

FDIC Quarterly Banking Profile - Opening Statement

Third Quarter 2018

Good afternoon, and welcome to our release of third quarter 2018 results for FDIC-insured institutions.

The banking industry reported another strong quarter and record profits. Net income improved on higher net operating revenue and a lower effective tax rate. Loan balances continued to increase, net interest margins improved, and the number of “problem banks” continued to decline.

Community banks also reported another positive quarter. Net income at community banks also benefitted from higher revenue and a lower effective tax rate, and loan growth that was stronger than the overall industry.

It is worth noting that the current economic expansion is the second-longest on record, and the nation’s banks are stronger as a result.

While results this quarter were positive, the extended period of low interest rates and an increasingly competitive lending environment have led some institutions to “reach for yield.” Additionally, the competition to attract loan customers has been strong, and it will remain important for banks to maintain their underwriting discipline and credit standards. These factors have led to heightened exposure to interest-rate risk and credit risk.

Attention to the prudent management of these risks will position banks to be resilient so that they can sustain lending through the economic cycle.

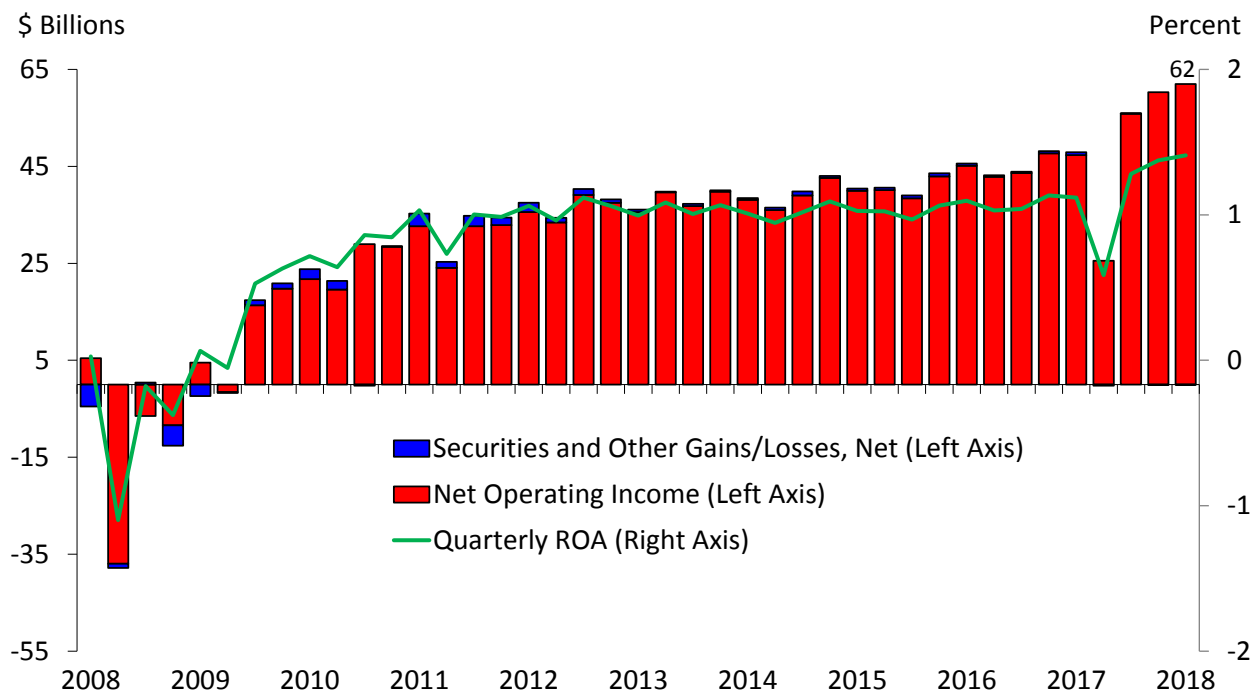
I am joined here today by Diane Ellis, Director of the Division of Insurance and Research; Pat Mitchell, Deputy Director of the Division of Insurance and Research; and Doreen Eberley, Director of the Division of Risk Management Supervision, to help provide details about bank performance during the third quarter.

Diane, I will turn this over to you. Thank you.

Chart 1:

Quarterly Net Income

All FDIC-Insured Institutions



Source: FDIC.

Thank you, Chairman McWilliams.

Our first chart shows that net income for the industry was 62 billion dollars in the third quarter, up 29.3 percent from a year ago.

About half of the dollar increase in net income was attributable to tax reform. Assuming the effective tax rate for the banking industry prior to the new tax law, we estimate that quarterly net income would have been 54.6 billion dollars, or 13.9 percent higher than third quarter 2017. The return-on-assets ratio increased to 1.41 percent in the third quarter from 1.12

percent one year ago. This is the highest quarterly level reported by the industry since the Quarterly Banking Profile began in 1986.

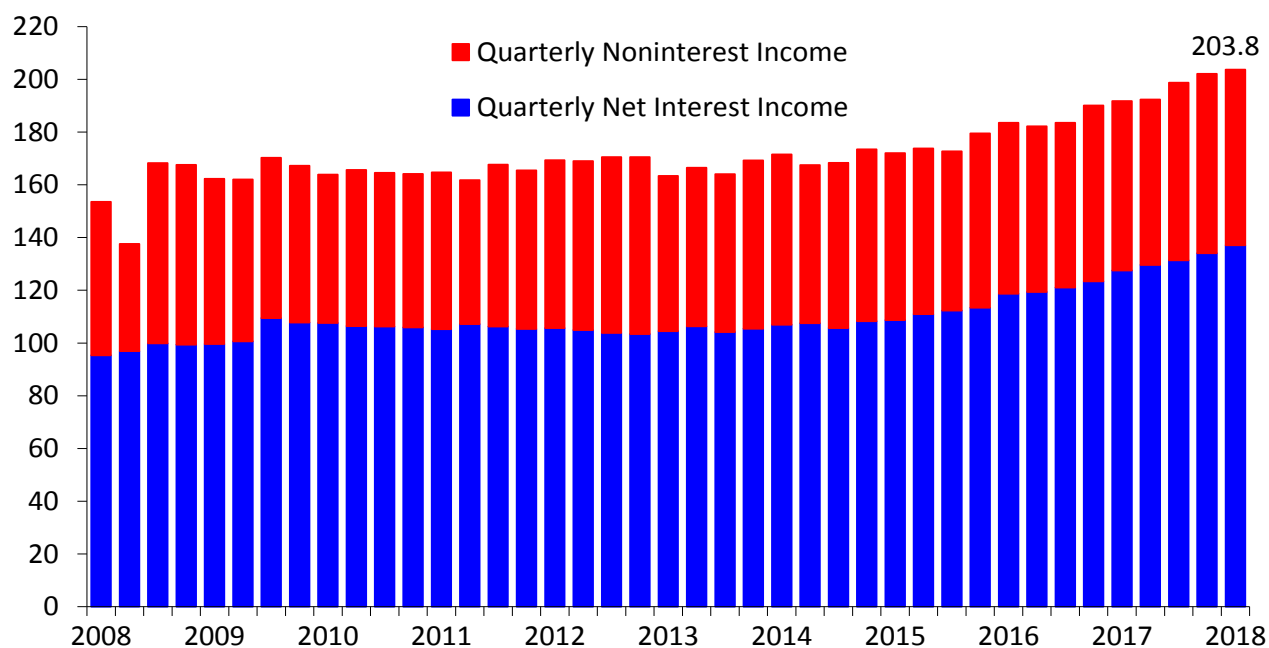
Community banks reported net income of 6.8 billion dollars in the third quarter, an increase of 21.6 percent from a year earlier. Assuming the effective tax rate for community banks prior to the new tax law, we estimate that quarterly net income would have been 6.4 billion dollars, an increase of 13.3 percent over third quarter 2017.

Chart 2:

Quarterly Net Operating Revenue

All FDIC-Insured Institutions

\$ Billions



Source: FDIC.

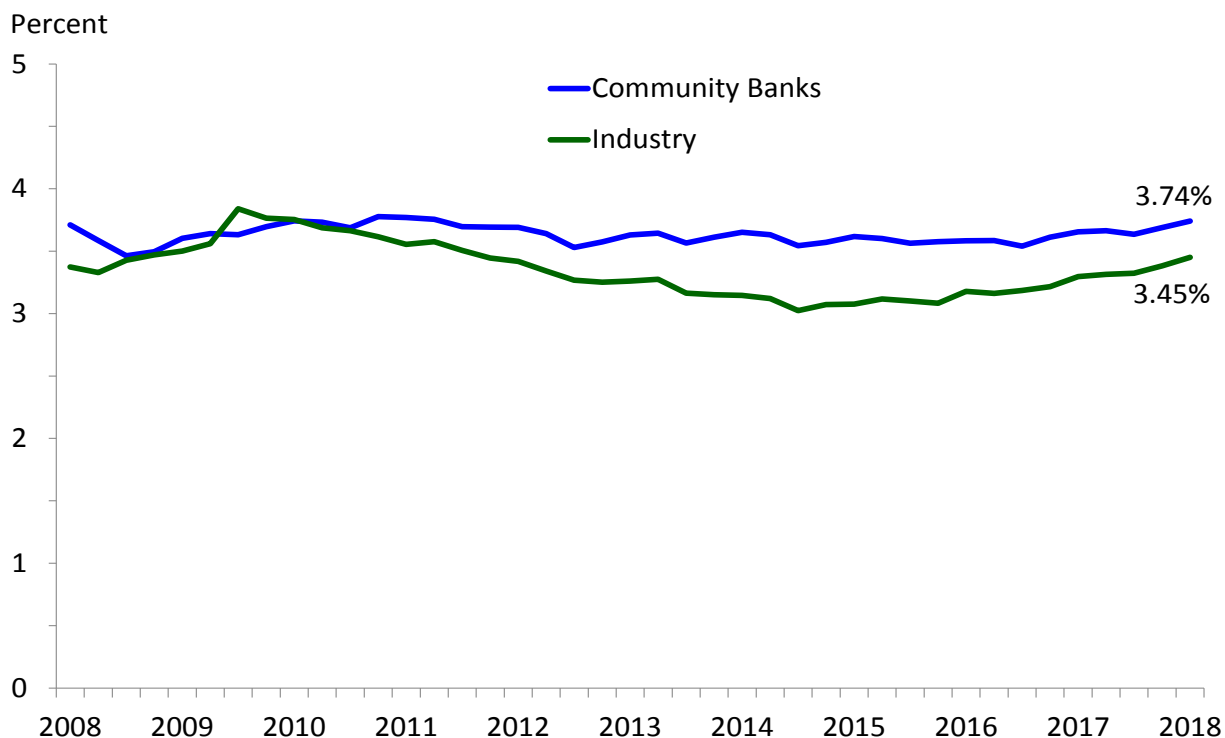
The next chart shows that net operating revenue totaled 203.8 billion dollars in the third quarter, an increase of 6.2 percent from a year ago. The

increase in revenue was broad-based across the industry, as close to 80 percent of all banks reported higher revenue than a year earlier.

The growth in revenue was driven by higher net interest income and higher noninterest income. Net interest income grew by 7.5 percent from a year ago because of loan growth and improved net interest margins. Noninterest income rose by 3.8 percent from a year ago because of higher servicing fees, investment banking fees, and other noninterest income.

Chart 3:

Quarterly Average Net Interest Margin



Source: FDIC.

Chart 3 shows that the average net interest margin for the industry was 3.45 percent in the third quarter, up from 3.30 percent a year earlier. The

average funding cost increased by 29 basis points from third quarter 2017, while the average asset yield rose by 44 basis points.

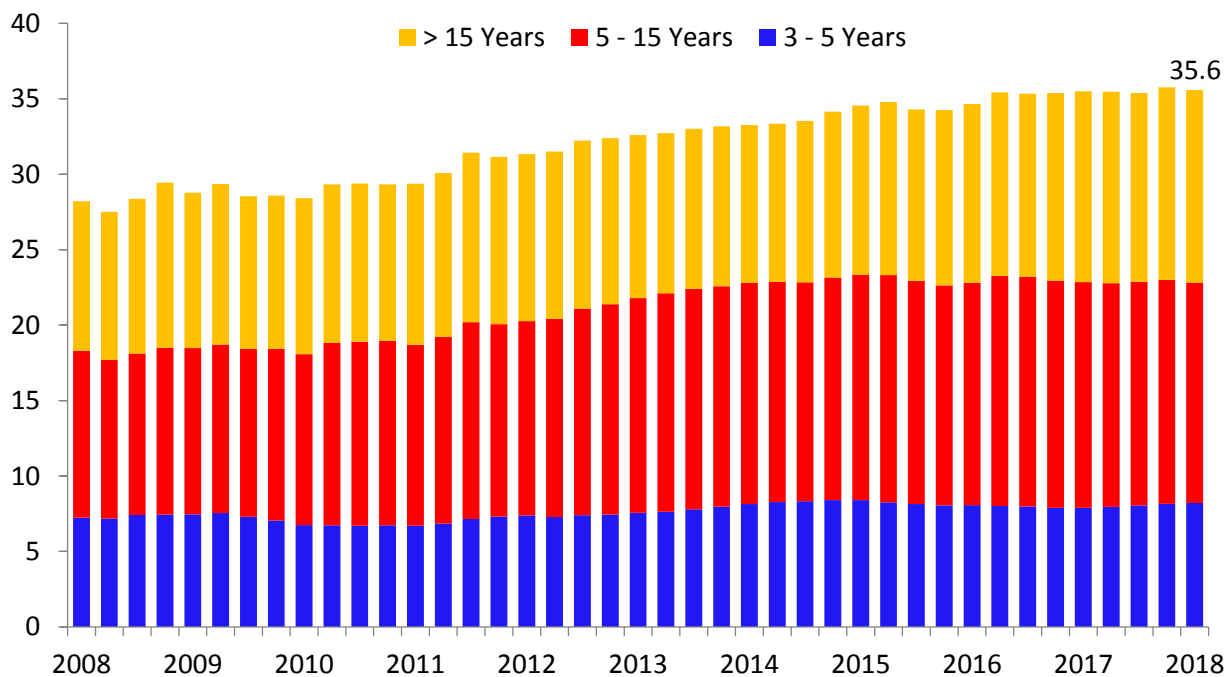
Community banks continue to report a higher average net interest margin than the overall industry. However, the gap has been narrowing. Large institutions have benefitted more than community banks from rising short-term interest rates, as large institutions have a greater share of assets that reprice quickly.

Chart 4:

Loans and Securities > 3 Years as a Percent of Total Assets

All Insured Call Report Filers

Percent of Total Assets



Source: FDIC.

Chart 4 shows that the shares of longer-term assets relative to total industry assets remain elevated, with more than a third of industry assets maturing or repricing in three or more years.

Some banks responded to low interest rates by “reaching for yield” through investments in longer-term assets, while other banks reduced on-balance sheet liquidity – cash, federal funds – to increase overall yields on earning assets and maintain net interest margins.

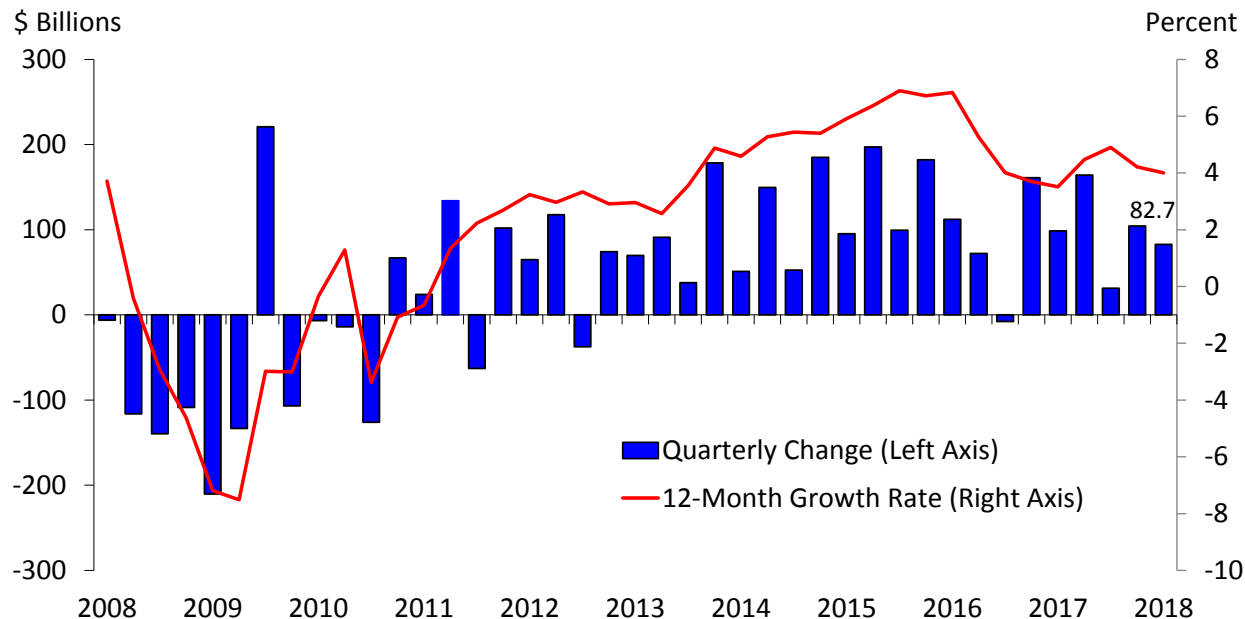
Further flattening of the yield curve in conjunction with banks’ increased proportion of long-term assets could be a headwind against future earnings.

So far, increases in interest rates have been largely beneficial to most banks as assets have repriced at a faster rate and in a greater amount than liabilities. Repricing of deposits in response to depositor demands for increased rates could result in earnings pressure for banks, particularly those that have a significant amount of long-term assets or those that are reliant on rate-sensitive deposits.

Community banks are particularly vulnerable to interest-rate risk, as nearly half of their assets mature or reprice in three or more years.

Chart 5:**Quarterly Change in Loan Balances**

All FDIC-Insured Institutions



Source: FDIC.

Note: FASB Statements 166 and 167 resulted in the consolidation of large amounts of securitized loan balances back onto banks' balance sheets in the first quarter of 2010. Although the total amount consolidated cannot be precisely quantified, the industry would have reported a decline in loan balances for the quarter absent this change in accounting standards.

Chart 5 shows that loan balances increased by 82.7 billion dollars during the third quarter, as all major loan categories registered growth. The largest increases were in consumer loans, led by credit card balances, residential mortgage loans, and commercial and industrial loans.

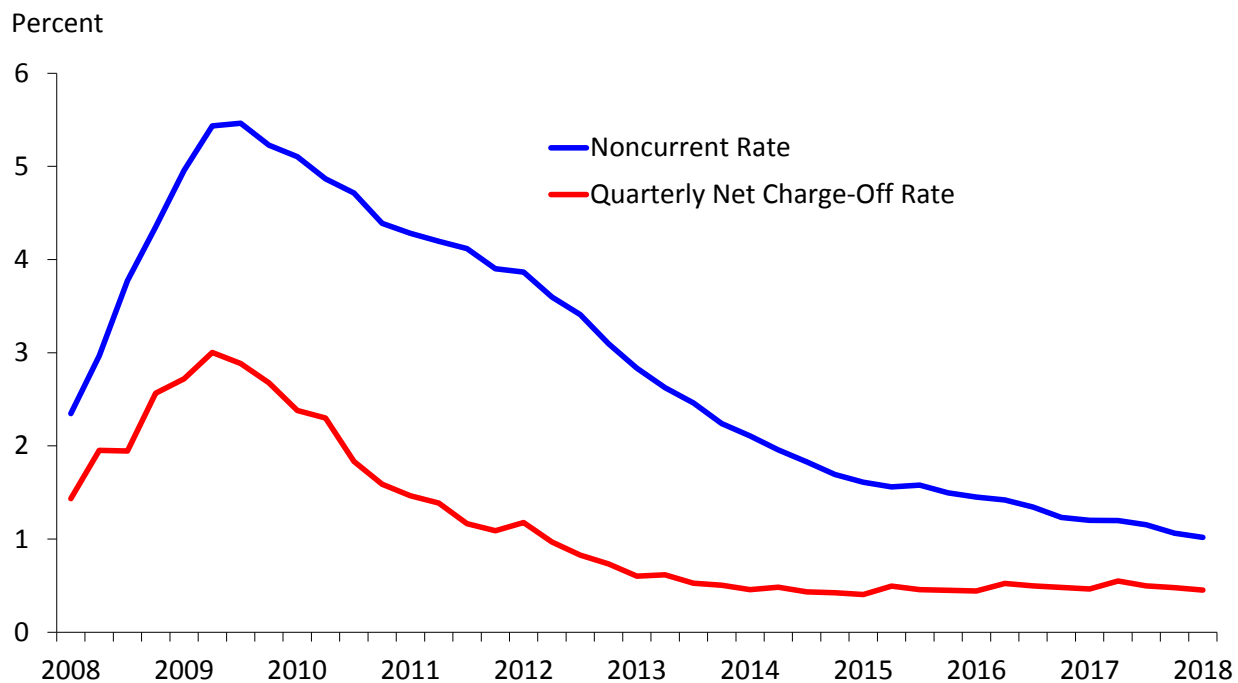
Over the past year, loan balances rose by 4 percent. This is a slight decline from the 4.2 percent annual growth rate reported last quarter.

Loan growth at community banks was also strong, measuring 6.6 percent for the past 12 months, led by growth in commercial real estate loans, residential mortgages, and commercial and industrial loans.

Chart 6:

Noncurrent Loan Rate and Quarterly Net Charge-Off Rate

All FDIC-Insured Institutions



The next chart shows that overall asset quality indicators remain strong.

The noncurrent rate declined from the previous quarter, and the net charge-off rate was lower than a year ago. Among the major loan categories, credit card balances registered the largest dollar increase in net charge-offs this quarter. The net charge-off rate for credit cards increased 14 basis points to 3.60 percent in the third quarter, but the net charge-off

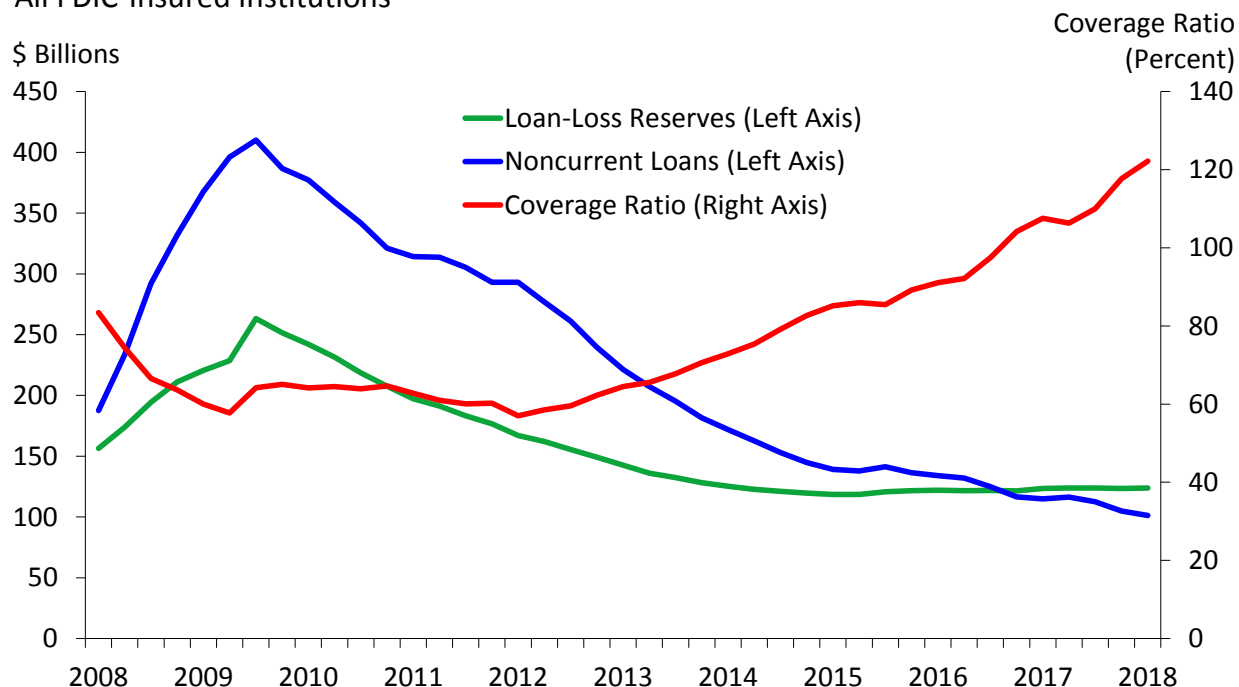
rate remains below the recent high of 13.21 percent reported in first quarter 2010.

We continue to monitor trends in the agricultural sector. Commodity prices remain low, and net farm income has declined by roughly 50 percent since reaching its peak in 2013. Farmland loan delinquencies have ticked up, but remain relatively low.

Chart 7:

Reserve Coverage Ratio

All FDIC-Insured Institutions



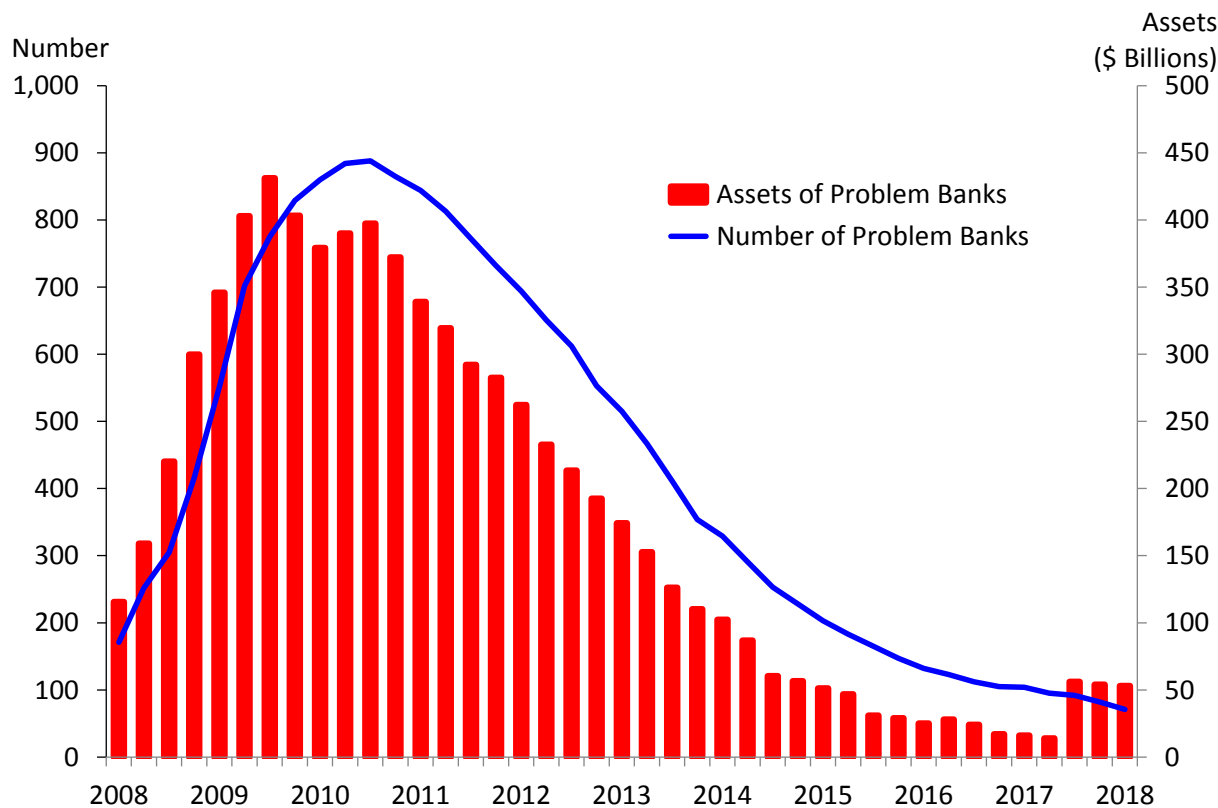
Source: FDIC.

Note: Loan-loss reserves to noncurrent loans and leases.

Chart 7 shows that the industry’s reserve coverage ratio, which measures loan-loss reserves relative to total noncurrent loan balances, increased to 122.2 percent at the end of the third quarter. This is the highest reserve

coverage ratio since first quarter 2007. The primary driver for the improvement in the reserve coverage ratio is the 3.6 billion dollar decline in noncurrent loans this quarter.

**Chart 8:
Number and Assets of Banks on the "Problem Bank List"**



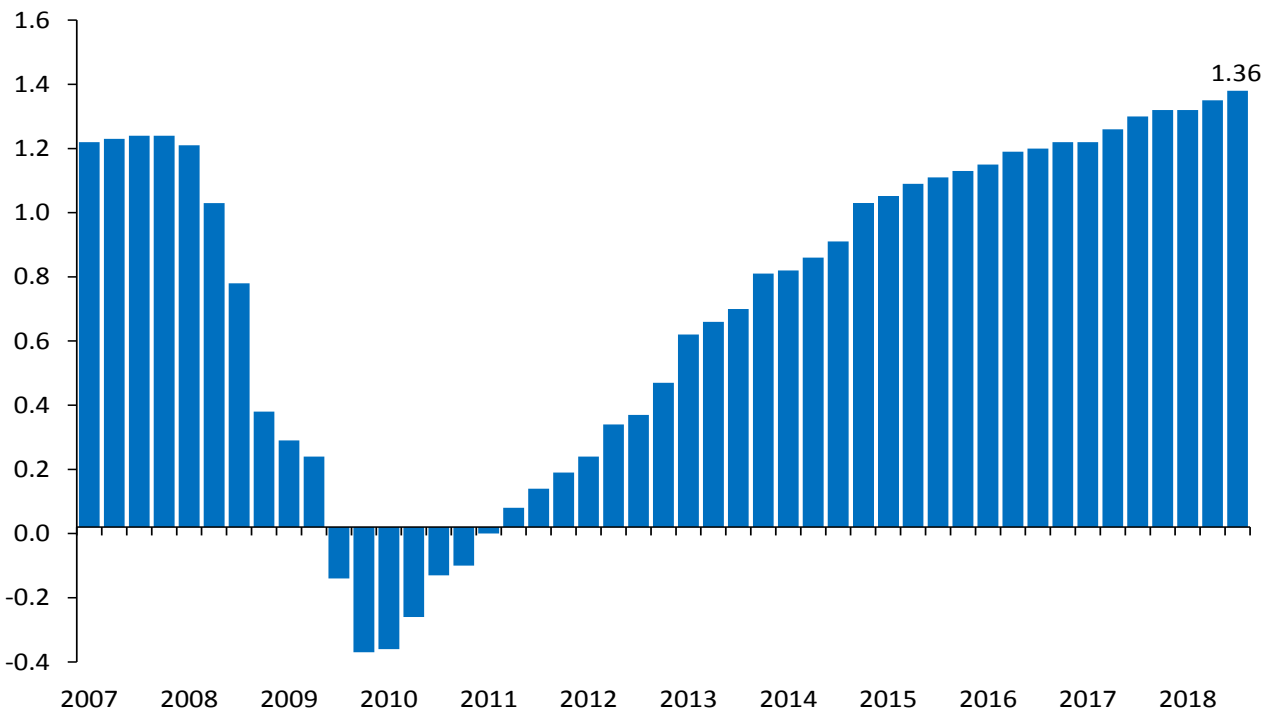
Source: FDIC.

Chart 8 shows that the number of banks on the FDIC’s “Problem Bank List” declined from 82 to 71 during the quarter. This is the lowest number of problem banks since third quarter 2007. One new bank opened, and no failures occurred in the third quarter.

Chart 9:

DIF Reserve Ratio, 2007 Q1 – 2018 Q3

Percent of Insured Deposits



Source: FDIC.

The Deposit Insurance Fund balance was 100.2 billion dollars on September 30, up 2.6 billion dollars from the end of last quarter. The increase in the fund was largely driven by assessment income. Estimated insured deposits totaled 7.4 trillion dollars at the end of September, increasing 0.3 percent in the second quarter and 3.8 percent over the past four quarters.

Chart 9 shows that the reserve ratio—the amount in the Deposit Insurance Fund relative to insured deposits—was 1.36 percent on September 30, up from 1.33 percent at the end of last quarter.

Since the reserve ratio was 1.36 percent on September 30, it has achieved the minimum reserve ratio of 1.35 percent that is required by law. As a result, the third quarter of 2018 marks the last period that large banks will be assessed quarterly surcharges by the FDIC.

When the reserve ratio is at or above 1.38 percent, small banks will receive credits for the portion of their assessments that contributed to growth in the reserve ratio from 1.15 percent to 1.35 percent. We estimate these credits to be approximately 750 million dollars in aggregate.

In summary, the banking industry reported positive results for the quarter. Higher net operating revenue and a lower effective tax rate boosted net income. Loan balances grew, net interest margins improved, and the number of “problem banks” continued to decline.

We will now answer any questions you have regarding third-quarter performance of the banking industry.

Thank you.

And with that, we will take questions.