

Message from the Chairman



I am pleased to present the Federal Deposit Insurance Corporation's (FDIC) 2013 Annual Report.

SUMMARY

During 2013, the banking industry continued to experience a process of gradual recovery that has been evident for the past four years

since the financial crisis. Fewer institutions reported quarterly losses, lending grew at a modest pace, credit quality continued to improve, the number of problem banks declined, and fewer banks failed.

In addition, we have seen sustained improvement in all the key bank performance indicators: three years of net income growth; improved credit quality; and growth in loan balances. Lower loan-loss provisions, reflecting improved credit quality, drove much of the improvement in earnings over the last few years. Revenue growth has remained flat. Going forward, industry earnings will depend more on increased lending, consistent with sound underwriting.

Internal indicators for the FDIC also continued to move in a positive direction. The numbers of both failed and problem institutions continued to decline in 2013, although they still remain elevated. Meanwhile, the Deposit Insurance Fund (DIF), which had been nearly \$21 billion in the red during the financial crisis, stood at over \$47 billion at year-end.

While some uncertainties remain, we now seem to be moving from an environment where the key focus had been repairing the damage from the financial crisis and the economic recession, into one where institutions are likely to explore opportunities to expand lending as conditions improve. One key issue lies with rising interest rates, which will provide banks an opportunity to increase margins, but

also the challenge of managing interest rate risk. From a supervisory standpoint, interest rate risk will be a key focus of our examiners.

The FDIC is well prepared to carry out our mission of maintaining stability and public confidence in the nation's financial system by insuring deposits, examining and supervising financial institutions for safety and soundness and consumer protection, and managing receiverships. At the end of 2013, the FDIC insured \$6.0 trillion of deposits in over 600 million accounts at 6,800 institutions.

In addition to carrying out our basic core mission responsibilities, our policy agenda includes the following:

- ◆ Carrying forward our major new responsibilities for reviewing and evaluating the resolution plans submitted by the largest bank holding companies and certain other systemically important financial institutions (SIFIs) under Title I of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), continuing to develop a strategy for resolving SIFIs under the new authorities provided the FDIC under Title II of the Dodd-Frank Act, and promoting cross-border cooperation and coordination with respect to an orderly resolution of a globally active SIFI;
- ◆ Implementing new capital, liquidity, trading and derivatives rules to reduce systemic risk and improve the resilience of the financial system;
- ◆ Continuing the FDIC's Community Banking Initiatives, including further research on the future of community banks and providing technical assistance to community banks such as our recently-released series of training videos on key risk management and consumer compliance issues; and
- ◆ Continuing our focus on expanding access to the mainstream banking system for everyone who lives in the United States, including the national household survey of the unbanked and underbanked that the FDIC conducts jointly with the U.S. Census Bureau.

The FDIC also recognizes that information technology and cybersecurity developments pose increasing risk to

the financial services sector. We are actively engaged in efforts to promote the security and resilience of the financial services sector through the newly formed FFIEC Cybersecurity and Critical Infrastructure Working Group and the Financial and Banking Information Infrastructure Committee. The FDIC has also taken steps to ensure its operational readiness and response capabilities through internal exercises and the execution of several cyber-related performance goals.

A great strength of the FDIC continues to be a highly dedicated and motivated workforce. The FDIC's employees understand the agency's mission and how it relates to what they do. For the third year in a row, the FDIC took a top spot in the *Best Places to Work in the Federal Government* based on a survey conducted by the Office of Personnel Management.

STRENGTHENING THE DEPOSIT INSURANCE FUND AND RESOLVING FAILED BANKS

The FDIC has made significant progress in rebuilding the DIF. In 2010 and 2011, the FDIC Board of Directors approved a comprehensive, long-term plan for fund management based on Dodd-Frank Act requirements and on an FDIC historical analysis of DIF losses. We experienced a steady increase in the year-end fund balance from 2011 through this year. The DIF balance rose to \$47.2 billion at the end of 2013. Assessment revenue, a decrease in the estimate of losses from banks that have failed, and fewer bank failures were the main drivers of fund growth in 2013. The fund is on track to build up the reserve ratio, the ratio of the DIF to all insured deposits, to the statutorily required level of 1.35 percent by September 2020.

Bank failures in 2013 totaled 24, 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 467 from a high of 888 in March 2011. These trends are still significantly higher than historical averages. As a result, although these trends are positive and may be accelerating to some degree, the FDIC must still devote considerable resources to managing receiverships, examining problem institutions, and implementing provisions of the Dodd-Frank Act.

Nonetheless, as the banking industry continues to recover, the FDIC will require fewer resources. The FDIC's authorized workforce for 2013 was 8,026 full-time equivalent positions compared with 8,713 the year before. The 2013 Corporate Operating Budget was \$2.7 billion, a decrease of \$600 million (18 percent) from 2012.

For 2014, the Board reduced the budget by 11 percent to \$2.4 billion and reduced authorized staffing by approximately 10 percent to 7,199 positions, in anticipation of a further drop in bank failure activity in the years ahead. Two temporary satellite offices that were set up to handle the crisis-related workload have now closed. The last of them, in Jacksonville, Florida, will close in 2014. However, contingent resources are included in the budget to ensure readiness should economic conditions unexpectedly deteriorate.

During 2013, the FDIC successfully continued to use resolution strategies instituted in 2008 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. [All told, these strategies saved the FDIC over \$40 billion since the beginning of the financial crisis.]

IMPLEMENTING THE FDIC'S NEW AUTHORITIES UNDER THE DODD-FRANK ACT AND OTHER FINANCIAL REFORMS

The Dodd-Frank Act included far-reaching changes to make financial regulation more effective in addressing systemic risks and provided significant new authorities to the FDIC and other U.S. regulators to plan for and manage the orderly failure of a SIFI. In particular, Title I of the Act requires all bank holding companies with assets over \$50 billion, as well as nonbank financial companies designated as systemic by the Financial Stability Oversight Council, to prepare resolution plans (or "living wills") to demonstrate how they would be resolved in a rapid and orderly manner under the Bankruptcy Code in the event of material financial



distress or failure. Title II of the Act provides the FDIC with back-up authority to place a failing SIFI, including a consolidated bank holding company or a nonbank financial company deemed to pose a risk to the financial system, into an FDIC receivership, should an orderly resolution under the Bankruptcy Code not be possible. In 2013, the FDIC made considerable progress in implementing both of these new authorities. Significant progress has also been made on the implementation of key improvements to supervisory standards included in the Act, as well as those that are the product of international efforts.

With respect to the living will process, it is widely recognized that U.S. SIFIs present a challenge to resolution in bankruptcy or under an FDIC receivership, because they are organized under a holding company structure with potentially thousands of interconnected subsidiaries that span legal and regulatory jurisdictions across international borders and share funding and critical support services. Title I provided new authority intended to make these companies more resolvable under the Bankruptcy Code, in a process jointly overseen by the FDIC and the Board of Governors of the Federal Reserve System.

By the end of 2013, all covered bank holding companies had submitted their initial plans, and the 11 largest, most systemically significant companies had submitted their second round resolution plans by October 1st. The FDIC and Federal Reserve Board developed guidance with specific benchmarks for those companies to address in the second-round submissions. The benchmarks included global cooperation with foreign regulators, multiple insolvencies of subsidiaries, counterparty derivative actions, maintenance of critical operations, funding, and liquidity. The companies were required to provide analysis to support the strategies and assumptions contained in their resolution plans. The FDIC and Federal Reserve Board have been evaluating the plans under the standards provided in the statute.

When bankruptcy is not a viable option and a resolution under the bankruptcy process would pose a systemic risk to the U.S. financial system and economy, the Title II Orderly Liquidation Authority (OLA) of the Dodd-Frank Act provides broad new back-up authorities to place any systemically important financial institution into an FDIC

receivership. The FDIC has worked for several years to develop the strategic and operational capability to carry out this new authority.

During 2013, the FDIC released for public comment a Federal Register Notice on the Single Point of Entry (SPOE) strategy, developed by the FDIC to manage an orderly resolution of a SIFI. Under the strategy, the FDIC would take control of the top-tier holding company, allowing the firm's operating subsidiaries, both domestic and foreign, to remain open and operating. The strategy is designed to diminish contagion effects while removing culpable management and imposing losses on shareholders and unsecured creditors without imposing costs on taxpayers. The Federal Register Notice provides a detailed overview of what would be a complex resolution process, describing how it would address key issues of liquidity, capital, restructuring, and governance consistent with purposes and authorities contained in Title II.

The FDIC's Systemic Risk Advisory Committee continued to provide advice and guidance on a wide range of issues regarding the resolution of large SIFIs. The Committee members have a wide range of knowledge and experience, including leading federal regulatory agencies; managing complex firms; administering bankruptcies; and working in the legal system, the accounting field, and academia.

Also during the year, the FDIC continued to engage our major foreign counterparts with whom we would have to collaborate on a cross-border basis in resolving failing global SIFIs. We worked directly with regulators in the United Kingdom, Switzerland, Germany, Japan, and the European Union. As part of our efforts in this area, the FDIC, in conjunction with the prudential regulators in our jurisdictions and internationally, has been working to develop contingency plans for the failure of Global SIFIs (G-SIFIs). Of the 28 G-SIFIs designated by the Financial Stability Board of the G-20 countries, eight are headquartered in the United States.

The FDIC made progress with efforts to develop international capital standards as a member of the Basel Committee on Banking Supervision and implement Dodd-Frank Act reforms to strengthen the safety and soundness of the financial system.

In July 2013, the FDIC approved an interim final rule that implemented the international Basel III capital agreement. The interim final rule adopted, with revisions, the June 2012 proposals related to the Basel III, Standardized, and Advanced Approaches rules. The interim final rule on Basel III strengthens both the quality and quantity of risk-based capital for all banks. The FDIC and the other federal banking agencies carefully considered more than 2,500 comments, the majority of which were from community banking institutions. Most of the key concerns of community banks were addressed through a few significant modifications to the proposed rule. The new capital requirements become effective for most banking organizations on January 1, 2015.

Also in July 2013, the FDIC approved a joint Notice of Proposed Rulemaking that would increase the supplementary leverage capital requirements for the largest, most systemically important banking organizations. The NPR addresses one of the main causes of the financial crisis, the excessive leverage that had built up in the system.

In October 2013, the FDIC and the other federal banking agencies issued a Notice of Proposed Rulemaking to implement the Basel III liquidity coverage ratio (LCR) standard. The LCR requires covered companies to maintain a sufficient amount of high quality liquid assets to cover a short-term stress event and applies to large, internationally active banking organizations and certain of their subsidiaries.

Finally, in December 2013, the FDIC with four other agencies jointly issued final rules to implement Section 619 of the Dodd-Frank Act (often referred to as the “Volcker Rule”). The purpose of the Volcker Rule is to limit the type and amount of speculative risk that can be undertaken by entities that are supported by the public safety net. In order to achieve that goal, the provision places prohibitions and restrictions on the ability of depository institution holding companies, insured depository institutions, and their subsidiaries and affiliates to engage in proprietary trading or investing in, or having relationships with, hedge funds and private equity funds.

COMMUNITY BANKING INITIATIVE

The financial crisis and its aftermath had significant consequences for community banks, which play a crucial role in the U.S. financial system. Community banks account for about 14 percent of the banking assets in the United States, but provide nearly 46 percent of the small loans that FDIC-insured depository institutions make to businesses and farms.

The FDIC is the lead federal supervisor for the majority of community banks, and the insurer of all. The FDIC has a particular responsibility for the safety and soundness of community banks, and for understanding and communicating the role they play in the banking system.

We launched a number of community banking initiatives in 2012, including the first comprehensive study on the role and future of community banks in the United States. Our research efforts continued through 2013. During the year, we published an update of trends in community bank structure and performance through year-end 2012. This updated study showed that, by a number of measures, community banks in 2012 enjoyed their best year since before the financial crisis began. Our research efforts will continue into the coming year as we address topics such as banking industry consolidation, rural depopulation, and Minority Depository Institutions.

As part of our outreach to community bankers, I participated in roundtable discussions with community bankers in each of the FDIC’s six supervisory regions during the year. Our supervisory and compliance examiners undertook an Examination and Rulemaking Review with the goal of identifying ways to make the supervisory process more efficient, consistent, and transparent. In response to concerns about pre- and post-examination processes, our supervisory staff developed a web-based tool that generates a pre-examination document and information request tailored to a specific institution’s operations and business lines. We are also improving how information is shared electronically between bankers and examiners.

During 2013, the FDIC launched a technical assistance video program designed to provide useful information to bank



directors, officers, and employees on areas of supervisory focus and proposed regulatory changes. Throughout the year, we released technical videos that address the roles and responsibilities of bank board directors, the FDIC's Risk Management and Compliance Examination processes, a virtual version of the FDIC's Directors' College Program that regional offices deliver throughout the year, and a variety of supervisory topics, including interest rate risk, troubled debt restructurings, appraisals and evaluations, the allowance for loan and lease losses, evaluations of municipal securities, and flood insurance. The feedback on the videos has been very positive.

Throughout 2013, FDIC supervisory staff also continued to offer additional on-site technical training opportunities on subjects of interest to community bankers. As part of this ongoing effort, our supervisory staff hosted Director and Banker Colleges in each region. These Colleges are typically conducted jointly with state trade associations and address topics of interest to community bankers. We conducted extensive outreach to community bankers on complex rulemakings, including the Basel III capital rulemaking process.

Finally, we continue to rely on our Advisory Committee on Community Banking as an ongoing forum for discussing critical issues and receiving valuable feedback and input from the industry. The advisory committee met three times during 2013. The Committee, which is composed of 15 community bank CEOs from around the country, 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.

PROTECTING CONSUMERS AND EXPANDING ACCESS TO BANKING SERVICES

Expanding access to the banking system for all those living in the United States is part of the FDIC's core mission. The FDIC biennial National Survey of Unbanked and Underbanked Households, conducted jointly with the

Census Bureau, has documented that a large portion of the population in our country has either no access or limited access to insured institutions. We have undertaken a major effort through a number of initiatives to protect consumers and expand access to mainstream banking services. This continues to be an important priority for the agency.

The FDIC's Advisory Committee on Economic Inclusion — composed of bankers, community and consumer organizations, and academics — has continued to explore strategies to bring the unbanked into the financial mainstream. In 2013, the committee focused on promoting household savings, reaching the underserved through mobile technology, examining financial education strategies for school-aged youth, and providing access to safe and affordable savings and transaction products.

At the local level, the FDIC's Alliance for Economic Inclusion organizes coalitions of financial institutions, community organizations, local government officials, and other partners in communities across the country to bring unbanked and underbanked households into the financial mainstream. The effort includes better access to basic retail financial services, such as checking and savings accounts, affordable remittance products, small-dollar loans, targeted financial education programs, and asset-building programs. These partnerships are currently operating in 16 communities nationwide.

Our efforts in this area are also focused on supervisory guidance designed to promote safe and sound practices and to promote consumer protection. During 2013, the FDIC issued final guidance regarding deposit advance products that are offered or may be offered by FDIC-supervised institutions. The guidance is intended to ensure that banks are aware of the potential credit, reputation, operational and compliance risks associated with deposit advance products. The guidance also recognizes consumers' need for responsible small-dollar credit products and encourages institutions to develop new or innovative programs to effectively meet the need for small-dollar credit that do not exhibit the risks associated with deposit advance products and payday loans.

CONCLUSION

The recovery of the banking industry continued to advance during 2013 with stronger earnings and improved asset quality. The industry is experiencing fewer bank failures and problem institutions, and the FDIC's Deposit Insurance Fund is steadily growing. Despite these improvements, we remain mindful of uncertainties and potential challenges, and are pursuing a number of important policy initiatives. The workforce of the FDIC remains committed to carrying out our core mission responsibility of maintaining stability

and public confidence in the nation's financial system. I am very grateful to the dedicated professionals of the FDIC for their commitment to public service and their continued dedication to the mission of the FDIC.

Sincerely,

A handwritten signature in blue ink that reads "Martin J. Gruenberg". The signature is written in a cursive style with a large, prominent "M" and "G".

Martin J. Gruenberg