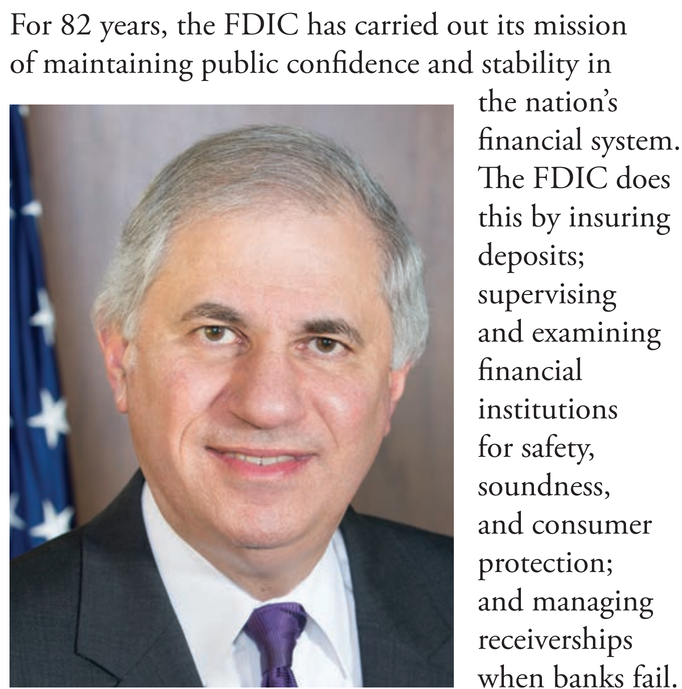
MESSAGE FROM THE CHAIRMAN

For 82 years, the FDIC has carried out its mission of maintaining public confidence and stability in the nation's financial system. The FDIC does this by insuring deposits; supervising and examining financial institutions for safety, soundness, and consumer protection; and managing receiverships when banks fail.



At the end of September 2015, the FDIC insured deposits of $6.4 trillion in more than half a billion accounts at almost 6,300 institutions, supervised 3,995 institutions, and managed 470 active receiverships having total assets of $23.9 billion.

The U.S. economy and the banking industry continued to improve in 2015. After experiencing the most severe financial crisis and economic downturn since the 1930s, the United States is now well into the recovery. The economy is expanding, although the pace of economic growth has been weaker than the long-term trend and bank profitability remains lower than pre-crisis levels. Still, the industry has been strengthening balance sheets, building capital, and enhancing liquidity.

Stronger balance sheets indicate ample capacity for FDIC-insured institutions to continue to support the economic recovery. During the 12 months ended September 30, loan balances at banks increased by $482 billion, the largest 12-month dollar gain since the year ending June 2008. Moreover, that growth was broad-based, with all major loan categories posting increases, and more than three-quarters of all institutions reporting larger loan balances. Loan growth was strongest at community banks, which posted an 8.5 percent gain versus 5.9 percent for the industry overall. Rising loan demand and a recent pickup in the pace of economic activity are creating favorable conditions for FDIC-insured institutions, although the global economic outlook remains uncertain and poses a potential downside risk for the U.S. economy and financial system.

The number of both failed and problem institutions declined again in 2015, and the Deposit Insurance Fund (DIF) balance, which was almost $21 billion in the red during the financial crisis, was $72.6 billion in the black at year-end.

The FDIC is working to wind down the receiverships of failed institutions and to address the emerging supervisory challenges of interest-rate risk, credit risk, and cybersecurity threats. This shift is indicative of the move from a post-crisis recovery environment to one of expanding economic growth and financial activity. Following is an overview of the key strategic challenges facing the FDIC.

REBUILDING THE DIF, RESOLVING FAILED BANKS, AND FDIC RESOURCES

Under a restoration plan that reflects Dodd-Frank Act requirements to rebuild the DIF, the FDIC has had a steady increase in the year-end fund balance from 2011 through 2015. Recently, lower than estimated losses for past bank failures, together with assessment income, have contributed to the increase in the fund balance to $72.6 billion as of December 31, 2015. The reserve ratio was 1.09 percent as of September 30, 2015.

The Dodd-Frank Act raised the minimum reserve ratio of the DIF from 1.15 percent to 1.35 percent and requires that the reserve ratio reach that level by September 30, 2020. Further, the Dodd-Frank Act

also makes banks with $10 billion or more in total assets responsible for the increase from 1.15 percent to 1.35 percent. Under a rule adopted by the FDIC in 2011, regular assessment rates for all banks will decline when the reserve ratio reaches 1.15 percent. Banks with total assets of less than $10 billion will have substantially lower assessment rates then. To ensure that the reserve ratio reaches 1.35 percent by the statutory deadline, the FDIC proposed a rule in 2015 that would impose on banks with at least $10 billion in assets a surcharge of 4.5 cents per $100 of their assessment base, after making certain adjustments. The FDIC expects the reserve ratio – the ratio of the DIF balance to estimated insured deposits - would likely reach 1.35 percent after approximately two years of payments of the proposed surcharges.

Bank failures in 2015 totaled eight, 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 203 at the end of September 2015 from a high of 888 in March 2011. The United States is now approaching pre-crisis levels for failed banks and problem banks.

As the banking industry continues to recover, the FDIC requires fewer resources. The agency's authorized workforce for 2015 was 6,886 full-time equivalent positions compared with 7,200 the year before. The 2015 Corporate Operating Budget was $2.3 billion, a decrease of 3.0 percent from 2014.

The FDIC reduced its budget for 2016 from the prior year by 4.7 percent to $2.2 billion and reduced authorized staffing by approximately 4.6 percent to 6,569 positions, in anticipation of a further drop in bank failure activity in the years ahead. However, contingent resources are included in the budget to ensure readiness should economic conditions unexpectedly deteriorate.

During 2015, the FDIC successfully used various resolution strategies to protect insured depositors of failed institutions at the least cost to the DIF. The FDIC actively marketed failing institutions and sold them 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.

IMPLEMENTING THE FDIC'S AUTHORITIES UNDER THE DODD-FRANK ACT

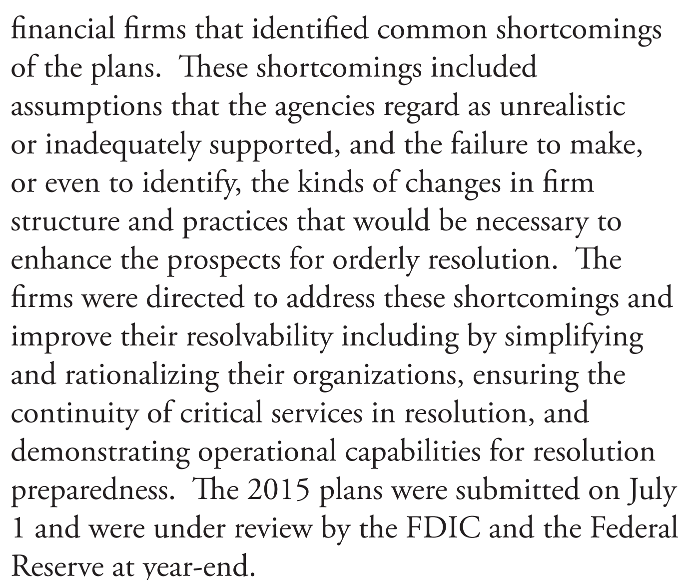
The FDIC continues to make progress in developing a framework under the Dodd-Frank Act for the orderly failure of a large, complex, systemically important financial institution while avoiding the taxpayer bailouts and the market breakdowns that took place during the recent financial crisis.

Under the Dodd-Frank Act, bankruptcy is the statutory first option for the failure of a Systemically Important Financial Institution (SIFI). The largest bank holding companies, as well as non-bank financial companies designated by the Financial Stability Oversight Council for supervision by the Federal Reserve Board, are required to prepare resolution plans, also referred to as "living wills," under Title I of the Dodd-Frank Act. These living wills must demonstrate that the firm could be resolved under bankruptcy without severe adverse consequences for the financial system or the U.S. economy. As a backstop, for circumstances in which an orderly bankruptcy might not be possible, Title II of the Dodd-Frank Act provides the Orderly Liquidation Authority. This public resolution authority allows the FDIC to manage the orderly failure of the firm.

The Living Wills Process

The FDIC and the Board of Governors of the Federal Reserve System are charged with reviewing and assessing each firm's plan. If a plan does not demonstrate the firm's resolvability, the FDIC and the Federal Reserve may jointly determine that it is not credible or would not facilitate an orderly resolution of the company under the Bankruptcy Code and issue a notice of deficiencies.

In August 2014, the FDIC and the Federal Reserve Board delivered individual letters to the largest



financial firms that identified common shortcomings of the plans. These shortcomings included assumptions that the agencies regard as unrealistic or inadequately supported, and the failure to make, or even to identify, the kinds of changes in firm structure and practices that would be necessary to enhance the prospects for orderly resolution. The firms were directed to address these shortcomings and improve their resolvability including by simplifying and rationalizing their organizations, ensuring the continuity of critical services in resolution, and demonstrating operational capabilities for resolution preparedness. The 2015 plans were submitted on July 1 and were under review by the FDIC and the Federal Reserve at year-end.

The living wills submitted by firms also include public portions. Public and market understanding of the process for improving the resolvability of Global Systemically Important Financial Institutions (G-SIFIs) is important for a number of reasons, including allowing for the development of realistic market expectations about how the resolution of a G-SIFI might proceed. In the past year the agencies provided guidance to the firms requiring that the public portions of the plans include more detailed information in a number of areas. As a result, this year's public plans provide substantially more information.

The Orderly Liquidation Authority

Given the challenges and the uncertainty surrounding any particular failure scenario, Title II of the Dodd-Frank Act provides the Orderly Liquidation Authority, which is effectively a public-sector bankruptcy process for institutions whose resolution under the U.S. Bankruptcy Code would pose systemic concerns.

The Orderly Liquidation Authority is the mechanism for ensuring that policymakers will not be faced with the same poor choices they faced in 2008. Its tools are intended to enable the FDIC to carry out the process of winding down and liquidating the firm, while ensuring that shareholders, creditors, and culpable management are held accountable and taxpayers do not bear losses. In the years since enactment of Dodd-Frank, the FDIC has made significant progress in developing the operational capabilities to carry out a resolution if needed.

Further, since passage of the Dodd-Frank Act, other major jurisdictions have followed the United States in enacting systemic resolution authorities that are comparable to those provided in the Dodd-Frank Act. Pursuant to provisions of the Orderly Liquidation Authority, the FDIC has worked closely with all the major foreign jurisdictions, including the United Kingdom, Germany, France, Switzerland, and Japan, as well as European entities including the new Single Resolution Board and Single Supervisory Mechanism. This cooperation is essential to identifying issues and to addressing obstacles to cross-border resolution.

In 2014, the European Parliament established a Single Resolution Mechanism (SRM) for the resolution of financial institutions in Europe. The FDIC is actively engaging with the new Single Resolution Board, which oversees the SRM, to be of assistance in its set up and to discuss cooperation and resolution planning for G-SIFIs with assets and operations in the United States and the Eurozone. The FDIC and the European Commission have established a joint Working Group to focus on both resolution and deposit insurance issues. In addition, the FDIC participates in the Crisis Management Groups for G-SIFIs with significant assets and operations in the United States. Deepening our cross-border relationships with the key foreign jurisdictions will be an ongoing priority for the FDIC's work on systemic resolution.

Large Bank Deposit Insurance Determinations

In April, the FDIC issued an Advance Notice of Proposed Rulemaking (ANPR) that sought comment on some approaches aimed at improving the way deposit insurance determinations could be done at banks with a large number of deposit accounts—not just banks that are part of SIFIs, but any bank with a large number of deposit accounts. Providing depositors with prompt access to their funds is essential for preserving public confidence and maintaining financial system stability. For the typical bank resolved by the FDIC, insured deposits are

available the next business day. The questions and alternatives in the ANPR were aimed at bolstering the FDIC's capability to make equally prompt deposit insurance determinations at banks with a large number of deposit accounts, such as two million accounts.

Interest-Rate Risk and Credit Risk

While there were a number of positive trends in the banking industry, there are signs of growing interest-rate risk and credit risk that warrant attention. In order to mitigate the impact of low rates on net interest margins, banks have been going out further on the yield curve and increasing the mismatch between asset and liability maturities. Lending in higher-risk loan categories has been growing. The recent Shared National Credits review of large syndicated loans noted that "credit risk in the portfolio remains high, despite a relatively favorable economic environment." And loan portfolios in regions that depend on oil and gas revenue are increasingly at risk due to the significant decline in energy prices.

At the same time risk profiles have been rising, banks have not seen corresponding growth in overall revenue.

These signs of growing interest-rate risk and credit risk are important because – as history tells us – it is during this phase of the credit cycle when lending decisions are made that could lead to future losses. Timely attention by banks to address these growing risks will benefit banks and contribute to the sustainability of the current economic expansion. These risks will continue to be a focus of supervisory attention.

REGULATORY REVIEW

The Economic Growth and Regulatory Paperwork Reduction Act of 1996 (EGRPRA) requires that regulations adopted by the federal banking agencies, including the FDIC, be reviewed by the agencies at least once every 10 years. The current cycle began in late 2014 and will end in 2016 when a final report is sent to Congress. The purpose of this review is to identify outdated or unnecessary regulations and consider how to reduce regulatory burden on insured depository institutions while, at the same time, ensuring that safety and soundness and consumer compliance standards are maintained. The FDIC in 2015 hosted and participated in public outreach meetings nationwide to hear firsthand from bankers and consumer groups.

The regulatory review process is one we take very seriously. A particular interest to the FDIC is the impact of our regulations on community and rural banks. As the EGRPRA process unfolded in 2015, we worked with the other agencies through the Federal Financial Institutions Examination Council (FFIEC) on a multi-step process to review Call Report burden and the real estate appraisal standards. The agencies anticipate taking further actions prior to the issuance of the final report.

COMMUNITY BANKING INITIATIVE

Community banks are critically important to our economy and banking system. Community banks account for 13 percent of the banking assets in the United States, but also account for 44 percent of the small loans to businesses and farms made by all banks, making them key partners in supporting local economic development and job creation. Since the FDIC is the primary federal supervisor of the majority of community banks in the United States, community banking will continue to be an important focus of FDIC supervision, technical assistance, and research.

In late 2012, the FDIC published a comprehensive study on community banking. The study confirmed that the traditional community bank business model – careful relationship lending, funding from stable core deposits, and local market expertise – performed comparatively well during the recent banking crisis. Of the more than 500 banks that failed since 2007, the highest failure rates were among non-community banks and community banks that departed from this

traditional model by investing in risky assets funded by non-core deposits.

In 2015, FDIC analysts published a new study on the challenges and opportunities facing small, closely held community banks.

Apart from research, the community bank initiative includes a robust technical assistance program for bank directors, officers, and employees. The FDIC's latest innovation is a series of more than 20 online videos that are helping community bankers to understand better their management responsibilities. During 2015, new videos were released on interest-rate risk, corporate governance, cybersecurity, vendor management, the loan originator compensation rule, and mortgage servicing rules.

Finally, the FDIC's Advisory Committee on Community Banking is an ongoing forum for discussing current issues and receiving valuable feedback from the industry. The committee, which met three times during 2015, is composed of 15 community bank CEOs from around the country. It 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.

CYBERSECURITY

The rapidly evolving nature of cybersecurity risks reinforces the need for regulators, financial institutions, and critical technology service providers to have appropriate procedures to effectively respond to cybersecurity risk. The FDIC works with other bank regulators to analyze and respond to emerging cyber threats, bank security breaches, and other harmful or disruptive technology-related incidents. The federal banking agencies are currently reviewing security readiness at banks and technology service providers. We are also evaluating our supervisory policies for potential improvements.

The FDIC has taken a number of actions to raise awareness of cyber risks and to encourage practices to protect the banks we supervise, particularly community banks. For example, in 2015 the FDIC distributed to all FDIC-supervised banks three new videos that are part of our Cyber Challenge: a Community Bank Cyber Exercise series; added a cyber-awareness video to the Directors' Resource Center; and hosted a cybersecurity teleconference for the industry. Cyber Challenge provides operational risk-related scenarios and challenge questions designed to facilitate discussion and allow community bankers to assess their preparedness for and response to cyber-related events. The FDIC, in coordination with other members of the FFIEC, also published a Cybersecurity Assessment Tool to help institutions identify risks and determine their preparedness. The voluntary tool includes a process for measuring cybersecurity preparedness over time.

The FDIC monitors cybersecurity issues on a regular basis through on-site bank examinations and regulatory and intelligence reports. The FDIC also works with other federal agencies, law enforcement and a number of government groups and industry coordinating councils to facilitate collaboration and information sharing across the financial services sector.

PROTECTING CONSUMERS AND EXPANDING ACCESS TO BANKING SERVICES

Expanding access to mainstream banking services is part of the FDIC's core mission. The FDIC's National Survey of Unbanked and Underbanked Households, conducted every two years with the U.S. Census Bureau, has documented that a large number of households in our country do not have a relationship with an insured depository institution or rely on high cost alternative financial service providers to meet some of their financial services needs. The survey, which was last released in October 2014, is widely used by the industry, academics, government, consumer and community organizations, the media, and many others to better understand who lacks access to mainstream banking services in the United

States and to gain insights into opportunities to expand participation.

During 2015, the FDIC continued its efforts to protect consumers and expand access to mainstream banking services. A new national effort, for example, was launched to promote local outreach and awareness of safe accounts. These safe accounts, which are offered by banks with branches in counties where nearly 80 percent of Americans live, provide secure, affordable transaction services. The accounts follow the standards for a Model SAFE account developed by the FDIC's Advisory Committee on Economic Inclusion. The advisory committee, composed of bankers, community and consumer organizations and academics, also began the process of determining how mobile banking technologies could help expand economic inclusion in the banking system and explored opportunities to address the financial services needs of individuals with disabilities.

The FDIC has a longstanding commitment to financial education. In 2015, we added a new *Money Smart for Young People* curriculum series to the recently enhanced Teacher Online Resource Center. This age-appropriate resource involves educators, parents/caregivers, and young people in the learning process, including through the use of Parent/Caregiver Guides that are available in English and Spanish. Since financial education can be enhanced through hands-on learning approaches, we expanded a pilot to 21 participating banks that combine the offer of a savings account with financial education programs for young people. And along with the Financial Literacy and Education Commission and other regulatory agencies, the FDIC issued guidance that encourages banks to offer youth savings programs and answers related frequently asked questions. Entrepreneurs can also benefit from an enhanced *Money Smart for Small Business* curriculum, which is now also available in Spanish.

CONCLUSION

During 2015, the U.S. banking industry continued its recovery from the recent financial crisis. The industry benefited from stronger balance sheets, fewer problem banks and bank closings, increased lending activity, and a larger balance in the DIF. At the same time, it remains important for bankers and supervisors to heed the lessons of the recent crisis by maintaining a steady focus on risk management.

In 2016, the FDIC will continue to work to fulfill its mission of maintaining public confidence and stability in the nation's financial system. The workforce of the FDIC remains committed to the agency's core mission. I am very grateful to the dedicated professionals of the FDIC for their commitment to public service and for the high level at which they carry out their important responsibilities.

Sincerely,

Martin J. Gruenberg