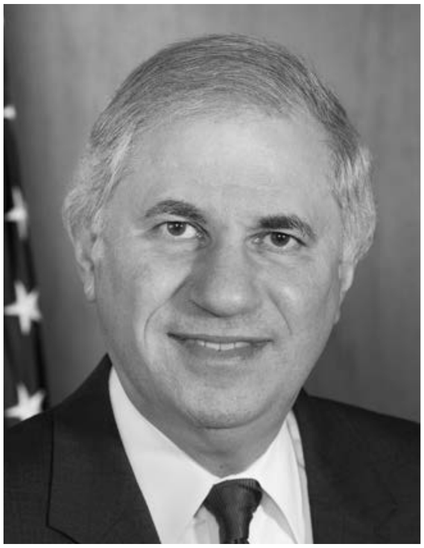
Message from the Chairman

For more than 80 years, the FDIC has carried out its mission of maintaining public confidence and stability in the nation's financial system.



The FDIC does this by insuring deposits; supervising and examining financial institutions for safety, soundness, and consumer protection; and managing receiverships when banks fail.

At the end of 2014, the FDIC insured deposits of $6.2 trillion in more than half a billion accounts at over 6,500 institutions. Further, the FDIC supervised 4,138 institutions, conducted 8,160 examinations, and managed nearly 500 active receiverships having total assets of $29.7 billion at year-end 2014.

The U.S. economy and the banking industry saw continued improvement in 2014. After experiencing the most severe financial crisis and economic downturn in the United States since the 1930s, the United States is now well into the recovery. The economy is expanding, although the pace of economic growth has been weaker than the long-term trend and bank profitability remains lower than pre-crisis levels. Still, the industry has been strengthening balance sheets, building capital, and enhancing liquidity.

Stronger balance sheets indicate ample capacity for FDIC-insured institutions to support the economic recovery. Last year, loan balances at banks increased by $416 billion, the largest dollar gain since 2007. Moreover, that growth was broad-based, with nearly all loan categories posting increases, and almost three-quarters of all institutions reporting larger loan balances. Loan growth was strongest at community banks, which posted an 8.6 percent gain in 2014 versus 5.3 percent for the industry overall. The numbers of both failed and problem institutions declined again in 2014, and the Deposit Insurance Fund (DIF) balance, which was almost $21 billion in the red during the financial crisis, was once again positive at nearly $63 billion at year-end.

Rising loan demand and a recent pickup in the pace of economic activity are creating favorable conditions for FDIC-insured institutions. The FDIC is working to wind down the receiverships of failed institutions and to address the emerging supervisory challenges of interest rate risk, credit risk, and cybersecurity threats. This shift is indicative of the move from a post-crisis recovery environment to one of expanding economic growth and financial activity. Following is an overview of the key strategic challenges facing the FDIC.

REBUILDING THE DIF, RESOLVING FAILED BANKS, AND FDIC RESOURCES

Under a long-term plan based on the Dodd-Frank Act requirements to rebuild the DIF, the FDIC has had a steady increase in the year-end fund balance from 2011 through 2014. Recently, lower than estimated losses for past bank failures, together with assessment income, have contributed to the increase in the fund balance to $62.8 billion as of December 31, 2014. The fund is on track to reach a reserve ratio — the ratio of the DIF fund balance to estimated insured deposits — of 1.35 percent by September 2020, as mandated by statute. The reserve ratio was 1.01 percent as of year-end 2014.

Bank failures in 2014 totaled 18, down dramatically from a peak of 157 in 2010, while the number of banks on the problem bank list (banks rated 4 or 5 on the CAMELS rating scale) fell to 291 at the end of 2014 from a high of 888 in March 2011. Although these trends are positive, we still have a way to go before these numbers return to more normal levels. The FDIC will continue to manage receiverships, examine problem institutions, and implement provisions of the Dodd-Frank Act.

As the banking industry continues to recover, the FDIC will require fewer resources. The agency's authorized workforce for 2014 was 7,200 full-time equivalent positions compared with 8,026 the year before. The 2014 Corporate Operating Budget was $2.4 billion, a decrease of $300 million (11 percent) from 2013.

The FDIC reduced its budget for 2015 from the prior year by 3 percent to $2.32 billion and reduced authorized staffing by approximately 5 percent to 6,875 positions, in anticipation of a further drop in bank failure activity in the years ahead. The three temporary satellite offices that were set up to handle the crisis-related workload have now closed. However, contingent resources are included in the budget to ensure readiness should economic conditions unexpectedly deteriorate.

During 2014, the FDIC continued to successfully use various resolution strategies to protect insured depositors of failed institutions at the least cost to the DIF. The FDIC actively marketed failing institutions and sold a large majority 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 AUTHORITIES UNDER THE DODD-FRANK ACT AND OTHER FINANCIAL REFORMS

The FDIC continues to implement its authorities under the Dodd-Frank Act, as well as important new capital and liquidity requirements.

Capital and Liquidity Rules Strengthened

In 2014, the FDIC Board of Directors (FDIC Board), in concert with the other regulators, adopted several important rules that strengthen the capital and liquidity standards for banking organizations. In April 2014, the FDIC Board finalized the Basel III capital rule that strengthens the quality of regulatory capital and increases the level of risk-based capital required under the prompt corrective action (PCA) standards. The FDIC's Basel III rule is substantively identical to rules adopted by the Board of Governors of the Federal Reserve System (FRB) and the Office of the Comptroller of the Currency (OCC). In April, the FDIC Board also approved an interagency, enhanced supplementary leverage ratio requirement for the largest systemically important financial institutions (SIFIs). The new leverage ratio goes beyond international standards agreed to by the Basel Committee on Banking Supervision.

The enhanced supplementary leverage ratio currently applies to eight large organizations designated as Global Systemically Important Banks, or G-SIBs. Insured banks within these G-SIB organizations would need to satisfy a 6 percent supplementary leverage ratio to be considered well capitalized for PCA purposes. The new rule also establishes an enhanced 5 percent supplementary leverage ratio at the holding company level. This should reduce the likelihood of failure, while increasing the ability of these firms to continue lending during periods of economic adversity. The introduction of the enhanced supplementary leverage ratio is one of the most significant step taken thus far to reduce the systemic risk posed by large, complex banking organizations.

In September 2014, the FDIC, the FRB, and the OCC adopted the first-ever quantitative liquidity standard for large banking organizations in the United States, the liquidity coverage ratio (LCR). During the recent financial crisis, many of the largest banks did not have a sufficient amount of high-quality liquid assets, such as cash and U.S. Treasury securities, and could not borrow enough funds from the marketplace to meet their liquidity needs. This new ratio will strengthen the liquidity positions of our largest financial institutions, thereby promoting safety and soundness, and the stability of the financial system.

The LCR applies to bank holding companies (BHCs) and depository institutions with $250 billion or more in total assets or with $10 billion or more in foreign exposures, and to depository institutions with $10 billion or more in assets that are consolidated subsidiaries of these covered banking organizations. Separately, the FRB issued similar rules for BHCs with at least $50 billion in assets. The new rule will not apply to community banks.

RESOLUTION PLANNING FOR SYSTEMICALLY IMPORTANT FINANCIAL INSTITUTIONS AND INTERNATIONAL COORDINATION

Under the framework of the Dodd-Frank Act, bankruptcy is the preferred path in the event of the failure of a SIFI.

To make this objective achievable, Section 165(d) of the Dodd-Frank Act and the implementing joint rules require that all BHCs with total consolidated assets of $50 billion or more, and nonbank financial companies that the Financial Stability Oversight Council (FSOC) designates for FRB supervision, prepare resolution plans, or "living wills," to demonstrate how the company could be resolved in a rapid and orderly manner under the Bankruptcy Code in the event of the company's material financial distress or failure. The living will process is an important new tool to enhance the resolvability of large financial institutions through the bankruptcy process.

Since 2010, the FRB and FDIC have been working to implement this new authority and have taken a number of important steps to do so, including the issuance of a joint rule in 2011 and joint guidance in 2013. In August 2014, the FDIC and FRB issued joint letters to the 11 largest, most complex banking organizations, directing them to make specific substantive changes to facilitate their orderly resolution in bankruptcy. The actions the firms are being directed to take include changes to simplify their legal structures, actions to ensure the continuation of critical services throughout the resolution process, and information system changes to ensure the timely delivery of information in resolution. The agencies in the letters directed a set of changes for the firms to implement that will make a meaningful difference in the ability to resolve these firms in an orderly manner in bankruptcy, as well as reduce the risk they pose to the financial system. Since that time, the agencies have been providing guidance to the banking organizations on the improvements needed to each plan, as those plans must demonstrate that the firms are making significant progress to address all the shortcomings identified in the letters.

In cases in which resolution under the Bankruptcy Code may result in serious adverse effects on financial stability in the United States, the Orderly Liquidation Authority set out in Title II of the Dodd-Frank Act serves as an important backstop. Upon recommendations by a two-thirds vote of the Federal Reserve Board and the FDIC Board and a determination by the Treasury Secretary in consultation with the President, a financial company whose failure is deemed to pose a risk to the financial system may be placed into an FDIC receivership. Under the Act, key findings and recommendations must be made before the Orderly Liquidation Authority can be considered as an option. These include a determination that the financial company is in default or danger of default; that failure of the financial company and its resolution under applicable federal or state law, including bankruptcy, would have serious adverse effects on U.S. financial stability; and that no viable private sector alternative is available to prevent the default of the financial company.

At the end of 2013, the FDIC Board approved publication of a *Federal Register* notice, which provides greater detail on a Single Point of Entry (SPOE) strategy for resolution and discusses the key issues that likely will be faced in the resolution of a SIFI. The notice sought public comment and views as to how the policy objectives set forth in the Dodd-Frank Act could better be achieved and a number of comments were received that will be considered as the FDIC continues its contingency planning.

Advance planning and cross-border coordination for the resolution of globally active SIFIs will be essential to minimize disruptions to global financial markets. Following up on progress made on international coordination in prior years, the FDIC continues to foster its relationships with foreign regulators to establish frameworks for effective cross-border cooperation.

In October, the FDIC hosted the heads of the Treasuries, central banks, and leading financial regulatory bodies in the United States and United Kingdom in an exercise designed to further understanding, communication, and cooperation between U.S. and U.K. authorities in the event of the failure and resolution of a G-SIB. In addition, the FDIC worked with its major foreign counterparts in significant efforts to develop cross-border cooperation for resolving failing global financial firms.

COMMUNITY BANKING INITIATIVE

Community banks are critically important to our economy and banking system. Community banks account for 13.3 percent of the banking assets in the United States, but also account for 45.1 percent of the small loans to businesses and farms made by all banks, making them key partners in supporting local economic development and job creation. Since the FDIC is the primary Federal supervisor of the majority of community banks in the United States, community banking will continue to be an important focus of FDIC supervision, technical assistance, and research.

In late 2012, the FDIC published a comprehensive study on community banking. The study confirmed that the traditional community bank business model – knowing your customer, funding from stable core deposits, and locally focused lending – performed comparatively well during the recent banking crisis. Of the more than 500 banks that failed since 2007, the highest failure rates were among non-community banks and community banks that departed from this traditional model by investing in risky assets funded by non-core deposits.

In 2014, FDIC analysts published new papers dealing with community bank consolidation, the effects of long-term rural depopulation, and the efforts of Minority Depository Institutions (MDIs) to provide essential banking services to customers. The FDIC also added a new community bank section to the FDIC's *Quarterly Banking Profile* (QBP). It includes new data on the structure, activity, and performance of community banks that will be useful in tracking the industry's performance more closely.

Apart from research, the community bank initiative includes a robust technical assistance program for bank directors, officers, and employees. The FDIC's latest innovation is a series of videos that are helping community bankers to understand better their management responsibilities. The video program grew out of requests by community bankers for help in a number of areas – from director responsibilities, to hot button issues in risk management and compliance supervision. Since 2013, the FDIC has produced and released more than 20 videos, available on the FDIC's website.

Finally, the FDIC's Advisory Committee on Community Banking is an ongoing forum for discussing current issues and receiving valuable feedback from the industry. The committee, which met three times during 2014, is composed of 15 community bank CEOs from around the country. It is a valuable resource for input on a wide variety of topics, including examination policies and procedures, capital and other supervisory issues, credit and lending practices, deposit insurance assessments and coverage, and regulatory compliance issues.

CYBERSECURITY

The rapidly evolving nature of cybersecurity risks reinforces the need for regulators, financial institutions, and critical technology service providers to have appropriate procedures to effectively respond to cybersecurity risk. The FDIC works with other bank regulators to analyze and respond to emerging cyber threats, bank security breaches, and other harmful or disruptive technology-related incidents. The federal banking agencies are currently reviewing security readiness at banks and technology service providers. We are also evaluating our supervisory policies for potential improvements.

The FDIC has taken a number of actions to raise awareness of cyber risks and to encourage practices to protect against threats at the banks we supervise, particularly community banks. For example, in 2014 the FDIC distributed Cyber Challenge: A Community Bank Cyber Exercise to all FDIC-supervised banks. Cyber Challenge provides operational risk-related scenarios and challenge questions designed to facilitate discussion and allow community bankers to assess their preparedness for and response to cyber-related events.

The FDIC monitors cybersecurity issues on a regular basis through on-site bank examinations, regulatory reports, and intelligence reports. The FDIC also works with other federal agencies, law enforcement and a number of government groups and industry coordinating councils, such as the Finance and Banking Information Infrastructure Committee, and the Financial Services Sector Coordinating Council for Critical Infrastructure Protection and Homeland Security, to facilitate collaboration and information sharing across the financial services sector.

PROTECTING CONSUMERS AND EXPANDING ACCESS TO BANKING SERVICES

Expanding access to mainstream banking services is part of the FDIC's core mission. The FDIC's National Survey of Unbanked and Underbanked Households, conducted every two years with the U.S. Census Bureau, has documented that a large portion of the population in our country does not have a relationship with an insured depository institution or relies on alternative financial service providers to meet some of their financial services needs. The survey, which was last released in October 2014, is widely used by the industry, analysts, government and non-governmental organizations, the media, and many others to better understand who lacks access to mainstream banking services and to gain insights into opportunities to expand participation.

During 2014, the FDIC continued its efforts to protect consumers and expand access to mainstream banking services. For example, the FDIC's Advisory Committee on Economic Inclusion — composed of bankers, community and consumer organizations, and academics — continues to focus on new ways to expand banking services to all consumers. During 2014, several banks offered low-cost transaction accounts that were consistent with the FDIC's model SAFE transaction account template that was developed under guidance from the committee. The committee also worked on developing ways to tap the economic inclusion potential of mobile financial services, expanding financial education programs for young people, and identifying prudent, feasible approaches to providing access to small-dollar credit within mainstream, insured financial institutions.

CONCLUSION

During 2014, the U.S. banking industry continued its recovery from the recent financial crisis. The industry benefited from stronger balance sheets, fewer problem banks and bank closings, increased lending activity, and a larger balance in the DIF. At the same time, it remains important for bankers and supervisors to heed the lessons of the recent crisis by maintaining a steady focus on risk management.

In 2015, the FDIC will continue to work to fulfill its mission of maintaining public confidence and stability in the nation's financial system.

The workforce of the FDIC remains committed to the FDIC's core mission. I am very grateful to the dedicated professionals of the FDIC for their commitment to public service and for the high level at which they carry out their important responsibilities.

Sincerely,

Martin J. Gruenberg

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