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FDIC to the Independent Community Bankers
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In my remarks today, I will comment briefly on the condition of the banking industry, provide an overview of the FDIC's efforts to carry out its responsibilities under the Dodd-Frank Act for the resolution of systemically important financial institutions, and conclude with a discussion of the FDIC's initiatives in regard to the future of community banking.

Condition of the Banking Industry

2011 represented the second full year of improving performance by the banking system.

The latest data, released by the FDIC in its Quarterly Banking Profile in February, indicate that banks have continued to make gradual but steady progress in recovering from the financial market turmoil and severe recession that unfolded from 2007 through 2009.

During the past two years, the banking industry has undergone a difficult process of balance sheet strengthening. Capital has been increased, asset quality has improved, and banks have bolstered their liquidity. The industry is now in a much better position to support the economy through expanded lending. However, levels of troubled assets and problem banks are still high. And while the economy is showing signs of improvement, downside risks remain a concern.

The FDIC data does show a continuation in the fourth quarter of last year of a trend in overall improvement in the condition of insured financial institutions. Industry earnings have grown over the past eight quarters. The percent of noncurrent loans on the books of FDIC-insured institutions has declined for seven consecutive quarters, reflecting improved credit quality. The number of institutions on the FDIC's problem bank list declined for the third consecutive quarter. The Deposit Insurance Fund moved into positive territory as of June 30 of last year, and continued to increase in the third and fourth quarters. The FDIC is forecasting significantly fewer failing banks this year than last year.

However, most of the improvement in earnings over the last two years has been the result of lower loan-loss provisions reflecting improved credit quality. But future earnings gains will have to be based to a greater extent on increased lending, consistent with sound underwriting. Prudent loan growth is a necessary condition for a stronger economy.

That is why we view the fourth quarter growth in the industry's loan portfolio, the third consecutive quarter of growth, as a hopeful sign.

The loan growth that has occurred so far has been led by lending to commercial borrowers. Loans to medium and large commercial and industrial borrowers have increased in each of the last six quarters. In the fourth quarter, we saw growth in small C&I loans as well. The FDIC began collecting quarterly data on small loans to businesses with the March 2010 Call Report; since that time, this is the first quarterly increase in small C&I loans.

This is a trend the FDIC will be following closely going forward

The FDIC's New Systemic Resolution Responsibilities

As you may know, 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.

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, and the treatment of similarly situated creditors.

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 also be an interactive dialogue with the firms 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. The first plans, for companies with assets over $250 billion, will be due in July.

In regard to the important cross-border issues, as I indicated the FDIC has established a unit within its new Office of Complex Financial Institutions dedicated to developing relationships with the foreign supervisors of the foreign operations of systemically important U.S. financial institutions. These include direct bilateral relationships with foreign supervisors, as well as extensive multilateral interactions with foreign supervisors through the various crisis management groups of global SIFIs, the Crisis Management Steering Committee of the Financial Stability Board, and the Basel Committee's Cross Border Resolutions Working Group, which the FDIC co-chairs.

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.

The Future of Community Banking

As you may know, the FDIC has established as a major priority for this year focusing on the future of community banking in the United States. Just last month the FDIC held a major conference in Washington on this issue and just last week I was in Dallas for our first of six regional roundtables with community bankers. Why has the FDIC made this among our top priorities for this year?

First, community banks play a crucial role in the financial system of the United States. Community banks with assets of less than $1 billion account for a little more than ten percent of the banking assets in our country, but provide nearly forty percent of all the small loans that insured financial institutions make to businesses and farms. Given the labor intensive, highly customized nature of many small business loans, it is not clear that large institutions would easily fill that critical credit need if community banks were not there. Community banks also play a crucial role in extending credit and providing financial services in rural communities, small towns, and inner-city neighborhoods. In many of those localities, if not for the community bank there would be no easy access to an insured financial institution. In my view there is a clear public interest in maintaining a strong community bank sector in the U.S. financial system.

Second, questions have been raised, often by community bankers themselves, about the future role of community banks in the financial marketplace. They identify

challenges such as keeping up with rapidly changing technology, raising capital, attracting qualified employees, and meeting regulatory obligations, as well as the general trend toward consolidation in the banking industry.

Third, the FDIC is the lead federal regulator for the majority of community banks in the United States and the insurer of all. In those capacities, it seems to me, we have a responsibility to use our resources to gain a better understanding of the challenges facing community banks and to share that understanding with the banks as well as the general public.

For that reason, the FDIC will be undertaking a series of initiatives over the course of this year related to the future of community banks, of which the Washington conference I mentioned was the first.

Following on the conference, I am holding a series of roundtables with groups of community bankers in each of the FDIC's six regions around the country. I will be joined at those roundtables by the FDIC's senior executives for supervision so that we can hear first hand about the concerns of bankers and what the FDIC can do to respond to those concerns. As I mentioned, we held the first roundtable in Dallas just last week. It was a productive and frank discussion, as I suspected it would be. In my experience community bankers are not shy about expressing their views and I welcome it.

I have also asked the FDIC's Division of Insurance and Research to undertake a comprehensive review of the evolution of community banking in the United States over the past twenty-five years, to identify the key challenges facing community banks as well as stories of successful community bank business models, and draw conclusions from that analysis that may be useful for community banks going forward. It does strike me that for all the attention community banks have drawn, there is still a need for more thoughtful and careful research and analysis about the role that community banks play in the U.S. financial system.

In addition, I have asked the Directors of the FDIC's Division of Risk Management Supervision and Division of Depositor and Consumer Protection to review the examination process for both risk management and compliance supervision, as well as to review how we promulgate and release rulemakings and guidance, to see if we can identify ways to improve our processes and communication while maintaining our supervisory standards.

I expect to report by the end of this year on the progress we have made on all of these initiatives.

Thank you very much.

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