Message from the Chairman • Sheila C. Bair

Daniel Rosenbaum/The New York Times/Redux

As the first decade of the new century came to a turbulent close, the FDIC continued to meet the challenge of protecting deposits in over half a billion insured accounts at over 8,000 FDIC-insured institutions. Our guarantee has protected depositors since 1933 with none ever losing so much as a penny of insured funds. While the recent period of historic financial turmoil has required us to take some extraordinary actions to carry out our mission, it was precisely for times like these that the FDIC was established some 76 years ago.

Following the liquidity crisis that struck the financial system in the fall of 2008, the FDIC continued to focus its efforts in 2009 on stabilizing the liquidity of the industry through our temporary support programs, strengthening bank supervision, ensuring the financial capacity of the Deposit Insurance Fund (DIF), and promptly resolving failed institutions. During 2009, the number of failed banks rose to 140, up from 25 the previous year and the highest annual total since 1992. Meanwhile, the number of problem institutions—those with the two lowest supervisory ratings—rose to 702, which was the highest year-end total since 1992. Historically, the vast majority of problem institutions do not fail. However, elevated numbers of problem and failed institutions are expected to remain a near-term challenge, even as the economy recovers, and there is substantial residual workload from the failures that occurred in prior years.

Accordingly, the FDIC has been adding to the operational resources it needs to deal with its increased workload. The FDIC workforce grew to 6,557 full-time equivalent positions at year-end 2009, up from 4,988 at year-end 2008. In December 2009, the FDIC Board approved a

2010 operating budget of almost $4 billion, a 56 percent increase from 2009, and authorized the hiring of some 1,600 additional temporary workers, which will expand the FDIC's total workforce by nearly 25 percent.

Stabilizing Bank Funding Through the TLGP

In October 2008, at the height of the financial crisis, the FDIC introduced a Temporary Liquidity Guarantee Program (TLGP) to help stabilize the liquidity of the industry through our temporary support programs and promote confidence across the financial system. During 2009, the FDIC worked to fully implement the two elements of the TLGP, extended its time frame, and made plans for an orderly exit as financial market conditions continued to stabilize. Under the Debt Guarantee Program, a total of over $618 billion in guaranteed debt was issued, generating over $10 billion in fees from participating banks. This program had been instrumental in helping to reduce risk premiums in the interbank lending markets until its expiration on October 31, 2009. The Transaction Account Guarantee Program, which provides a full guarantee of all deposits in noninterest-bearing transaction accounts, has been extended through December 2010.

Balanced Supervision Under Adverse Banking Conditions

As supervisor for nearly 5,000 community banks, the FDIC saw its workload rise in 2009 with the increase in the number of FDIC-supervised problem institutions. The FDIC responded to these challenges by prioritizing examination activities, increasing staffing levels, and making greater use of off-site monitoring and on-site visitations between examinations. We actively communicate with bankers through a variety of outreach activities, including a Community Bank Advisory Committee that was launched this year. This Advisory Committee was formed to provide the FDIC with advice and guidance on a broad range of important policy issues impacting small community banks throughout the country, as well as impacting the local communities they serve. We have also worked closely with other bank regulatory agencies to issue a number of Financial Institution Letters on risk management issues, including a statement encouraging banks to meet the borrowing needs of creditworthy businesses and consumers. Striking this balanced approach to bank supervision during a period of adversity for the industry will be essential to ensuring that credit is made available to finance the anticipated economic recovery.

Keeping the DIF Strong While Banks Recover

As part of a plan to replenish the liquidity of the DIF, insured institutions pre-paid almost $46 billion of deposit insurance premiums at the end of 2009. This amount represents approximately what non-exempted institutions were expected to pay for the 39-month period beginning October 1, 2009. As designed, the assessment prepayment did not impact the industry's earnings and capital, allowing the industry to continue rebuilding its capital base and increasing its capacity to lend. The prepayments increased the DIF's total cash and investments to approximately $66 billion as of year-end. According to current projections, this level of resources will be sufficient to resolve insured institutions that are projected to fail over the next few years; as such, the DIF will not have to borrow from the U.S. Treasury to meet its insurance obligations.

Protecting Depositors and Resolving Failed Institutions

As the number of failed institutions rose to its highest level since 1992, the FDIC instituted strategies to protect the depositors and customers of these institutions at the least possible cost to the DIF. The FDIC moved to an aggressive marketing campaign for failing institutions that successfully led to the sale of the vast majority of these failed entities to healthier acquirers. These strategies helped to preserve banking relationships in many communities and provide depositors and customers with uninterrupted access to essential banking services. To this end, analysis is performed on every failing institution to identify branches located in low- and moderate-income areas so as to minimize the impact that any proposed resolution transaction may have on its customers. Moreover, the FDIC's use of loss-share arrangements, where failed bank assets are passed to the acquirer, thus remaining in the private sector with the FDIC sharing in losses on the assets, is expected to save the FDIC $30 billion over the cost of liquidation. Finally, in selling assets, the FDIC developed an innovative structured transaction program that utilizes private sector asset management expertise while the FDIC retains an equity interest in all of the future cash flows. The overarching rationale behind both the loss-share agreements and the structured transaction asset sales initiative is that the long-term intrinsic value of these assets exceeds their current depressed market value. Both of these strategies should minimize asset losses and maximize recoveries to receivership creditors, including the DIF.

Preventing Unnecessary Foreclosures

Throughout the year, the FDIC remained at the forefront of efforts to stem the sharp rise in home foreclosures caused by unaffordable mortgages and rising unemployment. In addition to advocating wider adoption of streamlined and sustainable loan modifications, we required failed-bank acquirers under loss-sharing agreements to modify qualifying at-risk mortgages by cutting interest rates and, in some cases, deferring principal. As 2009 ended, the FDIC worked to expand the availability of principal write-downs as the erosion of homeowner equity may increase the likelihood of delinquencies and, in the case of loss-sharing agreements, losses to the DIF.

Reviving Mortgage Securitization

Mortgage securitization and the "originate to distribute" model of mortgage lending played leading roles in the buildup to the financial crisis. Since the crisis, private securitization virtually shut down as investors lost confidence in market practices that were insufficiently transparent and ineffective in aligning their interests with those of originators and underwriters. During 2009, the FDIC Board began considering new standards for its existing "safe harbor" protections for securitizations by banks that are later placed into receivership. These rules, still pending input from the public and scheduled to take effect in 2010, will be designed to foster better risk management by strengthening underwriting, providing better disclosure, and requiring issuers to retain a financial interest in the securities while supporting profitable and sustainable securitizations by insured banks and thrifts. The goal is to improve industry standards in these areas in order to avoid future losses to the DIF and support a revival of mortgage securitization on a sounder footing.

Protecting Consumers and Expanding Access to Banking Services

The FDIC has traditionally played a leading role in shielding consumers from predatory practices and promoting access to mainstream financial services for all segments of the population. We built on that tradition in 2009 by launching www.economicinclusion.gov, a new information portal with links to the FDIC's many sources of consumer information and our initiatives to reach underserved communities. The web site provides easy access to information on the FDIC's Advisory Committee on Economic Inclusion, our Alliance for Economic Inclusion, our *Money Smart* financial literacy program, and the FDIC *National Survey of Unbanked and Underbanked Households*. This groundbreaking survey, conducted for us in 2009 by the U.S. Bureau of the Census, revealed that one in four, or 30 million U.S. households, are either unbanked or underbanked. We are certain that our new Economic Inclusion web site will take us one step closer to our goal of bringing these unbanked and underbanked populations into the financial mainstream.

Reforming the Regulatory Structure

In the wake of the financial crisis, Congress is considering major legislation to overhaul financial regulation. The FDIC testified numerous times during the year on regulatory reform before committees in both the House and the Senate. Our broad policy view is that Congress needs to help restore market discipline by repudiating the doctrine that certain large, complex, and interconnected financial institutions are simply too big to fail. Regulators need to have a clear mandate and the necessary statutory authorities to close even the largest banks and non-bank financial institutions when they get into trouble. We also need to implement regulatory incentives to limit the size and complexity of systemically important firms.

We support creating a new consumer protection authority for financial products and services that sets consistent national standards for banks and non-banks alike. Such an across-the-board authority would eliminate regulatory gaps where risks grew unchecked in the buildup to the current crisis. We also support more stringent regulation of derivatives markets and creation of a systemic risk council to share data among regulators and focus on macro-prudential risks to our financial system. Finally, the regulatory community needs to use the powers it already has to more effectively supervise financial institutions and markets and limit the risky activities that undermined our financial system.

Creating a More Effective International Framework

To meet the challenges of the future and to protect insured depositors, it is vitally important that the FDIC continue to improve its capabilities to resolve internationally active banks and to strengthen the international framework for responding to financial crisis in cooperation with other regulators both within the U.S. and overseas. During 2009, the FDIC was at the forefront of efforts to learn from the lessons of the financial turmoil by identifying and addressing weaknesses in responses to banks that are active across borders. The FDIC co-chaired the Basel Committee on Banking Supervision's Cross-border Bank Resolution Group, which prepared a report on needed reforms to allow for the orderly liquidation of large, complex international banks. These recommendations have formed an integral part of the international effort by the G20 and the Financial Stability Board to reform the international framework for regulation and resolution of the largest financial firms. The FDIC continues to work closely with the Financial Stability Board on these issues.

The FDIC: An Enduring Symbol of Confidence

During 2009, the FDIC was called upon to once again carry out its unique mission as the nation's symbol of confidence in an economic crisis. We successfully performed this mission by protecting the insured deposits of the American public and stabilizing the funding base of the industry during a period of great economic turmoil.

The effects of the recession are likely to persist for some time, and, as a result, the FDIC will continue to experience a heavy workload and some unique policy challenges. But we are prepared to meet these challenges and committed to seeing that our mission is carried out to a successful conclusion. I am especially grateful for the hard-working, dedicated, can-do men and women of the FDIC for all they have done to respond to the demands of the crisis and help put the nation's economy back on the road to recovery. No matter the pressures, they will never waver in their commitment to excellence in the service of the American people.

Sincerely,

Sheila C. Bair