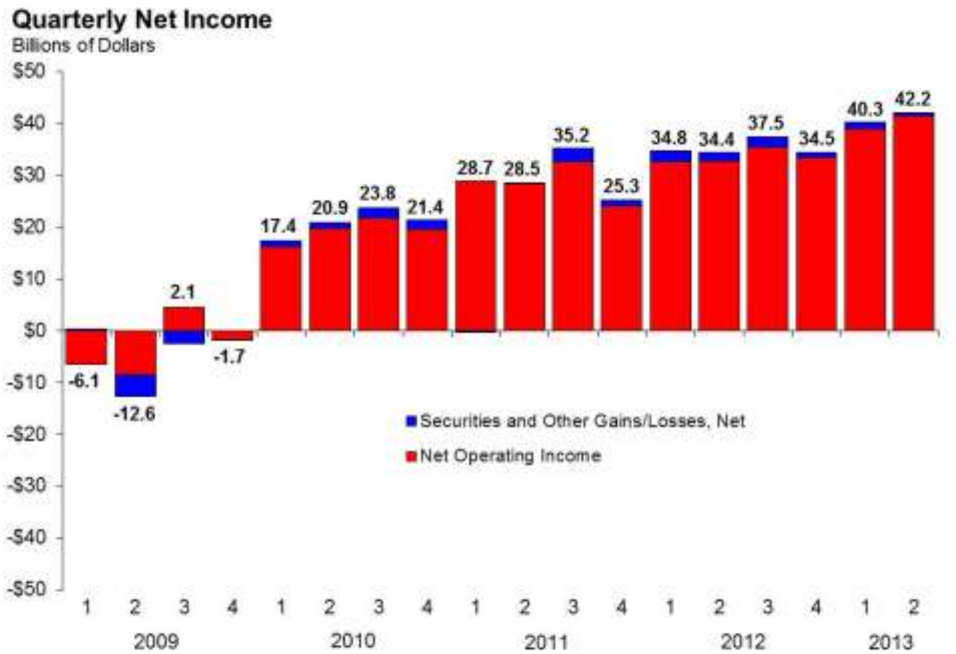
Remarks by Martin J. Gruenberg, FDIC Chairman, on the Second Quarter 2013 Quarterly Banking Profile

August 29, 2013

Good morning, and welcome to our release of second quarter results for FDIC-insured institutions. Today's report provides further evidence of the recovery that has been underway in the banking industry for almost four years. Over the past quarter, asset quality improved, loan balances grew, fewer institutions were unprofitable, and the number of problem banks continued to fall. These improvements were shared by community banks as well as larger institutions.

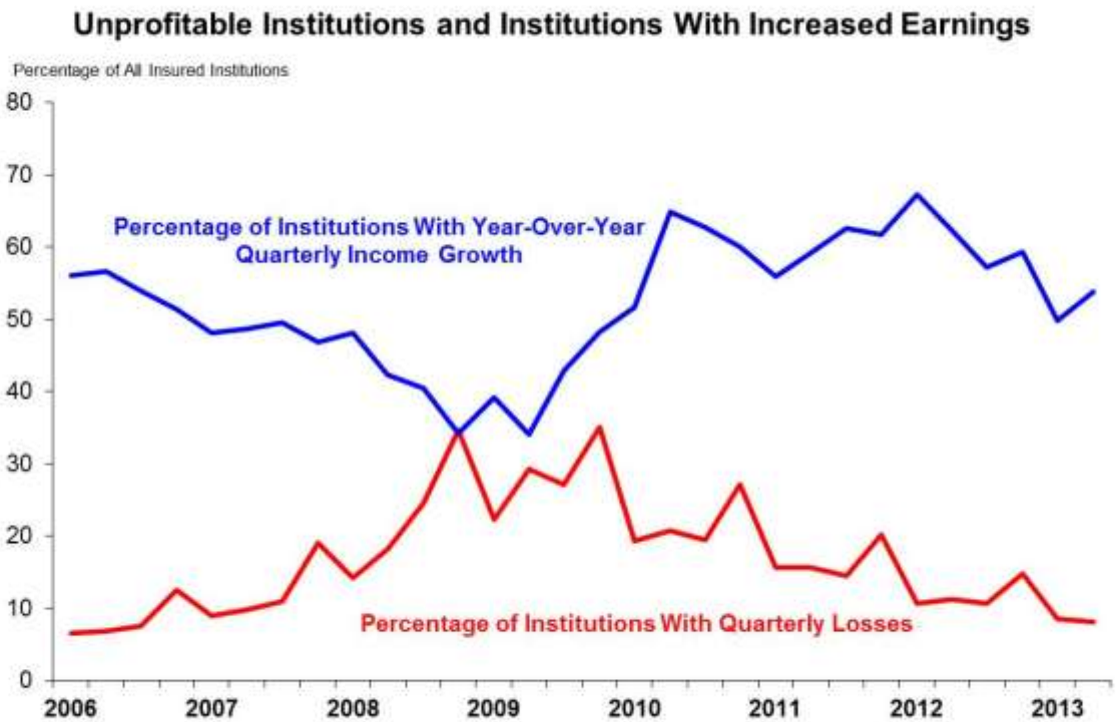
However, challenges still remain. Narrow net interest margins and modest loan growth have made it difficult for banks to increase revenue. And the recent rise in interest rates led to the largest nominal decline in the value of available-for-sale securities during a quarter since banks started reporting these data in 1994.

Chart 1



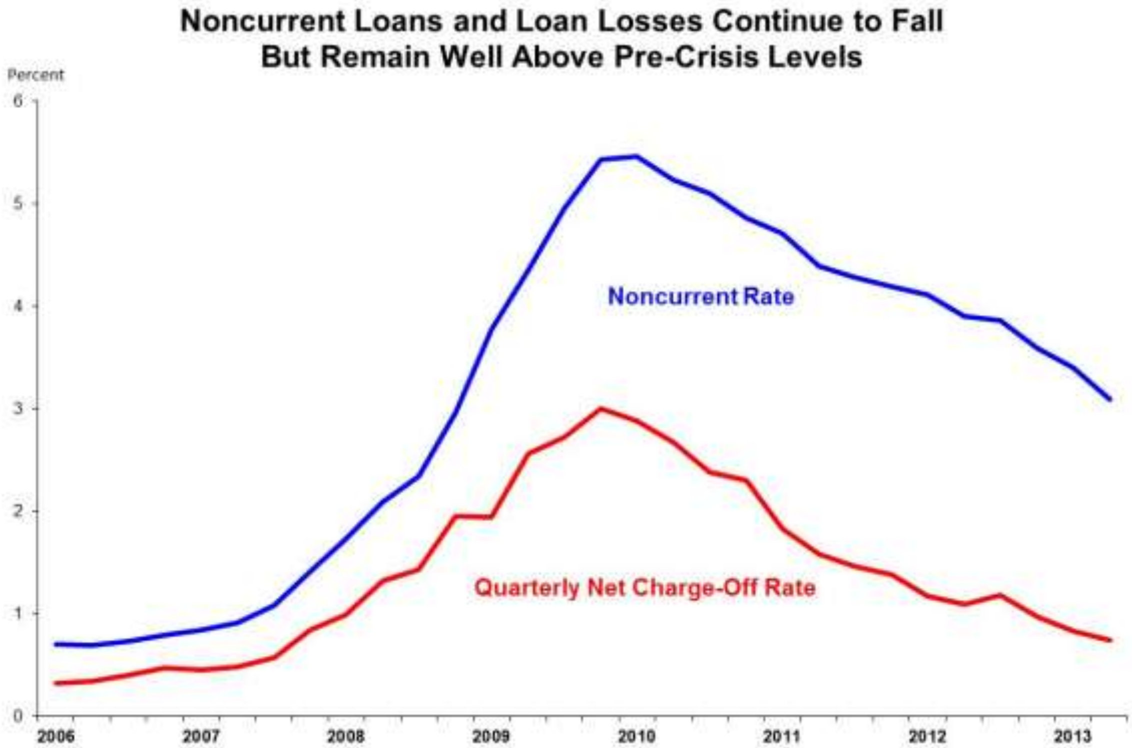
Our first chart shows that net income was 42.2 billion dollars in the second quarter. This is the sixteenth consecutive quarter that earnings posted a year-over-year increase. And the average return on assets of 1.17 percent for the quarter, while still well below the highs we saw in the early 2000s, was the highest in over six years.

Chart 2



Most performance trends were positive during the quarter. As you can see in the second chart, more than half of all institutions reported higher net income than a year ago. And the percentage of institutions that reported a quarterly loss was the lowest since third quarter 2006.

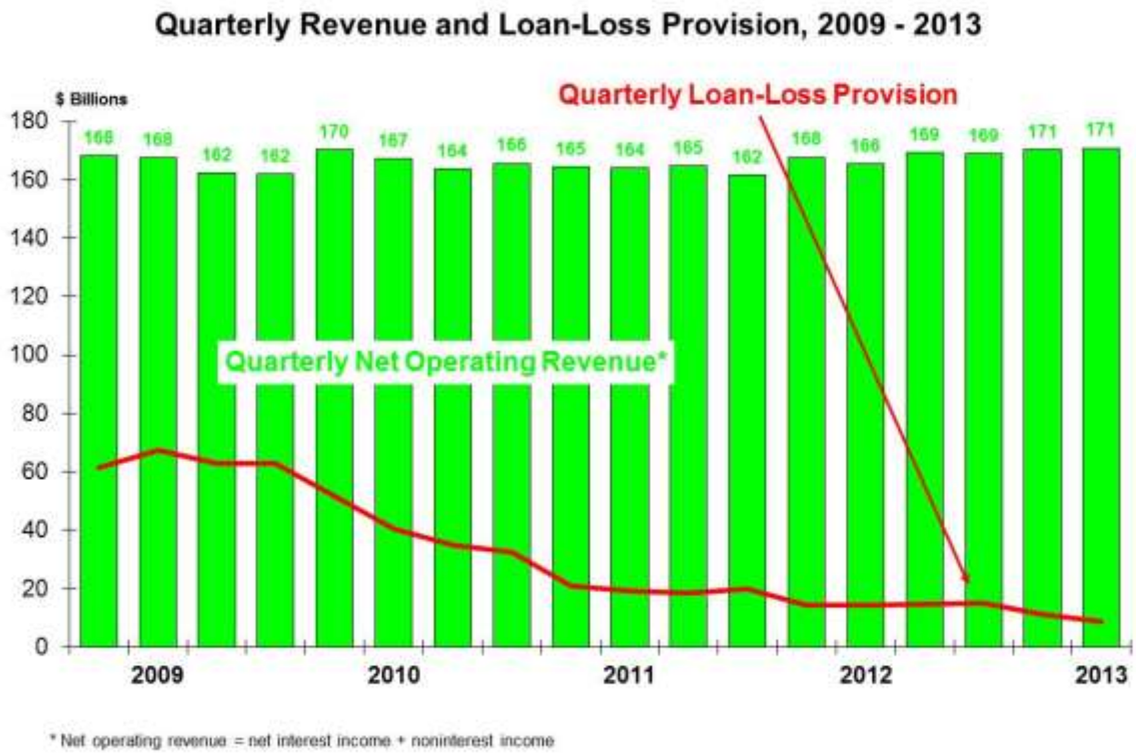
Chart 3



The next chart shows that asset quality continued to improve at FDIC-insured institutions. Although still elevated relative to historical norms, the noncurrent loan rate and the net charge-off rate both remain on a steady, downward trend.

The improvement in asset quality—which was shared by institutions of all sizes—has allowed banks to reduce their loan loss provisions. Banks set aside 8.6 billion dollars in loss provisions during the quarter, the lowest since third quarter 2006. At the same time, the industry's coverage ratio—which is total loan loss reserves as a percent of noncurrent loans—increased to 62 percent, as the continued improvement in asset quality reduced total noncurrent loan balances.

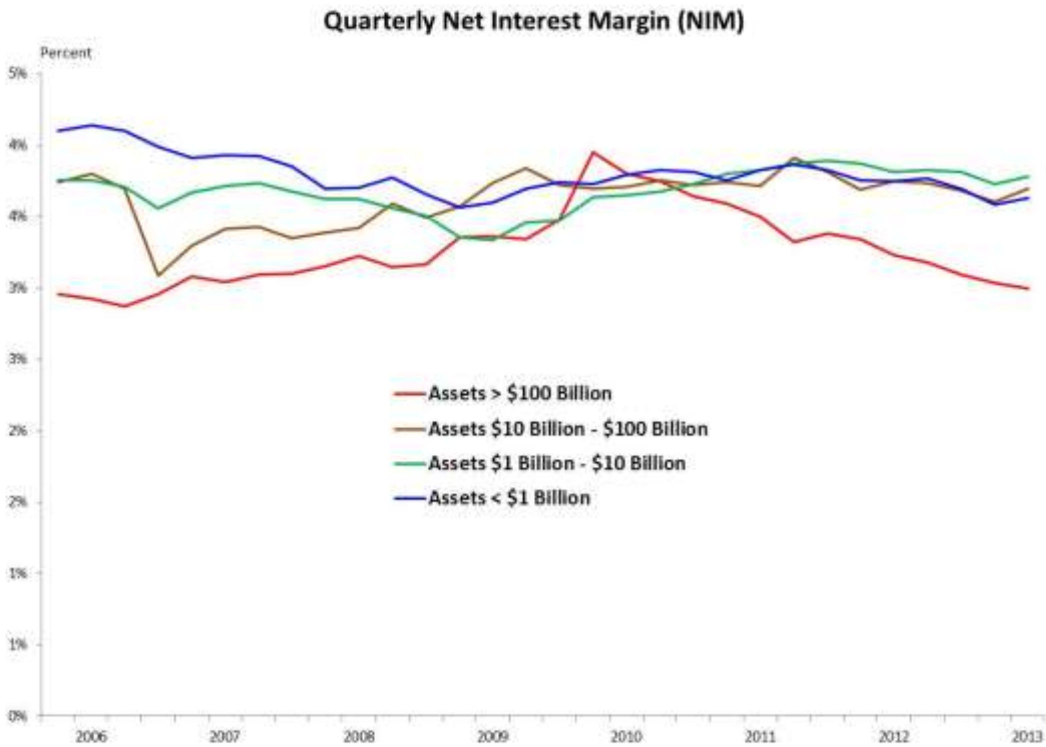
Chart 4



As we have noted previously, declining loss provisions have been a primary driver of earnings growth in the industry in recent years. However, the red line in the next chart shows that the decline in loss provisions has been largely exhausted. In future quarters, earnings will be increasingly dependent on revenues.

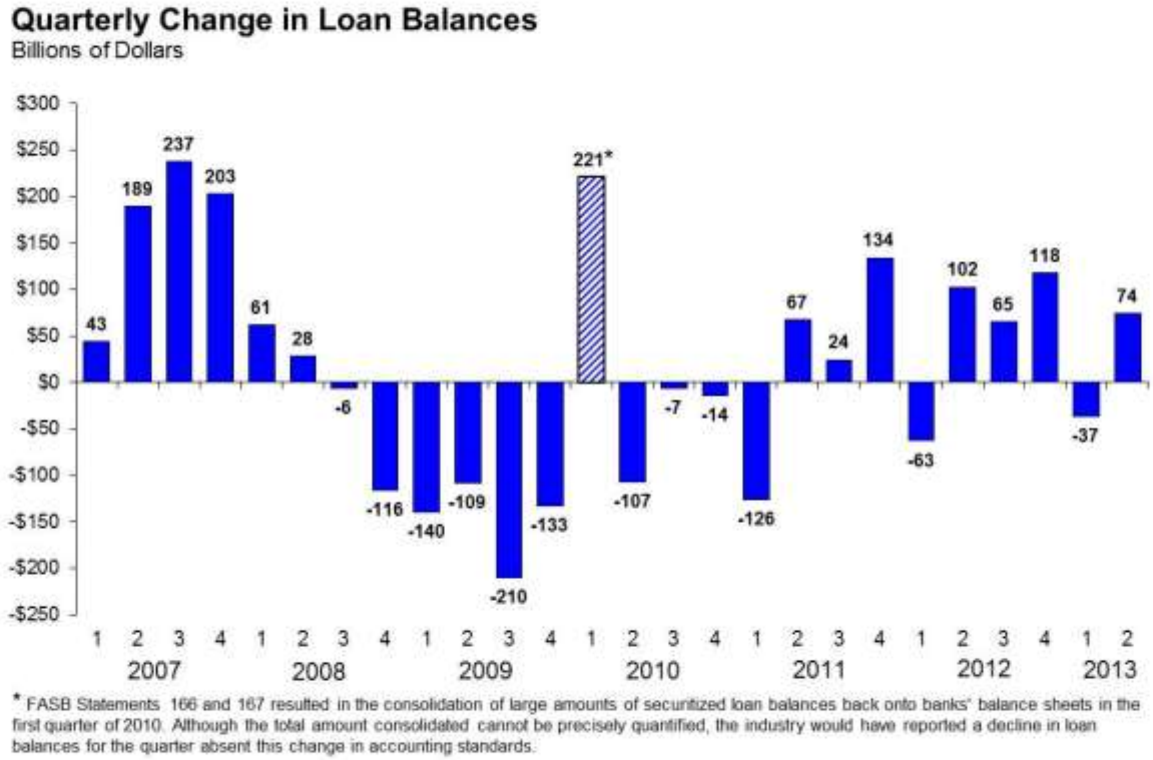
The green bars in the chart show that industry revenue has grown by less than two percent over the past four years. The primary reason for the industry's slow revenue growth is the ongoing erosion of net interest margins in a low interest rate environment. Net interest income totaled 103.7 billion dollars in the second quarter, the lowest since fourth quarter 2009. And the net interest margin of 3.26 percent is the lowest since third quarter 2006.

Chart 5



Our next chart shows that the erosion of net interest margins in recent years has been greatest at the largest banks. Smaller banks generally have been better able to maintain their margins, although they are well below their long-term averages. Margin trends are especially important at smaller banks since net interest income is a larger share of their overall revenue.

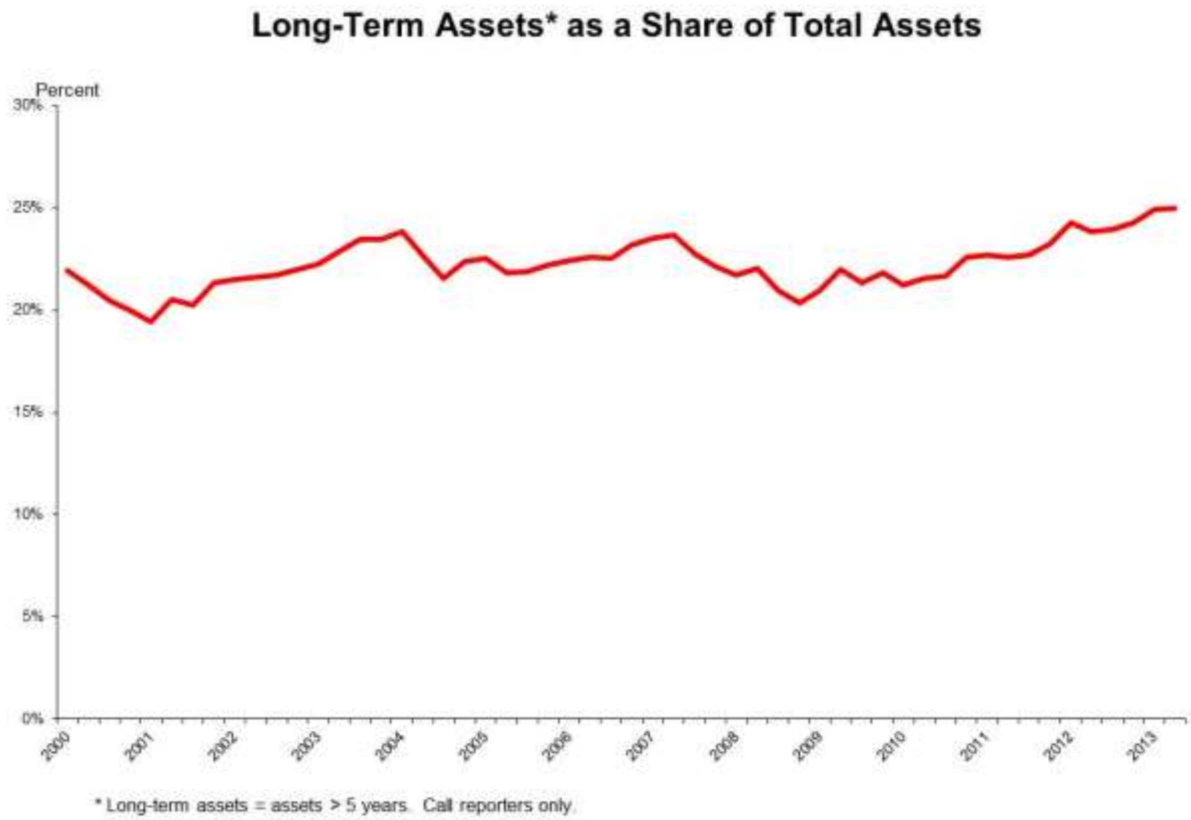
Chart 6



The next chart shows that total loan balances increased in the second quarter following a seasonal first quarter decline. This continues the pattern we have seen over the past three years, of a seasonal first quarter decline followed by an increase in loan balances during the second quarter.

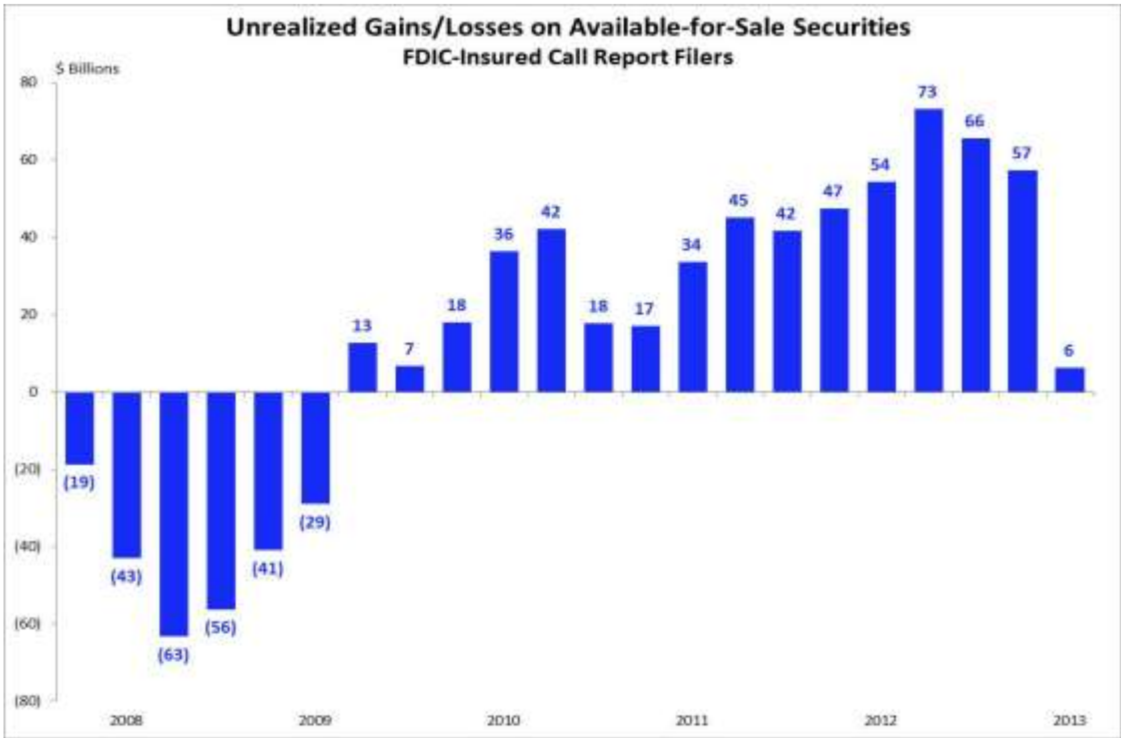
Commercial and industrial lending continued to be relatively strong during the quarter and nonmortgage consumer lending trended up. However, real estate loan growth was weak. Small business loans were up, with community banks leading the increase.

Chart 7



As we noted last quarter, banks have been reaching for yield by increasing the share of longer-term assets in their portfolios. This shift, which is illustrated in the next chart, leaves banks more exposed to interest rate risk as rates rise.

Chart 8

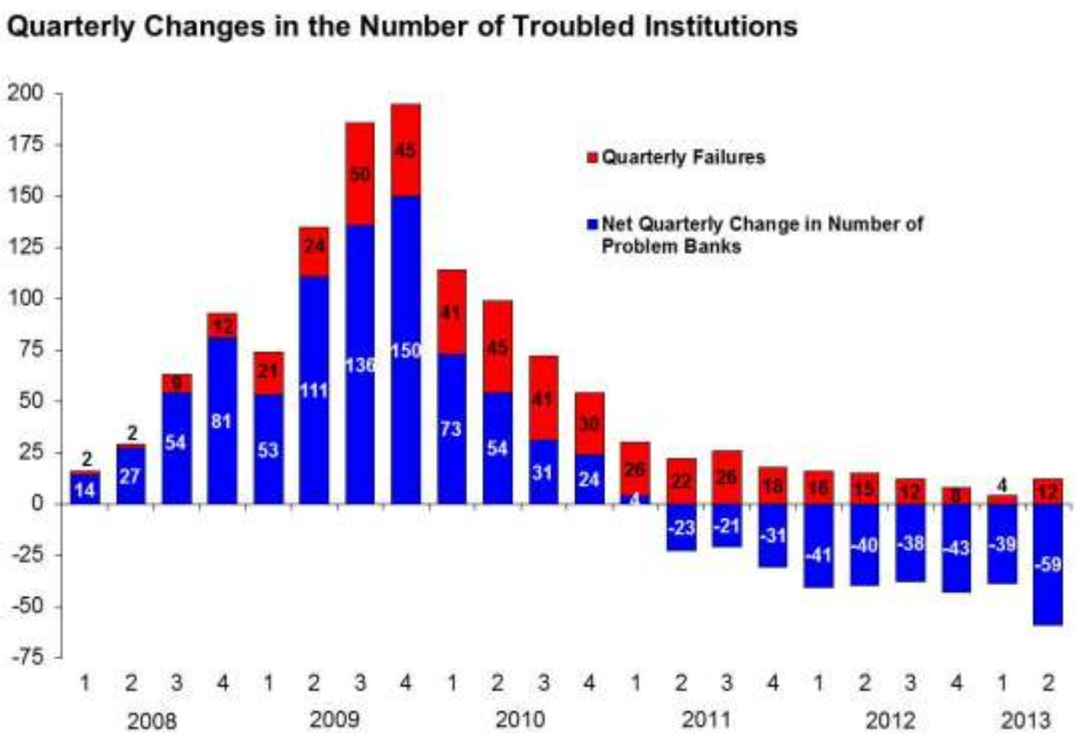


In fact, the next chart shows that there was a 51 billion dollar decline in unrealized gains on available-for-sale securities, primarily due to the increase in medium- and longer-term interest rates during the quarter. This is the largest nominal change during a quarter since banks started reporting these data in 1994. Unrealized gains and losses on available-for-sale securities do not affect current earnings, but they have implications for future earnings if the securities are sold.

Unrealized gains and losses also do not currently affect regulatory capital. But they will under the new Basel III capital rules at large banking organizations that are subject to the advanced approaches requirements, as well as other institutions that choose not to opt out.

Interest rate risk has been an ongoing concern to bank regulators. It will continue to be a focus of attention in our safety and soundness examinations, as well as guidance we provide to insured institutions. In response to requests from community bankers, the FDIC released a technical assistance video earlier this month to help bankers with key elements of interest rate risk.

Chart 9



We continue to see fewer "problem" banks, as the number of banks on the "Problem List" declined from 612 to 553 during the quarter. This is the ninth consecutive quarterly decline and the first quarter since 2009 that the number is less than 600. The "Problem List" is nearly 40 percent below the peak of 888 in first quarter 2011.

Twelve insured institutions failed in the second quarter, as the year-over-year trend in bank failures continued to improve. So far this year, 20 banks have failed compared to 40 in the same period last year.

The Deposit Insurance Fund balance rose to 37.9 billion dollars as of June 30, up from 35.7 billion dollars at the end of March. Assessment income continues to drive the growth in the Fund balance.

Estimated insured deposits declined by 0.8 percent, and the reserve ratio—which is the Fund balance as a percent of estimated insured deposits—increased to 0.63 percent at June 30 from 0.59 percent at March 31. The Deposit Insurance Fund must achieve a minimum reserve ratio of 1.35 percent by 2020.

In summary, the trends we have seen in recent quarters continued in the second quarter. Asset quality continues to recover, loan balances are trending up, fewer institutions are unprofitable, the number of problem banks is down, and the number of failures is significantly below levels of a year ago. However, industry revenue growth remains weak, reflecting narrow margins and modest loan growth. And the current interest rate environment creates an incentive for institutions to reach for yield, which is a matter of ongoing supervisory attention. Nonetheless, overall these results show a continuation of the recovery in the banking industry.

Thank you.

I am happy to take a few questions.