

Overview of the Industry

Through the first three quarters of 2003, insured commercial banks and savings institutions were on a record earnings pace, as a recovering economy and favorable interest-rate environment created conditions conducive to strong performance. The 9,237 commercial banks and savings institutions insured by the FDIC earned \$89.9 billion in the first three quarters of 2003, a \$9.6 billion (12.0 percent) improvement over the same period of 2002. Lower expenses for loan losses at large banks were a major contributor to the improvement in earnings. Strong growth in consumer-related assets led by mortgage refinancings helped boost net interest income. Growth in noninterest revenues and higher gains on sales of securities and other assets also contributed to the improvement in revenues. These positive developments helped offset narrower net interest margins.

Commercial banks earned \$76.1 billion in the first three quarters of the year, up \$7.6 billion (11.2 percent) from the first three quarters of 2002. More than half of all the 7,812 insured commercial banks – 57.6 percent – reported higher earnings, and only 5.4 percent were unprofitable, compared to 6.3 percent a year earlier. Their return on assets (ROA), a basic yardstick of earnings performance, was 1.39 percent, up from 1.37 percent in the same period of 2002. Provisions for loan losses were \$8.9 billion (25.3 percent)

lower than in the first three quarters of 2002, while noninterest income was \$10.1 billion (7.9 percent) higher. Net interest income was only \$1.9 billion (1.1 percent) higher, as commercial banks' average net interest margin fell to 3.81 percent, from 4.11 percent in 2002. Gains on sales of securities were up by \$1.1 billion (26.7 percent), as lower interest rates caused the values of fixed-rate securities to appreciate. Lower interest rates also stimulated demand for mortgage loans, particularly loans to refinance existing mortgages. Residential mortgage-related assets, including 1-4 family residential mortgage loans and mortgage-backed securities, increased by \$184 billion (9.9 percent) during the first nine months of 2003, accounting for almost half (46.3 percent) of the total growth in commercial bank assets. After deteriorating for the three previous years, banks' asset-quality indicators showed improvement in each of the first three quarters of 2003. Through the first nine months of the year, net loan charge-offs were \$5.3 billion (16.0 percent) lower than in the same period of 2002. Almost three-quarters of the improvement (\$3.8 billion, or 71.4 percent) consisted of lower losses reported by large banks on loans to commercial and industrial borrowers.

The nation's 1,425 insured savings institutions also benefited from the strong demand for residential mortgage loans. Thrifts' earnings for the first three quarters of 2003 totaled \$13.7 billion, an improvement of \$2.0 billion (16.8 percent) over the same period in 2002. The average ROA of 1.29 percent was well above the 1.20 percent registered a year earlier. More than half of all savings institutions – 57.7 percent – reported higher earnings for the first three quarters. The main sources of the earnings improvement were higher noninterest income, which was \$2.7 billion (32.3 percent) above the level of a year earlier, and increased gains on sales of securities and other assets, which were up by \$1.6 billion (41.1 percent). Net interest income increased by only \$602 million (2.0 percent), as the average net interest margin fell from 3.48 percent to 3.29 percent. Loan-loss provisions were \$372 million (14.9 percent) below the year-earlier level, while net loan charge-offs were \$566 million (35.3 percent) higher. Noninterest expenses were \$2.1 billion (9.5 percent) higher than in the first three quarters of 2002.

The FDIC administers two deposit insurance funds – the Bank Insurance Fund (BIF) and the Savings Association Insurance Fund (SAIF) – and manages the FSLIC Resolution Fund (FRF), which fulfills the obligations of the former Federal Savings and Loan Insurance Corporation (FSLIC) and the former Resolution Trust Corporation (RTC). The following summarizes the condition of the FDIC's insurance funds.

Deposit insurance assessment rates remained unchanged from 2002 for both the BIF and the SAIF, ranging from 0 to 27 cents annually per \$100 of assessable deposits. Under the assessment rate schedule, 92.0 percent of BIF-member institutions and 91.5 percent of SAIF-member institutions were in the lowest risk-assessment category and paid no deposit insurance assessment for the first semiannual period of 2004.

Deposits insured by the FDIC totaled \$3.4 trillion at the end of September 2003. Estimated insured deposits rose by \$27.8 billion (0.8 percent) during the first three quarters of the year, as total deposits at FDIC-insured institutions increased by \$282.6 billion (5.1 percent), and savings deposits at insured commercial banks grew by \$223.9 billion (11.0 percent).

During the first three quarters of 2003, deposits insured by the BIF increased by \$20.0 billion, or 0.8 percent, to \$2.55 trillion. The BIF balance was \$33.5 billion at the end of September, or 1.31 percent of estimated insured deposits. This was up from the year-earlier reserve ratio of 1.25 percent, as deposits insured by BIF increased by \$34.7 billion and the BIF fund balance increased by \$2.1 billion.

The reserve ratio of the SAIF was 1.40 percent at the end of September, up from 1.39 percent a year earlier. The balance of the SAIF surpassed the \$12 billion level in 2003, and stood at \$12.2 billion on September 30. Estimated SAIF-insured deposits totaled \$868 billion at the end of the third quarter, having grown 0.9 percent during the first nine months of the year.

Continued strong growth in assets, combined with the relatively slow growth of insured deposits, meant that insured institutions continued to rely increasingly on other funding alternatives. Insured deposits funded 38.1 percent of industry assets at the end of September, compared to 40.4 percent a year earlier. At the end of 1991, insured deposits funded 60.2 percent of the total assets of insured banks and savings institutions.