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STATEMENT OF

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on

THE STATE OF THE BANKING INDUSTRY

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Chairman Dodd, Senator Shelby and members of the Committee, I appreciate the opportunity to testify on behalf of the Federal Deposit Insurance Corporation (FDIC) regarding the condition of FDIC-insured depository institutions and the deposit insurance fund.

Last week, the FDIC released its *Quarterly Banking Profile*, a comprehensive summary of financial results for all FDIC-insured institutions for the fourth quarter of 2007.[1] Not surprisingly, the data in this report demonstrated that FDIC-insured institutions experienced significant declines in earnings and credit quality during the latter half of 2007, especially compared to the past several years of record performance. However, the vast majority of institutions remain well-capitalized, which will help them withstand the difficult challenges in 2008 until broader economic conditions improve.

While certain performance indicators -- including return on assets and the percentage of institutions reporting net losses -- were at levels that have not been seen since the early 1990s, recent industry financial results remain significantly better than the condition of the industry during that period. For example, the relative level of asset quality problems is considerably lower. At the end of 1991, 3.60 percent of all loans and leases were noncurrent compared to 1.39 percent at the end of 2007. The net charge-off rate in 1991 was 1.35 percent compared to 0.59 percent at the end of 2007. Another very significant difference between now and then is capital. At the end of 1991, the industry's risk-based and leverage capital ratios were 10.63 percent and 6.25 percent respectively; at the end of 2007, the risk-based capital ratio was 12.79 percent and the leverage capital

[1] See http://www2.fdic.gov/qbp/qbpSelect.asp?menuItem=QBP.

ratio was 7.98 percent. In 1991, there were more than 2,000 institutions that failed to meet the highest regulatory capital standard while fewer than 90 institutions were below this standard at the end of 2007. Perhaps the greatest difference between the early 1990s and today is the health of insured institutions. At the end of 1991, there were 1,430 institutions on the FDIC's "problem list" compared to 76 institutions at the end of 2007.

My testimony will review the financial performance of FDIC-insured institutions during the current period of economic uncertainty, highlight the risks to the industry going forward, and discuss the condition of the Deposit Insurance Fund. In addition, I will discuss the FDIC's actions to manage industry risks and address problems in the credit markets that affect insured institutions.

The Recent Financial Performance of FDIC-Insured Institutions

FDIC-insured institutions reported total industry earnings of $105 billion in 2007, down 27 percent from the previous year. The decline ended a string of six consecutive years in which industry net income set new records. More than half of all insured institutions reported lower profitability and 12 percent were unprofitable for the year. However, to put the decline in perspective, last year's earnings for the industry still surpassed the $100 billion mark for the sixth year in a row.

The earnings decline was most acute in the fourth quarter, when the industry earned just under $6 billion -- a 16-year low. It should be noted that the industry's

earnings decline was concentrated among larger institutions. Six institutions accounted for half of the decline in earnings. Nevertheless, all of the institutions reporting the largest declines in earnings were well-capitalized at year-end 2007.

Much of the earnings decline stemmed from an increase in loan loss provisions, goodwill impairment expenses, and trading losses at large banks. In contrast, although earnings were down from previous periods at many community banks, they were more profitable as a group than large institutions in the fourth quarter. While industry return on assets (ROA) declined from 1.20 percent in fourth quarter 2006 to 0.18 percent in fourth quarter 2007, the average ROA at institutions with assets less than $1 billion fell from 1.03 percent to 0.74 percent. In addition, the balance sheets of community banks were healthier than larger institutions. At the end of 2007, the average percentage of loans that were 90 days or more past due or in non-accrual status at community banks was 1.21 percent compared to 1.42 percent at larger institutions.

The credit quality of banks' balance sheets deteriorated in 2007, reflecting weakness in the housing sector and disruptions to financial markets. The amount that banks set aside last year for expected loan losses equaled about 12 percent of net operating revenue, the highest proportion since 1992. In dollar terms, total industry loss provisions more than doubled to $68 billion. Net charge-offs were up year-over-year in all major loan categories except loans to the farm sector.

The decline in credit quality was most pronounced in the last three months of 2007. Total non-current loans rose by one-third during the fourth quarter to $110 billion. The increase was led by an $11 billion increase in noncurrent residential mortgage loans. At the end of 2007, almost 1.4 percent of all loans were non-current, while the non-current rate on residential mortgage loans reached a record high of over 2 percent.

Loss reserves at FDIC-insured institutions posted their largest increase in 20 years during the fourth quarter of 2007, but did not keep pace with the growth in noncurrent loans. The coverage ratio of reserves to noncurrent loans fell from $1.05 in reserves for every $1.00 of non-current loans to 93 cents during the fourth quarter. This is the first time since 1993 that the industry's non-current loans have exceeded its reserves. Because accounting rules require that loan loss allowances cover only probable losses, they do not permit banks to build reserves in a benign economic environment. As a result, bank reserves often must be significantly increased when there is a sharp turn in the credit cycle. As credit conditions continue to deteriorate, we are strongly encouraging institutions to increase reserves at a rate that keeps pace with institutions' projections for non-current loans. In the current environment, the attention banks have been giving to boosting reserves and capital needs to continue.

Although the industry faced significant challenges during the past year, the banking industry entered this difficult environment well-capitalized following years of record earnings. At the end of 2007, 99 percent of all insured institutions, representing more than 99 percent of total industry assets, met or exceeded the highest regulatory

capital standard according to the statutory definitions under Prompt Corrective Action. This strong capital base is the result of a long and sustained favorable operating environment that has only recently deteriorated.

Certain elements of the current economic environment also are potentially favorable to the outlook for bank earnings. For example, history suggests that the recent decline in short term interest rates and the repricing of credit risk will help to improve net interest margins and boost net interest income over time, other things being equal. In certain situations, lower interest rates will also help to mitigate credit losses by reducing debt service costs to borrowers.

Credit Distress and Credit Disruption

The end of the historic boom in U.S. housing prices has contributed to credit market disruptions that continue to propagate through the financial system. Much of the disruption relates to uncertainty about the extent of the credit losses that will result from problem mortgage loans. Delinquency and foreclosure rates for subprime mortgages continue to rise. In third quarter 2007, over 16 percent of subprime mortgages were 30 days or more past due and 11 percent were seriously delinquent, meaning that the loans were 90 days or more past due or in the process of foreclosure.[2] During the third quarter, foreclosure was initiated in over 3 percent of almost 6 million subprime mortgages surveyed.

[2] Source: Mortgage Bankers Association's third quarter 2007 National Delinquency Survey.

Among conventional prime mortgages, over 3 percent were 30 days or more past due in third quarter 2007, and 1.3 percent of prime mortgages were seriously delinquent.[3] Both measures are at historical highs. Foreclosures started in third quarter 2007 represented 0.4 percent of over 35 million prime mortgage loans in the survey, almost double the rate of one year ago.

Credit distress in the U.S. mortgage securities market that emerged during the summer of 2007 has continued to worsen, with the most pronounced deterioration seen in recently originated loans. Serious delinquency rates on subprime mortgages securitized in 2006 are significantly higher than those for any of the previous three years. After a full year of seasoning, 12 percent of subprime loans securitized in 2006 were seriously delinquent, which is more than double the rate for loans securitized in 2005 and more than triple the rate for loans securitized in 2004.[4] Similarly, over 3 percent of Alt-A loans[5] securitized in 2006 were seriously delinquent after one year of seasoning, up from less than one percent for loans securitized in 2005. Preliminary data indicate that the serious delinquency rate for loans securitized in 2007 may eventually be higher than for the 2006 vintage.

Problems in the housing and mortgage markets have led to reductions in mortgage originations and securitizations. Subprime mortgage originations declined by 68 percent during 2007, and issuance of related mortgage-backed securities dropped by more than

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[3] *Ibid.*
[4] FDIC calculations based on data from Loan Performance Corporation.
[5] Alt-A loans are those made under expanded underwriting guidelines to borrowers with marginal to very good credit. Alt-A loans are riskier than prime loans due to the underwriting standards of the loans, not necessarily the credit quality of the borrowers.

half.[6] Origination of Alt-A mortgages fell by 31 percent during 2007, and issuance of related mortgage-backed securities declined by 32 percent. According to Merrill Lynch, no home equity loan securitizations have been issued since November 2007.[7]

The problems in the residential mortgage markets have spread to other credit markets and are limiting the flow of credit to other sectors of the economy. Among the reasons for this trend is a perceived lack of transparency in structured finance and a general over reliance on ratings and quantitative methods as a substitute for good judgment and traditional credit discipline. These two problems are closely linked -- if accepted market practice is to rely on a rating, then no reason exists for investors and other market participants to demand additional information about the collateral. The result of this mindset was the rapid growth of speculative markets for structured finance vehicles such as collateralized debt obligations (CDOs), driven by investors lacking the basic information necessary to make informed investment decisions.

The resulting shake-out in structured finance has caused CDO issuance to fall dramatically. Only $1.5 billion of CDOs were issued through mid-February 2008. At this pace, the 2008 annualized amount would be $12 billion compared to a total of $248 billion in 2007.[8] To date, Standard and Poor's has cut ratings on over 1,500 CDO tranches.[9] Many of the write-downs among the nation's largest banks in late 2007 and early 2008 were on CDOs. Some institutions have had to either allocate additional

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[6] *Inside Mortgage Finance*, February 8, 2008, and *Inside MBS & ABS*, January 11, 2008
[7] Merrill Lynch, "Structured Finance - Market Update ABS," February 20, 2008.
[8] *Ibid*.
[9] "S&P Cuts Ratings On $6.75 Billion In CDO Tranches," *Wall Street Journal*, February 13, 2008.

capital against those assets or sell them. Some banks have brought CDOs onto their balance sheets, placing an additional burden on capital. Several institutional funds have had to suspend redemptions because of losses on CDOs.

The municipal bond market has recently become an area of concern, mainly due to the possible downgrade of the bond insurance companies. Nine of the largest companies insure about $2.5 trillion of domestic and international securities, about 60 percent of which are municipal bonds.[10] As the municipal bond market became more competitive in recent years, many bond insurers began insuring the highest rated tranches of structured finance products. As the lower tranches lost value, the bond insurers became increasingly exposed to credit risk and took major losses on their positions. Several bond insurance companies have been downgraded, which restricts their ability to insure municipal bonds. The Securities Industry and Financial Markets Association forecasts that the total municipal bond issuance will be $456 billion in 2008 -- a 5.4 percent decline from the record $482 billion issued in 2007. However, unlike the CDO market, underlying asset quality in the municipal bond market remains very strong overall.

Broader Economic Effects

The U.S. economy slowed markedly in fourth quarter 2007 in the face of the historic housing market downturn and ongoing credit market disruptions. Residential construction declined at an inflation-adjusted annual rate of 24 percent in the fourth

[10] See http://www.federalreserve.gov/newsevents/testimony/parkinson20080214a.htm

quarter, subtracting some 1.2 percentage points from net GDP growth. But virtually every other sector slowed as well, keeping net inflation-adjusted growth in GDP down to just 0.6 percent during the quarter. U.S. payroll employment shrank slightly in January for the first time in four and a half years, and the unemployment rate has risen by half a percentage point from its low in March of last year. Consensus forecasts call for the U.S. economy to grow by less than 2 percent in 2008, and most of the risk to this forecast appears to be on the downside.

Consumer spending, which accounts for over 70 percent of total economic activity, has slowed with the end of the housing boom. Prior to last year, large home price increases helped households extract hundreds of billions of dollars per year in equity from their homes, and consumer spending grew by more than 3 percent for three consecutive years starting in 2004. However, now the "wealth effect" from rising home prices is declining, helping to slow the pace of growth in consumer spending, and contributing to credit distress in consumer loan portfolios. Business investment also slowed in the fourth quarter in the face of slowing profit growth and uncertainty about the economic outlook. Spending on equipment and software grew at an annualized rate of just 1.6 percent for the year as a whole, the weakest performance since 2005.

Taken together, these trends point to a slower pace of economic activity in coming quarters that will have adverse effects on bank loan demand and credit performance. While the monetary and fiscal stimulus that has been undertaken to date will help to moderate this slowdown, it would be safe to characterize the operating

environment of the banking industry during the coming year as one of significant challenge.

Risks to the Banking Industry

Construction and Development Loans

Given the current slowdown in financial and economic activity, the challenging bank environment of 2007 is expected to continue into 2008. One of the chief risks to the banking industry arises from an expected continued deterioration in the credit quality of construction and development (C&D) loans. The credit quality measures of these loans are now at levels not seen since the first half of the 1990s. For example, the percentage of C&D loans that are noncurrent increased to over 3 percent at year-end 2007 from less than one percent a year ago. Residential C&D lending is under the most stress, likely due to a decline in both home sales and home prices.

Although C&D loan growth has slowed across FDIC-insured institutions, concentration ratios continue to increase at community and mid-sized institutions, while leveling off at large institutions. The ratio of C&D loans to total risk-based capital ratio for the industry was 50 percent as of December 31, 2007, significantly above the 21 percent reported a decade ago.

The percentage of institutions that report C&D lending greater than 100 percent of total risk-based capital shows the extent of C&D loan concentrations among insured institutions. As of year-end 2007, close to 28 percent of FDIC-insured institutions reported C&D loans in excess of total risk-based capital. Just over half of mid-sized institutions reported C&D loan concentrations over 100 percent of total risk-based capital, while 26 percent of community institutions and 23 percent of large institutions reported C&D loans in excess of total risk-based capital.[11]

Commercial Real Estate

Upheavals that began in residential markets now affect commercial real estate capital markets, resulting in sharply curtailed liquidity. Commercial real estate prices rose rapidly during the past several years. However, as resale options have diminished, banks have shifted back to fundamentals and rental income is the main source of commercial real estate loan repayment. Securitizing commercial real estate loans has become difficult. After a record $234 billion in commercial mortgage-backed securities were issued in 2007,[12] January 2008 was the first month since at least 1995 in which no commercial mortgage-backed security issue came to market.

Commercial real estate loans at insured institutions are showing signs of deterioration at the same time that concentration levels are at or near record highs, particularly among small and mid-sized institutions. Over half of institutions with assets

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[11] Community institutions in this context refers to institutions with less than $1 billion in total assets.
[12] See http://www.financialnews-us.com/?page=ushome&contentid=2449801639

between $1 billion and $10 billion have commercial real estate loan portfolios that exceed 300 percent of their capital, nearly double the share for institutions in this size range in 2000.[13] Similarly, the share of institutions with less than $1 billion in assets with commercial real estate concentrations exceeding 300 percent has almost doubled since 2000 to over 32 percent as of year-end 2007.

Mortgage Finance and Consumer Credit

The coming year could prove to be a transitional year for the performance and business models of institutions engaged in non-traditional mortgage lending, structured finance, and leveraged lending activities. Very large commercial banks and thrifts involved in these areas have been particularly hard hit. Loan originations are down and many institutions are holding loans that normally would have been sold. Some institutions have experienced strained capital and liquidity positions, but fortunately these institutions have so far been able to raise funds through borrowings, deposits, and capital infusions.

As mortgage credit problems have risen, households have increasingly turned to other forms of consumer credit. As of December 2007, consumer credit outstanding was over $2.5 trillion, up almost 6 percent over the prior year. This increase was driven largely by revolving credit, which climbed approximately 8 percent year-over-year to $943 billion. While the increase in mortgage debt has been slowing, revolving consumer

[13] Commercial real estate loans include real estate construction and development loans, loans secured by nonfarm nonresidential properties, loans secured by multifamily residential properties, and loans to finance commercial real estate, construction and land development activities that are not secured by real estate.

credit outstanding has been growing, particularly since 2006. This may be a result of tightened underwriting standards that have made it more difficult for people to borrow against their home equity, forcing them into higher-interest unsecured personal debt. Consumer loan performance peaked in first quarter 2006 due to factors such as strong job growth and strength in the housing sector. Since then, broader economic and financial conditions have weakened, causing delinquency rates to increase, although they currently remain low by historical standards.

The Condition of the Deposit Insurance Fund

The Deposit Insurance Fund (DIF) remains in a financially strong condition. The DIF balance grew during 2007 by 4.5 percent to $52.4 billion, up from a 3.2 percent increase in 2006. The higher rate of increase is attributable primarily to greater assessment revenue. The Federal Deposit Insurance Reform Act of 2005 permitted the FDIC to charge every insured institution a risk-based premium, but also provided one-time credits to many institutions that had paid high assessments to build up the insurance funds in the early to mid-1990s. In 2007, the DIF recognized $643 million in assessment revenue, a result of $3.7 billion in risk-based assessments charged, minus $3.1 billion in credits. By contrast, the DIF recognized only $32 million in assessment revenue in 2006. Assessment income is expected to rise in 2008 as institutions deplete their available credits.

From February 2007 through February 2008, four FDIC-insured institutions failed with total assets of $2.4 billion and estimated losses of $126 million. These were the first failures since June 2004. The DIF's contingent liability for probable and reasonably estimable losses from anticipated failures was $124 million at year-end 2007, with $1.7 billion in additional possible losses identified. The estimate was based on industry financial data for the third quarter of 2007 and supervisory information as of the end of the year -- the most current data available at the time of the issuance of the FDIC's 2007 financial statements. However, industry financial data for the fourth quarter that have only recently been released and new supervisory information indicate that losses from failures this year will be higher than the year-end 2007 contingent liability, and that higher losses may continue into 2009, while remaining within historical norms.

The number of failures in recent years has been unusually low by historic standards and it is reasonable to expect that bank failure activity in the near term will be more consistent with traditional levels. As of year-end 2007, the FDIC had 76 insured institutions with approximately $22 billion in assets on its problem bank list.[14] These are institutions that are subject to heightened supervisory attention due to their supervisory ratings. Although the number of institutions on the list increased from 2006, it currently is well below levels seen during previous economic downturns -- and most banks on the list ultimately do not fail.

[14] 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 ascending 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."

Although there were no bank failures in 2005 and 2006, rapid insured deposit growth in those years (7.4 percent and 6.8 percent, respectively) pushed down the DIF's reserve ratio -- the ratio of the fund balance to estimated insured deposits -- from 1.31 percent at year-end 2004 to 1.25 percent at year-end 2005 and 1.21 percent at the end of 2006. After declining to 1.20 percent in March 2007, the reserve ratio began to rise as insured deposit growth slowed and assessment revenue began to increase. The DIF reserve ratio ended 2007 at 1.22 percent, with insured deposits rising by 3.4 percent for the year. The DIF appears to be on track to reach the designated reserve ratio of 1.25 percent in 2009, in accordance with the FDIC Board's stated objective for the fund.

FDIC's Response to Industry Risks and Problems in the Credit Markets

The FDIC is moving proactively to manage industry risks and address problems in the credit markets that affect insured institutions. Restoring the function of credit markets will depend on improvements in disclosure and the elimination of moral hazards. We are focused on keeping families in their homes by encouraging mortgage loan modifications, directing supervisory efforts towards key areas of risk, strengthening lending standards, and enhancing disclosure and transparency in both the primary and secondary credit markets.

Subprime Mortgages

The FDIC has been working for many months to address issues surrounding subprime mortgages, especially the increasing volume of foreclosures. Institutions have been encouraged to work toward long-term sustainable and affordable payment obligations that will provide stability for servicers and investors as well as borrowers. I would again remind borrowers who are having difficulty making their payments -- or anticipate having difficulty making their monthly payments when their interest rate resets -- to contact their loan servicer directly as soon as possible to discuss options. I also would caution troubled borrowers to be careful in dealing with organizations that encourage borrowers to cease making payments or walk away from their home while also promising to repair their credit. If it sounds too good to be true, it may well be a scam that will damage the borrower's credit and increase their expenses. Working directly with the servicer or legitimate non-profit organizations is the best approach for troubled borrowers.

As I testified before this Committee last month, I proposed a systematic approach to addressing subprime adjustable rate mortgage loans for owner-occupied properties where the borrowers are current on their payments but will not be able to maintain the payments following the reset of their interest rates. For this group of borrowers, I have recommended that servicers take a systematic and streamlined approach to restructuring these loans into long-term, sustainable loans at the starter rate -- which is already above market rates for prime loans.

For other borrowers, by applying reasonable measures of the likelihood of default, such as commonly accepted debt-to-income ratios, servicers should quickly identify loans facing likely default, develop broad templates for restructuring these loans into long-term, sustainable loans with fixed rates for at least five years, and proactively initiate that process. In addition, in appropriate circumstances, lenders and servicers also should consider forgiving a portion of the principal balance owed. This would likely be the case where the home is owner-occupied, the borrower's current income cannot support repayment of the loan, and the net present value of reducing the principal to a sustainable level is greater than the anticipated net recovery that would result from a foreclosure. Investors should be pushing for these types of modifications. Given current market conditions, servicers who take no action and choose to rely on the traditional loan-by-loan process leading to foreclosure could run a risk of legal liability to investors for their failure to take steps to limit losses to the loan pool as a whole.

Some servicers continue to express concern about potential legal liability to investors for loan modification activity. We believe that servicers have significant flexibility to restructure loans under current law. Indeed, as previously indicated, there may be litigation risk in failing to modify troubled mortgages. However, to address these concerns, Congress could explicitly affirm that servicers have such legal authority and establish litigation safe harbors for responsible, systematic modifications.

Although many servicers have recognized the benefits of addressing problematic loans on a systematic basis, some have yet to demonstrate an aggressive effort to dramatically increase the pace of loan modifications. While loan modification activity is picking up, foreclosures remain unacceptably high. I am optimistic that loan modifications will continue to accelerate. At the same time, I recognize that additional action might be necessary to reduce foreclosures and prevent the housing market from "overshooting" as prices adjust downward

In spite of some encouraging signs that servicers are increasing the pace of loan modifications, some reports continue to show a great reliance by servicers on repayment plans. Repayment plans or brief deferrals of payments will not allow us to get past our current problems. They are analogous to "kicking the can down the road". In addition, we need more consistent, transparent reporting of loan modification activity. Just this week, the FDIC and other federal regulators are issuing a statement calling for all servicers and lenders to provide more detailed reporting on their efforts through the Hope Now Alliance. The FDIC similarly supports state efforts to gather reliable information on servicers' programs

Safety and Soundness of Financial Institutions

From a supervisory perspective, we expect 2008 to be a challenging year compared to the past few years. Experience has demonstrated that credit losses stemming from broad economic shocks can take time to fully manifest themselves in financial

institutions. The FDIC will continue to closely monitor the direction of the economy, the changing condition of institutions, and managements' actions in response to these changes. The FDIC takes a risk focused approach to bank supervision and we are actively concentrating our attention and resources on the areas of greatest risks for the institutions we supervise.

To keep abreast of risks related to non-traditional mortgage products, examiners are analyzing the structure of these credits to determine the ability to repay under periods of market stress. Their analysis includes an assessment of disclosures, the ability to repay, financial exposure to recourse provisions in sale agreements and litigation, the sustainability of liquidity under stress scenarios, appropriate accrual of interest income and expenses (including provisions for losses) and the adequacy of capital.

The FDIC is particularly focused on the risks posed by concentrations of commercial real estate in many financial institutions. Examiners are emphasizing to banks the need for risk management systems commensurate with loan concentrations as outlined in the final interagency *Guidance on Concentrations in Commercial Real Estate Lending, Sound Risk Management Practices* issued in late 2006.

FDIC examiners also are closely monitoring institutions that have been impacted by the stress in the market, focusing on these institutions' ability to maintain earnings and funding and to appropriately value thinly-traded assets. Our examiners are evaluating the impact of strained interest margins and deteriorating credit quality on earnings. The

FDIC also is assessing the level of capital in institutions that have experienced deterioration in asset quality or an increase in off-balance-sheet exposures. This includes requiring institutions to raise capital, if necessary. Our examiners also are assessing valuation practices and techniques for thinly-traded assets. In cases where institutions do not address their risks appropriately, the FDIC is taking corrective action, including downgrading ratings, increasing deposit insurance assessments and taking enforcement actions when necessary.

Finally, as we take appropriate supervisory action to address the safety and soundness of the institutions we supervise, the FDIC will continue to promote consumer protection during this challenging period. Recent conditions in the mortgage industry have demonstrated that ensuring fair treatment of consumers is vital to a safe and sound financial industry. The FDIC supports strong national lending standards and will work closely with our fellow regulators to ensure that standards are established and enforced pursuant to the provisions of the Home Ownership Equity Protection Act (HOEPA). Our ultimate goal is to ensure that financial products are both beneficial to consumers and profitable to banks.

Conclusion

The banking industry is currently facing a number of challenges. The vast majority of FDIC-insured institutions remain well-capitalized as they face significant risks from economic conditions, the fallout from recent unsustainable mortgage lending

practices and disruptions in the credit and capital markets. In response, the FDIC is focusing its attention on these risks to ensure that the institutions it supervises respond appropriately to maintain their safety and soundness. In addition, the FDIC is prepared to move promptly to handle any bank failures that may occur.

Longer term, there are lessons to be learned from the current economic situation that will prove beneficial for the financial industry. By returning to fundamentals, banks, including community banks, should have an opportunity to recapture market share from non-bank competitors as some credit market funding shifts from the secondary market to banks and thrifts. The industry and its customers also will benefit from an emphasis on proven standards and the importance of adequate capital. Less reliance on model driven risk assessment and a more judicious approach to using rating agency analyses will improve the functioning of the markets. Finally, increased transparency will ensure that all market participants better understand the products they are investing in and the risks they are accepting.

This concludes my testimony. I welcome any questions that the Committee might have.