

MESSAGE FROM THE ACTING CHAIRMAN



I am pleased to present the Federal Deposit Insurance Corporation's (FDIC) 2011 Annual Report. I assumed my duties as Acting Chairman on July 9, 2011, upon the departure of Chairman Sheila C. Bair at the end of her term.

During 2011, our nation's banking system continued to make gradual but steady progress in recovering from the financial market turmoil and severe recession that unfolded from 2007 through 2009. Over the past two years, the banking industry has undergone a difficult process of balance sheet strengthening. Capital has been increased, asset quality has improved, and banks have bolstered their liquidity. The industry is now in a much better position to support the economy through expanded lending. However, levels of troubled assets and problem banks are still high. And while the economy is showing signs of improvement, downside risks remain a concern.

Despite these challenges, bank performance indicators did improve during 2011, particularly in terms of industry earnings and improved credit quality of loans on the books of FDIC-insured institutions. The number of institutions on the FDIC's problem bank list declined for three consecutive quarters, the Deposit Insurance Fund (DIF) moved into positive territory, and significantly fewer banks failed in 2011 compared to 2010. However, most of the improvement in earnings over the last two years has been the result of lower loan-loss provisions reflecting improved credit quality. Sustainable bank industry earnings gains will depend on increased lending,

consistent with sound underwriting. Prudent loan growth is a necessary condition for a stronger economy.

Although challenges related to the recovery remain, the FDIC is well positioned to carry out its primary mission of upholding public confidence in the nation's financial system by protecting insured depositors. During 2011, the FDIC insured a record \$7.0 trillion of deposits in over half a billion accounts at more than 7,000 institutions, with no losses of insured funds. Other notable achievements during 2011, discussed in further detail below, include returning the DIF to a positive balance, largely completing the core rulemaking necessary to carry out the FDIC's responsibilities under the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) and implementing the FDIC's new authorities related to systemic resolutions, launching a series of initiatives to deepen our understanding of the unique role community banks perform in our nation's economy, and continuing our work to expand access to mainstream financial services to all Americans.

A great strength of the agency is its highly dedicated and motivated workforce. The FDIC's employees understand the agency's mission and how it relates to what they do. In 2011 the FDIC was ranked number one on the *Best Places to Work in the Federal Government* list of 33 large agencies, moving up two positions from 2010. This recognition is a tribute to the commitment and dedication of the FDIC workforce and to the leadership of former FDIC Chairman Sheila Bair.

STRENGTHENING THE DEPOSIT INSURANCE FUND AND RESOLVING FAILED BANKS

The FDIC has made significant progress in rebuilding the Deposit Insurance Fund (DIF) and achieving the goals set by Dodd-Frank reforms. In 2010, the FDIC Board approved a comprehensive, long-term plan for fund

management based on the new law and an FDIC historical analysis of DIF losses. Additionally, the DIF balance—the net worth of the fund—rose to \$11.8 billion at the end of 2011 compared with negative \$7.4 billion a year earlier. Assessment revenue and fewer bank failures drove growth in the fund balance.

While 2010 was the peak year for problem and failed institutions, substantial work remained in 2011, with an additional 92 failures, continuing post-failure receivership management, more examination hours because of the elevated number of problem institutions, and staffing up for new responsibilities under Dodd-Frank.

Accordingly, the FDIC's authorized workforce for 2011 stood at 9,269 full-time equivalent positions compared with 9,029 the year before. The FDIC Board approved a 2011 Corporate Operating Budget of just under \$3.9 billion, a slight decrease from 2010.

For 2012, the Board reduced the budget by 15.4 percent to \$3.3 billion and reduced authorized staffing by 6 percent to 8,704 positions in anticipation of a substantial drop in failure activity in the years ahead. The FDIC also announced plans to close two of three temporary satellite offices, which had been established to address crisis-related workload. The Irvine, California, office closed in January 2012 and the Schaumburg, Illinois, office is set to close in September 2012. Contingent resources are included in the budget to ensure readiness should economic conditions unexpectedly deteriorate.

During 2011, the FDIC continued using strategies instituted in 2009, including the use of loss-share agreements, to protect the depositors and customers of failed institutions at the least cost to the DIF. The FDIC actively marketed failing institutions, and the vast majority were sold to healthier entities. These strategies preserved banking relationships in many communities while providing depositors and customers with uninterrupted access to essential banking services.

PROGRESS ON THE RESOLUTION OF SYSTEMICALLY IMPORTANT FINANCIAL INSTITUTIONS

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

One of the FDIC's top priorities has been preparing for a resolution of a large SIFI. The FDIC was given significant new responsibilities under the Dodd-Frank Act to resolve SIFIs. Specifically, these include an Orderly Liquidation Authority to resolve the largest and most complex bank holding companies and non-bank financial institutions, if necessary, and a requirement for resolution plans for covered financial companies that will give regulators additional tools with which to manage the failure of large, complex enterprises.

In late 2010, the FDIC established the Office of Complex Financial Institutions (OCFI), to carry out three core functions:

- ★ Monitor risk within and across these large, complex firms from the standpoint of resolution;
- ★ Conduct resolution planning and the development of strategies to respond to potential crisis situations; and
- ★ Coordinate with regulators overseas regarding the significant challenges associated with cross-border resolution.

During 2011, OCFI began developing its own resolution plans in order to be ready to resolve a failing systemic financial company. These internal FDIC resolution plans, developed pursuant to the Orderly Liquidation Authority, provided under Title II of Dodd-Frank, apply many of the same powers that the FDIC has long used to manage failed-bank receiverships to a failing SIFI.

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 maximizes the value of the company's assets and ensures that creditors and shareholders appropriately bear any losses. The goal will be to close the institution without putting the financial system at risk.

This internal resolution planning work is the foundation of the FDIC's implementation of its new responsibilities under the Dodd-Frank Act.

Developing a credible capacity to place a SIFI into an orderly resolution process is essential to subjecting these companies to meaningful market discipline. Without this capability, these institutions—which by definition pose a risk to the financial system—create an expectation of public support to avert failure. That distorts the financial marketplace, giving these institutions a competitive advantage that allows them to take on even greater risk and creating an unlevel playing field for other financial institutions that are not perceived as benefiting from potential public support. There is a very strong public interest in the FDIC developing the capability to carry out its new systemic resolution responsibilities in a credible and effective way.

COMMUNITY BANKING INITIATIVES LAUNCHED

In late 2011, the FDIC established a series of initiatives focusing on the future of community banking in the United States. The FDIC is the lead federal regulator for the majority of community banks in the United States and the insurer of all. As such, the FDIC has a responsibility to use its resources to gain a better understanding of the challenges facing community banks and to share that understanding with the banks as well as the general public.

Community banks play a crucial role in the financial system of the United States. Community banks with assets of less than \$1 billion account for a little more than ten percent of the banking assets in our country, but provide nearly forty percent of all the small loans that insured financial institutions make to businesses and farms. Given the labor intensive, highly customized nature of many small business loans, it is not clear that large institutions would easily fill that critical credit need

if community banks were not there. Community banks also play a crucial role in extending credit and providing financial services in rural communities, small towns, and inner-city neighborhoods. In many of those localities, if not for the community bank there would be no easy access to an insured financial institution. There is a clear public interest in maintaining a strong community bank sector in the U.S. financial system.

The first of the FDIC's initiatives in this area was a national conference in early 2012 on the Future of Community Banking. Following on the conference, the FDIC plans to hold a series of roundtables with groups of community bankers in each of the FDIC's six regions around the country during 2012. The FDIC's most senior executives and I will attend each roundtable to hear first hand about the concerns of bankers and what the FDIC can do to respond to those concerns.

As part of the initiatives, the FDIC's Division of Insurance and Research is undertaking a comprehensive review of the evolution of community banking in the United States over the past twenty-five years, to identify the key challenges facing community banks as well as stories of successful community bank business models, and draw conclusions from that analysis that may be useful for community banks going forward. The agency is also undertaking a review of the bank examination process for both risk management and compliance supervision, and the process for promulgating and releasing rulemakings and guidance, to identify potential process and communication improvements while maintaining supervisory standards.

PROTECTING CONSUMERS AND EXPANDING ACCESS TO BANKING SERVICES

Deposit insurance is essentially about making people feel secure about putting their money into financial institutions. However, accessing insured financial institutions has proven elusive for millions of people in our country.

In 2009, pursuant to a statutory provision, the FDIC partnered with the Census Bureau to conduct the first national survey ever undertaken of who is unbanked and underbanked in the United States. It found that 7 percent of U.S. households do not have bank accounts, and another nearly 18 percent who may have an account still utilize non-bank financial services such as check cashers and payday lenders, which are frequently more expensive. Taken together, this means that nearly a quarter of American households are underserved by the mainstream banking system, and the proportions are significantly higher for low-income and minority households. The Census Bureau will now conduct this survey on behalf of the FDIC every two years. The second survey was conducted in mid-2011, and the findings will be released during 2012.

In response to this issue, the FDIC has undertaken initiatives at both the local and national level.

At the local level, the FDIC's Alliance for Economic Inclusion (AEI) has organized coalitions of financial institutions, community organizations, local government officials, and other partners in communities across the country to bring unbanked and underserved households into the financial mainstream by expanding access to basic retail financial services, including savings accounts, affordable remittance products, small-dollar loan programs, targeted financial education programs, and asset-building programs. These partnerships are currently operating in 14 communities nationwide, and the FDIC plans to expand the program further during 2012.

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

The Advisory Committee is now nearing completion of a pilot program called Model Safe Accounts to evaluate how banks can offer safe, low-cost transactional and savings accounts that are responsive to the needs of underserved consumers. Participating banks are in the process of testing the model accounts, which feature electronic debit-card based accounts with low fees and low minimum balance requirements. The intention of the pilot program is to help banks better understand the benefits and feasibility of offering such products.

The Advisory Committee will continue to meet during 2012 and a focus of the Committee and the FDIC going forward will be the potential role that technology and innovation, particularly mobile banking, can play in expanding access to mainstream financial services.

THE FDIC: AN ENDURING SYMBOL OF CONFIDENCE

The year 2011 marked a turning point for American banking, as the number of bank failures declined, industry earnings grew, and balance sheets improved. There appear to be reasonable prospects for continued recovery in 2012, although this is dependent on the pace of the U.S. economic growth and financial conditions in global markets, notably developments in Europe.

These are still challenging times for our nation and for the FDIC. Our workforce remains committed to carrying out our mission. I am very grateful to the hard-working, dedicated men and women of the FDIC for all they have done during the financial crisis to maintain the stability of the U.S. financial system and put it on the road to recovery.

Sincerely,



Martin J. Gruenberg