Remarks by
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Good morning and Happy New Year, everyone. It is a pleasure to be with you today. I would like to use our time together to hear from you as well. Before I take your questions, which I am sure will have me looking ahead to the changes we both will have to navigate in 2007, I would like to take a quick look back at what was truly a whirlwind 2006. It is hard for me to believe that it has only been seven months since I became Chairman of the FDIC as I recall the issues that we confronted and made progress on during the year.

Deposit Insurance Reform

In many ways, 2006 was dominated by the implementation of the Deposit Insurance Reform Act. Congress gave the FDIC just 270 days to complete the final rulemaking, which we accomplished on November 2. The new law provided for a comprehensive overhaul of the deposit insurance system, including the merger of the bank and thrift insurance funds, an increase in coverage for retirement accounts, an award of $4.7 billion of assessment credits to recognize the contributions that established institutions made to build the insurance funds, and a method for charging risk-based deposit insurance premiums.

The new rule will enable the FDIC to more closely tie each bank's premiums to the risk it poses to the deposit insurance fund. The FDIC will evaluate each institution's risk based on three primary sources of information — supervisory ratings for all insured institutions, financial ratios for most institutions, and long-term debt issuer ratings for large institutions that have them. The ability to differentiate on the basis of risk will improve incentives for effective risk management and will reduce the extent to which safer banks subsidize riskier ones.

The Board also established a base rate schedule and approved a somewhat higher rate schedule that will take effect at the beginning of 2007. The rates for well-capitalized and well-run institutions will be between five and seven cents per $100 of assessable deposits. Based on recent data, we estimate that about 40 percent of institutions would initially be charged the minimum five cent rate.

Institutions will see the effect of the new rates on their June 2007 invoices. I know bankers are not looking forward to paying something for deposit insurance after years of receiving this benefit for free. However, it is important to keep in mind that even without the new law, all institutions would have been assessed premiums next year because the

reserve ratio is already below the 1.25 percent reserve ratio target. What would have been different is that without the reform law, institutions would not have received credits for their past contributions to offset these rates.

Congress intended the fund to grow in good economic times so that it could withstand periods of financial stress without the need to raise premium rates sharply. Keeping the fund strong now, when industry conditions are favorable, will help ensure that assessment rates remain stable and moderate over the longer term.

Capital Reform

It would have been a very busy year if deposit insurance reform implementation was the only thing we worked on, but as you know, it was not. The FDIC continued to be active in the implementation of Basel II, with the Board voting in early September to publish the proposed rule for public comment.

I encourage you, as community bankers, not to dismiss Basel II as simply a large bank issue. Basel II banks would most likely face lower risk-based capital requirements in all the major asset categories in which community banks are most active. We are concerned about the effect this could have on community banks. The U.S. financial system benefits from a balance between large complex banks, regionally focused banks and community banks. Community banks are integral to their local economies and to the customers they serve – individuals and businesses alike. Our capital framework should not place community banks at a competitive disadvantage.

We address these issues first by including a number of essential safeguards in the Basel II proposal to mitigate capital reductions. Second, in conjunction with Basel II, we are developing a more risk sensitive capital framework for non-Basel II banks. The Basel I-A proposal has also been published for comment. I hope you will take the time evaluate both the Basel II and the Basel I-A proposals and add your thoughts to the debate. The comment period for both proposals is open until March 26.

Affordable Small Dollar Lending

Another initiative I want to tell you about – and ask for your help on – is making the mainstream financial system available to more consumers and promoting economic inclusion. In 2006, the FDIC took two very important steps in this area – focusing attention on the need for affordable small-dollar loan products and creating the Advisory Committee on Economic Inclusion.

In early December, the FDIC hosted a conference to highlight a serious gap in consumer lending – the shortage of responsibly priced small-dollar loans. The conference focused specifically on meeting the needs of military personnel and their families, who are frequently turning to high-cost providers for short-term loans and other financial services. Our conference was especially timely, given the recent passage of the Talent/Nelson amendment restricting interest rates on loans to military personnel

and their dependents. The FDIC worked with the Association of Military Banks of America and contacted more than 125 banks located near military bases. The banks that attended our conference shared ideas and developed a template for an affordable, small denomination loan product, with a savings component. I hope that the concepts and prototypes we discussed at our conference can be expanded and more broadly adopted by the banking industry. It is clear that many consumers, not just military personnel and their families, have a need for reasonably priced small dollar loan products. This demand is currently being filled by high-cost providers, such as payday lenders.

A growing number of insured institutions have found ways to offer these types of loans in a safe and sound manner that is also cost-effective and responsive to customer needs. Indeed, several California community banks have such programs in place or have indicated their interest in pursuing this market niche. I appreciate your support and your willingness to work with us to see the opportunities that present themselves as we consider this problem. I look forward to continuing to work with the industry in 2007 to find ways to promote both affordable short-term loan products and creative ways to encourage savings.

In that regard, the FDIC released Affordable Small Loan Guidelines for public comment on December 4. The guidelines explore several aspects of product development, including affordability, streamlined underwriting and savings. You have until February 2 to comment on these guidelines. I hope you will take this opportunity to add your voice to our efforts to find solutions that will be win-win propositions for both banks and consumers.

Economic Inclusion

Further, I was very pleased in 2006 to be able to announce the creation of the FDIC Advisory Committee on Economic Inclusion. The Committee members represent a cross section of interests from consumer and public advocacy organizations, community-based groups, the banking industry, state regulatory authorities, government, academia, and others affected by banking-related practices. I am convinced that their experience and insight will result in practical solutions to the barriers to economic inclusion. I am also very pleased that Diana Taylor, the New York State Superintendent of Banks has agreed to chair the Committee. We look forward to receiving a wide range of recommendations from the Committee.

Before I conclude, I would like to talk about two areas where we issued regulatory guidance last year, both of which I think speak to some of the challenges you may face in the coming year.

Nontraditional Mortgage Guidance

Insured institutions in California have performed very well in recent years, reporting pre-tax profits consistently higher than the national median. Asset quality and capital have

also remained very strong. But while California's biggest job sectors – government, professional services, health services, and tourism – continue to report solid growth, the cooling housing market is beginning to show its effects on the overall economy. Existing home sales in California have dropped to their lowest levels since 1995. According to the OFHEO house price index, half of the 25 largest metro areas in the state reported a decline in home prices during the third quarter.

The housing affordability dilemma that California homebuyers have faced for so long has become even more pronounced after the historic home price boom that took place during the first half of this decade. Declining affordability, in turn, has spurred the growth of nontraditional mortgage products such as interest-only and option ARMs, not just in California but across much of the rest of the nation as well. In addition, these products are being offered to a wider spectrum of borrowers, including many who might not qualify for a similar-size mortgage under traditional terms and underwriting standards.

As you know, the FDIC and other banking agencies issued guidance on nontraditional mortgage products in 2006. The purpose of the guidance was to remind bankers of the need to carefully underwrite and manage the risks associated with these types of loans. The guidance also cautioned that some borrowers may not fully understand the risks that they assume with these types of mortgages, particularly if they have chosen the minimum payment options many of these loans allow. The speed of innovation in the mortgage market has heightened the need to ensure that the disclosure of terms and possible outcomes is as clear as possible. Like you, we will be closely watching the performance of these products to assess how they perform as their interest rates reset upward and as housing market conditions soften.

Commercial Real Estate Guidance

The slowdown in housing also has implications for banks' construction and development (C&D) loan portfolios. Nationally, FDIC-insured institutions grew their C&D loan portfolios by 30 percent in the year ending last September, on the heels of a 31 percent increase the year before. As has traditionally been the case, California institutions report a median concentration of C&D loans to capital that is among the highest in the nation. This increased reliance on C&D loans, if not properly managed, could lead to higher losses at banks should the housing sector continue to weaken. Indeed, we have begun to see a modest uptick in non-current C&D loans nationally and among community banks in California, albeit from historically low levels.

As with non-traditional mortgages, the federal banking regulators recently issued guidance regarding best practices in the underwriting and management of commercial real estate and construction loan portfolios. I know some bankers are concerned that the thresholds included in the guidance will effectively become caps rather than simply triggers for risk-focused attention during the examination process. We understand that for many institutions, particularly community banks, commercial real estate and C&D lending has become a well-managed specialty, and for that reason concentrations alone should not necessarily be viewed as problematic. It is for that reason that I advocated

the addition of the three-year fifty percent or greater growth overlay for the entire commercial real estate portfolio that is part of the final guidance. The threshold for C&D lending, which arguably is a more risky component of commercial real estate portfolios and where in the past we have seen more significant problems arise as market conditions softened, does not include a growth component.

I want to emphasize that the guidance does not limit commercial real estate lending of any kind by banks. I want to assure you that the bottom-line purpose of the guidance is to simply remind bankers that their risk management practices need to keep pace with increasing exposures to commercial real estate and construction activity. We do not intend to disrupt or limit the volume of commercial real estate lending that is prudently underwritten and well managed, nor should the guidance be interpreted as supporting a reduction in the current volume. But we also do not intend to back away from the expectations we have always placed on institutions with rapid growth and high concentrations in this sometimes-volatile line of business. To the extent that an institution is already following best practice in this regard, it has nothing to worry about.

Concluding Remarks

That is just a quick highlight reel from 2006, and hopefully gives you some sense of the issues we will be tackling – together – in 2007. Now, I would be happy to take your questions.

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