Remarks by
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American Banker Regulatory Symposium,
Washington, DC
September 14, 2012

It is a pleasure to take part in the American Banker Regulatory Symposium. In my remarks, I will touch briefly on three topics: the condition of the banking industry, an overview of the progress being made by the FDIC and the Federal Reserve on the resolution plans or so-called “living wills,” and the FDIC's community banking initiatives.

Condition of the Banking Industry

We released the second quarter results for FDIC-insured commercial banks and savings institutions in our Quarterly Banking Profile on August 28th. While the second quarter results are new, the story they tell is not. The data show the banking industry continues to make gradual but steady progress in recovering from the financial crisis and severe recession that followed. Since that time, the industry has undergone a difficult process of balance sheet repair, by bolstering capital, reducing problem assets, and improving liquidity. We have also seen a declining trend in the number of bank failures and problem banks, and there are some encouraging signs of a return to loan growth. Overall, insured depository institutions are in a position to contribute in important ways to economic growth.

Insured institutions reported $34.5 billion in net income in the second quarter of 2012, a $5.9 billion increase over the same period last year. This is the twelfth quarter in a row that earnings have been higher than a year earlier. Moreover, almost two out of every three institutions are reporting better earnings results than a year earlier, and the number of unprofitable institutions is returning to pre-crisis levels. At the same time, indicators of asset quality continue to show signs of steady improvement, although levels remain elevated. Noncurrent loan balances have declined for nine consecutive quarters, while quarterly net charge-offs have fallen from year-earlier levels for eight quarters in a row.

Problem banks declined for a fifth consecutive quarter, from 772 to 732, and now stand at the lowest level since the end of 2009, but remain high by historical standards. A total of 41 banks have failed so far this year, compared to 68 failures at this point last year. The Deposit Insurance Fund balance turned positive as of second quarter 2011, and continues to grow – it is up to $22.7 billion at June 30, from $15.3 billion at March 31. The reserve ratio now stands at 0.32 percent.

One key element of industry conditions is loan growth. After posting three quarters of positive growth to close out 2011, loan balances declined in the first quarter of this year, driven largely by seasonal effects. However, the second quarter has brought renewed growth of over $100 billion, particularly in commercial and industrial loans. This is certainly an encouraging development. We will see if the trend in loan growth gains can be sustained.

We are particularly focused on a return to prudent loan growth for a couple of reasons. First, the improvement we have seen in industry earnings over the past two years has been largely driven by lower loan-loss provisions – a trend that cannot go on forever. At some point, future earnings gains will have to be based to a greater extent on increased lending, consistent with sound underwriting. Second, we know that a return to greater lending is a necessary condition for a growing economy.

To summarize: the banking industry continued to make gradual but steady progress toward recovery in the second quarter. Levels of troubled assets and troubled institutions remain high, but they are continuing to improve. After declining in the first quarter, loan balances once again expanded in the second quarter – extending a positive trend that began in 2011. Most institutions are profitable and are improving their profitability. All of these trends are consistent with the moderate pace of economic growth that has occurred over the past year. The continuing improvement in the industry is likely to be tied to the future performance of the economy

Implementation of the Dodd-Frank Act: Title I Resolution Plans

Prior to and during the recent financial crisis, the FDIC's resolution authority was limited to insured depository institutions. The FDIC did not have the authority to place either the parent company of the bank or the non-bank affiliates within the holding company into receivership The FDIC also lacked the authority to resolve large, non-bank financial companies, such as Lehman Brothers Holdings Inc. These limitations proved to be a significant constraint on the ability of the government to manage and respond to severe problems at these firms without serious disruption to the financial system and economy.

Title II of the Dodd-Frank Act fills these important gaps in FDIC authority. Title II enables the FDIC to resolve the insured depository institution, its parent holding company and any affiliate as well as other non-bank systemically important financial institutions (SIFIs). The FDIC has been working over the past two years to develop the strategic and operational capability to carry out this new authority.

It is important to recognize, however, that in addition to providing the Title II authorities to the FDIC, the Dodd-Frank Act, in Title I, requires bank holding companies with more than $50 billion in assets and other firms designated as systemic to develop their own resolution plans, these are the so-called "living wills." These firms are required to demonstrate how they could be resolved under the bankruptcy code without disruption to the financial system and the economy.

This requirement makes clear that under the Dodd-Frank Act, bankruptcy is the option of first recourse. The purpose of these living wills is to require these firms to prepare themselves to be resolved in an orderly way under the bankruptcy code. Only in the extraordinary circumstances in which an orderly resolution could not be conducted under the bankruptcy code would a Title II orderly liquidation be considered. Title II should not be viewed as a replacement for bankruptcy, but as a last resort to allow the firm to fail without broad systemic disruption. Thus, Title I plans take on an important role as a new tool for these companies to make themselves resolvable under the bankruptcy code.

The FDIC Board has adopted two rules regarding the resolution plans. The first resolution plan rule, jointly issued with the Federal Reserve Board last year, 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 the Federal Reserve and the FDIC.

The FDIC also required 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.

The first resolution plans were submitted in early July by the nine largest companies with non-bank assets of over $250 billion. The FDIC and the Federal Reserve Board are now in the process of reviewing the plans for information completeness and compliance with the requirements of the rulemaking. This will be a thorough and in-depth review process that takes into account each financial company's unique characteristics. It involves an ongoing interactive dialogue between the financial companies and the regulators.

The statute requires that the ultimate result of this process is that these plans would allow these firms to be resolvable under bankruptcy. That is the standard that the FDIC and the Federal Reserve Board will have to jointly apply in order to make an ultimate determination on the credibility of the plans as required by the statute.

FDIC Community Banking Initiatives

Now, having discussed resolution planning for the largest banking and financial organizations, I'd like to turn to another important FDIC priority – our Community Banking Initiatives.

As the lead federal regulator for the majority of community banks in the United States and the insurer of all, we believe it is important for us to understand the role of community banks in our economy and the particular challenges they face in the financial marketplace. To that end, the FDIC has undertaken a series of initiatives related to the future of community banks. The purpose is to further the FDIC's dialogue with the industry and deepen our understanding of the evolving challenges and opportunities facing community banks.

We began in February with a conference on the Future of Community Banking that provided a forum to explore the unique role community banks play in the country's economy and the challenges and opportunities they face. In addition, we have held roundtables with groups of community bankers in five of the FDIC's six regions around the country. Our sixth will be held in San Francisco in October. At these roundtables, we have heard firsthand about the concerns of bankers and what the FDIC can do to respond to those concerns. The roundtables have been very productive and we appreciate the ideas and input we have received.

Among the many concerns that have been voiced at these roundtables, several have stood out. Community bankers are concerned about their financial performance in this difficult economic environment. Margins are low and loan demand remains weak. Management succession and the recruitment of qualified personnel, particularly in rural banks, is of great concern, as is managing the cost of meeting their regulatory obligations. Maintaining a competitive position in bank technology is also frequently mentioned as a challenge.

It is no surprise that we heard from community bankers about supervision and regulation. Community bankers said that communication between examiners and the banks is crucial. This is particularly true in the pre-exam planning process. Bankers expect that the materials they provide to facilitate this advance planning will enable examiners to be as efficient as possible once they are on site. We have also heard that the examiners' communication with management at the beginning of the exam should clearly lay out the focus and goals of the exam. In addition, we heard about how important it is that the exam is followed up by a timely examination report that focuses on the same issues identified during the on-site discussions with bank management.

I think it is fair to say that participants in the roundtables continue to believe in the community bank model. The model depends on knowledge and understanding of their borrowers, particularly small businesses, and reliance on core deposits for funding. Many of the community banks that failed during this crisis diverged from this model. But the vast majority of community banks stuck to the basics and have emerged from the crisis in good shape and in a position to support renewed economic growth in their communities.

We also recognize the importance of updated research and analysis on the critical role that community banks play in their communities, our financial system and the economy as a whole. Community banks with assets under $1 billion currently represent just over 10 percent of banking assets, yet they provide nearly 40 percent of the loans made by the banking industry to small businesses, extending credit that is essential to job creation.

It is also important to recognize that in key parts of this country -- rural areas, small towns and certain urban neighborhoods -- community banks are often the only providers of banking services. If not for the community bank, many of these communities would have no bank at all.

Thus, as part of our community banking initiatives, we are undertaking a comprehensive review of the development of community banking in the United States over the past 25 years and its prospects.   Our study will analyze the long-term structural changes and performance trends in the community banking industry, with the goal of identifying the main forces that are driving those changes. Targeted research explores topics including the determinants of community bank return on assets and factors influencing the ability of community banks to raise capital. Our research also explores how community banks may be affected by trends in the small business economy, and analyzes successful community bank models over the years that could potentially serve as guideposts for the future.

We are also taking a closer look as the examination process for risk management and compliance supervision. We are reviewing the examination process and how we promulgate and release rulemakings and guidance to see if we can improve our processes and communications in ways that benefit community banks, while maintaining our supervisory standards. The banker roundtables and our research effort will help to inform this review.

As I indicated, our outreach with bankers throughout the country and our research effort should do much to inform our review of our approach to risk management and compliance supervision. We hope to produce outcomes by the end of this year, and we also plan to continue these efforts into next year and beyond.

I would be happy to take your questions.

Last Updated 9/14/2012