Message from the Chairman

I am pleased to present the Federal Deposit Insurance Corporation's (FDIC) 2012 Annual Report.

In 2012, we saw the continuation of the gradual but steady recovery of FDIC-insured institutions. Capital has increased and banks have bolstered their liquidity. Loan growth has shown improvement, and banks continued to strengthen their balance sheets. Revenue growth surpassed reductions in loss provisions as the principal contributor to earnings, although much of that growth came from loan sales.

At year-end, domestic and international issues still presented challenges for the economy and the banking industry, but the underlying trends were positive. Indeed, bank performance indicators improved during 2012, particularly earnings and credit quality of loans on the books of FDIC-insured institutions. Much of the improvement in earnings over the last few years was driven by lower loan-loss provisions, reflecting improved credit quality. Going forward, industry earnings will depend on increased lending, consistent with sound underwriting.

Although challenges to the recovery remain, the FDIC is well positioned to carry out its mission of maintaining stability and public confidence in the nation's financial system by insuring deposits, examining and supervising financial institutions for safety and soundness and consumer protection, and managing receiverships. At the end of 2012, the FDIC insured a record $7.4 trillion of deposits in over half a billion accounts at more than 7,000 institutions.

Our current top priorities include:

- continuing implementation of FDIC's systemic resolution responsibilities under the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), including resolution planning and promoting cross border cooperation and coordination with respect to an orderly resolution of a globally active, systemically important financial institution;

- following up on the FDIC's Community Banking Initiatives, including pursuing additional research relating to the continued viability of community banks, and continuing our review of examination and rulemaking processes with the goal of identifying additional ways to make the supervisory process more efficient, consistent, and transparent, consistent with safe and sound banking practices; and
- continuing our economic inclusion initiatives to expand access to mainstream financial services for all people in the United States.

A great strength of our agency is a highly dedicated and motivated workforce. The FDIC's employees understand the agency's mission and how it relates to what they do. For the second year in a row, the FDIC took the top spot in the *Best Places to Work in the Federal Government* rankings, this year in the new category for mid-sized federal agencies. We are very proud of this recognition. All of us at the FDIC share the responsibility for cultivating a high-performance environment with a deep sense of mission among our workforce.

STRENGTHENING THE DEPOSIT INSURANCE FUND AND RESOLVING FAILED BANKS

The FDIC has made significant progress in rebuilding the DIF. In 2010, the FDIC Board approved a comprehensive, long-term plan for fund management based on Dodd-Frank Act requirements and on an FDIC historical analysis of DIF losses. After returning to a positive balance of $11.8 billion at the end of 2011, from negative $7.4 billion a year earlier, the DIF balance rose to $33.0 billion at the end of 2012. Assessment revenue, fewer bank failures, and fees transferred to the DIF from the Temporary Liquidity Guarantee Program, were the main drivers of fund growth in 2012.

The number of both failed and problem institutions continued to decline in 2012. Failed institutions peaked in 2010 at 157, and declined to 92 in 2011 and 51 in 2012. Similarly, problem banks peaked at 888 in March 2011 and declined to 651 by the fourth quarter of 2012. Although both trends are positive, they still represent highly elevated levels of failed and troubled banks. As a result, the FDIC continues to devote considerable resources to managing receiverships, examining problem institutions, and implementing provisions of the Dodd-Frank Act.

Nonetheless, as the banking industry continues to stabilize, the FDIC will require fewer resources. The FDIC's authorized workforce for 2012 was 8,713 full-time equivalent positions compared with 9,269 the year before. The 2012 Corporate Operating Budget was $3.3 billion, a decrease of $0.6 billion (15 percent) from 2011.

For 2013, the Board reduced the budget by 18 percent to $2.7 billion and reduced authorized staffing by 8 percent to 8,026 positions in anticipation of a further drop in bank failure activity in the years ahead. The FDIC also announced plans to close the last of three temporary satellite offices that were set up to handle crisis-related workload. The Irvine (California) office closed in January 2012, and the Schaumburg (Illinois) office closed in September 2012. The Jacksonville (Florida) office is now scheduled to close in 2014. Contingent resources are included in the budget, however, to ensure readiness should economic conditions unexpectedly deteriorate.

During 2012, the FDIC continued using successful resolution strategies instituted in 2009 to protect insured depositors of failed institutions at the least cost to the DIF. The FDIC actively marketed failing institutions, and the large majority of those institutions were sold to other financial institutions. These strategies protected insured depositors and preserved banking relationships in many communities, providing depositors and customers with uninterrupted access to essential banking services.

IMPLEMENTING THE FDIC'S NEW AUTHORITIES UNDER THE DODD-FRANK ACT AND OTHER FINANCIAL REFORM

The Dodd-Frank Act included far-reaching changes to make financial regulation more effective in addressing systemic risks and gave the FDIC the authority to resolve systemically important financial institutions (SIFIs).

For SIFIs, the Title II – Orderly Liquidation Authority (OLA) of the Dodd-Frank Act provides the FDIC authority to resolve a parent holding company, and any financial affiliate, as well as other nonbank SIFIs. The FDIC has been working for the past two years to develop the strategic and operational capability to carry out this new authority.

During 2012, the FDIC developed internal plans for resolving a failing SIFI premised on utilizing the new Title II OLA authorities of the Dodd-Frank Act. 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 mitigates systemic risk, imposes losses on shareholders and creditors, replaces culpable management, and ensures, as required by the statute, that taxpayers bear no losses.

The FDIC also engaged with our counterparts overseas on cross-border protocols for resolving failing SIFIs. As part of our bilateral efforts in this area, the FDIC and the Bank of England, in conjunction with the prudential regulators in our jurisdictions, have been working to develop contingency plans for the failure of Global SIFIs (G-SIFIs) that have operations in both the U.S. and the U.K. Of the 28 G-SIFIs designated by the Financial Stability Board of the G-20 countries, four are headquartered in the U.K., and another eight are headquartered in the U.S. As part of this effort, the FDIC and the Bank of England jointly released a paper in December 2012 discussing resolution strategies for G-SIFIs. In addition to the close working relationship with the U.K., the FDIC and the European Commission (E.C.) established a joint Working Group in 2012 comprised of senior staff to discuss resolution and deposit guarantee issues common to our respective jurisdictions. We expect that these meetings will enhance close coordination on resolution related matters between the FDIC and the E.C., as well as European Union Member States.

In addition, the Dodd-Frank Act requires bank holding companies with more than $50 billion in assets and other financial companies, designated by the Financial Stability Oversight Council (FSOC) for heightened prudential supervision by the Board of Governors of the Federal Reserve System, to develop their own resolution plans, otherwise known as "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. Bankruptcy remains the preferred resolution option for these firms. Only when bankruptcy is not a viable option would the FDIC's OLA under Title II of the Dodd-Frank Act be considered.

The FDIC Board has adopted two rules regarding resolution plans. The first rule, jointly issued with the Federal Reserve Board in 2011, requires SIFIs to develop, maintain, and periodically submit resolution plans or "living wills" to the Federal Reserve Board and the FDIC. The second rule requires any FDIC-insured depository institution with assets over $50 billion to develop, maintain, and periodically submit plans for rapid and orderly resolution under the Federal Deposit Insurance Act in the event of material financial distress or failure.

Eleven institutions submitted plans in 2012 under the rulemaking. The FDIC and the Federal Reserve Board are jointly reviewing the plans as required by the statute.

Along with the other U.S. banking agencies, the FDIC participated in an intensive international effort to strengthen bank capital standards that resulted in the Basel III capital agreement. In broad terms, the new standards aim to improve the quality and increase the required level of bank capital. The FDIC Board has proposed implementing rules for Basel III and is now reviewing public comments.

Ongoing resolution planning, regular dialogue with potential SIFIs, stronger capital standards, and international cooperation are critical to the FDIC's implementation of its new responsibilities under the Dodd-Frank Act. The FDIC's Systemic Resolution Advisory Committee continues to advise the FDIC on a variety of issues including the effects on financial stability and economic conditions resulting from the failure of a SIFI, the ways in which specific resolution strategies would affect stakeholders and their customers, and the tools available to the FDIC to wind down the operations of a failed organization.

COMMUNITY BANKING INITIATIVE

Community banks play a crucial role in the American financial system. Community banks account for about 14 percent of the banking assets in our nation, but they provide nearly 46 percent of all the small loans that FDIC-insured depository institutions make to businesses and farms.

The FDIC is the lead federal regulator for the majority of community banks, and the insurer of all. As such, the FDIC has an ongoing responsibility to better understand the challenges facing community banks, and to share that knowledge with bankers and the general public.

In early 2012, the FDIC announced a series of initiatives focusing on the challenges and opportunities facing community banks. The first was a national conference in early 2012 on the Future of Community Banking. During the year, we held a series of roundtables with community bankers in each of the FDIC's six regions. Our most senior executives and I attended these roundtables to hear firsthand the concerns of bankers and to discuss what the FDIC could do in response.

We also issued a comprehensive study of the evolution of community banking in the United States over the past 25 years. The *FDIC Community Banking Study* is an important initial step in understanding the current state of the industry. It also will provide a platform for future research and analysis by the FDIC and other interested parties. Key areas that the study covered include: the definition of a community bank, structural changes among community and non-community banks, the geography of community banking, the performance of community banks compared to non-community banks, the performance of community bank lending specialty groups, and capital formation at community banks. The study is the most comprehensive analysis of the financial performance and structural change in the community banking industry over the past 25 years.

We reviewed the FDIC's bank examination process for both risk management and compliance supervision. We also looked at the rulemakings and guidance process, in an effort to make it more efficient and transparent while maintaining supervisory standards. The FDIC solicited input from community bankers and incorporated that feedback into specific actions we took in response. Based on feedback received, the FDIC began implementing a number of enhancements to our supervisory and rulemaking processes in 2012, including revamping the pre-exam process to better scope examinations and taking steps to improve communication by using web-based tools to provide critical information regarding new or changing rules and regulations as well as comment deadlines. The FDIC has also instituted a number of new outreach and technical assistance efforts, including increased direct communication between examinations, increased opportunities for attendance at training workshops and symposiums, and current and planned conference calls and training videos on complex subjects of interest. The FDIC's review of examination and rulemaking processes will be an ongoing effort, and we plan to pursue additional enhancements and modifications to our processes.

Finally, our Advisory Committee on Community Banking is a permanent forum for discussing critical issues. The Committee, which is composed of 15 community bank CEOs from around the country, is a valuable source of information and input on a wide variety of topics, including the latest examination policies and procedures, capital and other supervisory issues, credit and lending practices, deposit insurance assessments and coverage, and regulatory compliance issues.

Our community banking initiative will remain an ongoing priority that includes outreach programs, research, and improvements in the examination process.

PROTECTING CONSUMERS AND EXPANDING ACCESS TO BANKING SERVICES

Deposit insurance provides security and peace of mind for customers depositing their money into financial institutions. However, accessing insured institutions has proven elusive for millions of people across the U.S.

In September 2012, the FDIC released the results of the second biennial survey of unbanked and underbanked households, conducted jointly with the U.S. Bureau of the Census. The survey was conducted in mid-2011. It found that one in four U.S. households (28 percent) do not have bank accounts or are underbanked, a slight increase from the 2009 survey.

A separate survey of banks, conducted by the FDIC and released in 2012, found that four in 10 banks develop products and services specifically for unbanked and underbanked consumers, while eight in 10 provide free counseling. Nearly two-thirds said they charged no maintenance fees on basic checking accounts but some banks have account opening requirements that can be challenging for underserved populations, such as initial deposits of $100 or more.

At the national policy level, the FDIC's Advisory Committee on Economic Inclusion—composed of bankers, community and consumer organizations, and academics—explored strategies to bring the unbanked into the financial mainstream. The Committee has pursued a number of initiatives since it was formed in 2007. One of its initial projects—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.

In 2012, the Committee completed another pilot program, Model Safe Accounts, that evaluated how banks can offer safe, low-cost transaction and savings accounts that are responsive to the needs of underserved consumers. Nine financial institutions participated in the pilot, which featured electronic and card-based accounts. The results indicated that Safe Accounts performed on par with, or better than, other transaction and savings accounts offered by the pilot banks. A large portion of account holders remained banked during the year, suggesting that consumers can maintain successful banking relationships using Safe Accounts. Most of the pilot institutions reported that the cost of offering Safe Accounts was roughly the same, if not lower, because the pilot accounts do not have paper check-related costs.

The Committee also looked at the role that technology and innovation, particularly mobile banking, can play in expanding access to mainstream financial services. The Committee formed a Mobile Financial Services Subcommittee to examine ways in which the FDIC can support the ongoing development of mobile financial services in ways that facilitate broader access to mainstream financial services. The Committee will continue to meet during 2013, and mobile banking will continue to be a focus of the Committee and the FDIC.

At the local level, the FDIC's Alliance for Economic Inclusion has organized coalitions of financial institutions, community organizations, local government officials, and other partners in communities across the country to bring unbanked and underbanked households into the financial mainstream. The effort includes better access to basic retail financial services, such as checking and savings accounts, affordable remittance products, small-dollar loans, targeted financial education programs, and asset-building programs. These partnerships are currently operating in 16 communities nationwide, with two new partnerships formed in 2012.

CONCLUSION

The banking industry made measurable progress in 2012, with stronger earnings, better asset quality, and fewer bank failures and problem institutions. Still, we remain mindful that challenges remain.

The FDIC's workforce remains committed to carrying out our mission. I am very grateful to the dedicated professionals of the FDIC for their work during the financial crisis to maintain the stability of and public confidence in the financial system, and have full confidence that this commitment to our mission will continue as the banking system recovers.

Sincerely,

Martin J. Gruenberg

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