Remarks of
Martin J. Gruenberg, Acting Chairman, FDIC
To
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In my remarks today, I will comment briefly on the condition of the banking system and then discuss the FDIC's new responsibilities for the resolution of systemically important financial institutions.

Condition of the Banking Industry

The FDIC and the banking industry are only now emerging from the most severe financial crisis since the 1930s. The latest data, released by the FDIC in its Quarterly Banking Profile in August, indicate that banks' balance sheets have continued to make gradual but steady progress in recovering from the financial market turmoil and severe recession that unfolded from 2007 through 2009.

The economic recovery, now entering its third year, has been marked by continued distress in real estate markets and a slow, painful process of balance-sheet repair by households, financial institutions, small businesses, and, now, governments at all levels. The result has not only been sub-par growth compared with previous recoveries, but also a persistent uncertainty about the future prospects for the economy, for jobs, and for the banking industry.

More recently, financial market turmoil related to government finances in Europe has further contributed to concerns about the future pace of growth.

All of these trends are, of course, of concern to policymakers and to the public. The FDIC remains highly alert to these challenges going forward.

There is also positive news in the financial services industry. FDIC data show an overall improvement in the condition of insured financial institutions in the second quarter. Industry earnings have grown over the past eight quarters. The percent of noncurrent loans on the books of FDIC-insured institutions has declined for five consecutive quarters, reflecting improved credit quality. The number of institutions on the FDIC's problem-bank list declined in the second quarter for the first time in nearly five years. The Deposit Insurance Fund returned to positive territory as of June 30. The FDIC is forecasting substantially fewer failing banks this year than last year.

FDIC-insured institutions are generally well positioned to continue working through this difficult episode. Industry capital ratios have been restored to record-high levels. This capital cushion represents not only the wherewithal to absorb additional loan losses, if needed, but also to back new lending as the demand for credit recovers.

However, reductions in loan-loss provisions -- the money that banks set aside against expected loan losses -- account for most of the improvement in industry earnings to this point. As the levels of loan-loss provisions approach their historic norms, the prospects of earnings improvement from this source will diminish. That's why increased lending will be essential for future revenue growth.

The FDIC will be releasing the Quarterly Banking Profile for the Third Quarter on November 22, so we will soon have updated data to share with you.

Putting the FDIC's New Systemic Resolution Responsibilities in Perspective

The FDIC has been given significant new responsibilities under the Dodd-Frank Act to resolve systemically important financial institutions. Specifically, these include an Orderly Liquidation Authority to resolve the largest and most complex bank holding companies and non-bank financial institutions, if necessary, and a requirement for resolution plans that will give regulators additional tools with which to manage the failure of large, complex enterprises.

Before discussing our efforts to carry out these new responsibilities, I wanted to try to place these responsibilities within the broader framework of the way the FDIC's resolution activities regularly work together with bank supervision in responding to the financial difficulties of FDIC-insured institutions.

It is important to recognize up front that resolution is always the option of last resort. The purpose of the supervisory process is to make sure that institutions manage their risks so that the risk of failure is minimized. The goal is to have a supervisory process that can recognize problems early and encourage management to address problems in a proactive way. When an institution's supervisory rating or capital adequacy is downgraded, the institution is subject to a variety of supervisory responses intended to encourage management to take prompt action. These supervisory actions may include:

- specific criticisms of risk management practices;
- formal or informal enforcement actions;
- orders to raise capital or seek merger partners that can bring in new capital and management expertise.

Under the current arrangement, should the condition of the institution deteriorate, the FDIC begins its resolution planning process in conjunction with the ongoing supervisory process and in close coordination with the primary supervisor of the institution. This would include undertaking a deposit download for deposit insurance purposes, and developing a detailed resolution plan for the institution. The goal is to have an integrated process of supervision and resolution that will hopefully avoid closure of the institution, but that will enable the FDIC to prepare to carry out an orderly resolution if necessary. In such a process - motivated by the credible threat of failure - the managers and investors of problem institutions have an incentive to:

- work with regulators to address their problems sooner rather than later;.
- access new sources of capital if available; or
- sell the institution, in part or whole, if necessary to salvage some value in the institution.

Our goal in regard to the FDIC's new systemic resolution responsibilities is to adapt this framework to systemically important financial institutions, including their holding companies and affiliates, as well as designated non-bank financial companies. This will obviously pose significant new challenges that I will discuss in a moment. But the basic goal is the same. What is needed is an integrated process of supervision and resolution planning for systemically important financial institutions that will provide for early supervisory intervention to avoid resolution, but that will be prepared to carry out an orderly resolution if needed.

The FDIC outlined in a paper how this process might have worked in the Lehman Brothers case. That paper is available on the FDIC website.

Orderly Liquidation Authority, Resolution Planning, and the Office of Complex Financial Institutions

The FDIC has taken a number of steps over the past year to carry out its new systemic resolution responsibilities.

First, the FDIC established a new Office of Complex Financial Institutions to carry out three core functions:

- monitor risk within and across these large, complex firms from the standpoint of resolution;
- conduct resolution planning and the development of strategies to respond to potential crisis situations; and
- coordinate with regulators overseas regarding the significant challenges associated with cross-border resolution.

For the past year, this office has been developing its own resolution plans in order to be ready to resolve a failing systemic financial company. These internal FDIC resolution plans, developed pursuant to the Orderly Liquidation Authority, provided under Title II of Dodd-Frank, apply many of the same powers that the FDIC has long used to manage failed-bank receiverships to a failing systemically important financial institution (SIFI). If the FDIC is appointed as receiver of such an institution, it will be required to carry out an orderly liquidation in a manner that maximizes the value of the company's assets and ensures that creditors and shareholders appropriately bear any losses. The goal is to close the institution without putting the financial system at risk.

This internal resolution planning work is the foundation of the FDIC's implementation of its new responsibilities under Dodd-Frank.

In addition, the FDIC has largely completed the basic rulemaking necessary to carry out its responsibilities under Dodd-Frank.

In July, the FDIC Board approved a final rule implementing the Orderly Liquidation Authority. This rulemaking addressed, among other things, the priority of claims, including administrative expenses, amounts owed to the United States, post-insolvency interest, and the treatment of similarly situated creditors, as well as the claims procedures and how creditors can seek relief in federal court.

In September, the FDIC Board adopted two rules regarding resolution plans that systemically important financial institutions themselves will be required to prepare - the so-called "living wills."

The first resolution plan rule, jointly issued with the Federal Reserve, implements the requirements of Section 165(d) of the Dodd-Frank Act. This section requires bank holding companies with total consolidated assets of $50 billion or more, and certain nonbank financial companies that the Financial Stability Oversight Council designates as systemic, to develop, maintain and periodically submit resolution plans to regulators. The plans will detail how the top-tier legal entity in the enterprise - as well as any subsidiary that conducts core business lines or critical operations - would be resolved under the U.S. Bankruptcy Code.

Complementing this joint rulemaking, the FDIC also issued an Interim Final Rule requiring any FDIC-insured depository institution with assets over $50 billion to develop, maintain and periodically submit plans outlining how the FDIC would resolve it through the FDIC's traditional resolution powers under the Federal Deposit Insurance Act.

These two resolution plan rulemakings are designed to work in tandem and complement each other by covering the full range of business lines, legal entities and capital-structure combinations within a large financial firm. Both of these resolution plan requirements will improve efficiencies, risk management and contingency planning at the institutions themselves. They will supplement the FDIC's own resolution planning work with information that would help facilitate an orderly resolution in the event of failure.

We expect that the process of developing these plans - or "living wills" -- will be a dialogue between the regulators and the firm. It is not a simple "check-the-box" exercise, and it must take into account each firm's unique characteristics. The planning process must be an interactive dialogue, especially for the largest and most complicated firms.

Together, these efforts will ensure comprehensive and coordinated resolution planning for both the insured depository and its holding company and affiliates in the event that an orderly liquidation is required.

With the joint rule now final, the FDIC and the Federal Reserve have now started the process of engaging with individual companies on the preparation of their resolution plans.

I should note that developing a credible capacity to place a systemically important financial institution into an orderly resolution process is essential to subjecting these companies to meaningful market discipline. Without this capability, these institutions -- which by definition pose a risk to the financial system -- create an expectation of public support to avert failure. That distorts the financial marketplace, giving these institutions a competitive advantage that allows them to take on even greater risk and creating an unlevel playing field for other financial institutions that are not perceived as benefiting from potential public support. There is a very strong public interest in the FDIC developing the capability to carry out its new systemic resolution responsibilities in a credible and effective way.

Economic Inclusion and Access to Mainstream Banking Services

If I may, let me now turn to a different topic that is a very high priority for the FDIC and also has been a subject of attention by the Clearing House: expanding access to insured financial institutions to all Americans.

Deposit insurance is essentially about making people feel secure putting their money into financial institutions. However, accessing insured financial institutions has proven elusive for millions of people in our country.

In 2009, pursuant to a statutory provision, the FDIC partnered with the Census Bureau to conduct the first national survey ever undertaken of who is unbanked and underbanked in the United States. It found that 7 percent of U.S. households do not have bank accounts, and another nearly 18 percent who may have an account still utilize non-bank financial services such as check cashers and payday lenders, which are frequently more expensive. Taken together, this means that nearly a quarter of American households are underserved by the mainstream banking system, and the proportions are significantly higher for low-income and minority populations. The Census Bureau will now conduct this survey on behalf of the FDIC every two years. The second survey was conducted a few months ago, and we plan to release the findings next year.

In response to this issue, the FDIC has undertaken initiatives at both the local and national level.

At the local level, the FDIC's Alliance for Economic Inclusion (AEI) has organized coalitions of financial institutions, community organizations, local government officials, and other partners in communities across the country to bring unbanked and underserved households into the financial mainstream by expanding access to basic retail financial services, including savings accounts, affordable remittance products, small-dollar loan programs, targeted financial education programs, and asset-building programs. These partnerships are currently operating in 14 communities nationwide, and the FDIC plans to expand the program in the coming months

At the national policy level, the FDIC's Advisory Committee on Economic Inclusion - composed of bankers, community and consumer organizations, and academics - also explores ways to bring the unbanked into the financial mainstream. The Committee has pursued a number of initiatives since it was formed in 2007. One of the initial projects it recommended - the Small-Dollar Loan Pilot Program - demonstrated that banks can offer safe, affordable small-dollar loans as an alternative to high-priced sources of emergency credit, such as payday loans or fee-based overdrafts.

The Advisory Committee is now undertaking a pilot program called Model Safe Accounts to evaluate how banks can offer safe, low-cost transactional and savings accounts that are responsive to the needs of underserved consumers. Participating banks are in the process of testing the model accounts, which feature electronic debit-card based accounts with low fees and low minimum balance requirements. We are hopeful that the results of the testing will encourage more banks to offer such products.

The Advisory Committee will meet again later this year. A focus of the Committee and the FDIC going forward will be the potential role that technology and innovation can play in expanding access to mainstream financial services.

Conclusion

In conclusion, I would like to acknowledge the interest that the Clearing House has taken in the issue of financial inclusion. I believe that our largest financial companies have a very significant contribution to make in this area. The FDIC would welcome the opportunity to work with you in expanding this very important avenue to economic opportunity.

We also look forward to working with you on the resolution plans that will now be required. As I indicated, we expect this to be an iterative process between the companies and the agencies. This is something new in our regulatory framework. We look forward to working with you as we implement what the FDIC considers an important tool in carrying its systemic resolution responsibilities.

Thank you.

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