MESSAGE FROM THE CHAIRMAN

During 2010, the FDIC met the challenge of protecting a record $6.2 trillion of insured deposits in over half a billion accounts held by approximately 7,700 FDIC-insured institutions. Our guarantee has protected depositors since 1933, with none ever losing so much as a penny of insured funds. The FDIC's mission remains one of the most important and compelling across all of government, especially as we continue working through the fallout from the recent financial crisis. Our mission—promoting and maintaining the public's confidence in our nation's financial system by protecting insured depositors—motivates each of us on a daily basis to engage meaningfully in our work for the betterment of the American public.

Our commitment to the FDIC's mission and the pride and ownership displayed by our employees, resulted in our being recognized as the third best place to work among large federal agencies in the Partnership for Public Service's 2010 *Best Places to Work in the Federal Government*. These rankings are the most comprehensive and authoritative rating and analysis of federal employee satisfaction. The rankings reflect the sentiments of more than 263,000 federal employees who completed the survey, and were driven by responses to questions about whether employees would recommend their agency as a good place to work, how satisfied they are with their jobs, and how satisfied they are with their agency on an overall basis.

Daniel Rosenbaum/The New York Times/Redux

The year 2010 was a year of transition in dealing with the aftermath of the financial crisis that began in 2008 and of major change in the financial regulatory system. The FDIC continued to focus on cleaning up failed banks, strengthening bank supervision, ensuring the financial capacity of the Deposit Insurance Fund (DIF), and beginning the huge task of implementing regulatory reforms passed by the Congress that are intended to prevent another financial meltdown.

During 2010, 157 banks failed, up from 140 the previous year and the highest number since 1992. However, fewer banks failed than we had projected, and failures likely peaked in 2010, although the number of problem institutions—those with the two lowest supervisory ratings—rose to 884, which was the highest year-end total since 1992. Historically, the vast majority of problem institutions do not fail.

While we expect 2010 to have been the peak year for problem and failed institutions, as the economy recovers, substantial residual workload remains from the failures that occurred in prior years. Accordingly, we have been adding to our operational resources. The FDIC workforce grew to 8,150 full-time equivalent positions at year-end 2010, up from 6,557 at year-end 2009, and is authorized to increase by another 13 percent during 2011 as we move some contracting work in-house to achieve cost savings. In recognition of anticipated lower projected bank failure resolution costs, the FDIC Board approved a 2011 Corporate Operating Budget of $3.9 billion, a slight decrease from 2010.

Reforming the Regulatory Structure

Congress passed and President Obama signed the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) in late July. The new law includes far-reaching changes to restore market discipline, internalize the costs of risk-taking, and make our regulatory process more attuned to systemic risks. It greatly expands the FDIC's regulatory responsibilities. It also made permanent the $250,000 standard maximum deposit insurance limit that had been raised temporarily from $100,000 during the crisis.

One of the objectives of the Dodd-Frank Act is to restore market discipline by repudiating the doctrine that certain large, complex, interconnected financial institutions are simply too big to fail; hence, the law gave the FDIC the power to resolve these institutions when they get into trouble. The new law also created the Financial Stability Oversight Council (FSOC)—of which the FDIC was made one of the 10 voting members—to identify and respond to the threat of systemic risks, such as the housing bubble that triggered the recent financial crisis. The new law also created an independent consumer watchdog, the Consumer Financial Protection Bureau (CFPB).

In carrying out our many new responsibilities, we were authorized to write 44 rulemakings, some of which are discretionary, including 18 independent and 26 joint rulemakings. We were also granted new or enhanced enforcement authorities. In addition, we are subject to new reporting requirements and are required to undertake numerous studies and other actions. Implementation will require extensive coordination among the regulatory agencies and will fundamentally change the way we regulate larger complex financial institutions. Work began on a number of these rules in 2010.

The most significant rulemakings include implementation of:

- the new resolution plan requirement;
- the new capital floor requirement;

- the new orderly liquidation authority;
- the change to the deposit insurance assessment base;
- the so-called Volcker Rule that imposes trading restrictions on financial institutions;
- source of strength requirements for bank and thrift holding companies; and
- credit risk retention requirements for securitizations.

Reorganization of the Supervision Function

In addition to issuing rulemakings, we reorganized our banking supervisory function to help carry out our new responsibilities under the Dodd-Frank Act. We created the new Office of Complex Financial Institutions to focus on the FDIC's expanded responsibilities to implement a comprehensive risk analysis and assessment program for the largest, systemically important financial institutions. This office will perform continuous review and oversight of bank holding companies with more than $100 billion in assets as well as nonbank financial companies designated as systemically important by the new FSOC and will be responsible for establishing relationships and agreements with the relevant foreign jurisdictions involved in the supervision of these large firms. The new office will also be responsible for ensuring that the resolution plans developed by these firms are credible.

We also split our Division of Supervision and Consumer Protection into two separate divisions: the Division of Risk Management Supervision and the Division of Depositor and Consumer Protection. The new consumer division will allocate our resources more effectively while maintaining the cooperation and information sharing between consumer protection and safety and soundness examiners that are critical to an integrated supervisory approach. It will also complement, and work closely with, the new CFPB.

Keeping the DIF Strong as Banks Recover

The Dodd-Frank Act requires that the DIF reserve ratio reach 1.35 percent by September 30, 2020. It also removed the upper limit on the designated reserve ratio (DRR) and therefore, on the size of the fund. The law also changed the insurance premium assessment base from domestic deposits to assets minus tangible equity.

In carrying out these changes, the FDIC Board proposed a comprehensive, long-term plan for fund management based on the new law and an FDIC historical analysis of DIF losses. This analysis demonstrates that to maintain a positive fund balance and steady, predictable assessment rates, the reserve ratio must be at least 2 percent before a period of large fund losses and average assessment rates over time must be approximately 8.5 basis points of domestic deposits to achieve this ratio.

Protecting Depositors and Resolving Failed Institutions

As the number of failed institutions rose during the year, the FDIC continued using strategies instituted in 2009 to protect the depositors and customers of these institutions at the least possible cost to the DIF. The FDIC continued aggressively marketing failing institutions leading 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 provided 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 to minimize the effect that any proposed resolution transaction may have on these customers. Moreover, the FDIC's use of loss-share agreements, where failed bank assets are passed to the acquirer—thus remaining in the private sector—with the FDIC sharing in any potential losses on the assets, is expected to save the FDIC $39.0 billion over the cost of liquidation.

Balanced Supervision under Adverse Conditions

As supervisor for approximately 4,700 community banks, the FDIC saw its workload rise in 2010 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 communicated with bankers through a variety of outreach activities, including a Community Bank Advisory Committee, now in its second year. This Advisory Committee provides real-time advice and guidance on a broad range of small community bank issues, as well as local conditions in communities throughout the country. We have also worked closely with other bank regulatory agencies to issue a number of Financial Institution Letters on risk management and compliance issues, including the *Secure and Fair Enforcement for Mortgage Licensing Act of 2008*. Striking a balanced approach to bank supervision during a period of adversity for the industry remains essential to ensuring that credit is made available to finance the economic recovery.

Preventing Unnecessary Foreclosures

Once again, the FDIC was at the forefront of efforts to stem the sharp rise in home foreclosures caused by unaffordable mortgages and high unemployment. In addition to advocating wider adoption of streamlined and sustainable loan modifications, we required failed-bank acquirers under loss-share agreements to modify qualifying at-risk mortgages by cutting interest rates and, in some cases, deferring principal. The FDIC also 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-share 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. After 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. After seeking and reviewing public comment, the FDIC Board approved new standards for its existing "safe harbor" protections for securitizations by banks that are later placed into receivership. These rules are 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 to 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 accomplish this through a special website (**www.economicinclusion.gov**), our Advisory Committee on Economic Inclusion, our Alliance for Economic Inclusion, our *Money Smart* financial literacy program, and our *National Survey of Unbanked and Underbanked Households.*

A new initiative under way to improve access to mainstream banking services for low-income families is the Model Safe Accounts Pilot program approved by the FDIC Board in August. This program is designed to evaluate the feasibility of insured depository institutions offering basic, "no frills" transactional and savings accounts. The accounts will be FDIC-insured, have low rates and fees, and be subject to consumer protection laws, regulations, and guidance.

We are also committed to ensuring that banks monitor their overdraft programs to protect consumers from excessive fees as well as protect their own reputations as stewards of customer trust. In late November, we issued final guidance on how to reduce problems and avoid hefty fees associated with automatic overdraft programs. A 2008 FDIC study found that some people were chronically using overdraft programs as a way to obtain short-term—and very expensive—loans. While many community banks already prudently manage their overdraft programs, some banks operate automated programs that lead to inappropriate use of these high-cost, short-term credit products. The new guidelines provide consumers with better information about the cost of automatic overdraft programs and require banks to intervene when customers use the backstop too frequently.

Basel Committee on Banking Supervision: Capital and Liquidity

To meet the challenges of the future and to protect insured depositors, the FDIC actively participated in the Basel Committee's efforts to raise global capital standards and institute new liquidity requirements. In December 2010, the Basel Committee released *Basel III: A global regulatory framework for more resilient banks and banking systems*, which increases the quality of capital, introduces a Tier 1 common equity ratio, requires banks to hold capital conservation and countercyclical buffers, increases the minimum Tier 1 capital ratio from 4 to 6 percent, and increases risk weights for certain bank exposures such as counterparty credit risk. The Basel Committee also agreed for the first time to institute an international leverage ratio and new quantitative liquidity thresholds, including both a short-term threshold and a longer-term structural metric. These capital standards and liquidity requirements will improve the ability of internationally active banks to meet funding needs and lend during periods of stress.

The FDIC: An Enduring Symbol of Confidence

The year 2010 was another very busy and challenging year for the FDIC, and hopefully the peak year for bank failures. These are unprecedented times for our economy and the FDIC, but we are prepared to meet the demands of our times and committed to carrying out our mission of maintaining confidence and stability in the American financial system. 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 financial system back on the road to recovery.

Sincerely,

Sheila C. Bair