FDIC
Federal Deposit Insurance Corporation
550 17th Street NW, Washington, D.C. 20429-9990

Risk Analysis Center

November 2, 2006

To: FDIC Board of Directors

From: Arthur J. Murton
Director
Division of Insurance and Research

Sandra L. Thompson
Acting Director
Division of Supervision and Consumer Protection

Subject: Semiannual Report: Economic Conditions and Emerging Risks in Banking

Please find attached our semi-annual report entitled "Economic Conditions and Emerging Risks in Banking."

This report (also referred to as the "Risk Case") is prepared by staff two times each year, in May and November. The Risk Case is presented to the Board in conjunction with its consideration of deposit insurance assessment rates for the upcoming period. The purpose of the Risk Case is to provide a broad context as to economic conditions, banking industry trends, and supervisory perspectives on the condition of the industry.

The report was prepared by analysts from the Division of Insurance and Research (DIR) and the Division of Supervision and Consumer Protection (DSC), working in tandem under the auspices of the FDIC Risk Analysis Center. A previous version of this report was presented to the FDIC National Risk Committee on October 24.

Staff will be available to answer questions at the Board meeting on November 2.

attachment

Executive Summary
Economic Conditions and Emerging Risks in Banking

Report to the FDIC Board of Directors
November 2, 2006

This report summarizes emerging risks among FDIC-insured financial institutions. It was prepared by staff and management of the Risk Analysis Branch of the FDIC Division of Insurance and Research (DIR) in collaboration with other FDIC Divisions. The report combines the perspectives of FDIC economists, financial and risk analysts, examiners, and case managers working through the FDIC Risk Analysis Center. The report also includes input from the six FDIC regions through their Regional Risk Committees.

Bank Performance. The financial health of the banking industry remains very good overall. Industry earnings are at record-high levels, capital is historically high, and loan performance remains at record-strong levels. The number of institutions on the Problem Financial Institution List remains near historical lows, and there has not been an insured financial institution failure in more than two years. Still, two negative trends in the industry bear monitoring: (1) the narrowing of the net interest margin (NIM) to a 15-year low and (2) the performance of small institutions (under $100 million in assets), which have underperformed relative to the rest of the industry due to higher expense ratios and a limited ability to generate noninterest income.

U.S. Economy. As the economy enters a sixth year of expansion, U.S. economic growth appears to be slowing significantly and is expected to remain at a rate below its long-run average over the next year. Several economic leading indicators have been signaling weakness, but none are strongly signaling recession. A leading cause of moderating U.S. growth is the slowing U.S. housing market (see below), but exports, nonresidential construction, and the corporate sector remain areas of strength. Inflation remains above the Federal Open Market Committee’s unofficial target range, which could limit their ability to counter economic slowing by reducing short-term interest rates. Easing oil prices may moderate inflation pressures during the next two years, but energy remains a concern due to growing global demand, significant supply constraints, and ongoing geopolitical tensions in some oil-exporting nations.

Yield Curve, Interest Margins, and Asset Growth. The slope of the Treasury yield curve became negative over the summer and is currently more inverted than at any point since 2001. NIMs have fallen in this environment, particularly at large institutions. Evidence from surveys and the annual shared national credit review suggests that competitive pressures have led to narrower spreads and loosened standards for commercial and industrial (C&I) loans. In addition, small and mid-sized institutions appear to have increased their concentrations in riskier assets, such as construction and development (C&D) loans and commercial real estate (CRE) loans. Regulators continue to note increasing concentrations of C&D and CRE loans to capital, especially at institutions with total assets between $1 billion and $10 billion. Total C&D loans held by FDIC-insured institutions grew 32 percent in the twelve months ending June 30, 2006. All of these underwriting and growth trends are reflected in the industry's ten percent growth in total assets through the same period.

Housing Markets and Mortgage Credit Quality. The U.S. housing market has cooled significantly during 2006. Housing starts, new home sales, and sales of existing homes have all declined at double-digit rates compared to year-ago levels. Home price increases in most markets appear to be tapering off to single-digit rates, and over one million more existing homes were on the market as of September than at the end of last year. Condominium prices are under particular pressure in markets where construction activity has been the strongest. To this point, indicators of mortgage loan performance remain strong even as market conditions begin to deteriorate. However, there are emerging signs of potential credit distress among holders of subprime adjustable-rate mortgages. In addition, there are concerns that a high degree of leverage on the part of households and an unprecedented reliance on nontraditional mortgage products could amplify the adverse effects of a housing slowdown.

<u>**Economic Conditions and Emerging Risks in Banking**</u>

Report to the FDIC Board of Directors
November 2, 2006

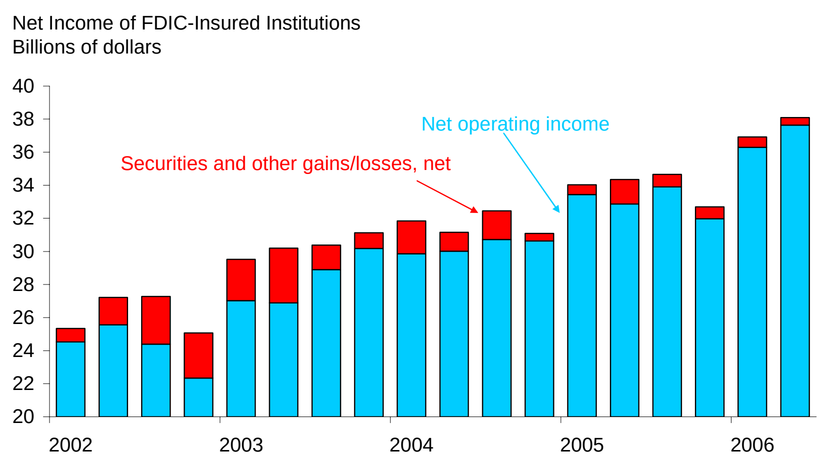
This report summarizes emerging risks among FDIC-insured financial institutions. It was prepared by staff and management of the Risk Analysis Branch of the FDIC Division of Insurance and Research (DIR) in collaboration with other FDIC Divisions. The report combines the perspectives of FDIC economists, financial and risk analysts, examiners, and case managers working through the FDIC Risk Analysis Center. The report also includes input from the six FDIC regions through their Regional Risk Committees.

The Banking Sector Remains Strong

The banking industry remains healthy, with key performance indicators signaling continued strength. Earnings are at record-high levels, capital is historically high, and asset quality remains solid. The number of institutions on the Problem Financial Institution List remains near historical lows; as of June 30, 2006, there were 50 "problem" institutions holding $5.5 billion in assets. There has not been an insured financial institution failure in more than two years.

Earnings continued to set records in the first half of 2006. Net income of $36.9 billion in the first quarter of 2006 and $38.1 billion in the second quarter exceeded the previous record of $34.7 billion in third quarter 2005. Higher earnings were driven by increases in noninterest income, including income from trading and securitization activities and servicing fees. Narrower margins weighed on net interest income, with the industry net interest margin (NIM) falling to a 15-year low; however, low NIMs were offset by strong asset growth. Industry assets increased by more than $1 trillion during the 12-month period ending June 30, 2006, with net loan growth accounting for almost two-thirds of the increase.

Banking industry profits continue to set records.

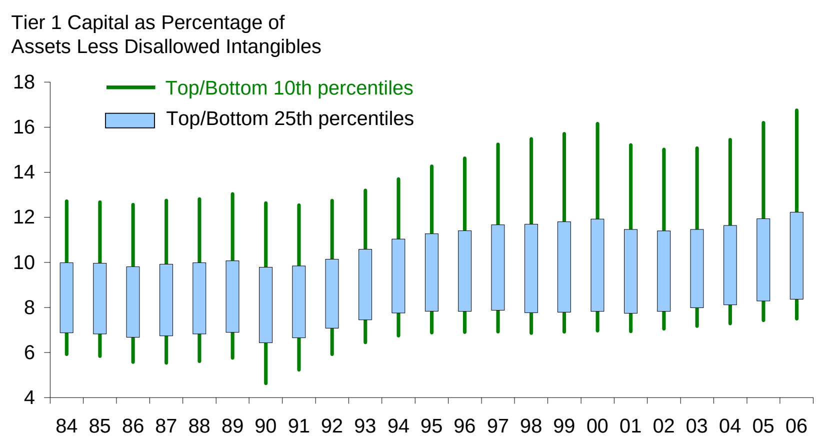


Source: FDIC

The industry's two primary indicators of profitability remain near record highs. Annualized return on assets (ROA) of 1.34 percent for the first half of 2006 was up from 1.30 percent in 2005. Annualized return on equity (ROE) also trended up, increasing to 12.99 percent in the first half of 2006 from 12.73 percent in 2005. While overall industry earnings remain strong, the smallest institutions continue to underperform relative to the rest of the industry. Annualized ROA for institutions with total assets less than $100 million was 1.01 percent. The relative underperformance of these smaller institutions is due in part to higher expense ratios and their limited ability to generate noninterest income.

Equity capital for the industry is the strongest it has been since the late 1930s. Some of the recent capital improvement has likely been driven by the effects of merger accounting, and goodwill now represents more than 20 percent of total equity capital. However, regulatory capital, which does not include goodwill, also remains high, and more than 99 percent of insured institutions were in the highest regulatory capital category as of June 30, 2006.

More FDIC-insured institutions have stronger capital ratios than in prior years.



Source: FDIC

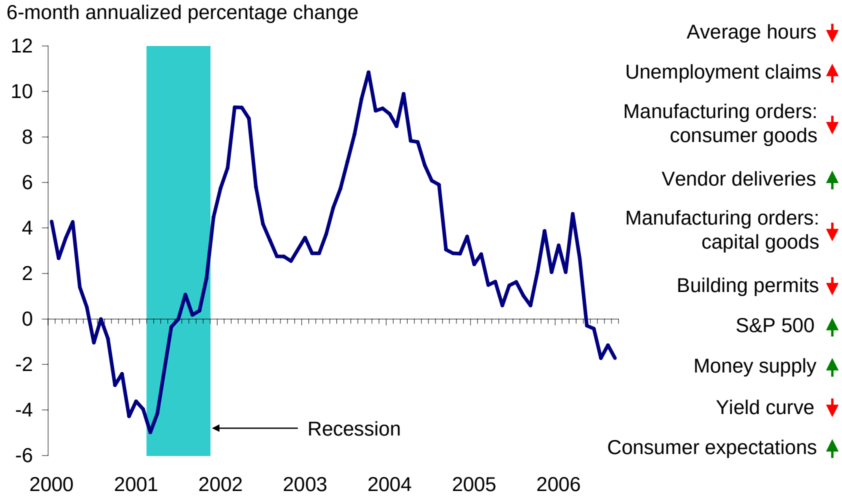
Year-end values shown, except for June 30, 2006

Asset quality in the banking industry remains solid. The industry's noncurrent loan rate on total loans and leases and the annualized net charge-off rate for the first half of 2006 were lower than at any other time in the 23 years that insured institutions have reported these data. After two years of declines, industry loan-loss reserves grew modestly in the first half of 2006; however, the small increase in reserves did not keep pace with the growth in total loans and noncurrent loans. At June 30, 2006, FDIC-insured institutions held only $1.10 in reserves for every $100 of loans and leases on their books—the lowest level since 1985.

U.S. Economic Expansion Begins to Moderate

Recent indicators of economic activity are signaling that the U.S. business cycle is no longer in a high-growth phase. Job growth averaged 118,000 per month during the second and third quarters of 2006, compared to 165,000 for all of 2005.[1] The components of the index of leading economic indicators are currently mixed, with the overall index pointing to contraction in the pace of economic activity. Other leading indices of economic activity corroborate this assessment, including the Conference Board's Index of Leading Economic Indicators, the Economic Cycle Research Institute's Weekly Leading Index, and the Federal Reserve Bank of Chicago's National Activity Index. However, none of these indicators are strongly signaling recession, and they often move back and forth between positive and negative territory.

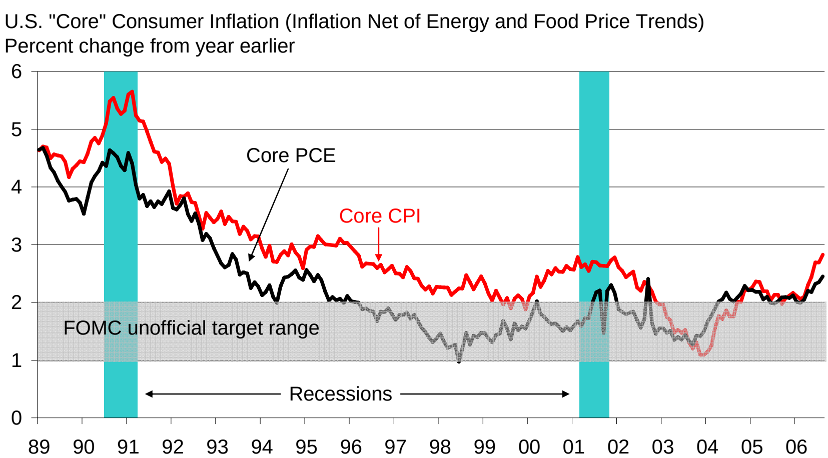
Leading indicators were weakening through September.



Source: Conference Board

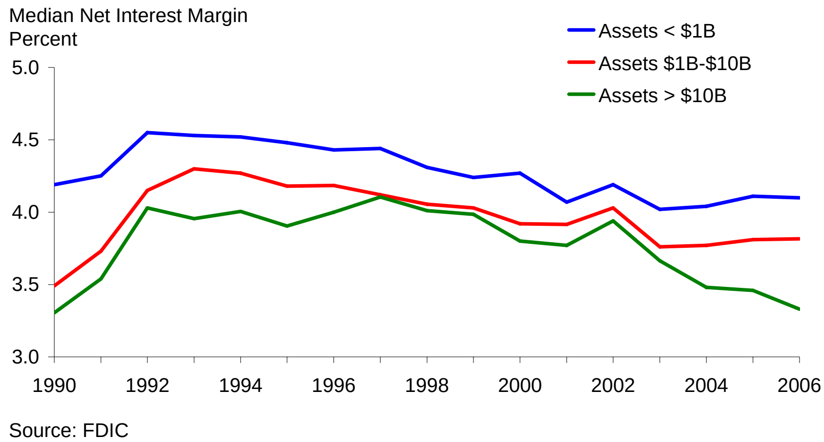
Inflation continues to drift above the Federal Open Market Committee's (FOMC) unofficial target range. Due to declining oil prices, the overall consumer price index recently declined to a year-over-year increase of just over 2 percent, but "core" inflation, which strips out energy and food price movements, remains above the target range. The September Blue Chip Financial Forecast predicts an average annualized increase in the CPI inflation rate of just under 2.6 percent between Q3 2006 and Q4 2007, gradually increasing over that period. Macroeconomic Advisers is projecting an annual increase in the core personal consumption (PCE) deflator of 2.6 percent in 2006, followed by increases of 2.3 percent in 2007 and 2.3 percent in 2008.

Core inflation has moved decidedly above the Fed's unofficial comfort zone but remains low historically.



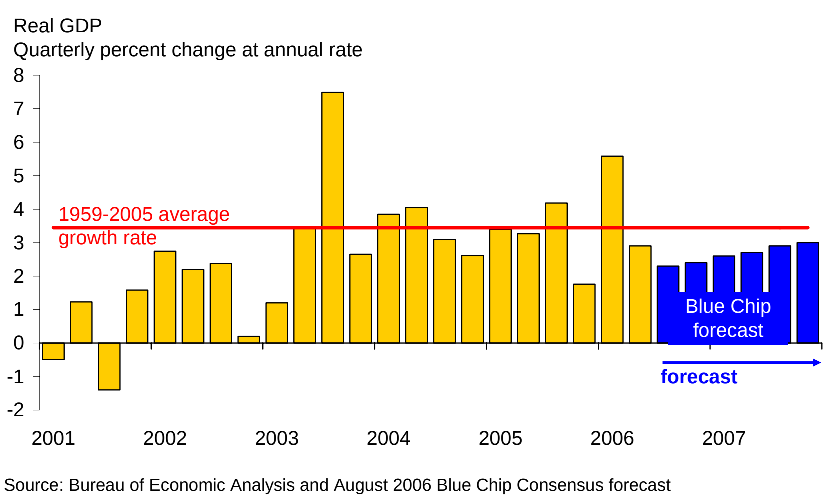
Source: Bureau of Labor Statistics, Bureau of Economic Analysis

Net interest margins continue to tighten for large institutions.



The FOMC ended its string of 17 straight federal funds rate increases in August, and futures markets are strongly predicting a continuation of the current policy rate through at least the remainder of this year. However, the Treasury yield curve, which exhibited a small positive slope at the time of our last report, is currently more inverted than at any point since 2001. The inverted yield curve is pressuring lending institutions, which tend to have liabilities priced according to short-term interest rates and assets priced according to long-term interest rates. As a result, NIMs have fallen, particularly at large institutions, whose liabilities are more elastic than smaller banks' due to their smaller percentage of core deposits. Four of six Regional Risk Committees cited interest rate risk as a potential concern due to the flat-to-inverted yield curve and narrowing margins.

Forecast is for below-trend growth through 2007.



While a steep yield curve inversion has tended to be a precursor of past recessions, the odds of a recession in 2007 remain relatively low. GDP is expected to grow at a rate below its long-run average over the next year due to the combination of a slowing housing market, continued high energy prices, slowing production in the auto industry, and lagged effects of previous interest rate increases. However, the corporate sector continues to perform well. Corporate profits currently make up more than 12 percent of GDP—the highest proportion since the 1960s—and grew more than 20 percent in the twelve months to June 30, 2006. Corporate balance sheets are also strong and reflect a debt-to-net-worth ratio for the second quarter of just over 40 percent, the lowest point since the mid-1980s.

Household liabilities, on the other hand, reached an all-time high of more than 19 percent of assets by the end of the second quarter 2006, as the personal saving rate has fallen into negative territory for five consecutive quarters. Housing-related debt service costs are at all-time highs, and use of home equity loans has slowed sharply as the effects of recent interest rate increases set in.

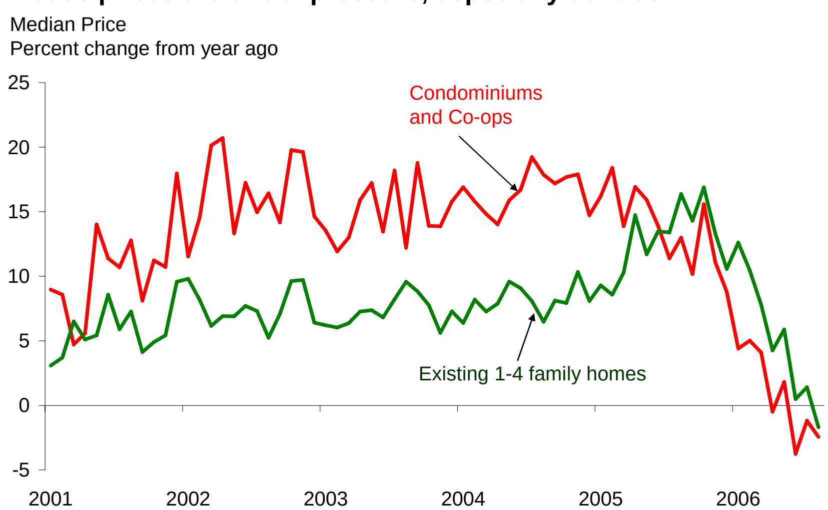
Risks to U.S. Economic Growth and the Banking System

Although both the economy and banking industry are expected to remain in good condition over the medium term, a number of downside risks still exist. These risks include, but are not limited to, softness in the housing market and the effects of high energy prices. In addition, recent trends within the industry itself, such as strategies for addressing narrowing NIMs, loosened loan underwriting standards, and increasing commercial real estate (CRE) concentrations, also merit scrutiny from a risk-management perspective. Some of these issues are discussed below.

The housing market is clearly softening.

The housing market has been an extremely important source of strength for the economy over the past few years, but activity in the sector has declined significantly in 2006. Existing single-family home sales fell by 13.9 percent in September 2006 from year-ago levels, while new home sales were down 21.4 percent from their 2005 record high. The inventory of existing homes available for sale has risen to a record high. Home price increases in most markets appear to be tapering off to single-digit rates, while small price declines have been seen in a number of markets in the upper Midwest.[2] Condominium prices are under the most pressure, particularly in the South and West, where new condominium supply has been robust even as listings have increased and sales have slumped.[3]

House prices are under pressure, especially condos.



Source: National Association of Realtors

Mortgage credit quality remains strong at present, with delinquency and foreclosure still near cyclical lows and well below the peaks seen around the 2001 recession. Delinquent loans made up 4.4 percent of all mortgages outstanding in second quarter 2006, while the number of loans entering the foreclosure process represented 0.4

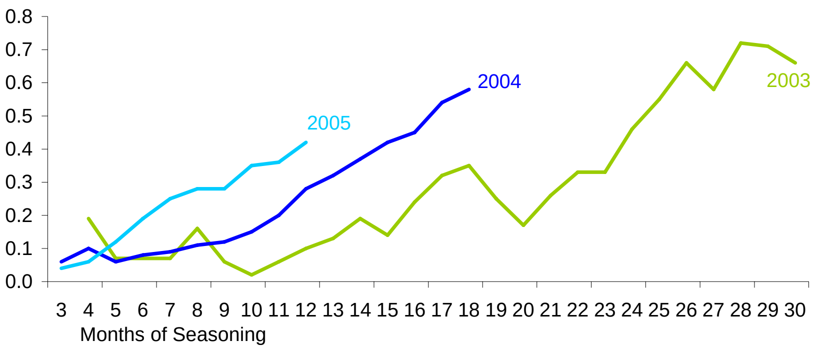
percent of all mortgages outstanding. It is very likely that both delinquency and foreclosure rates will rise if the housing slowdown deepens. The first fault lines likely to appear in mortgage credit performance would be among highly leveraged, variable rate borrowers who have stretched their financial resources to purchase a home during the recent housing boom. Five of six Regional Risk Committees reported some level of concern about future performance of prime residential loans due to slowing home price appreciation.

There are emerging signs of potential credit distress among holders of subprime adjustable-rate mortgages (ARMs). Nationwide, foreclosures started on subprime ARMs made up 2.0 percent of loans in the second quarter, up from 1.3 percent in mid-2004. Subprime ARMs are experiencing stress in states as diverse as California, which has had rapid home price gains and solid economic performance, and Michigan, where house prices have been stagnant and the economy is weaker. This suggests that national factors, like interest rate increases, are important factors behind subprime mortgage credit stress, in addition to local economic or housing market conditions.

Certain household-sector developments that have emerged during the recent housing boom could potentially amplify the adverse effects of a housing slowdown. These developments include: (1) a negative personal saving rate and unprecedented levels of home equity liquidation, (2) a greater degree of homeowner leverage, and (3) much broader use of so-called *alternative mortgage products*, including interest-only and payment option mortgages. With household finances already under pressure from high financial obligation ratios, these developments may place homeowners in a more tenuous position than has been the case prior to previous periods of housing weakness. This may be especially true for those who purchased homes using low teaser-rate and payment option ARMs, which can require significantly higher monthly mortgage payments when rates reset. While the prevalence of alternative mortgage products remains relatively small as a percent of total U.S. mortgage debt, there is uncertainty as to how well they will perform as interest rates reset upwards and home prices level off.[4]

Recent vintages of nonprime, nontraditional mortgage loans show higher rates of delinquency.

Seriously Delinquent Pay Option Loans*
Percentage of active balance by vintage



* Seriously delinquent refers to loans that are 90+ days past due and/or in foreclosure.
Note: Vintage analysis begins 3 months following year's end. 2005 reflects January-June data
Source: LoanPerformance Corp. nonprime, non-Agency securitized mortgage originations

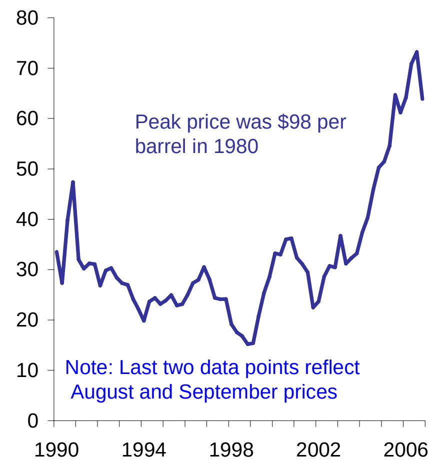
Oil prices are falling, but energy remains a risk to the economy.

Oil prices have fallen over the past three months but remain well above the levels of a few years ago. As of October 20, 2006, the price of a November crude contract closed on the New York Mercantile Exchange at $56.82, its lowest level since March 21.

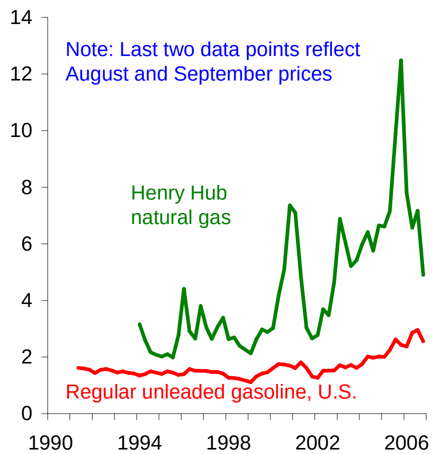
Although high energy prices have undoubtedly been a drag on recent U.S. economic growth, the impact has not been as devastating as in previous episodes. In fact, some simulations on the economic effects of high oil prices indicate that the price per barrel would have to reach as high as $130 to result in an outright recession. The U.S. economy is less energy-intensive than it was during the oil shocks of the 1970s and 1980s. Less energy is required for every dollar of goods produced in 2006 compared to 1980 because of more efficient technology and a shift of economic activity from energy-intensive industries (e.g., the shift from manufacturing to services). Despite the steep rise in oil prices that followed the 2005 hurricane season, U.S. energy use has continued to rise with the sustained expansion in overall economic activity.

Energy prices have eased recently, but remain historically high.

WTI Crude Oil
2006* dollars per barrel



Natural Gas and Regular Unleaded Gasoline Prices
2006* dollars per million btu (gas) and per gallon (gasoline)



* Price index, 2006 = 1
Source: Haver Analytics, Bureau of Labor Statistics

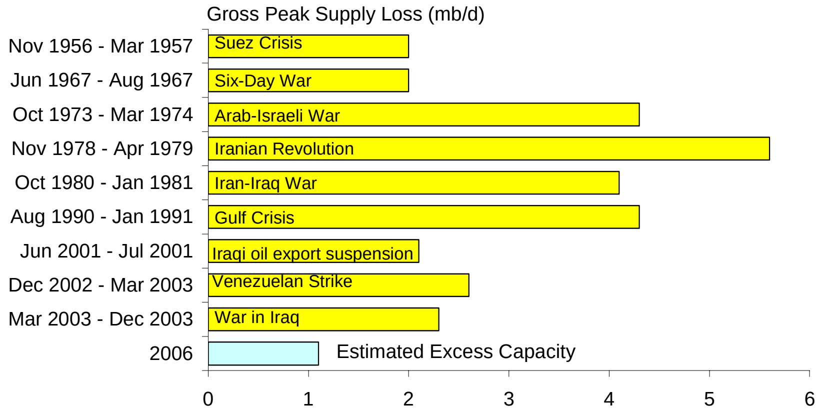
The transportation industry is the one most affected by petroleum costs, followed by waste management services, mining, and chemicals. Of these sectors, however, only the airline sector appears to be suffering serious financial difficulties due to higher energy costs.

Oil producers currently have little spare capacity, and demand continues to rise rapidly due to worldwide economic growth. Developing countries, which tend to have particularly high rates of growth, are also more energy-intensive than the United States and will ensure continued high oil demand in the future. As discussed in our Spring

2006 report, global excess oil production capacity is not sufficient to absorb a major supply disruption.

Interruptions in the supply of oil and gas could continue to threaten economic growth. Ongoing political tensions associated with a number of major oil-producing countries raise the risk of supply disruptions and are thought to be contributing to increased volatility in oil markets. In 2003, approximately 17 percent of world crude oil exports came from Iran, Iraq, Nigeria, and Venezuela. The U.S. vulnerability to supply disruptions varies by fuel type: 60 percent of crude oil is currently imported compared to less than 20 percent of natural gas and other refined fuels.

Past oil supply disruptions exceed current global excess production capacity.

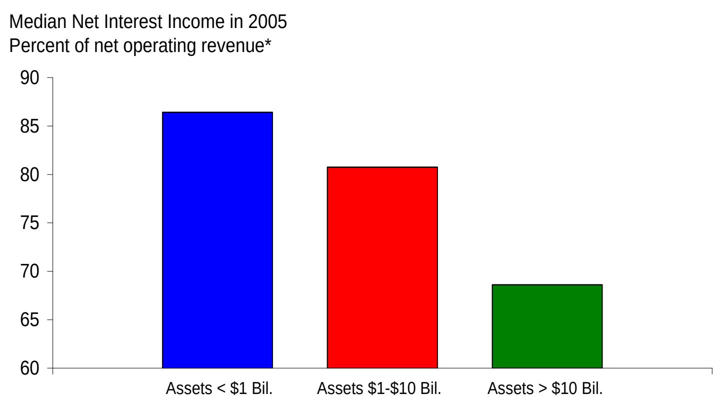


Note: Magnitude of supply shortfall is the peak gross supply loss excluding supply increases of other oil producing countries.
Source: International Energy Agency

Institutions appear to be growing riskier assets to compensate for NIM compression.

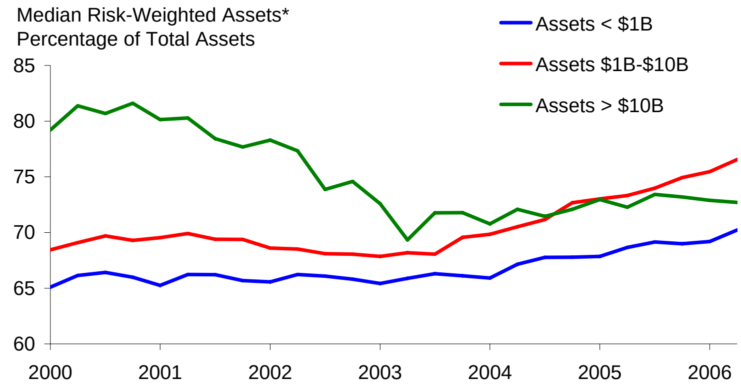
The yield curve for Treasury securities first flattened and then inverted after the Federal Reserve began raising short-term interest rates in June 2004. Although the Federal Reserve recently paused its two-year program of short-term interest rate increases, industry experts expect that the yield curve could remain flat through 2007. Higher short-term interest rates have caused average funding costs at financial institutions to rise more rapidly than asset yields. Higher funding costs, combined with increased competition, have exerted downward pressure on NIMs. As a result, the banking industry's NIM has fallen to a 15-year low of 3.46 percent. While NIM erosion has been most pronounced for larger institutions, it is a more significant concern for smaller institutions because they depend on net interest income for a larger share of their revenue.

Smaller institutions rely more on net interest income for their revenue.



* Net operating revenue = net interest income plus total noninterest income.
Source: FDIC

Small and mid-size institutions have been growing their riskier assets.



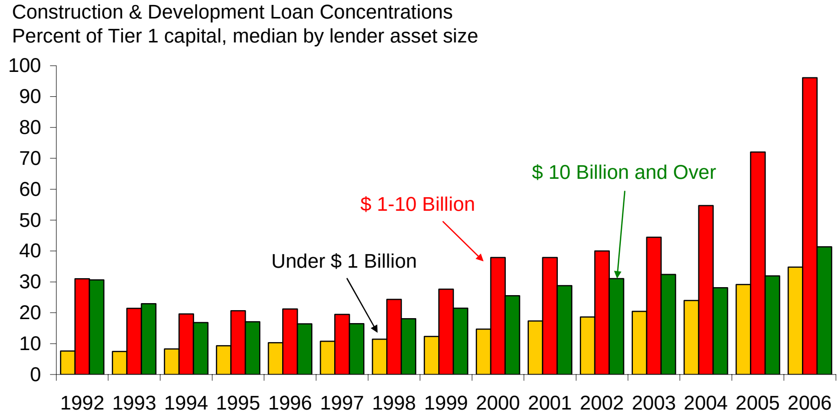
* Risk weights represent those used in risk-based capital calculations.
Source: FDIC

To offset the effects of lower margins, institutions have been growing their asset portfolios. During the year ending June 30, 2006, the total assets of insured institutions increased by more than $1 trillion, or 10 percent, which is relatively high by historical standards. Small and mid-size institutions have been increasing their concentrations in riskier assets, such as CRE loans and construction and development (C&D) loans. This suggests that, although small and mid-size institutions have been more successful in limiting the erosion of their nominal NIMs, they have achieved this success in part by assuming higher levels of credit risk.

CRE loan growth continues.

Slowing housing construction and investment activity during the first half of 2006 were somewhat offset by a 2.5 percent growth rate in loans secured by nonfarm, nonresidential properties.[5] Real investment in nonresidential structures in the second quarter was 8 percent higher than a year ago. Office vacancy rates continue to decrease, while rents in most areas are increasing or stable. On the other hand, retail market fundamentals appear to be weakening in the face of weaker consumer spending.[6] Availability rates increased for the second consecutive quarter, while retail rents likewise declined for the second consecutive quarter. Industrial market fundamentals appear to be generally sound, due in part to continued growth in imports. However, Torto Wheaton Research has expressed concerns about the possible overbuilding of warehouse space in certain regions.[7]

C&D loan concentrations are significantly higher at mid-sized institutions.



Note: All data reflect June 30 totals.
Source: FDIC

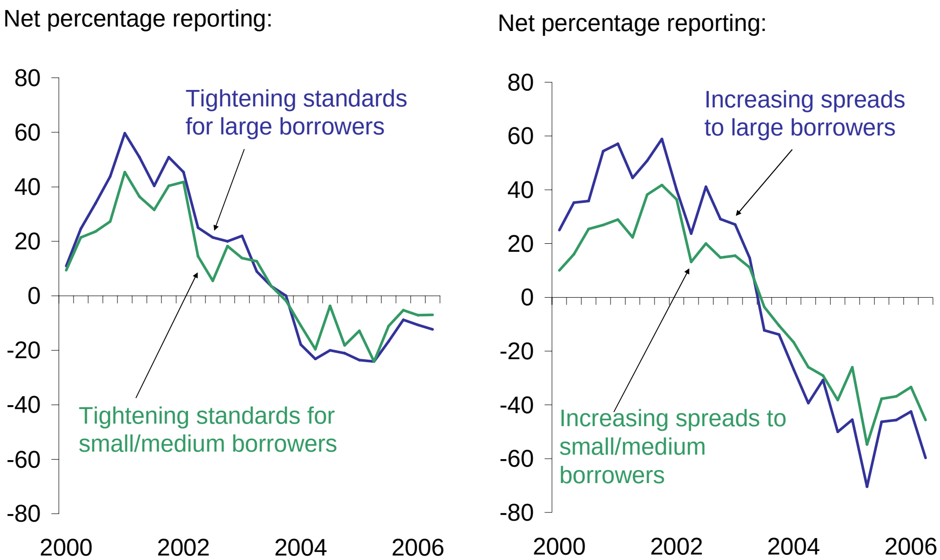
The performance of CRE loans is not expected to decline significantly in the short term.[8] However, continued increases in concentrations and reports of loosened underwriting standards at FDIC-insured institutions signal the potential for future credit quality deterioration. In addition, regulators have noted increasing C&D and overall CRE loan concentrations, especially at institutions with total assets between $1 billion and $10 billion. Four of six Regional Risk Committees expressed some level of concern about CRE lending, in part due to continuing increases in concentrations.

C&D lending continues to drive overall CRE loan growth among FDIC-insured institutions. C&D loans grew 32 percent in the 12 months ending June 30, 2006, continuing their most rapid growth since the mid-1980s. CRE loan performance remains strong at present, with noncurrent CRE loans totaling just 0.49 percent of loan balances as of June 30. Net charge-offs increased slightly among each of the three CRE loan categories during second quarter 2006 but also remain at cyclically low levels.

Commercial lending continues to expand, while lending standards have loosened.

The pace of growth in commercial and industrial (C&I) loans was 2.8 percent during second quarter 2006, a decline from the 4.3 percent increase during the first quarter. The growth was driven by credits above $1 million, which grew by 13 percent, while loans of $1 million or less rose by 4.5 percent. There is growing market competition for the larger corporate loans which, in some institutions, is resulting in more generous terms and financial covenants.[9] Second quarter 2006 was the first time in the past year that the net charge-off rate for C&I loans has risen. The increase was a modest 2 percent, and the overall loss rate remains below 1 percent. There is no indication the quality of this portfolio will deteriorate significantly in the short term absent a serious disruption in the economy.[10] Although C&I current quality remains strong, there are some indications of a loosening of both underwriting standards and pricing spreads due to increased competitive pressures relative to two years ago.[11]

Commercial loan pricing has eased more than underwriting conditions, and overall conditions are still very accommodative.



Source: Federal Reserve Senior Loan Officer Survey on Bank Lending Practices

Credit derivative confirmation backlogs are being reduced.

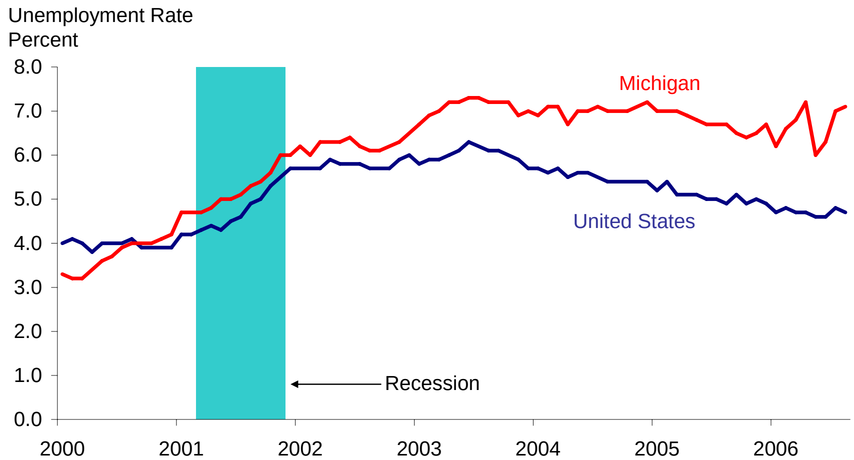
Credit derivatives, which give market participants a means to either hedge or expand credit exposure, continued to increase in notional value. According to the International Swaps and Derivatives Association's (ISDA) Mid-Year 2006 Market Survey, the notional value of credit derivatives outstanding grew 52 percent during the first six months of 2006 to $26 trillion.[12] FDIC-insured institutions also reported a 13 percent increase in credit derivatives holdings, to $6.5 trillion, during the first half of 2006.

As discussed in our last report, the surge in activity in the credit derivatives market poses certain challenges for banks, including an increase in both operational and counterparty risk. Lagging trade confirmations, for example, continue to pose a potential threat to the smooth operation of this market. However, there has been a significant reduction in backlog confirmations in the past several months; in a press release dated July 19, 2006, the ISDA announced an 80 percent reduction in the backlog of unconfirmed trades.[13] This represents substantial progress in improving the infrastructure and overall efficiency of the credit derivatives market. Going forward, the ISDA hopes market participants will improve other operational procedures, including the time in which trades are submitted and confirmed.

The domestic auto sector continues to face financial challenges.

U.S. domestic auto manufacturers and auto parts suppliers are undergoing significant restructuring as a result of recent financial difficulties. Declining market share, increasing commodity prices, and relatively high labor costs continue to pose challenges to these sectors. As a result, U.S. manufacturers GM and Ford have continued to fight an uphill battle, while Japanese firms have posted more solid performance. To counter these struggles, GM and Ford/Visteon have announced plans for plant sales, cutbacks, or closures that could cost approximately 92,000 jobs in North America through 2008.[14] Delphi also plans to sell or close plants that could cost around 23,000 jobs, the timing of which has not been announced.[15] As a result, in Michigan, and to some extent Ohio, labor market conditions have been weaker relative to the nation.

Labor market conditions continue to be weak in Michigan, primarily due to trouble in the domestic auto industry.



Source: Bureau of Labor Statistics

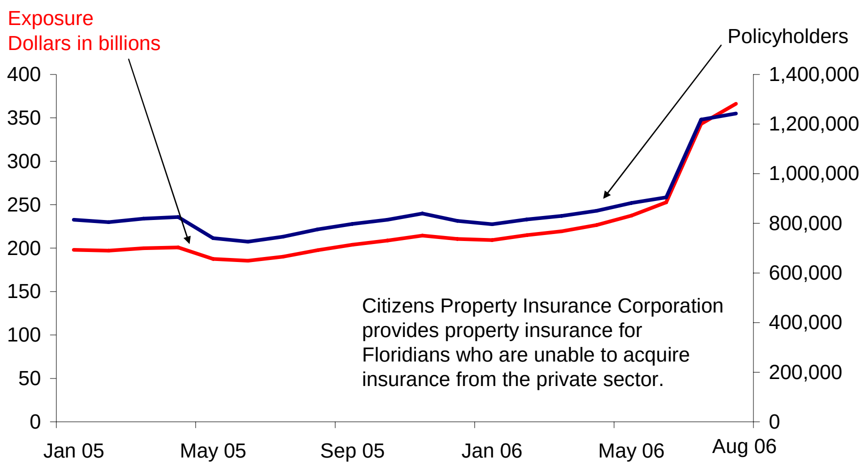
Institutions identified in the higher risk areas of Southeast Michigan, where the majority of auto-related employment exists, have reported relatively stable conditions, though these areas could potentially see weakening consumer credit resulting from increased household financial stress. Commercial loan credit quality could be affected as auto manufacturer difficulties further pressure financially weak auto parts suppliers. Loss of area jobs and the potential for out-migration could slow loan and deposit growth.

Property insurance premiums are increasing, while policies are being dropped.

Despite large catastrophe losses in 2005 (mostly from hurricanes), the Property and Casualty (P&C) insurance industry is entering the 2006 hurricane season with a solid financial cushion. Overall, hurricane losses to the P&C industry last year were more than offset by other underwriting gains. Significant price increases are expected to continue in the lines and regions affected by the 2005 hurricanes, mainly marine, energy, and property insurance and reinsurance in the Gulf of Mexico region. According to anecdotal evidence, property insurance costs this year are expected to increase as much as 500 percent for some customers.[16] Property-catastrophe reinsurance rates are also expected to rise outside of the Gulf of Mexico region. Rates for California earthquake coverage are reportedly up 10 to 20 percent, while rates for Eastern seaboard property catastrophe reinsurance are up by similar amounts.[17]

Amid the likelihood of a continued pullback of private sector insurers from coastal areas, local and state governments may face pressure to find a way to offset these potential coverage shortages. More than 160,000 polices are already expected to be dropped in Florida, New York, and Massachusetts in 2006 alone.[18]

Citizens has become the new Property and Casualty insurer for many Floridians.

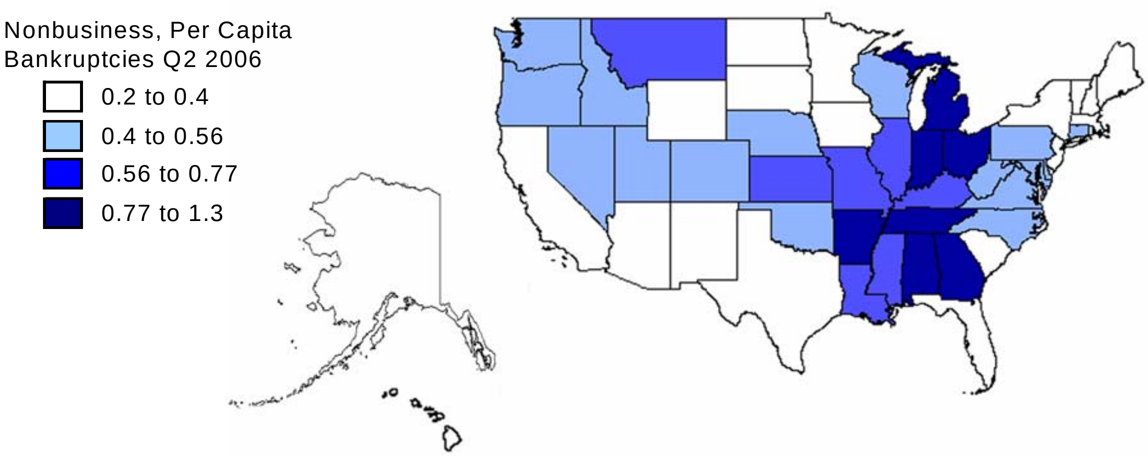


Source: Citizens Property Insurance Corporation

Bankruptcy filings continue to decline.

The total number of U.S. bankruptcies filed during the first six months of 2006 was the lowest level of first-half filings in 20 years.[19] According to the Administrative Office of the U.S. Courts, the total number of filings fell nearly 70 percent from the same period in 2005. Non-business filings in the year ending in June 2006 were nearly 10 percent lower than year-ago levels. Analysts credit the more stringent requirements of the 2005 bankruptcy reform legislation and the rush to file in advance of its implementation as reasons for this precipitous decline. What is less clear is whether the lower rate of bankruptcy filings will persist and how the changes in the law will affect loss rates on consumer loans over the long run. For now, consumer credit quality remains stable to strong.

States in the Midwest and South record the highest non-business bankruptcies per capita.



Sources: FDIC, the Administrative Office of the US Courts, and Haver Analytics

Endnotes

[1] A pending revision to payroll employment data collected by the U.S. Department of Labor is expected to result in the addition of some 810,000 additional jobs between March 2005 and March 2006.
[2] The National Association of Realtors defines the Midwest region as including Illinois, Indiana, Iowa, Kansas, Michigan, Minnesota, Missouri, Nebraska, North Dakota, Ohio, South Dakota, and Wisconsin.
[3] The National Association of Realtors defines the South region as including Alabama, Arkansas, Delaware, District of Columbia, Florida, Georgia, Kentucky, Louisiana, Maryland, Mississippi, North Carolina, Oklahoma, South Carolina, Tennessee, Texas, Virginia, and West Virginia. The West region includes Alaska, Arizona, California, Colorado, Hawaii, Idaho, Montana, Nevada, New Mexico, Oregon, Utah, Washington, and Wyoming.
[4] It is estimated that innovative mortgage products made up approximately 10 percent of outstanding U.S. mortgage debt as of year-end 2005. See: Statement Of Richard A. Brown, Chief Economist, Federal Deposit Insurance Corporation on "The Housing Bubble And Its Implications For The Economy" Before The Subcommittee On Economic Policy And Subcommittee On Housing And Transportation, Committee On Banking, Housing And Urban Affairs, U.S. Senate, September 13, 2006, p. 16.
[5] Commercial real estate growth rate was calculated based on the June 30, 2006, Call Reports of all insured financial institutions.
[6] Abigail Marks, "Overextended Consumer, Lowered Expectations," Torto Wheaton Research, September 5, 2006.
[7] TWR Overview & Outlook, Industrial, Fall 2006.
[8] Commercial Real Estate (CRE) loans include construction and development (C&D) loans, loans secured by nonfarm, nonresidential properties, and loans secured by multifamily properties.
[9] Joint Interagency Press Release: Shared National Credit Data Reflect Good Credit Quality Performance, Large Increase in Credit Commitment Volume, and Small Rise in Riskier Deals, September 26, 2006, http://www.fdic.gov/news/news/press/2006/pr06084.html.
[10] Charge-off rates for C&I loans closely track the Global Speculative Bond 12-month Issuer Default Rate reported by Moody's Investor Service. The Moody's forecast reflects loss rates rising throughout 2006.
[11] The July 2006 Federal Reserve Senior Loan Officer Opinion Survey on Bank Lending Practices reflects loosening underwriting standards, a consistent trend since 2004.
[12] International Swaps and Derivatives Association, Inc, "2006 Mid-Year Market Survey," September 19, 2006.
[13] Lauren Dobbs and Steven Kennedy, "Industry Groups Urge Continued Focus on Credit Derivative Efforts; Confirmation Backlog Reduction Exceeds Target," *International Swaps and Derivatives Association*, July 19, 2006.
[14] Sales, cutbacks, and closure statistics were released by Ford in a news release dated September 15, 2006, and by GM in a news release dated November 21, 2005.
[15] Delphi statistics were gathered by Robert Vilim, Senior Financial Analyst for the FDIC, during a discussion with Lindsey Williams, Vice President, Public Relations at Delphi in May.
[16] Jeff Bliss and Jay Newton-Small, "Insurance Battles Slow Post-Katrina Rebuilding, Reshaping Coast," *Bloomberg,* August 24, 2006.
[17] Jean-Francois Tremblay, "US P&C Insurance—Between a Rock and a Hard Place," *HSBC Global Research*, August 18, 2006.
[18] M.P. McQueen, "Homeowners Face Rising Insurance Rates—Reeling After Katrina, Insurers Drop Policies And Increase Premiums Far From Disaster Zones," *Wall Street Journal*, March 23, 2006, section D1.
[19] John Hartgen, "Bankruptcy Filings During First Half 2006 Fall To Lowest Levels Since 1986," *American Bankruptcy Institute*, August 28, 2006.