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Good afternoon. Thank you for your kind offer to come visit with you today. It is a pleasure to see so many familiar faces and I also appreciate the opportunity to meet new friends.

It is appropriate that we're meeting this year in such a wonderful island location because, in many respects, the banking industry has been an island of growth and prosperity in recent years, compared with the difficulties and hardships suffered by so many sectors of the broader economy. It is especially nice when we consider the hardships our industry suffered just over a decade ago. We have truly been blessed and I know that you - and indeed all of us who lived through that time - appreciate the fact that the past few years could have been much, much worse.

You have led a charmed life. Because of your prudent and conservative banking strategies, and the hard lessons learned in the crisis, you have enjoyed more than a decade now of return on assets of more than one percent. Banking assets have nearly doubled in that time, and non-interest income has tripled. The industry remains far better capitalized than it was a decade ago. And while the recent reversal of fortunes in corporate America took its toll on credit quality, it caused barely a hiccup in your earnings. Indeed, you made more money last year, as an industry, than in any year in history. You made nearly $60 billion in the first six months of this year. And the second quarter of 2003 saw the lowest number of unprofitable institutions in more than five years.

There is more good news where that came from. Banks have revolutionized the customer service platform, seizing on new technologies to provide a level of service and convenience to customers we could only dream about when I started in the business 30 years ago. The industry has shown tremendous competence in asset/liability management, improved your access to the capital markets for capital and funding, diversified your income stream, and shown greater ability to control and manage the risk on your balance sheets. These are cultural changes in the business of banking that will provide benefits for years to come.

Indeed, it is truly a remarkable time for our industry and you are to be commended. It is important - critical - however, that none of us, either on the business or the regulatory

side, be guilty of overconfidence as a result of these positive developments. We must be on our guard always against the siren song of invincibility, against the tempting belief that the good times we enjoy today will always last.

And that's what I want to discuss with you today. It is important to remain vigilant. It is important because you - and your regulators, your shareholders, and your customers - want the good times to last. And it is important to be vigilant because the graveyard of corporate America is littered with companies and sectors that were once ten feet tall and bulletproof. Andrew Grove, the chief of Intel, once wrote a book called Only the Paranoid Survive, which contains a quote that sums up, in my view, what you need to be considering during this period of prosperity:

"Business success contains the seeds of its own destruction. The more successful you are, the more people want a chunk of your business, and then another chunk, and then another, until there is nothing left."

My father had a simpler expression to capture the same concept: "There is a big enough paddle to get anybody."

A few examples come to mind. AT&T once had a near monopolist position in a highly regulated industry. They controlled most aspects of their business from the phone on the wall (remember when you used to rent them from the phone company?) to the switches and lines and directories. They laid the first trans-oceanic cables, they pioneered the development of cellular telephones and launched communications satellites. But the unexpected happened. A court order broke up the Bell system on New Year's Day 1984. AT&T suddenly found itself a much smaller company in a world of continual change. New competitors and new technologies began further slicing into market share and cutting the price of long distance service. The company responded by constantly trying to add or spin off units in an attempt to regain a leadership position. How many of their pioneering technologies and the businesses they created are now dominated by other firms? But the fact remains that the foundation of their profitability - long distance service - has become a commodity that has not yet stopped falling in price.

Other examples are equally relevant to our discussion here today. The telecommunications industry, once the target of innovators and tremendous venture capital funding, now struggles under the twin burdens of bankruptcy and overcapacity. IBM, once a titan in the world of personal and business computing, has undergone a lengthy and difficult restructuring to once again achieve a position of dominance - although in a business very different than it was 25 years ago. Pan-Am, once one of the most celebrated and exotic names in aviation, did not survive the shift into an era of deregulated airlines. Just three years ago, one of the most respected names in the accounting profession was Arthur Andersen.

You could probably name ten more companies that were forced by the marketplace to reconfigure their business plans - or close their doors forever. They were all victims, in one way or another, of unexpected events, unplanned-for trends, and surprise twists in the marketplace. The difference, really, between those who survive and those who don't

is proper planning. The good managers spent a little of their time and resources on the unending effort to know the unknowable, and positioned their companies and their business plans to handle unexpected and dramatic change.

You are on top. Your risk-management strategies and your business plans seem - by and large - to be working. Your shareholders and your boards have come to expect you to routinely break earnings records or post high returns on assets. You know that. But what is it that you don't know? What dangers lurk over the horizon that you don't anticipate, that you haven't planned for? How is your bank positioned to handle significant shifts in consumer preferences, or non-bank competitors that want a share of your business, or interest rates? How good are you at questioning your own assumptions? Are you guilty - as so many in your shoes are - of believing your own press clippings, and thinking you're really as good as those favorable earnings reports say you are?

These are things you should be thinking about. And they are often the hardest things to think about. Like the rooster taking credit for the dawn, it is very easy for us, as humans, to believe that serendipity is a product of our own genius, that the favorable alignment of external events is fully some result of our own inspiration and imagination. As someone who has seen good times and bad, I caution you against letting this happen to you.

It isn't easy to anticipate the unanticipated, and know the unknown. We know this at the FDIC because we are engaged in the same exercise I'm asking you to engage in. We're trying to lift our heads beyond the data points and today's numbers and try to understand better the trends that are driving the banking industry - and, by extension, our risk. This is more an exercise in culture change, outreach, and information awareness than it is one of science and foolproof prediction. You sometimes drill in dry holes. You sometimes prepare for events that do not come to pass. But hopefully, by engaging in such an exercise and by making clear that this priority is worthy of scarce resources, you better position your organization to handle the unexpected when it happens. This is our challenge - and it is yours as well.

So what should you be watching? How should you be thinking about this? I'd break it into two broad categories. First, you need to fully understand the quantifiable risks that are on your balance sheet today - and think through how they could change, and how those changes could impact your business. At the FDIC, our economists and analysts talk about these issues in terms of emerging risks, developing imbalances, and potential inflection points. You can call them whatever you want, but either way they bear watching.

Here are a few examples. Your list may be different, depending on the makeup of your business.

Subprime lending is an issue we are following. We've paid close attention to it because it is still fairly new, it involves higher and less predictable credit losses, and it can be highly profitable - and therefore tempting - to many banks. The FDIC recognizes the risks well, in part because subprime lending was a factor in 30 percent of all bank failures during the last five years, accounting for almost 60 percent of all failed bank

assets. But while the scale of the subprime lending business continues to grow, we see fewer FDIC-insured institutions actively engaged in it today than was the case a couple of years ago. It's a risky line of business, to be sure, but it can be done safely and profitably if the appropriate practices and controls are put in place by the lender.

Another area of potential concern is commercial real estate. We've seen deteriorating fundamentals over the last couple of years in many large city commercial office markets. In these areas - like San Jose, San Francisco, and Dallas - vacancy rates have risen and rental rates have dropped sharply since 2000. However, so far we've not seen a great deterioration in the industry's CRE portfolios. Low interest rates have helped to a significant degree. Another factor has been better underwriting, in general, than we saw on the part of banks and thrifts in the last real estate cycle. The structure of commercial real estate finance has changed profoundly during the past decade with the rise of greater public market financing. We invited four of the leading experts in commercial mortgage-backed securitization to participate in a panel discussion with us on this topic last week. It was a highly informative session, and we will continue to reach out to the marketplace to better understand the trends in this area.

We're watching interest rate risk, and attempting to evaluate how an improving economy - and by definition an up-tick in rates - could impact the banking sector. The ability of homeowners to fix their mortgage rates while preserving the right to prepay at any time in the future presents risks that are difficult to quantify when mortgage loans are made.

As of mid-year 2003, more than a third of the assets of institutions insured by the FDIC were residential mortgages or were bonds backed by residential mortgages. On a positive note, the record level of refinancing that drove growth in mortgage-related assets was a boon for bank earnings because of fee income from originations. But, rates have risen since mid-year, and, now these institutions have a lot of mortgages on their books that were originated during a period of record-low rates. These assets could be a drag on industry earnings for some time. With each up-tick in interest rates, the expected life of these assets is lengthening, and their values are declining. This effect will pressure net interest margins or result in losses on sale if institutions move to replace these assets with higher yielding ones.

We're also following developments in the housing markets, not just the headline-grabbing problems at the big GSEs, but also the slowdown in refinancing, new housing starts, and housing price trends. We've noticed that certain metropolitan housing markets can have a tendency to undergo relatively wide swings in prices over time. In recent years, home prices in some markets on the East and West Coasts have significantly outstripped growth in personal incomes. However, given sufficient economic stress, markets such as these can also experience price declines. This is what happened in Southern California and New England in the late 1980s and early 1990s.

Recently, home price growth has begun to decelerate in many of the most costly U.S. markets, to a pace that is more in line with income growth. While most economists do not expect large or widespread price declines that would indicate a home price bubble, lenders need to be aware that the large price increases of recent years will not go on

forever. Preparing for a slowdown before it occurs is the best way to mitigate its effects on your bottom line.

These are all economic variables that could, within the next two to three years, change considerably. We want to make sure we're not surprised by any outcome in any of these areas. So should you.

The second category of things you should be thinking about, in my view, is the broader, more conceptual threats that have the potential to change the very nature of banking in America. These are the underlying trends in our country - generational, demographic, regulatory and market-based trends - that could transform the business you're in and leave you selling a product nobody wants to buy, or providing a service that others can perform cheaper and more efficiently. Despite all the good news we're seeing right now, the fact remains that banks are losing market share relative to other participants in the financial marketplace - as I told you last year, your share of the pie has never been richer and it has never been smaller, either.

You should, for example, be thinking about the range of products you offer and question whether they are appealing to the next generation of consumers. Are your procedures and mechanisms for dealing with your customers sufficiently convenient and seamless?

You should give some thought to the consolidation trend that accelerated during the nineties and may well begin to pick up steam again. What does that portend for your bank? As banking continues to consolidate in the top 50 or so holding companies, does that mean opportunities gained or lost for your bank? Are you able to compete with organizations with such economies of scale and nationwide brand identification? If not, how do you get ready?

Think for a moment about the competition you're getting from outside the banking arena. The capital markets are growing more sophisticated in funding many of the largest loans in the market. GSEs and non-bank mortgage brokers have developed highly efficient platforms for servicing the nation's housing finance needs. Think about those car ads we've all seen: "$2000 cash back or 0.9 percent financing." How many of you have lost car loans as a result of this market move? Will we see this in other areas? How many payroll checks are directly deposited into brokerage accounts at Merrill Lynch and Edward Jones? How many times do these firms' customers write checks against these funds to non-bank providers of auto loans, credit cards, and mortgages? I'm willing to bet the figures are significantly higher today than they were ten years ago.

Banks have begun responding to these challenges over the past several years, securing approval for laws allowing diversification into other non-bank financial services businesses like investment banking and insurance business. They have embraced technology to design products and relate to customers more efficiently. They have offered a range of brokerage and mutual fund products to their customers. This progress has been intermittent, however, and I'm not sure banks have made significant inroads into those businesses as of yet. And they may have difficulty doing so. A recent S&P report on banking made a chilling point: "In general, the evolution of the capital markets enables providers and users of funds to do business directly, bypassing

traditional intermediaries. Accordingly, the center of gravity of control of financial assets has moved away from banks and thrifts."

That ought to give you something to think about on the plane ride home.

My point is not to discourage you; rather, it is simply to help you think beyond the good news of today and the pinnacle of success you have achieved. The constant factor of your existence - from here on out - is going to be the relentless march of the changing marketplace, forcing you to adapt in ever more innovative ways.

To retain your position of dominance you are going to have to decide whether you are in the business of making loans and taking deposits, or whether you are in the business of meeting the financial needs of your customers. This focus on the core of your business will sometimes lead you to unorthodox conclusions about where you ought to go and the policies you ought to embrace. Being flexible and having an open mind about the right way to embrace the dynamics of today's marketplace will help you retain the position you've achieved over a decade of hard work. A narrow approach, and a failure to understand the underlying trends, is a one-way ticket to irrelevance.

You may, for example, decide the industry needs stronger charters, additional powers, and a different regulatory approach, in order to remain competitive - and press your trade associations and your regulators accordingly. You may decide to spin off a subsidiary, design a new customer service platform, turn your marketing more aggressively toward the next generation of financial consumer. You may decide to further diversify your income stream, purchase a bank in the next town, automate a process to save costs, or think through your product set and decide if you can offer it better - or even if you need to offer it at all. And perhaps you'll decide to plus-up your capital accounts - setting aside some funds to handle any unanticipated event. These are things I know you're engaged in already. But the steady pursuit of excellence in your business is not an empty exercise. It will build stronger banks that can withstand the rigors of competing in today's marketplace. And it will better position you for handling the unknown when it happens.

So as you leave this wonderful place - and return to your banks and communities all around the country - I ask you to spend some time thinking about all the things you don't know. Take a few minutes and study the landscape you're standing on. Evaluate how that scenery might change over time. And think through how your bank would withstand the worst that could happen.

It is never convenient to discuss umbrellas when the sun is shining, but I firmly believe that a little consideration of these things today could well prove the difference between surviving and going broke in some unanticipated tomorrow. Your continued prosperity - keeping banking at the center of American financial life - is a goal that all of us at the FDIC share with all of you. We're your companions in this journey into the unknown. And we all share an interest in your continued success.

Thank you.

Congress created the Federal Deposit Insurance Corporation in 1933 to restore public confidence in the nation's banking system. The FDIC insures deposits at the nation's 9,267 banks and savings associations and it promotes the safety and soundness of these institutions by identifying, monitoring and addressing risks to which they are exposed. The FDIC receives no federal tax dollars - insured financial institutions fund its operations.

FDIC press releases and other information are available on the Internet via the World Wide Web at www.fdic.gov and may also be obtained through the FDIC's Public Information Center (877-275-3342 or (703) 562-2200).

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