FEDERAL DEPOSIT INSURANCE CORPORATION, Washington, DC 20429

SHEILA C. BAIR
CHAIRMAN

October 26, 2009

Honorable Alan Grayson
House of Representatives
Washington, D.C. 20515

Dear Congressman Grayson:

Thank you for contacting me about de novo depository institutions and the Federal Deposit Insurance Corporation's recent issuance pertaining to new banks. I share your concern about the need to hasten an economic recovery and encourage banks to continue making prudent loans in their markets.

The FDIC is aware of the economic and real estate market challenges facing Florida. We also have a unique understanding of the important role community banks play in your state's economy as well as in local and regional economies across the country. We have supported and approved the establishment of hundreds of de novo financial institutions during the past five years and have issued clear new bank application guidelines. These guidelines focus on statutory factors under Section 6 of the Federal Deposit Insurance Act, including the financial history and condition of the bank, future earnings prospects, the general character of management, risk presented to the Deposit Insurance Fund, the convenience and needs of the community, and whether the institution's corporate powers are consistent with the purposes of the law. As you may be aware, the process for applying to become an insured institution is lengthy as the chartering authority and the FDIC must perform adequate due diligence to ensure the statutory factors are favorably resolved and the proponents' business plan is feasible.

As discussed in your letter, the FDIC's recent *Enhanced Supervisory Procedures for Newly Insured FDIC-Supervised Depository Institutions* (August 28, 2009 FIL-50-2009) seeks to address some of the issues that contributed to the recent failure of de novo institutions and to enhance our supervision program for newer banks. We believe our enhanced procedures will help the regulators and de novo institutions ensure that business plans are achievable and on track.

I assure you the FDIC understands the importance of de novo institutions at this stage in the economic cycle and the capacity of these institutions to intermediate credit to consumers and businesses. During 2009, the FDIC approved ten de novo institutions for federal deposit insurance and will approve future feasible requests subject to prudential bank supervisory guidelines.

Enclosed are responses to the four questions posed in your letter. If you have further questions, please do not hesitate to contact me at (202) 898-6974 or Paul Nash, Deputy for External Affairs, at (202) 898-6962.

Sincerely,

Sheila C Bair

Sheila C. Bair

Enclosure

Response for the Honorable Alan Grayson
Prepared by the Federal Deposit Insurance Corporation's
Division of Supervision and Consumer Protection

Q1. Do you have any updated statistics on new bank information?

Ten de novo depository institutions have been approved as of September 30, 2009 for Federal Deposit Insurance. Five de novo applications were withdrawn in 2009.

Q2. What steps are you taking to increase the availability of lending if very few new banks are being formed and the existing banks are being required to maintain elevated capital ratios which they can only meet by reducing their balance sheets (i.e., not renewing or dumping loans)?

The FDIC understands the importance of credit availability in maintaining a strong and vibrant economy, and we balance those considerations with prudential safety and soundness requirements. Businesses across the country are struggling with difficult conditions in local real estate markets that are further exacerbated by turmoil in the credit markets. The FDIC provides banks with considerable flexibility in dealing with customer relationships and managing loan portfolios. We strongly encourage banks to continue lending to creditworthy customers and work creatively with financially distressed borrowers. Last November we joined with the other federal banking agencies in issuing the enclosed *Interagency Statement on Meeting the Needs of Creditworthy Borrowers* (FDIC FIL-128-2008). This statement reinforces the FDIC's view that banks should continue to lend prudently to creditworthy borrowers, work closely with financially distressed borrowers to develop creative ways to modify loans and prevent unnecessary foreclosures, adjust dividend policies to preserve capital and lending capacity, and develop compensation policies that encourage prudent lending. Moreover, for institutions that received capital subscriptions as part of the Troubled Asset Relief Program's Capital Purchase Program, the FDIC expects these institutions to use those funds to enhance the availability of prudently underwritten loans.

Earlier this year, the FDIC hosted a roundtable discussion on how regulators and the banking industry can work together to improve credit availability. The attendees agreed that open communication between the regulators and the industry is vital to the process. With that in mind, last May the FDIC established a senior level office to further enhance community bank outreach and coordinate the activities of the FDIC's Advisory Committee on Community Banking. Members of the Advisory Committee will provide the FDIC with advice and recommendations on a range of policy issues that particularly affect small community banks. The Committee's first meeting is scheduled for October 15, 2009.

Q3. Thompson wrote that "recent experience has demonstrated that newly insured institutions pose an elevated risk to the FDIC Deposit Insurance Fund." Have

newly insured institutions posed an elevated risk to the FDIC Deposit Insurance Fund during non-bubble periods? What about during credit droughts? Or since the advent of the FDIC fund?

Depository institutions insured less than seven years are over-represented on the list of institutions that failed during 2008 and 2009; most of those failures occurred from the fourth through the seventh years of operation. A number of newly insured institutions have pursued early changes in business plans which, in some cases, heightened risk and exacerbated financial problems where accompanying controls and risk management practices were inadequate.

In addition, from an historical perspective, empirical studies were performed on a time series of de novo bank performance for 1980-1985 and 1995-2003. On average, new institutions from each period exhibited higher failure rates than established institutions. New institutions undergo rapid changes in the scale and scope of their operations that may make their financial ratios volatile. Further, a new institution's loan portfolio is unseasoned and, therefore, credit risk is difficult to assess based solely on a review of financial ratios.

Q4. What regulatory incentives are you putting in place to ensure that FDIC examiners allow healthy lending? Has an examiner been rewarded for encouraging banks to make more good loans?

The FDIC is committed to ensuring that examiners carry out their responsibilities judiciously and objectively. Examiners are expected to closely review and evaluate bank management's assessment of risk, market conditions, policy parameters, and use of any federal financial assistance. The examination process focuses on assessing management's own risk management process and identifying any weaknesses for consideration and action by bank management. We recognize that some believe bank supervisors have overreacted to the current economic problems and are discouraging bankers from making good loans. As a result, we have had a number of discussions with our regional management to increase sensitivity to issues of credit availability. The message that examiners should be encouraging banks to continue to make prudent loans and work with customers facing financial difficulties has been repeatedly conveyed to the field staff. That message has been further emphasized through our formal and on-the-job training process in which we instruct our examiners on how to deliver their observations without infringing on management's day-to-day decision-making and relationships with customers. Given their seasoning as regulators, we believe our examiners are keenly aware that credit extended by banks is critical to local economies across the country.

With regard to rewarding examiners for encouraging banks to make more good loans, FDIC examiners always have encouraged bank management to establish sound lending and collection policies that are clearly defined and provide for effective supervision by the directors and senior management. Banks must lend in order to be a sustainable and profitable business in the community. We believe banks that follow sound lending practices will make sound lending decisions.