller's Interests in Institution's Own Securitizations - Carried as Securities													
Home equity loans	9	10	10	10	10	-10.0	0	0	0	9			
Credit card receivables	436	374	327	281	322	35.4	0	62	374	0			
Commercial and industrial loans	2	6	9	1	5	-60.0	0	0	0	2			
Assets Sold with Recourse and Not Securitized													
Number of institutions reporting asset sales	757	749	738	731	716	5.7	154	455	103	45			
Outstanding Principal Balance by Asset Type													
1-4 family residential loans	57,554	57,407	55,156	55,719	55,777	3.2	939	6,857	2,719	47,040			
Home equity, credit card receivables, auto, and other consumer loans	674	775	603	1,906	708	-4.8	1	60	13	600			
Commercial and industrial loans	4,985	5,302	7,708	8,198	6,668	-25.2	0	172	390	4,423			
All other loans, leases, and other assets	24,082	21,509	8,035	8,103	6,981	245.0	1	89	419	23,573			
Total sold and not securitized	87,296	84,993	71,503	73,926	70,133	24.5	942	7,178	3,540	75,636			
Maximum Credit Exposure by Asset Type													
1-4 family residential loans	14,746	15,866	14,539	13,826	13,213	11.6	98	1,422	1,834	11,392			
Home equity, credit card receivables, auto, and other consumer loans	605	742	575	1,871	663	-8.7	1	6	4	595			
Commercial and industrial loans	3,650	3,671	4,453	4,543	4,499	-18.9	0	162	390	3,098			
All other loans, leases, and other assets	6,968	6,447	2,383	2,428	2,530	175.4	1	14	107	6,845			
Total credit exposure	25,969	26,726	21,951	22,668	20,904	24.2	100	1,604	2,335	21,930			
Support for Securitization Facilities Sponsored by Other Institutions													
Number of institutions reporting securitization facilities sponsored by others	47	49	50	47	47	0.0	24	12	4	7			
Total credit exposure	2,841	1,477	1,375	1,348	1,135	150.3	7	113	91	2,630			
Total unused liquidity commitments	10,314	8,242	14,093	5,827	5,857	76.1	0	0	0	10,314			
Other													
Assets serviced for others**	3,802,194	3,648,511	3,570,284	3,496,744	3,393,204	12.1	7,715	61,590	121,529	3,611,359			
Asset-backed commercial paper conduits													
Credit exposure to conduits sponsored by institutions and others	22,226	22,592	22,211	21,404	20,714	7.3	2	0	130	22,094			
Unused liquidity commitments to conduits sponsored by institutions and others	374,260	365,850	364,656	327,395	306,435	22.1	0	0	0	374,260			
Net servicing income (for the quarter)	2,705	3,635	5,330	3,601	2,162	25.1	66	128	138	2,373			
Net securitization income (for the quarter)	5,007	5,812	5,355	4,964	2,407	108.0	0	60	256	4,691			
Total credit exposure to Tier 1 capital (%)**	6.3	6.5	5.6	5.7	5.8		0.50	1.50	2.50	8.00			

*Line item titled "All other loans and all leases" for quarters prior to March 31, 2006.

**The amount of financial assets serviced for others, other than closed-end 1-4 family residential mortgages, is reported when these assets are greater than \$10 million.

***Total credit exposure includes the sum of the three line items titled "Total credit exposure" reported above.

TABLE VIII-A. Trust Services (All FDIC-Insured Institutions)

	All Insured Institutions					Asset Size Distribution			
	Dec 31 2007	Dec 31 2006	Dec 31 2005	Dec 31 2004	% Change 2006-2007	Less than \$100 Million	\$100 Million to \$1 Billion	\$1 Billion to \$10 Billion	Greater than \$10 Billion
<i>(dollar figures in millions)</i>									
Number of institutions reporting	8,533	8,680	8,833	8,976	-1.7	3,440	4,425	549	119
Number of institutions with fiduciary powers	2,407	2,463	2,515	2,573	-2.3	559	1,431	335	82
Commercial banks	2,213	2,268	2,312	2,369	-2.4	537	1,327	281	68
Savings institutions	194	195	203	204	-0.5	22	104	54	14
Number of institutions exercising fiduciary powers	1,783	1,826	1,866	1,897	-2.4	356	1,072	283	72
Commercial banks	1,631	1,672	1,708	1,740	-2.5	337	995	237	62
Savings institutions	152	154	158	157	-1.3	19	77	46	10
Number of institutions reporting fiduciary activity	1,692	1,739	1,791	1,820	-2.7	333	1,015	275	69
Commercial banks	1,549	1,593	1,642	1,670	-2.8	314	943	232	60
Savings institutions	143	146	149	150	-2.1	19	72	43	9
Fiduciary and related assets - managed assets									
Personal trust and agency accounts	801,832	764,549	735,821	740,141	4.9	10,663	71,742	64,841	654,586
Noninterest-bearing deposits	-55	-4	364	553	N/M	13	115	54	-236
Interest-bearing deposits	11,573	9,368	8,012	7,507	23.5	251	2,410	1,613	7,298
U.S. Treasury and U.S. Government agency obligations	31,725	32,866	34,664	34,519	-3.5	551	4,589	5,084	21,501
State, county and municipal obligations	67,161	70,908	73,332	77,554	-5.3	890	5,810	5,394	55,067
Money market mutual funds	51,290	38,133	33,640	33,442	34.5	944	4,387	4,480	41,479
Other short-term obligations	21,942	9,566	8,601	7,168	129.4	32	420	254	21,236
Other notes and bonds	25,429	26,894	27,268	31,964	-5.4	584	2,211	1,979	20,655
Common and preferred stocks	523,469	514,944	491,075	496,357	1.7	6,080	41,298	38,422	437,670
Real estate mortgages	1,531	1,604	1,476	1,495	-4.6	25	238	195	1,073
Real estate	34,269	31,876	29,721	26,812	7.5	685	4,110	3,718	25,756
Miscellaneous assets	33,474	27,937	27,520	22,770	19.8	609	6,131	3,649	23,086
Retirement related trust and agency accounts:									
Employee benefit - defined contribution	329,048	307,193	226,768	206,460	7.1	1,255	92,359	11,095	224,338
Employee benefit - defined benefit	1,060,203	1,153,825	1,067,293	1,067,158	-8.1	1,494	12,672	46,179	999,857
Other retirement accounts	414,981	309,451	249,466	211,635	34.1	6,625	8,723	12,588	387,046
Corporate trust and agency accounts	25,247	31,457	42,634	27,650	-19.7	33	1,001	2,566	21,647
Investment management agency accounts	1,592,442	1,505,170	1,311,707	1,287,407	5.8	27,091	93,013	65,178	1,407,160
Other fiduciary accounts	236,787	320,331	266,515	203,554	-26.1	3,764	1,938	5,419	225,666
Total managed fiduciary accounts:									
Assets	4,460,539	4,391,975	3,900,205	3,744,006	1.6	50,926	281,448	207,865	3,920,299
Number of accounts	3,337,630	2,998,573	2,915,478	3,994,184	11.3	71,461	217,422	194,463	2,854,284
Fiduciary and related assets - non-managed assets									
Personal trust and agency accounts	355,027	309,352	286,571	273,147	14.8	2,614	20,560	15,361	316,492
Retirement related trust and agency accounts:									
Employee benefit - defined contribution	1,824,711	1,779,447	1,525,454	1,325,041	2.5	5,815	490,374	77,232	1,251,291
Employee benefit - defined benefit	5,333,474	4,542,943	3,567,201	3,415,480	17.4	14,948	17,384	75,156	5,225,987
Other retirement accounts	2,097,068	2,121,450	2,107,183	1,538,809	-1.1	2,442	734,417	38,757	1,321,452
Corporate trust and agency accounts	4,427,690	2,961,810	2,567,357	2,155,927	49.5	5,227	12,567	637,748	3,772,148
Other fiduciary accounts	3,367,009	3,170,657	2,580,461	2,447,526	6.2	4,501	6,515	12,261	3,343,732
Total non-managed fiduciary accounts:									
Assets	17,404,979	14,885,658	12,634,226	11,155,930	16.9	35,547	1,281,817	856,514	15,231,101
Number of accounts	16,425,153	16,039,580	15,695,352	22,042,098	2.4	28,764	11,752,525	513,891	4,129,973
Custody and safekeeping accounts:									
Assets	58,167,932	48,360,083	36,798,168	33,496,968	20.3	267,264	934,499	840,542	56,125,627
Number of accounts	11,335,508	11,207,692	11,513,512	16,220,035	1.1	562,128	9,031,550	349,862	1,391,968
Fiduciary and related services income									
Personal trust and agency accounts	5,767	5,147	5,244	4,878	12.0	82	374	433	4,877
Retirement related trust and agency accounts:									
Employee benefit - defined contribution	1,183	1,305	1,187	1,173	-9.3	10	288	119	765
Employee benefit - defined benefit	1,808	1,949	1,789	1,465	-7.2	16	101	87	1,603
Other retirement accounts	1,034	871	753	710	18.7	36	69	113	816
Corporate trust and agency accounts	2,439	2,054	1,877	2,350	18.7	204	30	421	1,784
Investment management agency accounts	4,159	3,683	3,562	3,178	12.9	100	407	279	3,373
Other fiduciary accounts	2,156	1,440	1,350	992	49.7	4	22	24	2,106
Custody and safekeeping accounts	8,166	8,011	7,167	5,945	1.9	165	467	435	7,099
Other fiduciary and related services income	2,420	1,855	1,577	2,431	30.5	7	116	91	2,207
Total gross fiduciary and related services income	29,292	26,142	24,781	23,130	12.0	633	1,997	2,031	24,631
Less: Expenses	20,502	19,094	17,266	16,639	7.4	236	1,458	1,494	17,313
Less: Net losses from fiduciary and related services	360	155	190	202	132.3	1	1	7	351
Plus: Intracompany income credits for fiduciary and related services	4,543	2,897	1,302	1,135	56.8	1	29	1,479	3,035
Net fiduciary and related services income	12,809	9,962	8,424	7,417	28.6	384	443	1,981	10,001
Collective investment funds and common trust funds (market value)									
Domestic equity funds	448,225	449,079	478,087	482,294	-0.2	6,566	16,668	7,752	417,238
International/global equity funds	206,551	171,114	129,572	119,084	20.7	1,171	3,390	2,041	199,950
Stock/bond blend funds	215,849	217,734	77,526	69,116	-0.9	1,882	745	2,678	210,543
Taxable bond funds	214,145	185,398	248,050	243,403	15.5	943	46,454	2,376	164,372
Municipal bond funds	8,328	8,695	60,308	11,127	-4.2	4	607	348	7,369
Short term investments/money market funds	395,025	352,341	365,759	386,342	12.1	2,655	3,197	161	389,013
Specialty/other funds	121,628	96,902	102,112	93,594	25.5	549	33,703	1,126	86,249
Total collective investment funds	1,609,751	1,481,262	1,461,414	1,404,959	8.7	13,770	104,764	16,482	1,474,734

INSURANCE FUND INDICATORS

- **Insured Deposits Grow by 1.2 Percent in the Fourth Quarter**
- **DIF Reserve Ratio Is Unchanged at 1.22 Percent**
- **Three Insured Institutions Fail During the Year**

From September 30 to December 31, total assets of the nation's 8,533 FDIC-insured commercial banks and savings institutions increased by \$331.8 billion (2.6 percent). Total deposits, which increased by \$232.8 billion, funded about 70 percent of this asset growth. During the fourth quarter, total domestic deposits grew by 2.5 percent, the highest quarterly percentage increase since the fourth quarter of 2004. Brokered deposits increased by 12.4 percent, the largest quarterly percentage increase since the fourth quarter of 2000 when brokered deposits increased by 13.0 percent. Five institutions accounted for approximately two-thirds of this growth.

Domestic time deposits increased by 2.1 percent, while other domestic interest-bearing deposits increased by 1.7 percent and domestic non-interest bearing deposits increased by 5.8 percent. Over the 12 months ending December 31, total domestic deposits increased by 4.2 percent, with domestic interest-bearing deposits rising by 5.7 percent but domestic noninterest-bearing deposits declining by 2.2 percent.

Over the past year, the share of assets funded by domestic deposits declined from 56 percent to 53 percent. By contrast, foreign deposits as a percent of total assets rose during 2007 from 10.1 percent to 11.5 percent, and Federal Home Loan Bank (FHLB) advances' share of asset funding increased from 5.2 percent to 6.2 percent. In 2007, foreign office deposits increased by 25.8 percent (\$308.5 billion) and FHLB advances increased by 30.3 percent (\$187.9 billion).

Estimated insured deposits (including U.S. branches of foreign banks) increased by 1.2 percent during the fourth quarter of 2007, compared to nearly flat growth (0.2 percent increase) for the previous quarter. For all

of 2007, insured deposits increased by 3.4 percent, down from 6.8 percent in 2006. For institutions reporting as of December 31, 2007 and September 30, 2007, insured deposits increased during the fourth quarter at 5,178 institutions (62 percent), decreased at 3,259 institutions (38 percent) and remained unchanged at 46 institutions.

The Deposit Insurance Fund (DIF) increased by 1.3 percent (\$659 million) during the fourth quarter to \$52,413 million. Accrued assessment income added \$239 million to the DIF during the fourth quarter. The fund received \$138 million from unrealized gains on available for sale securities, and took in \$321 million from interest on securities and other revenue, net of operating expenses. The DIF was reduced by \$39 million in additional provisions for insurance losses. For the year, the fund balance grew by 4.5 percent, up from 3.2 percent growth in 2006.

The DIF's reserve ratio equaled 1.22 percent on December 31, 2007, unchanged from the previous quarter. During 2007, the reserve ratio increased by one basis point, from 1.21 percent at year-end 2006.

Only one FDIC-insured institution failed during the fourth quarter of 2007, a small commercial bank. At the time of failure, this institution had \$93 million in assets and an estimated failure cost of \$3 million. For all of 2007, three FDIC-insured institutions failed with assets of \$2.3 billion and an estimated failure cost of \$120 million. These are the first failures since 2004, during which four institutions failed.

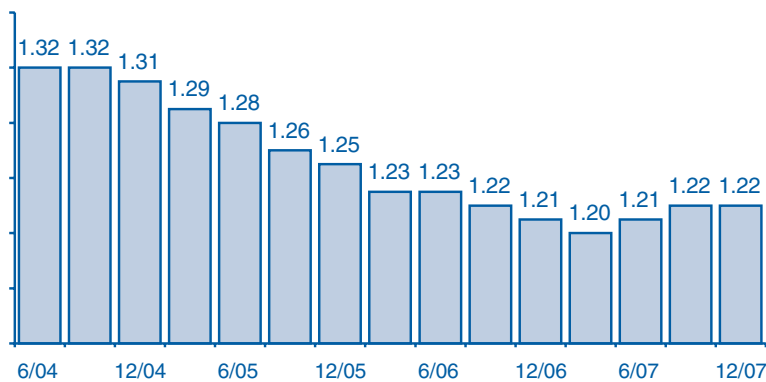
*Author: Kevin Brown, Sr. Financial Analyst
Division of Insurance and Research, FDIC
(202) 898-6817*

TABLE I-B. Insurance Fund Balances and Selected Indicators

(dollar figures in millions)

	Deposit Insurance Fund									
	4th Quarter 2007	3rd Quarter 2007	2nd Quarter 2007	1st Quarter 2007	4th Quarter 2006	3rd Quarter 2006	2nd Quarter 2006	1st Quarter 2006	4th Quarter 2005	3rd Quarter 2005
Beginning Fund Balance*	\$51,754	\$51,227	\$50,745	\$50,165	\$49,992	\$49,564	\$49,193	\$48,597	\$48,373	\$48,023
Changes in Fund Balance:										
Assessments earned.....	239	170	140	94	10	10	7	5	13	20
Interest earned on investment securities.....	585	640	748	567	476	622	665	478	675	536
Operating expenses.....	262	243	248	239	248	237	242	224	252	227
Provision for insurance losses.....	39	132	-3	-73	49	-50	-6	-45	-19	-65
All other income, net of expenses**.....	-2	24	1	4	5	1	12	349	4	3
Unrealized gain/(loss) on available-for-sale securities.....	138	68	-162	81	-21	-18	-77	-57	-235	-47
Total fund balance change.....	659	527	482	580	173	428	371	596	224	350
Ending Fund Balance*	52,413	51,754	51,227	50,745	50,165	49,992	49,564	49,193	48,597	48,373
Percent change from four quarters earlier.....	4.48	3.52	3.36	3.15	3.23	3.35	3.21	3.31	2.29	2.94
Reserve Ratio (%)	1.22	1.22	1.21	1.20	1.21	1.22	1.23	1.23	1.25	1.26
Estimated Insured Deposits	4,293,201	4,243,894	4,234,835	4,245,148	4,153,764	4,100,013	4,040,353	4,001,906	3,890,941	3,830,950
Percent change from four quarters earlier.....	3.36	3.51	4.81	6.08	6.75	7.02	7.52	8.50	7.42	7.63
Assessment Base	7,052,552	6,879,633	6,821,486	6,801,520	6,594,750	6,439,326	6,386,864	6,272,505	6,177,429	6,038,857
Percent change from four quarters earlier.....	6.94	6.84	6.80	8.43	6.76	6.63	8.64	8.15	8.88	9.47
Number of institutions reporting	8,544	8,571	8,625	8,661	8,692	8,755	8,790	8,803	8,846	8,871

DIF Reserve Ratio*
Percent of Insured Deposits



Deposit Insurance Fund Balance and Insured Deposits*
(\$ Millions)

	DIF Balance	DIF-Insured Deposits
6/04	46,521	3,531,806
9/04	46,990	3,559,489
12/04	47,507	3,622,068
3/05	47,617	3,688,562
6/05	48,023	3,757,728
9/05	48,373	3,830,950
12/05	48,597	3,890,941
3/06	49,193	4,001,906
6/06	49,564	4,040,353
9/06	49,992	4,100,013
12/06	50,165	4,153,764
3/07	50,745	4,245,148
6/07	51,227	4,234,835
9/07	51,754	4,243,894
12/07	52,413	4,293,201

TABLE II-B. Problem Institutions and Failed/Assisted Institutions

(dollar figures in millions)

	2007	2006	2005	2004	2003	2002
Problem Institutions						
Number of institutions.....	76	50	52	80	116	136
Total assets.....	\$22,189	\$8,265	\$6,607	\$28,250	\$29,917	\$38,927
Failed/Assisted Institutions						
Number of institutions.....	3	0	0	4	3	11
Total assets.....	\$2,345	\$0	\$0	\$166	\$1,097	\$2,558

* Prior to 2006, amounts represent sum of separate BIF and SAIF amounts.

** First Quarter 2006 includes previously escrowed revenue from SAIF-member exit fees.

TABLE III-B. Estimated FDIC-Insured Deposits by Type of Institution

(dollar figures in millions)

December 31, 2007

	Number of Institutions	Total Assets	Domestic Deposits*	Est. Insured Deposits
Commercial Banks and Savings Institutions				
FDIC-Insured Commercial Banks	7,282	11,176,096	5,806,795	3,426,148
FDIC-Supervised	4,772	1,874,698	1,370,557	927,470
OCC-Supervised	1,632	7,782,387	3,590,744	1,995,866
Federal Reserve-Supervised	878	1,519,012	845,494	502,812
FDIC-Insured Savings Institutions	1,251	1,862,669	1,104,986	860,936
OTS-Supervised Savings Institutions	826	1,556,670	892,592	696,835
FDIC-Supervised State Savings Banks	425	305,999	212,394	164,101
Total Commercial Banks and Savings Institutions	8,533	13,038,765	6,911,780	4,287,084
Other FDIC-Insured Institutions				
U.S. Branches of Foreign Banks	11	16,614	8,886	6,116
Total FDIC-Insured Institutions	8,544	13,055,379	6,920,667	4,293,201

* Excludes \$1.50 trillion in foreign office deposits, which are uninsured.

TABLE IV-B. Distribution of Institutions and Assessment Base Among Risk Categories

Quarter Ending September 30, 2007

(dollar figures in billions)

Risk Category	Annual Rate in Basis Points	Number of Institutions	Percent of Total Institutions	Assessment Base	Percent of Total Assessment Base
I - Minimum	5	2,709	31.6%	3,872	56.3%
I - Middle	5.01- 6.00	3,088	36.0%	2,078	30.2%
I - Middle	6.01- 6.99	1,422	16.6%	456	6.6%
I - Maximum	7	859	10.0%	296	4.3%
II	10	422	4.9%	163	2.4%
III	28	64	0.7%	14	0.2%
IV	43	7	0.1%	1	0.0%

Note: Institutions are categorized based on supervisory ratings, debt ratings and financial data as of September 30, 2007.

Rates do not reflect the application of assessment credits. See notes to users for further information on risk categories and rates.

Notes To Users

This publication contains financial data and other information for depository institutions insured by the Federal Deposit Insurance Corporation (FDIC). These notes are an integral part of this publication and provide information regarding the comparability of source data and reporting differences over time.

Tables I-A through VIII-A.

The information presented in Tables I-A through V-A of the *FDIC Quarterly Banking Profile* is aggregated for all FDIC-insured Institutions, both commercial banks and savings institutions. Tables VI-A (Derivatives) and VII-A (Servicing, Securitization, and Asset Sales Activities) aggregate information only for insured commercial banks and state-chartered savings banks that file quarterly Call Reports. Table VIII-A Trust Services aggregates Trust asset and income information collected annually from all FDIC-insured institutions. Some tables are arrayed by groups of FDIC-insured institutions based on predominant types of asset concentration, while other tables aggregate institutions by asset size and geographic region. Quarterly and full-year data are provided for selected indicators, including aggregate condition and income data, performance ratios, condition ratios and structural changes, as well as past due, noncurrent and charge-off information for loans outstanding and other assets.

Tables I-B through IV-B.

A separate set of tables (Tables I-B through IV-B) provides comparative quarterly data related to the Deposit Insurance Fund (DIF), problem institutions, failed/assisted institutions, estimated FDIC-insured deposits, as well as assessment rate information. Depository institutions that are not insured by the FDIC through the DIF are not included in the *FDIC Quarterly Banking Profile*. U.S. branches of institutions headquartered in foreign countries and non-deposit trust companies are not included unless otherwise indicated. Efforts are made to obtain financial reports for all active institutions. However, in some cases, final financial reports are not available for institutions that have closed or converted their charters.

DATA SOURCES

The financial information appearing in this publication is obtained primarily from the Federal Financial Institutions Examination Council (FFIEC) *Call Reports* and the OTS *Thrift Financial Reports* submitted by all FDIC-insured depository institutions. This information is stored on and retrieved from the FDIC's Research Information System (RIS) data base.

COMPUTATION METHODOLOGY

Certain adjustments are made to the OTS *Thrift Financial Reports* to provide closer conformance with the reporting and accounting requirements of the FFIEC *Call Reports*. Parent institutions are required to file consolidated reports, while their subsidiary financial institutions are still required to file separate reports. Data from subsidiary institution reports are included in the *Quarterly Banking Profile* tables, which can lead to double-counting. No adjustments are made for any double-counting of subsidiary data.

All asset and liability figures used in calculating performance ratios represent average amounts for the period (beginning-of-period amount plus end-of-period amount plus any interim periods, divided by the total number of periods). For "pooling-of-interest" mergers, the assets of the acquired institution(s) are included in average assets since the year-to-date income includes the results of all merged institutions. No adjustments are made for "purchase accounting" mergers.

Growth rates represent the percentage change over a 12-month period in totals for institutions in the base period to totals for institutions in the current period.

All data are collected and presented based on the location of each reporting institution's main office. Reported data may include assets and liabilities located outside of the reporting institution's home state. In addition, institutions may relocate across state lines or change their charters, resulting in an inter-regional or inter-industry migration, e.g., institutions can move their home offices between regions, and savings institutions can convert to commercial banks or commercial banks may convert to savings institutions.

ACCOUNTING CHANGES

FASB Statement No. 157 Fair Value Measurements issued in September 2006 and FASB Statement No. 159 The Fair Value Option for Financial Assets and Financial Liabilities issued in February 2007 – both are effective in 2008 with early adoption permitted in 2007. FAS 157 defines a fair value measurement framework, while FAS 159 allows banks to elect a fair value option when assets are recognized on the balance sheet and to report certain financial assets and liabilities at fair value with subsequent changes in fair value included in earnings. Existing eligible items can be fair-valued as early as January 2007 under FAS 159, if a bank adopts FAS 157.

FASB Statement 158 Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans – issued in September 2006 requires a bank to recognize in 2007 the funded status of its postretirement plans on its balance sheet. An overfunded plan is recognized as an asset and an underfunded plan is recognized as a liability. An adjustment is made to equity as accumulated other comprehensive income (AOCI) upon application of FAS 158 and AOCI is adjusted in subsequent periods as net periodic benefit costs are recognized in earnings.

FASB Statement No. 156 Accounting for Servicing of Financial Assets – issued in March 2006 and effective in 2007, requires all separately recognized servicing assets and liabilities to be initially measured at fair value and allows a bank the option to subsequently adjust that value by periodic revaluation and recognition of earnings or by periodic amortization to earnings.

Purchased Impaired Loans and Debt Securities – Statement of Position 03-3, *Accounting for Certain Loans or Debt Securities Acquired in a Transfer*. The SOP applies to loans and debt securities acquired in fiscal years beginning after December 15, 2004. In general, this Statement of Position applies to "purchased impaired loans and debt securities," i.e., loans and debt securities that a bank has purchased, including those acquired in a purchase business combination, when it is probable, at the purchase date, that the bank will be unable to collect all contractually required payments receivable. Banks must follow Statement of Position 03-3 for Call Report purposes. The SOP does not apply to the loans that a bank has originated, prohibits "carrying over" or creation of valuation allowances in the initial accounting and any subsequent valuation allowances reflect only those losses incurred by the investor after acquisition.

GNMA Buy-back Option – If an issuer of GNMA securities has the option to buy back the loans that collateralize the GNMA securities, when certain delinquency criteria are met, FASB Statement No. 140 requires that loans with this buy-back option must be brought back on the issuer's books as assets. The rebooking of GNMA loans is required regardless of whether the issuer intends to exercise the buy-back option. The banking agencies clarified in May 2005 that all GNMA loans that are rebooked because of delinquency should be reported as past due according to their contractual terms.

FASB Interpretation No. 45 – In November 2002, the FASB issued Interpretation No. 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others*. This interpretation clarifies that a guarantor is required to recognize, at the inception of a guarantee (financial standby letters of credit, performance standby letters of credit), a liability for the fair value of the obligation undertaken in issuing the guarantee. Banks apply the initial recognition and measurement provisions of Interpretation No. 45 on a prospective basis to guarantees issued or modified after December 31, 2002, irrespective of the bank's fiscal year end. A bank's previous accounting for guarantees issued prior to January 1, 2003, is not revised.

FASB Interpretation No. 46 – The FASB issued Interpretation No. 46, *Consolidation of Variable Interest Entities*, in January 2003 and revised it in December 2003. Generally, banks with variable interests in variable interest entities created after December 31, 2003, must consolidate them. The timing of consolidation varies with certain situations with application as late as 2005. The assets and liabilities of a consolidated variable interest entity are reported on a line-by-line basis according to the asset and liability categories shown on the bank's balance sheet, as well as related income items. Most small banks are unlikely to have any "variable interests" in variable interest entities.

FASB Statement No. 123 (Revised 2004) and Share-Based Payments

– requires all entities to recognize compensation expense in an amount equal to the fair value of share-based payments, e.g., stock options and restricted stock, granted to employees. As of January 2006 all banks must adopt FAS 123(R). The compensation cost is typically recognized over the vesting period with a corresponding credit to equity. The recording of the compensation cost also gives rise to a deferred tax asset.

Goodwill and intangible assets – FAS 141 terminates the use of pooling-of-interest accounting for business combinations after 2001 and requires purchase accounting. Under FAS 142 amortization of goodwill is eliminated. Only intangible assets other than goodwill are amortized each quarter. In addition companies are required to test for impairment of both goodwill and other intangibles once each fiscal year. The year 2002, the first fiscal year affected by this accounting change, has been designated a transitional year and the amount of initial impairments are to be recorded as extraordinary losses on a "net of tax" basis (and not as noninterest expense). Subsequent annual review of intangibles and goodwill impairment may require additional noninterest expense recognition. FASB Statement No. 147 clarifies that acquisitions of financial institutions (except transactions between two or more mutual enterprises), including branch acquisitions that meet the definition of a business combination, should be accounted for by the purchase method under FASB Statement No. 141. This accounting standard includes transition provisions that apply to unidentifiable intangible assets previously accounted for in accordance with FASB Statement No. 72. If the transaction (such as a branch acquisition) in which an unidentifiable intangible asset arose does not meet the definition of a business combination, this intangible asset is not be reported as "Goodwill" on the Call Report balance sheet. Rather, this unidentifiable intangible asset is reported as "Other intangible assets," and must continue to be amortized and the amortization expense should be reported in the Call Report income statement.

FASB Statement No. 133 Accounting for Derivative Instruments and Hedging Activities

– All banks must recognize derivatives as either assets or liabilities on the balance sheet, measured at fair value. A derivative may be specifically designated as a "fair value hedge," a "cash flow hedge," or a hedge of a foreign currency exposure. The accounting for changes in the value of a derivative (gains and losses) depends on the intended use of the derivative, its resulting designation, and the effec-

tiveness of the hedge. Derivatives held for purposes other than trading are reported as "other assets" (positive fair values) or "other liabilities" (negative fair values). For a fair value hedge, the gain or loss is recognized in earnings and "effectively" offsets loss or gain on the hedged item attributable to the risk being hedged. Any ineffectiveness of the hedge could result in a net gain or loss on the income statement. Accumulated net gains (losses) on cash flow hedges are recorded on the balance sheet as "accumulated other comprehensive income" and the periodic change in the accumulated net gains (losses) for cash flow hedges is reflected directly in equity as the value of the derivative changes. FASB Statement No. 149, Amendment of Statement 133 on Derivative Instruments and Hedging Activities provides guidance on the circumstances in which a loan commitment must be accounted for as derivative. Under Statement No. 149, loan commitments that relate to the origination of mortgage loans that will be held for sale, commonly referred to as interest rate lock commitments, must be accounted for as derivatives on the balance sheet by the issuer of the commitment.

DEFINITIONS (in alphabetical order)

All other assets – total cash, balances due from depository institutions, premises, fixed assets, direct investments in real estate, investment in unconsolidated subsidiaries, customers' liability on acceptances outstanding, assets held in trading accounts, federal funds sold, securities purchased with agreements to resell, fair market value of derivatives, and other assets.

All other liabilities – bank's liability on acceptances, limited-life preferred stock, allowance for estimated off-balance-sheet credit losses, fair market value of derivatives, and other liabilities.

Assessment base – assessable deposits consist of DIF deposits (deposits insured by the FDIC Deposit Insurance Fund) in banks' domestic offices with certain adjustments.

Assets securitized and sold – total outstanding principal balance of assets securitized and sold with servicing retained or other seller-provided credit enhancements.

Construction and development loans – includes loans for all property types under construction, as well as loans for land acquisition and development.

Core capital – common equity capital plus noncumulative perpetual preferred stock plus minority interest in consolidated subsidiaries, less goodwill and other ineligible intangible assets. The amount of eligible intangibles (including servicing rights) included in core capital is limited in accordance with supervisory capital regulations.

Cost of funding earning assets – total interest expense paid on deposits and other borrowed money as a percentage of average earning assets.

Credit enhancements – techniques whereby a company attempts to reduce the credit risk of its obligations. Credit enhancement may be provided by a third party (external credit enhancement) or by the originator (internal credit enhancement), and more than one type of enhancement may be associated with a given issuance.

Deposit Insurance Fund (DIF) – The Bank (BIF) and Savings Association (SAIF) Insurance Funds were merged in 2006 by the Federal Deposit Insurance Reform Act to form the DIF.

Derivatives notional amount – The notional or contractual amounts of derivatives represent the level of involvement in the types of derivatives transactions and are not a quantification of market risk or credit risk. Notional amounts represent the amounts used to calculate contractual cash flows to be exchanged.

Derivatives credit equivalent amount – the fair value of the derivative plus an additional amount for potential future credit exposure based on the notional amount, the remaining maturity and type of the contract.

Derivatives transaction types:

Futures and forward contracts – contracts in which the buyer agrees to purchase and the seller agrees to sell, at a specified future date, a specific quantity of an underlying variable or index at a specified price or yield. These contracts exist for a variety of variables or indices, (traditional agricultural or physical commodities, as well as currencies and interest rates). Futures contracts are standardized and are traded on organized exchanges which set limits on counterparty credit exposure. Forward contracts do not have standardized terms and are traded over the counter.

Option contracts – contracts in which the buyer acquires the right to buy from or sell to another party some specified amount of an underlying variable or index at a stated price (strike price) during a period or on a specified future date, in return for compensation (such as a fee or premium). The seller is obligated to purchase or sell the variable or index at the discretion of the buyer of the contract.

Swaps – obligations between two parties to exchange a series of cash flows at periodic intervals (settlement dates), for a specified period. The cash flows of a swap are either fixed, or determined for each settlement date by multiplying the quantity (notional principal) of the underlying variable or index by specified reference rates or prices. Except for currency swaps, the notional principal is used to calculate each payment but is not exchanged.

Derivatives underlying risk exposure – the potential exposure characterized by the level of banks' concentration in particular underlying instruments, in general. Exposure can result from market risk, credit risk and operational risk, as well as, interest rate risk.

Domestic deposits to total assets – total domestic office deposits as a percent of total assets on a consolidated basis.

Earning assets – all loans and other investments that earn interest or dividend income.

Efficiency ratio – Noninterest expense less amortization of intangible assets as a percent of net interest income plus noninterest income. This ratio measures the proportion of net operating revenues that are absorbed by overhead expenses, so that a lower value indicates greater efficiency.

Estimated insured deposits – in general, insured deposits are total domestic deposits minus estimated uninsured deposits. Prior to June 30, 2000, the uninsured estimate is calculated as the sum of the excess amounts in accounts over \$100,000. Beginning June 30, 2000, the amount of estimated uninsured deposits is adjusted to consider a financial institution's own estimate of uninsured deposits when such an estimate is reported. Beginning in 2006, the uninsured deposits estimate also considers IRA accounts over \$250,000.

Failed/assisted institutions – an institution fails when regulators take control of the institution, placing the assets and liabilities into a bridge bank, conservatorship, receivership, or another healthy institution. This action may require the FDIC to provide funds to cover losses. An institution is defined as "assisted" when the institution remains open and receives some insurance funds in order to continue operating.

FHLB advances – all borrowings by FDIC insured institutions from the Federal Home Loan Bank System (FHLB), as reported by Call Report filers and by TFR filers.

Goodwill and other intangibles – intangible assets include servicing rights, purchased credit card relationships and other identifiable intangible assets. Goodwill is the excess of the purchase price over the fair market value of the net assets acquired.

Loans secured by real estate – includes home equity loans, junior liens secured by 1-4 family residential properties and all other loans secured by real estate.

Loans to individuals – includes outstanding credit card balances and other secured and unsecured consumer loans.

Long-term assets (5+ years) – loans and debt securities with remaining maturities or repricing intervals of over five years.

Maximum credit exposure – the maximum contractual credit exposure remaining under recourse arrangements and other seller-provided credit enhancements provided by the reporting bank to securitizations.

Mortgage-backed securities – certificates of participation in pools of residential mortgages and collateralized mortgage obligations issued or guaranteed by government-sponsored or private enterprises. Also, see "Securities", below.

Net charge-offs – total loans and leases charged off (removed from balance sheet because of uncollectibility), less amounts recovered on loans and leases previously charged off.

Net interest margin – the difference between interest and dividends earned on interest-bearing assets and interest paid to depositors and other creditors, expressed as a percentage of average earning assets. No adjustments are made for interest income that is tax exempt.

Net loans to total assets – loans and lease financing receivables, net of unearned income, allowance and reserves, as a percent of total assets on a consolidated basis.

Net operating income – income excluding discretionary transactions such as gains (or losses) on the sale of investment securities and extraordinary items. Income taxes subtracted from operating income have been adjusted to exclude the portion applicable to securities gains (or losses).

Noncurrent assets – the sum of loans, leases, debt securities and other assets that are 90 days or more past due, or in nonaccrual status.

Noncurrent loans & leases – the sum of loans and leases 90 days or more past due, and loans and leases in nonaccrual status.

Number of institutions reporting – the number of institutions that actually filed a financial report.

Other borrowed funds – federal funds purchased, securities sold with agreements to repurchase, demand notes issued to the U.S. Treasury, FHLB advances, other borrowed money, mortgage indebtedness, obligations under capitalized leases and trading liabilities, less revaluation losses on assets held in trading accounts.

Other real estate owned – primarily foreclosed property. Direct and indirect investments in real estate ventures are excluded. The amount is reflected net of valuation allowances. For institutions that file a Thrift Financial Report (TFR), the valuation allowance subtracted also includes allowances for other repossessed assets. Also, for TFR filers the components of other real estate owned are reported gross of valuation allowances.

Percent of institutions with earnings gains – the percent of institutions that increased their net income (or decreased their losses) compared to the same period a year earlier.

"Problem" institutions – federal regulators assign a composite rating to each financial institution, based upon an evaluation of financial and operational criteria. The rating is based on a scale of 1 to 5 in ascend-

ing order of supervisory concern. “Problem” institutions are those institutions with financial, operational, or managerial weaknesses that threaten their continued financial viability. Depending upon the degree of risk and supervisory concern, they are rated either a “4” or “5”. For all insured commercial banks and for insured savings banks for which the FDIC is the primary federal regulator, FDIC composite ratings are used. For all institutions whose primary federal regulator is the OTS, the OTS composite rating is used.

Recourse – an arrangement in which a bank retains, in form or in substance, any credit risk directly or indirectly associated with an asset it has sold (in accordance with generally accepted accounting principles) that exceeds a pro rata share of the bank’s claim on the asset. If a bank has no claim on an asset it has sold, then the retention of any credit risk is recourse.

Reserves for losses – the allowance for loan and lease losses on a consolidated basis.

Restructured loans and leases – loan and lease financing receivables with terms restructured from the original contract. Excludes restructured loans and leases that are not in compliance with the modified terms.

Retained earnings – net income less cash dividends on common and preferred stock for the reporting period.

Return on assets – net income (including gains or losses on securities and extraordinary items) as a percentage of average total assets. The basic yardstick of bank profitability.

Return on equity – net income (including gains or losses on securities and extraordinary items) as a percentage of average total equity capital.

Risk-based capital groups – definition:

(Percent)	Total Risk-Based Capital *	Tier 1 Risk-Based Capital *	Tier 1 Leverage	Tangible Equity
Well-capitalized	≥10	and ≥6	and ≥5	–
Adequately capitalized	≥8	and ≥4	and ≥4	–
Undercapitalized	≥6	and ≥3	and ≥3	–
Significantly undercapitalized	<6	or <3	or <3	and >2
Critically undercapitalized	–	–	–	≤2

*As a percentage of risk-weighted assets.

Risk Categories and Assessment Rate Schedule – The current risk categories and assessment rate schedule became effective January 1, 2007. Capital ratios and supervisory ratings distinguish one risk category from another. The following table shows the relationship of risk categories (I, II, III, IV) to capital and supervisory groups as well as the

Capital Group	Supervisory Group		
	A	B	C
1. Well Capitalized	I 5-7 bps	II 10 bps	III 28 bps
2. Adequately Capitalized			
3. Undercapitalized	III 28 bps		IV 43 bps

assessment rates (in basis points) for each risk category. Supervisory Group A generally includes institutions with CAMELS composite ratings of 1 or 2; Supervisory Group B generally includes institutions with a CAMELS composite rating of 3; and Supervisory Group C generally includes institutions with CAMELS composite ratings of 4 or 5. For purposes of risk-based assessment capital groups, undercapitalized includes institutions that are significantly or critically undercapitalized.

Assessment rates are 3 basis points above the base rate schedule. The FDIC may adjust rates up or down by 3 basis points from the base rate schedule without notice and comment, provided that any single adjustment from one quarter to the next cannot move rates more than 3 basis points.

For most institutions in Risk Category I, the assessment rate assigned will be based on a combination of financial ratios and CAMELS component ratings.

For large institutions in Risk Category I (generally those with at least \$10 billion in assets) that have long-term debt issuer ratings, assessment rates will be determined by weighting CAMELS component ratings 50 percent and long-term debt issuer ratings 50 percent. For all large Risk Category I institutions, additional risk factors will be considered to determine whether assessment rates should be adjusted. This additional information includes market data, financial performance measures, considerations of the ability of an institution to withstand financial stress, and loss severity indicators. Any adjustment will be limited to no more than ½ basis point.

Beginning in 2007, each institution is assigned a risk-based rate for a quarterly assessment period near the end of the quarter following the assessment period. Payment will generally be due on the 30th day of the last month of the quarter following the assessment period. Supervisory rating changes will be effective for assessment purposes as of the examination transmittal date. For institutions with long-term debt issuer ratings, changes in ratings will be effective for assessment purposes as of the date the change was announced.

Risk-weighted assets – assets adjusted for risk-based capital definitions which include on-balance-sheet as well as off-balance-sheet items multiplied by risk-weights that range from zero to 100 percent. A conversion factor is used to assign a balance sheet equivalent amount for selected off-balance-sheet accounts.

Securities – excludes securities held in trading accounts. Banks’ securities portfolios consist of securities designated as “held-to-maturity”, which are reported at amortized cost (book value), and securities designated as “available-for-sale”, reported at fair (market) value.

Securities gains (losses) – realized gains (losses) on held-to-maturity and available-for-sale securities, before adjustments for income taxes. Thrift Financial Report (TFR) filers also include gains (losses) on the sales of assets held for sale.

Seller’s interest in institution’s own securitizations – the reporting bank’s ownership interest in loans and other assets that have been securitized, except an interest that is a form of recourse or other seller-provided credit enhancement. Seller’s interests differ from the securities issued to investors by the securitization structure. The principal amount of a seller’s interest is generally equal to the total principal amount of the pool of assets included in the securitization structure less the principal amount of those assets attributable to investors, i.e., in the form of securities issued to investors.

Subchapter S Corporation – A Subchapter S corporation is treated as a pass-through entity, similar to a partnership, for federal income tax purposes. It is generally not subject to any federal income taxes at the

corporate level. This can have the effect of reducing institutions' reported taxes and increasing their after-tax earnings.

Trust assets – market value, or other reasonably available value of fiduciary and related assets, to include marketable securities, and other financial and physical assets. Common physical assets held in fiduciary accounts include real estate, equipment, collectibles, and household goods. Such fiduciary assets are not included in the assets of the financial institution.

Unearned income & contra accounts – unearned income for Call Report filers only.

Unused loan commitments – includes credit card lines, home equity lines, commitments to make loans for construction, loans secured by commercial real estate, and unused commitments to originate or purchase loans. (Excluded are commitments after June 2003 for originated mortgage loans held for sale, which are accounted for as derivatives on the balance sheet.)

Volatile liabilities – the sum of large-denomination time deposits, foreign-office deposits, federal funds purchased, securities sold under agreements to repurchase, and other borrowings.

Yield on earning assets – total interest, dividend and fee income earned on loans and investments as a percentage of average earning assets.

Building Assets, Building Relationships: Bank Strategies for Encouraging Lower-Income Households to Save

Introduction

Personal saving enables individual households to withstand unforeseen expenses and income disruptions, such as job loss, health emergencies, or major home and automobile repairs. Saving also helps households fund large expenditures, including buying a home, starting a small business, or paying for college. In addition, saving helps ensure that households will have sufficient assets for retirement. Further, a cushion of savings provides households with many intangible benefits. For example, studies have shown that people who save feel that they have a “stake” in society and have better relationships with family and neighbors, increased community involvement, and enhanced personal respectability.¹

On a macro level, personal saving is a major component of national saving; a country with robust saving generally has more available capital to fund investment and support economic growth.

In very simple terms, individuals can save by putting funds in a deposit account at a bank, credit union, or brokerage firm. However, another way to save is to build financial assets by purchasing a home, insurance policy, stocks and bonds, or deferred retirement plans, among other things. Access to credit is a critical component of asset building, in that large financial assets are often accumulated by borrowing, which can magnify returns. In addition, households with access to reasonably priced credit can borrow money to fund purchases or meet emergency needs without tapping savings. Except in the case of a windfall, such as an inheritance, it is very difficult to build wealth without access to credit.

Not surprisingly, low- and moderate-income (LMI) households have the most difficulty saving. Conventional wisdom suggests that banks do not view LMI households as potential profitable customers because these households have less income and fewer assets.²

¹ Margaret Lombe and Michael Sherraden, 2007, *Effects of Participating in an Asset Building Intervention on Social Inclusion*, Working Paper Number 07-02, George Warren Brown School of Social Work, Washington University in St. Louis.

² In this article, the term “bank” refers to banks and savings associations insured by the Federal Deposit Insurance Corporation (FDIC).

Nevertheless, banks already have an account relationship or other connection with a large number of these households, and the majority of LMI customers have indicated a desire to expand these relationships. Since the bank has realized the fixed costs of acquiring these customers, the challenge is to increase the profitability of the relationships while also providing LMI households with opportunities to build assets.

This article explains the obstacles LMI households face in asset building, examines the incentives banks have for encouraging these households to save, and describes some strategies banks have used to build profitable relationships that also benefit LMI consumers.

Low- and Moderate-Income Households Lag in Asset Building

The U.S. personal saving rate has been declining since the early 1980s. As recently as the early 1990s, quarterly saving rates were often greater than 7 percent. Since 2005, however, saving rates have hovered between zero and 1 percent, even falling briefly into negative territory. The most recent saving rate, 0.0 percent as of fourth quarter 2007, is among the lowest since the government began collecting the data in 1959 (see Chart 1).

Chart 1

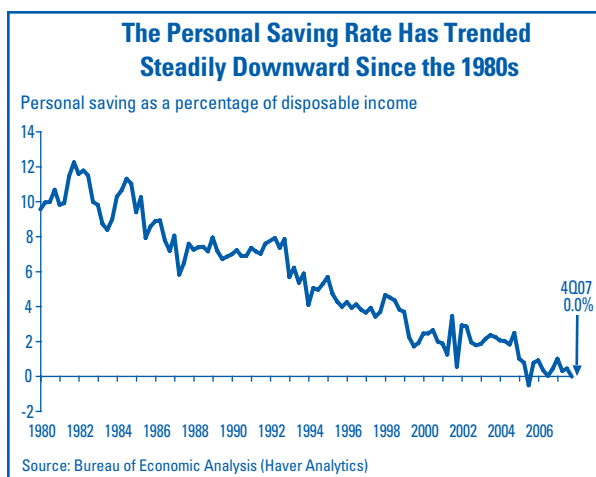
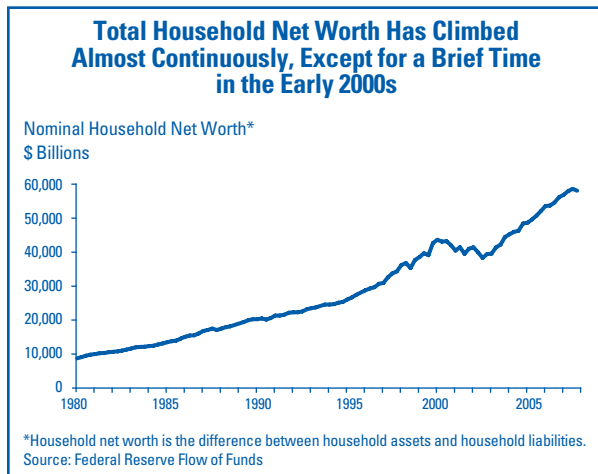


Chart 2



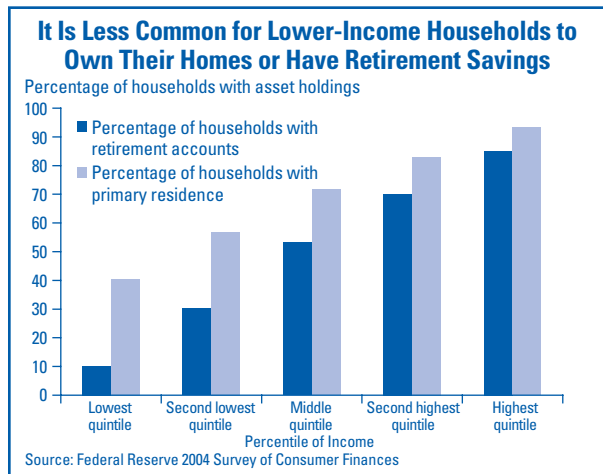
However, the saving rate is an imperfect measure of household wealth accumulation. Some observers have argued that the U.S. saving rate may be understated, primarily because several important asset classes are not included in the calculation (see Text Box on page 31). In addition, a breakdown of the U.S. saving rate by income level is not regularly published. This lack of granularity in the calculation masks the fact that wealthier households drive the overall U.S. saving rate because they earn and spend more and hold higher levels of assets.

To gain a better understanding of the dynamics of personal saving, it is useful to review alternative measures of asset-building progress, namely the trends in and distributions of total household wealth and net worth. According to the Federal Reserve, overall household net worth was \$57.7 trillion by fourth quarter 2007, up 3.4 percent on a year-over-year basis but down about 0.9 percent from the previous quarter. Net worth has grown nearly every quarter since 1953, with the only notable downturn occurring after the stock market declines of the early 2000s (see Chart 2). The most recent dip in household net worth was the first since 2002 and was caused by erosion in home equity and stock values.

Recent increases in overall household net worth have been driven in part by growth in the rate of homeownership—from 65 percent in 1995 to about 68 percent in 2007—as well as an increase in home values.³ In addition, equity holdings, including the increased participation in and value of retirement plans, have contributed to higher overall household wealth. Higher-income households drive overall house-

³ Homeownership rates are calculated by the U.S. Census Bureau.

Chart 3



hold wealth figures because asset holdings are heavily concentrated in upper-income bands. For example, homeownership rates for the top quintile of households exceed 90 percent, and retirement account participation is close to 85 percent. Conversely, about 40 percent of households in the lowest quintile own their homes, and only about 10 percent participate in retirement plans (see Chart 3).

Between 1989 and 2004, the median net worth for households increased in all but the second lowest income quintile, although higher-income households have far greater wealth in absolute terms (see Table 1).

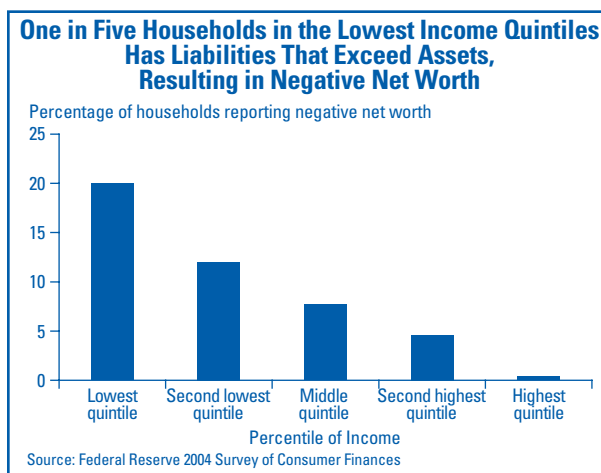
Moreover, while the median net worth of households in the lowest income quintile is about \$7,000, almost 20 percent of these households have negative net worth, compared with fewer than 1 percent of households in the highest quintile (see Chart 4).

Table 1

Between 1989 and 2004, Median Net Worth Grew for Almost All Income Groups, But High-Income Households Have Far Greater Wealth		
Income Quintile	Median Net Worth	
	1989	2004
Lowest (<\$18,900)	\$2,756	\$7,420
Second lowest (\$18,900–\$33,899)	\$36,358	\$33,800
Middle (\$33,900–\$53,599)	\$60,241	\$73,400
Second highest (\$53,600–\$89,299)	\$99,986	\$159,800
Highest (>\$89,299)	\$309,193	\$503,700

Note: Figures are in 2004 dollars.
Source: Federal Reserve 2004 Survey of Consumer Finances

Chart 4



Barriers to Asset Building for Low- and Moderate-Income Households

There is a seemingly straightforward reason why lower-income households save less—basic necessities such as food, clothing, and shelter consume most, if not all or more, of their available income. Indeed, the median balance in checking, savings, and money market accounts for households in the lowest income quintile was only \$600.⁴ Most of these funds would likely be used for day-to-day expenses, with little left for building emergency funds or long-term planning. In addition, other, perhaps less obvious, barriers to saving for lower-income households remain.

The Wage Gap

A growing wage gap has diminished the already limited ability of LMI households to save. A recent study on income inequality, using data from the U.S. Census Bureau's Current Population Survey, found that the average income of the lowest quintile of households grew by only \$2,660 (inflation adjusted) during a two-decade period from the early 1980s through the early 2000s. In contrast, average income of the highest-income households, or the top 20 percent, increased by \$45,100 during this period.⁵ By 2005, the wealthiest 1 percent of Americans earned 21.2 percent of all income earned, while the bottom 50 percent earned 12.8 percent of all income.⁶

⁴ Federal Reserve Survey of Consumer Finances, 2004.

⁵ Jared Bernstein, Elizabeth McNichol, and Karen Lyons, January 2006, *Pulling Apart: A State-by-State Analysis of Income Trends*, 12, Washington, DC: Center on Budget and Policy Priorities and the Economic Policy Institution.

⁶ "Income-Inequality Gap Widens," *Wall Street Journal*, October 12, 2007.

Effect of Public Policies on Saving

Many of the major public policies directed at asset building apply mainly to middle- and upper-income households through tax subsidies that reward saving. Examples of these subsidies include tax-advantaged 401(k) retirement accounts and Section 529 education accounts, as well as deductions for mortgage interest and state and local taxes on owner-occupied homes. Since the subsidies are proportional to the household's tax bracket, poorer households that pay few or no taxes receive little or no benefit.

For example, a government study estimates that more than 55 percent of the dollar value of the mortgage interest deduction accrues to households with incomes above \$100,000, while 46 percent of homeowners who pay mortgage interest receive no deduction benefit.⁷ Even the Credit for Qualified Retirement Savings Contribution, which was designed to encourage saving among LMI households, is limited to those with positive tax liabilities.⁸

In addition, some public policies can have unintended consequences for LMI households. Short-term poverty alleviation programs, such as the Temporary Assistance for Needy Families and food stamp programs, are sometimes "means-tested," meaning that households may only participate subject to asset-holding limits. Consequently, participants risk having their benefits eliminated or reduced if they build assets.

Limited Credit Alternatives

Access to reasonably priced credit is another obstacle to wealth building for lower-income households. Often, LMI households do not qualify for, or are unaware of, mainstream credit products, and they may turn to alternative financial services (AFS) providers when unforeseen expenses arise. Although AFS providers, including payday lenders, pawnshops, and car title lenders, provide needed credit, it can be very costly. In some cases, use of their products may contribute to a continuous cycle of debt if borrowers rely on them too heavily. For example, payday lenders typically charge annual percentage rates (APRs) of about 391 percent or more for

⁷ The President's Advisory Panel on Federal Tax Reform, *Simple, Fair, and Pro-Growth: Proposals to Fix America's Tax System*, November 2005. Data are as of 2002.

⁸ The Credit for Qualified Retirement Savings Contribution offers a tax credit for lower-income taxpayers who make contributions to existing retirement plans, such as employer-based 401(k) plans or Individual Retirement Accounts. For married, joint filer households, the maximum adjusted gross income to claim this credit is \$52,000.

small, very short-term, emergency loans. At these rates, the borrower will owe more in fees than the original cash advance if the loan is rolled over only a few times.⁹

Some banks also provide costly credit products, such as credit cards with high rates or fees, for those with impaired or limited credit histories. In addition, a number of banks provide fee-based overdraft protection—sometimes referred to as “bounce protection”—which imposes a fee for each overdrawn item. Per-item fees for this protection can be \$30 or more.¹⁰ Occasional use of fee-based bounce protection can help customers avoid overdrawing their accounts and incurring late fees on their bills. However, like payday loans, overuse of these programs can result in fees that exceed the amount of the overdrafts.

Why Banks Should Encourage Asset Building among Low- and Moderate-Income Consumers

On the surface, it may seem that banks have little financial incentive to build deposit relationships with LMI households. Although LMI deposit accounts can be used as a funding source, the profitability of these accounts is hampered by the costs of acquiring and servicing them and the limited ability of LMI consumers to build large account balances.

Because of the competitive nature of banking, banks do not publicly release much information regarding the profitability of specific products or relationships. However, one study reports that upfront fees for developing, marketing, and opening low-cost accounts for unbanked federal benefit recipients are in the range of \$27.60 to \$38.60 per account.¹¹ Yet the maximum fee banks may charge on these accounts is \$3.00 per month. Another study provides some insight into transaction costs—\$1.07 per teller window transaction, \$0.27 per automated teller machine transaction, and \$0.015 per

⁹ Payday lenders typically charge \$15 to \$20 per \$100 borrowed for two weeks; under a typical payday loan-fee scenario, \$500 is borrowed. Fees are at least \$75 for each two-week borrowing period, which translates into a 391 percent APR. At this price, it takes seven rollovers, or 14 weeks, for a consumer to owe more in fees (\$525) than the original loan.

¹⁰ The average overdraft fee climbed 3 percent in 2007 to a record high of \$28.23. See Greg McBride, “Bounced Check Fees Hit New High,” September 26, 2007, www.bankrate.com/brm/news/chk/chkstudy/20070924_bounced_check_fee_a1.asp.

¹¹ Michael Barr, *Banking the Poor: Policies to Bring Low-Income Americans into the Financial Mainstream*, Brookings Institution Research Brief, September 2004. These cost estimates assume that approximately 10,000 accounts are opened.

online banking transaction—suggesting that these costs could outstrip the benefit to the bank of what would likely be low-balance deposit accounts.¹²

In light of what would seem to be major financial barriers to pursuing deposit accounts with LMI households, it may be surprising to learn that banks are already serving, to some degree, large numbers of lower-income households. For example, while few banks target the very poorest households as customers, in a 2002 survey, banks reported that one-third to one-half of their customers earned between \$10,000 and \$49,900.¹³

A more recent study of check-cashing customers by the Center for Financial Services Innovation (CFSI) showed that the majority of these individuals already have relationships with banks. Indeed, 60 percent of those surveyed have checking accounts, 45 percent have savings accounts, and 27 percent have loan balances.¹⁴ Roughly 75 percent indicated that they used both check cashers and mainstream financial institutions (banks or credit unions) concurrently or at various times, compared with about 24 percent who use only check cashers.¹⁵

Perhaps most interesting for banks, the survey also indicated that a large percentage of respondents (both those who already have bank accounts and those who rely exclusively on check cashers) wish to increase the number of financial products they have with mainstream financial institutions (see Chart 5). Even among consumers who exclusively use check cashers rather than banks, almost 60 percent said they were “very open” to having a relationship with a bank. This is consistent with previous findings that LMI individuals in general can and do save, and wish to increase their saving and asset-building activities.¹⁶

¹² Steven Davidson, “Reaching out with Technology: Connecting the Low-Income Population to the Financial Mainstream,” Fannie Mae Foundation *Building Blocks* 3, no. 2 (Fall 2002).

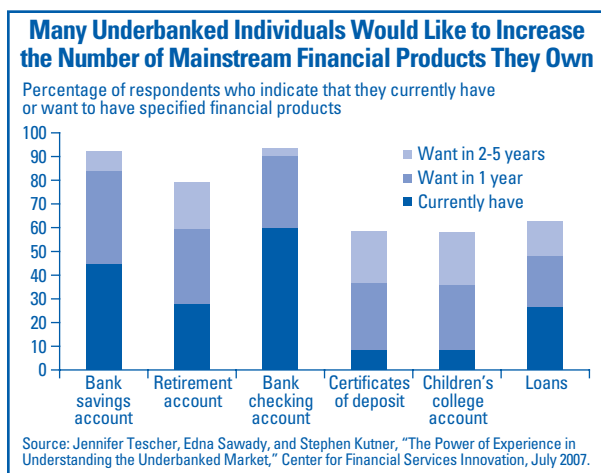
¹³ American Bankers Association, *American Bankers Association Retail Banking Survey Report*, Washington, DC, 2003.

¹⁴ Jennifer Tescher, Edna Sawady, and Stephen Kutner, *The Power of Experience in Understanding the Underbanked Market*, Chicago: Center For Financial Services Innovation, July 2007. The study surveyed the check-cashing and banking habits of 760 people from 24 urban markets earning between \$15,000 and \$50,000 a year. The average income was \$31,000. To participate in the study, respondents had to have cashed a check at a traditional check-cashing store or other nonbank company in the past six months, and at least one of the checks cashed had to be a payroll or government check.

¹⁵ Ibid.

¹⁶ Ellen Seidman, Moez Hababou, and Jennifer Kramer, *A Financial Services Survey of Low- and Moderate-Income Households*, Chicago: Center for Financial Services Innovation, July 2005.

Chart 5



There is no single explanation for why customers of check-cashing services, particularly those who already have relationships with banks, so regularly turn to alternatives to mainstream financial institutions. Some may not qualify for a checking account because they cannot meet minimum balances, or perhaps they have had difficulty managing an account in the past. Check-cashing customers in the CFSI study cited the price and convenience of check cashers, negative past experiences with banks, respectful treatment, and good-quality products and services as reasons for patronizing check cashers instead of banks.¹⁷

From a bank perspective, the sheer size of the market presents a strong incentive to capture some of the transaction volume flowing through check-cashing outlets. According to the Financial Services Center of America (FiSCA), a national trade group representing 5,000 financial service centers, check-cashing companies process 180 million checks annually at a face value of \$55 billion.¹⁸

One recent report indicated that LMI households pay more than \$8 billion in fees to nonbank check cashers and short-term loan providers.¹⁹ This finding suggests significant possibilities for banks to develop successful long-term relationships with LMI consumers. For check-cashing customers who already have deposit accounts, the bank's customer acquisition costs are

¹⁷ Tescher et al., *The Power of Experience*.

¹⁸ Data are from 2006/2007, according to FiSCA's website at www.fisca.org (accessed January 7, 2008).

¹⁹ Matt Fellowes and Mia Mabanta, *Banking on Wealth: America's New Retail Banking Infrastructure and Its Wealth-Building Potential*, Brookings Metropolitan Policy Program, Washington, DC, January 2008.

already "sunk," so the challenge is to transition these customers into profitable relationships and products that also enable them to build assets.

In addition to using deposit accounts as a strategy for gaining and strengthening business with LMI households, banks have a strong incentive to serve LMI consumers as part of their obligations under the Community Reinvestment Act (CRA). Banks that provide low-cost saving-related products or services that are responsive to the needs of the community, including LMI neighborhoods and individuals, may receive favorable consideration under the CRA.²⁰ More generally, banks recognize that helping to improve the financial well-being of individuals can result in a stronger, more stable local economy, thereby creating additional business opportunities for the institution over the long term.

Bank Strategies That Promote Asset Building

An increasing number of banks are beginning to view LMI households as a long-term business opportunity and are recognizing that asset-building programs can play an important part in engaging these consumers. While strategies vary, most banks realize that, like upper-income households, LMI families are not monolithic in terms of their needs, wants, financial awareness, and capabilities. To be successful, banks must determine the needs of their local market and tailor their product offerings accordingly.²¹ While many banks use multiple approaches and platforms, the following are some strategies that banks have used in developing asset-building programs for LMI consumers.

²⁰ For banks examined subject to large bank procedures, positive consideration may be available under the service test (12 CFR 345.12(i) & 345.24) and potentially also the investment test (12 CFR 345.12(t) and 345.23). Likewise, intermediate small banks may receive positive consideration (12 CFR 345.26 (c)). Small banks seeking an outstanding rating may also receive positive consideration for certain activities (Appendix A to 12 CFR 345 (d) (3) (ii) (B)).

²¹ Several research initiatives are under way that may help banks understand, segment, and market products to unbanked and underbanked consumers, many of whom are also LMI households. For example, the FDIC is working with the U.S. Census Bureau to explore the feasibility of conducting a survey of U.S. households in 2009 to estimate the percentage of the population that is unbanked or underbanked. The FDIC is also surveying banks about their interactions with these consumers and conducting a case study to highlight innovative practices that banks have used to bring underserved consumers into the financial mainstream.

Do No Harm. Banks that are successful in attracting and expanding relationships with LMI households appear to use a fairly straightforward strategy—they provide reasonably priced products and services. In other words, these banks have found that the best way to help customers save is by not overcharging them. Of course, most banks strive to ensure that all of their products and services are fairly priced. Nevertheless, high-cost bank products have been criticized for hampering peoples' ability to build assets.

One example is fee-based bounce protection (see page 26), particularly when it is paired with “free” checking accounts that have no minimum balance requirement. According to one analyst, “They [banks] are able to make money on this once-unprofitable segment by imposing hefty fees for overdrawing. Customers rarely consider these fees when opening an account, and the low-balance segment has a much higher frequency of non-sufficient fund incidents than others.”²² “Free” checking tied to fee-based bounce protection can be a profitable approach in the short term. However, as another analyst pointed out, the high, and sometimes unexpected, fees “provoked customer dissatisfaction,” which strains, and often ends, customer relationships.²³

Many banks offer lower-priced alternatives to fee-based bounce protection, such as “account linking,” which, for a small fee, automatically transfers funds from savings accounts or credit cards to checking accounts in the case of overdrafts. Another popular alternative is an overdraft line of credit tied to a checking account. For example, Citibank, N.A. offers the *Checking Plus* overdraft line of credit to all qualified checking account customers for a maximum \$5 annual fee and a variable APR currently at 19 percent in most states.²⁴ Another product specifically targeted to LMI consumers, or those who have difficulty balancing accounts, is a low-fee debit or stored-value card that helps prevent overdrafts by declining purchases that exceed the account balance.

Direct Deposit. A checking account is often considered the basic service for entry into mainstream banking.

Checking, particularly when paired with direct deposit of payroll or other steady income streams, is considered “sticky” in that its convenience tends to anchor the customer to the bank. The ability to split direct deposits among accounts is a simple and effective asset-building strategy, particularly for LMI customers who may be able to save only a small portion of their paycheck.

There is considerable potential for banks to increase customer relationships simply by promoting and expanding direct deposit programs. According to the CFSI study, two-thirds of checks cashed at nonbank outlets were payroll checks, and another 18 percent were state or federal benefits checks.

Many banks encourage direct deposit when accounts are first opened and may offer special pricing as part of their marketing efforts. For example, Apple Bank for Savings in New York offers *Apple Edge*, a workplace banking program that provides employees of participating employers with either advantaged pricing or waivers on minimum account balances if they use direct deposit for their paychecks. As of September 2007, more than 450 employers were enrolled in the *Apple Edge* program, which has generated more than 10,000 deposit accounts, many from households employed in traditionally lower-income professions and located in LMI communities.²⁵

Providing Nonaccount Services. The most common nonaccount service that banks provide to LMI households is free or low-fee financial education classes. These classes, often conducted on bank premises, allow bank staff to connect with potential new customers in a number of ways.²⁶ For instance, some institutions have offered LMI customers fee-based transactional services—such as remittance services, check cashing, and bill payment—without requiring the customer to have an account at the bank. The fees are generally competitive with, or better than, those at check-cashing outlets. The goal is to familiarize customers with mainstream banking and, over time, create more profitable banking relationships.

KeyBank in Cleveland, Ohio—with about one-quarter of its branch network located in LMI neighborhoods—

²² Somesh Khanna, David Schoeman, and Jack Stephenson, Profitability Under Pressure, *BAI Banking Strategies* (LXXIX:II) March/April 2003.

²³ Rick Spiler, “The New Survival Skills,” *ABA Banking Journal*, American Bankers Association, February 2005.

²⁴ Derived from Citibank N.A.'s Web site at www.citibank.com (accessed January 14, 2008). The APR in New York is 19.5 percent. Specific banks mentioned in this article are used only as examples. The FDIC and the authors do not endorse any particular bank or product.

²⁵ Information regarding *Apple Edge* was obtained from Apple Bank for Savings' publicly disclosed CRA Performance Evaluation from November 13, 2007.

²⁶ For more information regarding the effectiveness of financial education provided by banks, see Susan Burhouse, Angelisa Harris, and Luke Reynolds, “Banking on Financial Education,” *FDIC Quarterly* 1, no. 2 (2007): 33–42.”

has been experimenting with fee-based check cashing and other transactional services under a program called *KeyBank Plus*. The goal of the program is to transition at least 30 percent of check-cashing clients to other accounts and services. Although KeyBank has reported that the program is not yet profitable, bank managers recognize that it takes a long-term approach to change consumer behaviors and perceptions about mainstream banking.²⁷

Partnering with Other Organizations. Promoting saving through partnerships is another popular strategy banks use to build relationships with LMI households. A number of government agencies, nonprofits, faith-based organizations, schools, and philanthropic groups offer financial outreach programs for lower-income families. By partnering with these groups, banks create goodwill within their community while also gaining LMI customers.

For example, *America Saves* is a national social marketing campaign launched in 2001 that encourages people, particularly in LMI households, to save. More than 1,000 organizations are involved in *America Saves*, including more than 500 banks and credit unions that provide no- or low-fee savings accounts to LMI households. To date, *America Saves* has enlisted more than 90,000 people.²⁸

In addition, the FDIC's Alliance for Economic Inclusion (AEI) has established broad-based coalitions of financial institutions, community-based organizations, and other partners in several markets across the country to bring more households into the financial mainstream.²⁹ One of the many programs under the AEI is *Bank on California*, a partnership among the California governor's office, financial institutions, mayors, and community groups to market starter accounts for underserved consumers. Overall, as of year-end 2007, more than 700 banks and other organizations have joined the AEI nationwide, and almost 29,000 new bank accounts have been opened.

Individual development accounts (IDAs) are a relatively low-risk way for banks to partner with nonprofits

and other organizations to introduce LMI consumers to mainstream banking through a savings account. Introduced in 1996, IDAs provide matched savings for lower-income families who are trying to purchase an asset, usually a home, small business, or postsecondary education. About 240 banks, usually working through community groups and nonprofit sponsors, participate in the approximately 540 IDA programs operating across the United States.³⁰

Another way banks promote saving through partnerships is with school-based bank branches that establish savings accounts for students. These programs, which can also expose other family members to the benefits of having a bank account, are particularly beneficial to immigrant families, who may face language barriers or who are unfamiliar with or distrustful of banking institutions in their home countries. For example, Mitchell Bank, an \$81 million bank in Milwaukee, operates a high school bank branch primarily to reach Mexican immigrant youth.

Leveraging Tax Refunds. Tax season is one of the best times to reach out to LMI consumers. Annually, the Internal Revenue Service (IRS) processes refunds averaging \$2,100 each for more than 100 million taxpayers, many of whom are LMI consumers who receive the Earned Income Tax Credit.³¹ H&R Block Bank (a subsidiary of H&R Block, Inc., the country's largest tax preparer) offered several new wealth accumulation accounts during the 2006 tax season, including the *Emerald Savings Account* and the *Easy Individual Retirement Account* (IRA). Both accounts have no minimum balance requirements and feature competitive yields. H&R Block Bank in Kansas City also piloted a small program offering savings bonds purchased with tax refunds; 6 percent (220 of 3,729) of tax preparation clients who were offered this opportunity purchased the savings bonds.³²

²⁷ Ann Carrns, "Banks Court a New Client: The Low-Income Earner," *Wall Street Journal*, March 16, 2007.

²⁸ Information regarding *America Saves* was derived from www.americasaves.org (accessed February 11, 2008).

²⁹ The AEI markets are the semirural area of Alabama; Greater Boston/Worcester, Massachusetts; Chicago; Austin/South Texas; the Kansas City metropolitan area; Louisiana and the Mississippi Gulf Coast; Baltimore; Wilmington, Delaware; and Los Angeles. For more information regarding the FDIC's Alliance for Economic Inclusion, see www.fdic.gov/consumers/community/AEI.

³⁰ For more information regarding IDAs, see Rae-Ann Miller and Susan Burhouse, "Individual Development Accounts and Banks: A Solid 'Match,'" *FDIC Quarterly* 1, no. 1 (2007): 22–31. As described in this article, the Saving for Working Families Act, which was reintroduced in March 2007, includes a proposal to provide up to \$1.2 billion in tax credits to allow banks to offset part of the cost of opening and maintaining IDAs.

³¹ Anne Stuhldreher (New America Foundation) and Jennifer Tescher (Center for Financial Services Innovation), *Breaking the Savings Barrier: How the Federal Government Can Build an Inclusive Financial System*, New America Foundation, Asset Building Program, February 2005.

³² Nick Maynard, "Tax Time Savings: Testing U.S. Savings Bonds at H&R Block Tax Sites," D2D Fund, June 2007, www.d2dfund.org/downloads/block_bond_paper_061907.pdf (accessed March 5, 2008).

A number of banks also participate in the *Volunteer Income Tax Assistance* (VITA) program, which provides free tax-preparation services for LMI taxpayers. VITA gives banks an opportunity to open new accounts for these taxpayers to facilitate direct deposit of tax refunds. Opening a bank account may be even more attractive when taxpayers file their 2007 tax returns. Under new IRS rules, taxpayers can now split their refunds among three accounts, allowing at least a portion of the refund to be earmarked for savings.

Linking Credit and Other Products to Saving. Cash back, airline miles, and other rewards programs tied to credit cards have been available for many years. For example, the *One* card from American Express links a 1 percent rebate on all purchases to a high-yield savings account at American Express Bank.³³ In practice, most of the rewards programs tied to credit cards are largely limited to qualifying middle- and upper-income households.

However, Bank of America's *Keep the Change* program is one example of a saving-linked product that is more broadly available to LMI households and others. *Keep the Change* rounds up debit card purchases to the next dollar and sweeps the difference into a savings account. The bank also partially matches the customer's annual saving through the program. Bank statistics as of November 2007 show that 6.5 million customers have saved more than \$620 million through *Keep the Change*.³⁴ Wachovia Bank is also experimenting with a new saving-linked product, *Way2Save*, whereby a customer links a savings account to a checking account and receives \$1 for every debit card purchase, automatic debit transaction, or online bill payment.³⁵

A number of banks also provide "credit builder" products, in which all or a portion of an installment loan is placed in a certificate of deposit or savings account. When the loan is repaid, the consumer receives the account balance plus the interest earned. These products enable customers with no credit history, or with a challenged credit history, to positively affect their credit score over the life of the loan. Most banks that

offer this product strongly encourage customers to retain at least some funds in the account.

While the credit builder product is useful for consumers who wish to build or repair credit, it does not address LMI consumers who need access to reasonably priced credit for an emergency or other necessity. To address this need, a growing number of banks have found ways to offer reasonably priced small loans to their customers in a safe and sound manner that is also profitable for the bank. To encourage state nonmember banks to offer these types of products, the FDIC Board of Directors issued Affordable Small Dollar Loan Guidelines on June 19, 2007.³⁶ These guidelines explore several aspects of product development, including affordability parameters and streamlined underwriting. The guidelines also discuss tools such as financial education and linked savings accounts that may address long-term financial challenges for borrowers.

In addition, on June 19, 2007, the FDIC Board approved a two-year pilot project to demonstrate the value to banks of offering reasonably priced small-dollar lending programs. The pilot, known as the Affordable and Responsible Consumer Credit (ARC) initiative, involves 31 banks and will operate through mid-2010. While the components of small-dollar loans vary among participating banks, these loans generally feature streamlined underwriting, reasonable amortization periods, and APRs below 36 percent. Most also have a saving component, whereby banks offer borrowers the ability to set aside a portion of the amount borrowed, or a portion of each payment, in a savings account. The FDIC intends to follow the participating banks closely and periodically report on the results of the ARC initiative.³⁷

Conclusion

Although LMI households earn less and hold fewer assets, these consumers conduct a significant volume of financial transactions each year. Moreover, many banks already have a relationship with LMI households and are well-positioned to expand these relationships through asset-building products and strategies. Banks that are most successful take a long-

³³ Information on the *One* card was obtained from www.americanexpress.com (accessed January 24, 2008).

³⁴ Information on *Keep the Change* was obtained from www.bankofamerica.com (accessed January 8, 2008).

³⁵ Jane J. Kim, "Banks Offer Bonuses to Lure Deposits to Saving Accounts," *Wall Street Journal*, January 16, 2008.

³⁶ FDIC's Affordable Small Dollar Loan Guidelines can be found at www.fdic.gov/news/news/press/2007/pr07052a.html.

³⁷ See www.fdic.gov/small-dollarloans/ for information on the ARC initiative.

Factors That Determine the U.S. Household Saving Rate

Put simply, the U.S. household saving rate (shown in Chart 1 on page 23) is personal disposable income minus consumption expenditures and nonmortgage interest and transfer payments. However, some have argued that the way this ratio is calculated minimizes its usefulness as a true measure of saving.

For example, saving data do not uniformly reflect changes in the value of financial assets, such as homes, stocks and bonds, or private pensions. That is, capital gains on financial assets, whether they are realized or not, are not included in the household saving data, but taxes paid on capital gains realized are included in the expense portion of the calculation, which reduces the saving rate. Similarly, discretionary extraction of home equity does not count as income, but the portion spent outright counts as consumption expenditures and thus reduces the saving rate.

The omission of financial assets from the calculation has a more pronounced effect on the saving rate than in the past because these assets currently comprise a relatively larger portion of household balance sheets. For example, from the mid-1970s through the early 1990s, pension fund reserves, mutual fund shares, and corporate equities together accounted for less than 20 percent of all household assets. In fourth quarter 2007, the combined share stood at 32.3 percent, which, while below the peak of 45 percent reached in early 2001, is higher than levels seen in past decades.^a Also, tangible assets, including the value of homes, now represent a larger share of total asset holdings (37.1 percent in fourth quarter 2007) than they had during much of the 1990s and early 2000s.^b

Aside from concerns surrounding the calculation of the U.S. saving rate, a change in attitudes about saving,

shifting demographics, trends in retirement planning, and widespread access to credit could also explain some of the decline in the traditional saving rate. Near the end of World War II and continuing into the 1960s, the United States experienced a baby boom. The baby-boom generation now represents a larger portion of the U.S. population than any other generation. The retirement of this generation means that an increasing portion of the population is in retirement and spending down their previous saving, while a decreasing portion of the population is still working.

Among the working population, defined benefit plans—or traditional pensions—have been virtually phased out in favor of defined contribution plans, such as 401(k) plans. These plans place the responsibility for retirement saving on the individual. While many individuals choose to save in these tax-advantaged plans, participants have more discretion to decide how much to invest. In contrast, the contribution to defined benefit plans was set and mandatory.

According to the Federal Reserve's 2004 Survey of Consumer Finances, 45 percent of individuals cited retirement as a reason for saving, compared to 23 percent in 1989. There has also been a corresponding drop in emergency spending as a reason for saving (33 percent in 1989 compared with 29 percent in 2004). Long periods of economic prosperity may have led some individuals to believe that precautionary saving is less necessary.

The change in the perceived need for precautionary saving has been reinforced by increased access to low-cost credit among middle- and upper-income consumers. Today, credit cards, home equity lines of credit, and other forms of consumer loans are readily available to cover unanticipated expenses without tapping precautionary saving.

^a Federal Reserve Flow of Funds.

^b Ibid.

term approach and tailor products and services to their local market. Some successful strategies include “doing no harm” by offering reasonably priced products and services to LMI consumers, expanding direct deposit options, partnering with outside organizations to obtain motivated customers, leveraging tax refunds into saving, and linking saving to credit and other bank products. Going forward, there will continue to be considerable public debate and numerous policy proposals to expand asset-building opportunities for all households.

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Feature Article:

Increasing Deposit Insurance Coverage for Municipalities and Other Units of General Government: Results of the 2006 FDIC Study

Foreword

The Federal Deposit Insurance Reform Conforming Amendments Act of 2005 (FDIRCAA) required that the Federal Deposit Insurance Corporation (FDIC) study the feasibility and consequences of privatizing deposit insurance, establishing a voluntary deposit insurance system for deposits in excess of the maximum amount of FDIC insurance, and increasing the limit on deposit insurance coverage for municipalities and other units of general government. In February 2007, the FDIC sent its report to Congress. The results of the FDIC's findings on privatizing deposit insurance and establishing a voluntary deposit insurance system for excess deposits appeared in previous issues of the **FDIC Quarterly** (available at www.fdic.gov/bank/analytical/quarterly/index.html).¹ This article summarizes the FDIC's findings on providing additional coverage for municipal and other public deposits.

Introduction

Industry consolidation, globalization, the expanding use of technology, and other changes in the banking industry have dramatically altered the financial landscape. Accordingly, in March 2000, the FDIC began a comprehensive review of the deposit insurance system to ensure that it would continue to meet its responsibilities as deposit insurer in this new banking environment. Additional coverage for municipal deposits was one of many issues to emerge during this review, and the FDIRCAA required the FDIC to study the issue further. This article examines the findings from the FDIRCAA study, including the arguments for and against additional coverage for municipal deposits. It then considers whether options that are currently available in the private sector provide a viable alternative to traditional public deposit collateralization programs.

¹ Christine Bradley and Valentine V. Craig, "Privatizing Deposit Insurance: Results of the 2006 FDIC Study," *FDIC Quarterly* 1, no. 2 (2007): 23–32, and Bradley and Craig, "Establishing Voluntary Excess Deposit Insurance: Results of the 2006 FDIC Study," *FDIC Quarterly* 1, no. 3 (2007): 30–35.

Background

Municipal, or public, deposits are the funds of a state, county, municipal, or political subdivision that are held as deposits in an FDIC-insured institution.² Municipal deposits held in the same state as the public entity are insured up to \$200,000 (\$100,000 in time and savings accounts, and \$100,000 in demand deposits) in any one depository. Out-of-state public deposits are insured up to \$100,000.³ To limit the risk to public entities and, ultimately, local taxpayers, most state laws require banks to collateralize public deposits, typically with high-quality government securities, to the extent that they are not covered by federal deposit insurance (see Text Box on page 36.) At the end of 2006, state and local governments had \$2.4 trillion in financial assets.⁴ Of this amount, FDIC-insured commercial banks held \$289.7 billion, of which almost 76 percent (\$219.3 billion) was uninsured and secured.

Throughout the 1990s and into the next decade, depository institutions faced new funding challenges as asset growth outstripped the growth of core deposits. It was against this backdrop that FDIC-insured institutions began to look more closely at municipal deposits as a potential source of liquidity.⁵ Between 2000 and 2005, several bills were introduced in Congress that would have increased coverage of municipal deposits. A number of the bills recommended that the FDIC insure 80 percent of in-state municipal deposits above

² Public deposits also include deposits of Puerto Rico and other U.S. possessions and territories, and deposits of Indian tribes. 12 C.F.R. § 330.15(a)(2)-(5)(2007).

³ 12 C.F.R. §330.15(a)(2) (2007). Insurance coverage for municipal deposits, as for general deposits, may be adjusted for inflation beginning January 1, 2011. Federal Deposit Insurance Reform Act of 2005, Pub. L. No. 109–171, § 2101–2109, § 2103, 120 Stat. 4, 9–11 (2006) (to be codified at 12 U.S.C. § 1821(a)(1)(F)).

⁴ Board of Governors of the Federal Reserve System, *Flow of Funds Accounts of the United States*, December 6, 2007, www.federalreserve.gov/releases/z1/Current/z1.pdf (accessed January 3, 2008), p. 66.

⁵ Christine M. Bradley and Lynn Shibus, "The Liability Structure of FDIC-Insured Institutions: Changes and Implications," *FDIC Banking Review* 18, no. 2 (2006): 1–37.

the basic insurance coverage limit, up to a maximum of \$2 million. Other legislative measures suggested that the maximum coverage for in-state municipal deposits be raised to \$5 million or that the FDIC provide 100 percent coverage of all municipal deposits, regardless of size. In August 2000, the FDIC evaluated various reform options, including additional coverage for municipal and other public deposits, but did not take an official position.⁶ In 2003, then FDIC Chairman Donald E. Powell commented on one legislative proposal to increase coverage for municipalities:

Raising the coverage level on public deposits could provide banks with more latitude to invest in other assets, including loans. Higher coverage levels might also help community banks compete for public deposits and reduce administrative costs associated with securing these deposits. On the other hand, the collateralization requirement places a limit on the ability of riskier institutions to attract public funds, while a high deposit insurance limit would not. Traditionally, we [the FDIC] have taken a dim view of treating one class of deposits—in this case, municipals—dramatically differently than the others, and we have communicated that concern to Capitol Hill.⁷

While Chairman Powell expressed reservations about raising the limit on municipal deposit insurance, proponents of excess deposit insurance presented a number of reasons for increasing the coverage amount.

Arguments for Increasing Municipal Deposit Coverage

Early proponents of excess deposit insurance for municipalities argued that increased coverage would allow municipal deposits to remain in local institutions, where they would be used to meet local needs.⁸ In recent years, other arguments have emerged. Propo-

nents contend that increased municipal deposit coverage would make bank operations more efficient and less costly, provide a higher degree of safety and additional protection for taxpayers, and permit smaller institutions to compete more effectively for these deposits.

Bank Costs. Increasing municipal deposit insurance coverage would benefit insured institutions by lowering bank costs. State collateralization laws that require banks to secure municipal deposits with low-risk, low-yield investments impose opportunity costs by preventing participating institutions from investing in higher-yielding assets. It is estimated that collateralization typically costs 15 to 25 basis points in yield on the assets used to collateralize the deposits.⁹

Safety of Public Deposits. Increasing municipal deposit insurance coverage would provide a higher degree of safety for public deposits. For collateralization to safeguard public deposits, the collateral must be adequate and the security agreement enforceable. In situations involving bank fraud, collateral may be missing or otherwise unavailable if an insured institution fails. The failure of Oakwood Deposit Bank in February 2002 illustrates this risk. When the Ohio bank failed, some municipal depositors discovered that the collateral securing their deposits was valued at significantly less than agreed, while other depositors found that the bank had pledged the same collateral multiple times. Even if there is no malfeasance, the market value of the collateral may have deteriorated at the time of the failure.

Proponents of additional coverage for municipal deposits argue that because these deposits primarily consist of taxpayer funds, increasing the coverage limits would reduce local government exposure to a bank's credit risk and, ultimately, provide additional protection to taxpayers.

Competition for Municipal Deposits. Increased insurance coverage for municipal deposits may allow smaller institutions to compete more effectively for these deposits without having to pay higher interest rates. However, recent data suggest that smaller institutions are already attracting these deposits. As of December 31, 2006, FDIC-insured institutions with less than

⁶ Federal Deposit Insurance Corporation, *Options Paper*, Washington, DC: FDIC, August 2000, www.fdic.gov/deposit/insurance/initiative/OptionPaper.html (accessed January 8, 2008).

⁷ Federal Deposit Insurance Corporation, *Reducing Regulatory Burden—Deposit Insurance Coverage*, Washington, DC, FDIC, 2003, www.fdic.gov/regulations/resources/reducing/comments/DI.html (accessed September 27, 2006).

⁸ For example, U.S. Congress, *House Report on Federal Deposit Insurance Reform Act to May 16, 2002*, 107th Cong., 2nd sess. H. Rep. 467; (2002) and U.S. Congress, *House Report on Federal Deposit Insurance Reform Act to March 27, 2003*, 108th Cong., 1st sess. H. Rep. 50 (2003).

⁹ Steve Cocheo, "You Want \$5 Million in Deposits to Be Insured?" *ABA Banking Journal* 95, no.11 (2003): 28–30.

\$1 billion in total assets held only 15.2 percent of total insured deposits but approximately 24 percent of all collateralized public deposits.

Arguments against Increasing Municipal Deposit Coverage

There are three primary arguments against increasing municipal deposit insurance coverage: (1) additional coverage is not justified on the basis of the traditional goals of deposit insurance; (2) increasing coverage for municipal deposits could adversely affect moral hazard and market discipline; and (3) excess coverage is likely to increase deposit insurance assessments.

Consistency with Traditional Goals of Deposit Insurance. The traditional goals of deposit insurance are to promote financial market stability by maintaining depositor confidence in the banking system; to protect the country's local, regional, and national economies from the disruptive effects of bank failures; and to protect the deposits of small savers.¹⁰ While there are credible arguments for increasing the insurance coverage of municipal depositors, the traditional goals for the insurance program provide little justification for such an increase. In addition, as mentioned earlier, the FDIC does not generally advocate favoring one depositor class over another.¹¹

Effect on Moral Hazard and Market Discipline.

Greater insurance coverage for public deposits could remove an aspect of market discipline that is currently in the system.¹² State and local governments are gen-

erally considered more financially sophisticated than the average small saver and better able to monitor the performance of the depository institutions they use. Increasing insurance coverage on public deposits removes the incentive for public depositors to monitor the risk behavior of their depository institutions, thus increasing moral hazard. Also, to the extent that collateral requirements no longer constrain the investment options of depository institutions to investments in "safe assets," such as Treasury securities, depository institutions have an incentive to invest in riskier assets, increasing their overall risk profile.

Effect on Deposit Insurance Assessments. FDIC-insured deposits would likely increase by at least \$277.8 billion (the total amount of uninsured, secured public deposits held by commercial banks and thrifts as of year-end 2007) if all municipal deposits were fully insured.¹³ An increase of this amount at the end of December 2007 would have reduced the reserve ratio of the Deposit Insurance Fund from 1.22 percent to 1.15 percent, potentially leading to higher assessment rates.¹⁴ The financial industry press has reported that industry support for additional coverage of municipal deposits diminished when it became apparent that deposit insurance premiums might increase as a result.¹⁵

Structuring Increased Municipal Deposit Insurance

Congressional authorization would be required for the FDIC to provide excess deposit insurance for municipalities and other general units of government. However, the FDIC has considered a number of options for structuring this additional coverage, including limiting its availability, restricting excess coverage to protect taxpayers and the insurance fund, and establishing a

¹⁰ See, for example, Christine M. Bradley, "History of Deposit Insurance," *FDIC Banking Review* (13: 2) 2000, pp. 1–25; Gail Otsuka Ayabe, "The Brokered Deposit Regulation: A Response to the FDIC's and FHLBB's Efforts to Limit Deposit Insurance," *UCLA Law Review* (33), December 1985, pp. 594–641.

¹¹ Although the FDIC supported increased coverage for retirement accounts, it did so for unique reasons. First, increasing the coverage level for retirement accounts should help increase the saving rate by encouraging depositors to invest more of their retirement savings in insured bank deposits. Second, retirement accounts are usually held for the long term and depositors are less likely to respond to higher-yield offers or other attempts by riskier banks to gather deposits quickly. This would not necessarily be the case with insured municipal deposits.

¹² See, for example, Congressional Budget Office, *Modifying Federal Deposit Insurance*, 2005, www.cbo.gov/ftpdocs/63xx/doc6342/05-09-DepositInsurance.pdf (accessed March 5, 2008).

¹³ As explained later in this article, excess coverage might be made available only on a limited basis, in which case the increase in insured deposits might be less.

¹⁴ Under the FDIC Reform Act of 2005, whenever the reserve ratio for the Deposit Insurance Fund falls below 1.15 percent (or is projected to fall below 1.15 percent within six months), the FDIC must adopt a restoration plan that provides that the reserve ratio reach 1.15 percent within five years. 12 U.S.C. § 1817(b)(3)(E) (2007).

¹⁵ See, for example, Steve Cocheo, "Community Bankers See Pluses and Minuses in FDIC Reform Plan," *ABA Banking Journal* 93, no. 6 (2001): 7–9.

premium pricing structure based on risk.¹⁶ Each option seeks to limit the FDIC's loss exposure, constrain moral hazard, and restrict the ability of riskier banks to use municipal deposits as a source of deposit gathering. State legislatures could assist in meeting these goals by amending their laws so that excess municipal deposits could be placed only in institutions that are eligible to receive increased insurance coverage.

Availability. Excess municipal deposit coverage might be made available only on a limited basis. For example, term policies could be cancelled if an institution failed to maintain the qualifying standards, or only well-capitalized institutions might be eligible to offer increased coverage. If a participating institution lost its eligibility to offer extra coverage, the insurance coverage of existing municipal deposits could revert to the amount covered under the general deposit insurance rules after some period (unless the excess coverage were allowed to continue on existing municipal deposits).¹⁷ Although a depository institution could be required to be responsible for informing public officials of any loss of coverage, this responsibility might be shifted to the FDIC to ensure that depositors received prompt and adequate notice.

Caps and Other Limits. A cap could be placed on the amount of additional coverage for a municipal depositor. In addition, the municipal depositor might share in any loss on the excess deposit. For example, insurance coverage for any municipal depositor could be limited to a maximum of \$2 million per institution, or only 80 percent of the excess deposit might be insured up to the designated cap.

Despite the appeal of a system in which municipal depositors share in any losses, such a system has the potential to contribute to a bank run in the event of financial problems, as recently occurred in the case of Northern Rock in the United Kingdom. Under the British deposit insurance system, only 90 percent of the deposit above a basic level is covered by

insurance.¹⁸ As a result, most depositors stood to lose money if Northern Rock failed, which contributed to a run on the bank when it experienced financial difficulties.¹⁹ Because deposits made by municipalities are typically quite sizable, public withdrawals during a period of financial difficulty would likely exacerbate a bank's liquidity problems. The prevention of bank runs has been one of the great successes of the U.S. deposit insurance system, and any change that might diminish the ability of this system to contain bank runs would need to be carefully considered.

Other limits could be imposed on additional insurance coverage for municipal deposits. For example, to control aggressive deposit gathering and consistent with some state requirements, increased insurance coverage could be limited to deposits from a municipality in the same state as the insured institution. Limits could also be placed on the aggregate value of the public deposits held by any one institution.

Pricing. A decision would need to be made as to whether all participating institutions would pay a uniform premium. One option might be to reduce the premiums of participating institutions based on the amount of low-risk assets held, but not pledged, as security. Another possibility would be to deduct low-risk assets from the total value of the municipal deposits assessed, which might reduce some of the administrative costs associated with a strict pledging arrangement.

Private Sector Options

There are public sector options currently available that allow depository institutions to satisfy the safety requirements of many municipal authorities without requiring collateralization or increased FDIC coverage. These options include surety bonds and deposit-placement services. (Reinsurance, which was discussed in a previous issue of the *FDIC Quarterly*, is a private sector option that could be used to limit the FDIC's exposure

¹⁶ Because of the added costs involved, we have assumed in this part of the discussion that premiums for excess municipal deposit coverage would be paid only by institutions that offered the additional coverage. However, this need not be the case. Assessments for excess deposit insurance could be structured so that all insured institutions bore the additional cost.

¹⁷ Pass-through coverage for employee benefit plans and coverage for brokered deposits do not terminate when a bank or thrift ceases to become eligible to accept them. 12 U.S.C. §§ 1821(d) and 1831f.

¹⁸ Under the British deposit insurance system, approximately the first \$4,000 is fully insured, and 90 percent of the next \$68,000 receives insurance coverage. Unlike the U.S. system, deposits held at failed British banks are not immediately available.

¹⁹ In the case of Northern Rock, the Bank of England and the British Treasury provided depositors with greater assurances than required under the law.

Current Practices in Supervising and Administering Collateral

All states currently require one of three options for the supervision and administration of collateral: uniform statewide collateralization; statewide collateral pools; or uncoordinated, autonomous collateral pledging.*

Uniform Statewide Collateralization. This model prescribes a single system of collateralization for all political subdivisions throughout the state. States that use a uniform statewide system commonly require that public deposits be fully collateralized. Local officials are typically responsible for enforcement and implementation of the collateral requirements under this system. Banks bear the full expense of establishing the custodial account and forgo the higher income they would normally earn by making loans.

Although full collateralization of public funds would appear to completely protect municipal deposits, a number of risks remain. For example, the market value of the collateral pledged by the bank may turn out to be less than the face value, making the protection inadequate. This can occur when the collateral accepted by the government entity is subject to interest rate risk, credit risk, or liquidity risk. One example is municipal bonds. These bonds, which are accepted as collateral in several states, are interest-rate sensitive and contain liquidity risk because they have a limited secondary market. A shallow secondary market can also delay recovery for the depositor. For example, mortgage-backed securities, which are accepted as collateral in some states, have recently lost market value because of their perceived credit risk. Finally, fraud can result in unexpected losses to the collateralized depositor. (Fraud is a potential risk in any of the three collateralization options.)

Statewide Collateral Pools. Some state legislatures have created statewide collateral pools. These pools are supervised by a central state agency that administers all collateral set aside by banks as security for the portion of the municipal deposits not covered by FDIC deposit insurance. For example, Florida requires that banks deposit with the state central agency acceptable securities equal to 50 percent of the deposit not covered by FDIC insurance. Statewide collateral pools reduce the costs to individual depository institutions in two ways. First, banks save the cost of individually supervising and administering the assets used as collateral. Second, because full collateralization is not required, a greater portion of an institution's assets can be invested in higher-yielding assets, such as loans. Local governments and agencies also save with this method, as a central agency manages the administration of the collateral. States typically require the collateral pool to exceed the total public deposits held by the largest institution in the state.

Uncoordinated, Autonomous Collateral Pledging. Some states permit public treasurers to obtain collateral for public funds at the treasurer's discretion. This method, called the "home rule" or permissive approach, places complete responsibility for collateralization practices with local officials. However, because of the lack of uniformity in collateralization agreements, each agreement must be separately negotiated by the depository institution and the public official. This lack of standardization results in an increased risk of error or negligence in market-monitoring processes and safekeeping procedures, as well as an increased cost to the depository institution. This increased cost is usually passed on to the municipality through deposits bearing a lower yield.

* Much of the information about the supervision and administration of collateral is derived from Corinne M. Larson, *An Introduction to Collateralizing Public Deposits*, Government Finance Officers Association, 2006.

to excess coverage of municipal deposits.²⁰ Reinsurance is not discussed further in this article.)

Surety Bonds. Most states allow municipal governments to protect their local deposits by means other than collateralization. At least 30 states allow the use of a surety bond. Surety bonds, which are issued by insurance companies, guarantee the payment of principal and interest on the covered deposits. Most states provide guidelines for insurance company eligibility. Surety bonds eliminate much of the administrative burden for both the municipality and the bank because they do not require custodial agreements, security agreements, or a continual revaluation of the collateral. In the event of a default, payment on the bond is generally made within two days. From the bank's perspective, these bonds are more economical and efficient because they do not tie up bank security, thus saving the bank administrative and opportunity costs normally associated with collateralization.

Despite their advantages, some public officials are wary of using surety bonds because the municipality must relinquish some control. For example, the municipality is not part of the contract negotiation, which is between the bank and the insurance company. Nevertheless, if proper precautions are taken, surety bonds can be a reasonable and efficient alternative to collateralization.

Deposit-Placement Services. As discussed in a previous issue of the *FDIC Quarterly*, the FDIC issued an advisory opinion in 2003 confirming that pass-through deposit insurance rules apply to funds placed with a deposit-placement service. As a result, FDIC-insured institutions that use deposit-placement services can, in effect, insure deposits in excess of the statutory limit.²¹

²⁰ Bradley and Craig, "Establishing Voluntary Excess Deposit Insurance."

²¹ *Ibid.* A bank belonging to a deposit-placement service can divide large deposits into \$100,000 increments, which it transfers to other participating institutions, resulting in full coverage of the deposit.

Currently, a depositor can obtain insurance coverage for a \$50 million deposit by using a deposit-placement service. These services can reduce the administrative costs of collateralization. They also reduce the opportunity costs incurred when the bank sets aside collateral necessary to secure municipal deposits.

Because most state laws clearly describe how public deposits must be secured, use of a deposit-placement service may require state legislative action. However, some states (for example, Missouri, Ohio, and Oregon) have amended existing laws to permit their use. Other states are allowing local governments to use deposit-placement services with certain restrictions, such as requiring municipal deposits to be kept within the state or placing a limit on the amount of the deposit.

Summary

Increased federal coverage for public deposits could benefit local communities, lower bank costs, and increase safety for taxpayers. However, additional municipal deposit insurance would represent a departure from the traditional goals of deposit insurance and would likely increase both moral hazard and deposit insurance assessments. Credible private sector options, in the form of surety bonds and deposit-placement services, currently offer protection for municipal deposits. If federal deposit insurance coverage were to be increased on municipal deposits, concerns about increased exposure to the Deposit Insurance Fund, moral hazard, and appropriate pricing of such coverage would need to be addressed.

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