# Chairman's Opening Statement

## Third Quarter 2017 Quarterly Banking Profile

## November 21, 2017

Good morning, and welcome to our release of third quarter 2017 results for FDIC-insured institutions.

This was another positive quarter for the banking industry. Revenue and net income were both higher, loan balances increased, net interest margins improved, and the number of unprofitable banks and "problem banks" continued to fall. Community banks also reported another solid quarter of revenue, net income, and loan growth.

While overall performance improved from the prior year, the interest-rate environment and competitive lending conditions continue to pose challenges for many institutions. Some banks have responded to this environment by "reaching for yield" through investing in higher-risk and longer-term assets.

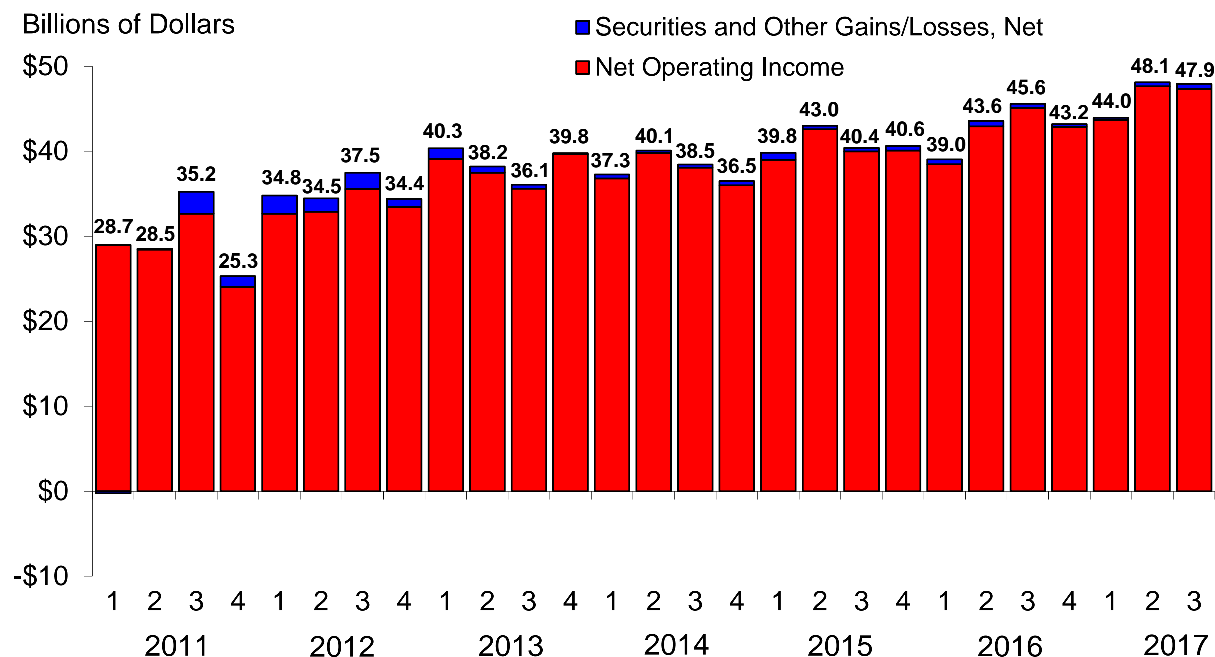
In addition, with the economy in the ninth year of an expansion that has been characterized by modest economic growth, the annual rate of loan growth has slowed in recent quarters. This slowdown has occurred across all major loan categories and banks of all sizes.

Going forward, the industry must manage interest-rate risk, liquidity risk, and credit risk carefully to continue to grow on a long-run, sustainable path. These challenges facing the industry will continue to be a focus of supervisory attention.

## Chart 1:

### Quarterly Net Income

All FDIC-Insured Institutions




Source: FDIC.

Our first chart shows that net income for the industry was 47.9 billion dollars during the quarter, a 5.2 percent increase from a year earlier. Two-thirds of all banks reported year-over-year growth in quarterly net income, and less than 4 percent of banks reported a net loss during the quarter.

The industry's return on assets was 1.12 percent in the third quarter. That is up from 1.10 percent a year earlier, and is the second highest quarterly return on assets in the past 10 years.

Community banks reported net income of 6 billion dollars in the third quarter, an increase of 9.4 percent from a year earlier.

## Chart 2:

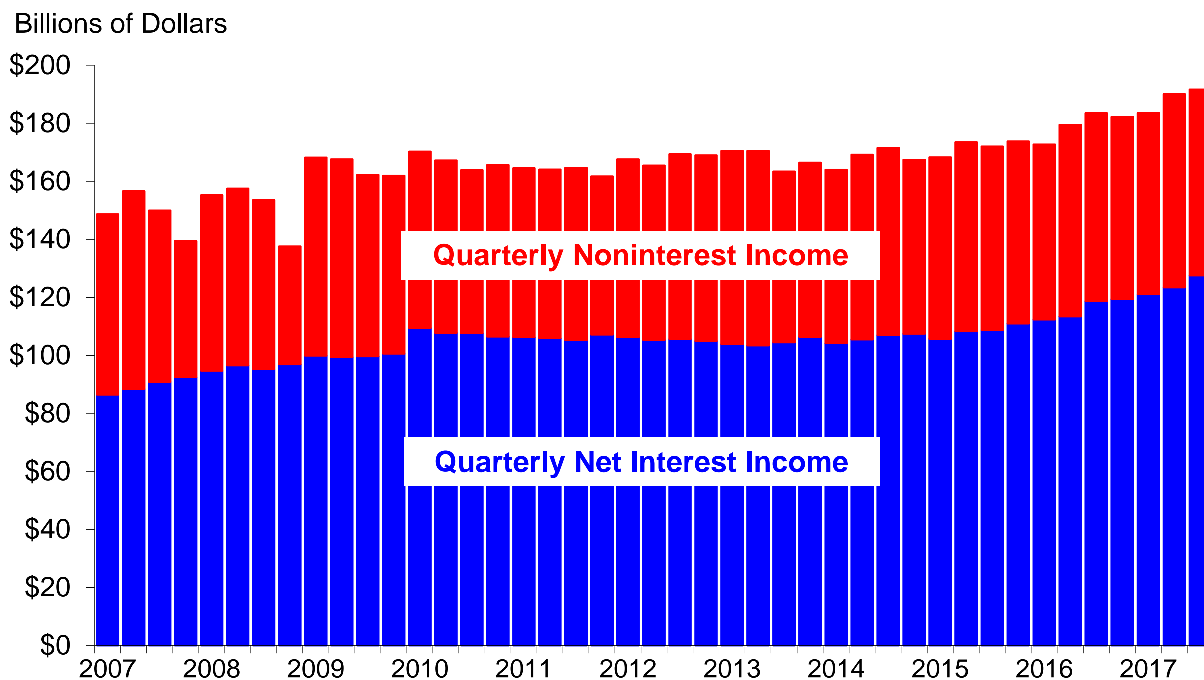
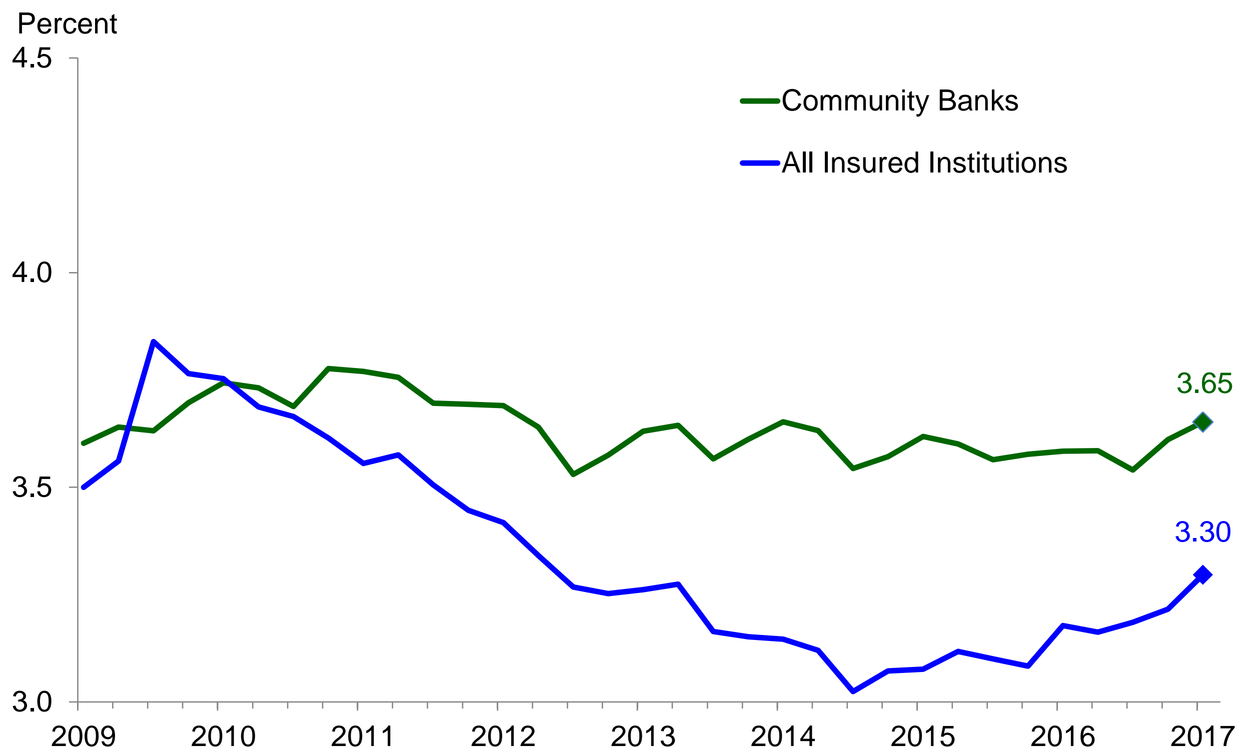



Chart 2 shows that net operating revenue totaled 191.7 billion dollars in the third quarter, an increase of 4.5 percent from a year earlier. The increase in revenue was broad-based across the industry, as more than three quarters of all banks reported higher revenue than a year earlier.

The growth in revenue was driven by higher net interest income, which grew 7.4 percent from the prior year. Noninterest income fell 1 percent from a year earlier due to a decline in income from the sale, securitization, and servicing of residential mortgages, and a decline in trading income.

**Chart 3:**




The growth in net interest income reflects an improvement in net interest margins at most institutions. Chart 3 shows that the average margin for the industry was 3.30 percent in the third quarter, up from 3.18 percent a year earlier.

Community banks continue to report higher net interest margins than the overall industry. However, the gap has narrowed in recent quarters. Large institutions have benefitted more than community banks from rising short-term interest rates, as large institutions have a greater share of assets that reprice quickly.

## Chart 4:

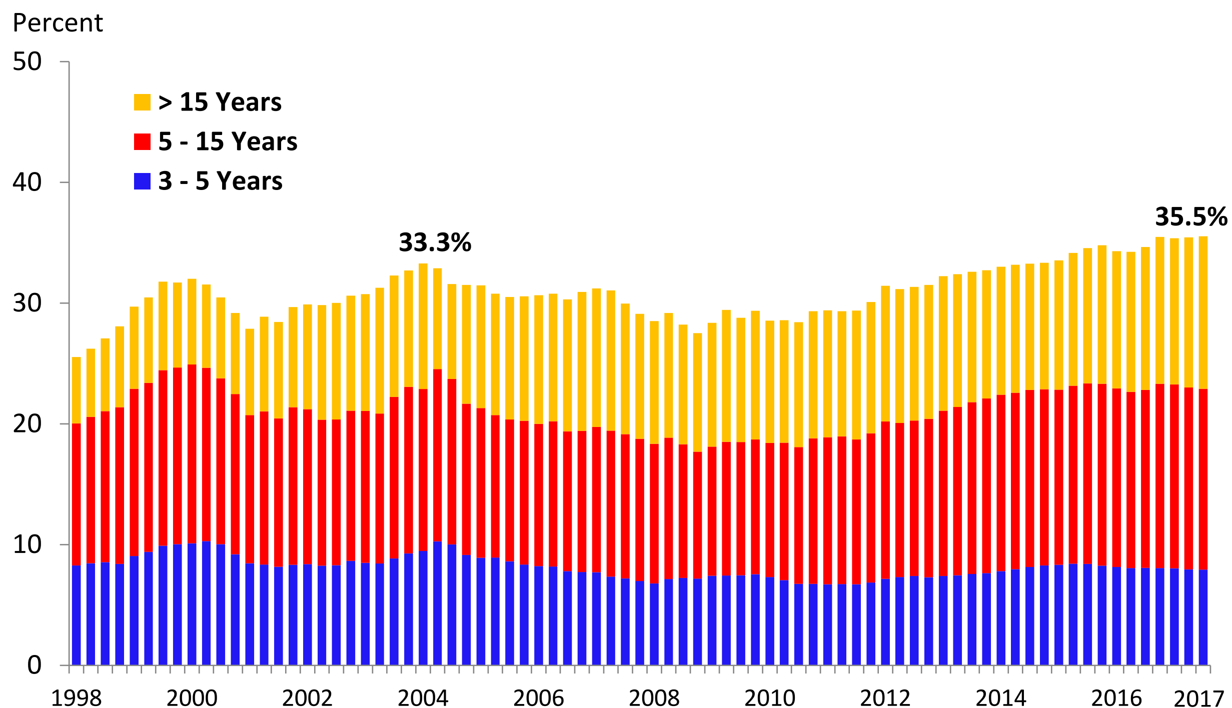


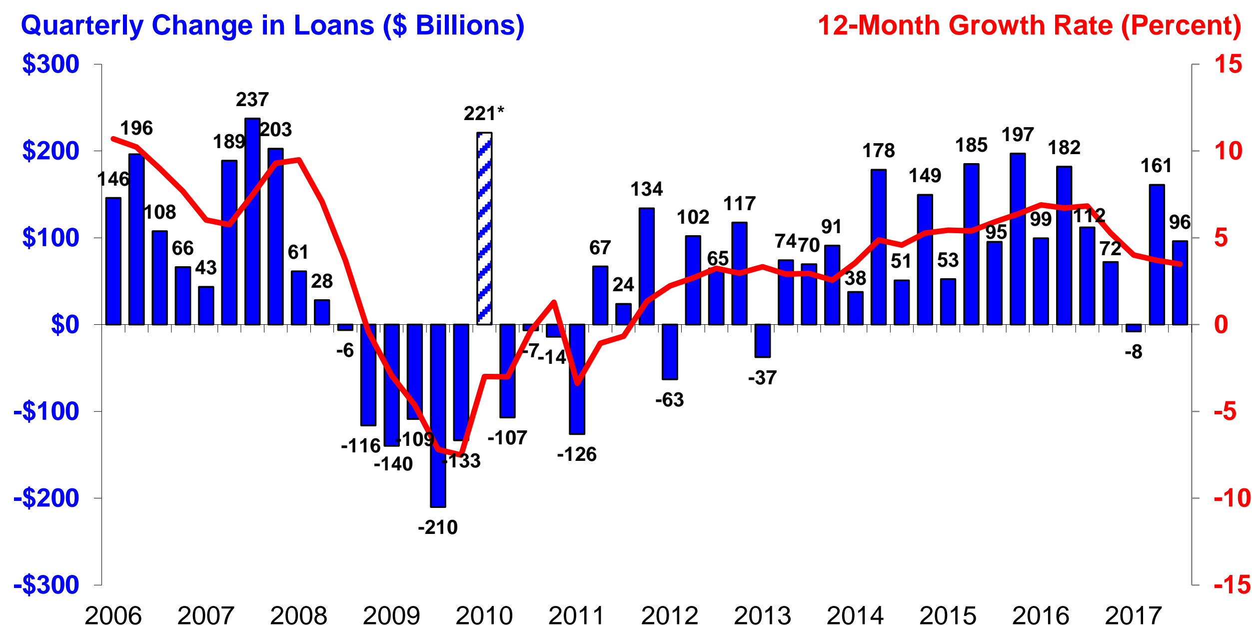

Chart 4 shows that the share of longer-term assets relative to total industry assets remains elevated, with more than a third of industry assets maturing or repricing in three or more years. Banks have been extending asset maturities to increase yields and maintain margins in a low-rate environment. However, this has left many institutions more vulnerable to interest-rate risk.

Community banks are particularly vulnerable to interest-rate risk – approximately half of their assets mature or reprice in three or more years.

## Chart 5:

### Quarterly Change in Loan Balances

All FDIC-Insured Institutions




Source: FDIC. *FASB Statements 166 and 167 resulted in the consolidation of large amounts of securitized loan balances back onto banks' balance sheets in the first quarter of 2010. Although the total amount consolidated cannot be precisely quantified, the industry would have reported a decline in loan balances for the quarter absent this change in accounting standards.

Chart 5 shows that loan balances increased 96 billion dollars during the third quarter. All major loan categories registered growth in the quarter. The largest increase was in residential mortgage loans, followed by credit card balances and commercial real estate loans.

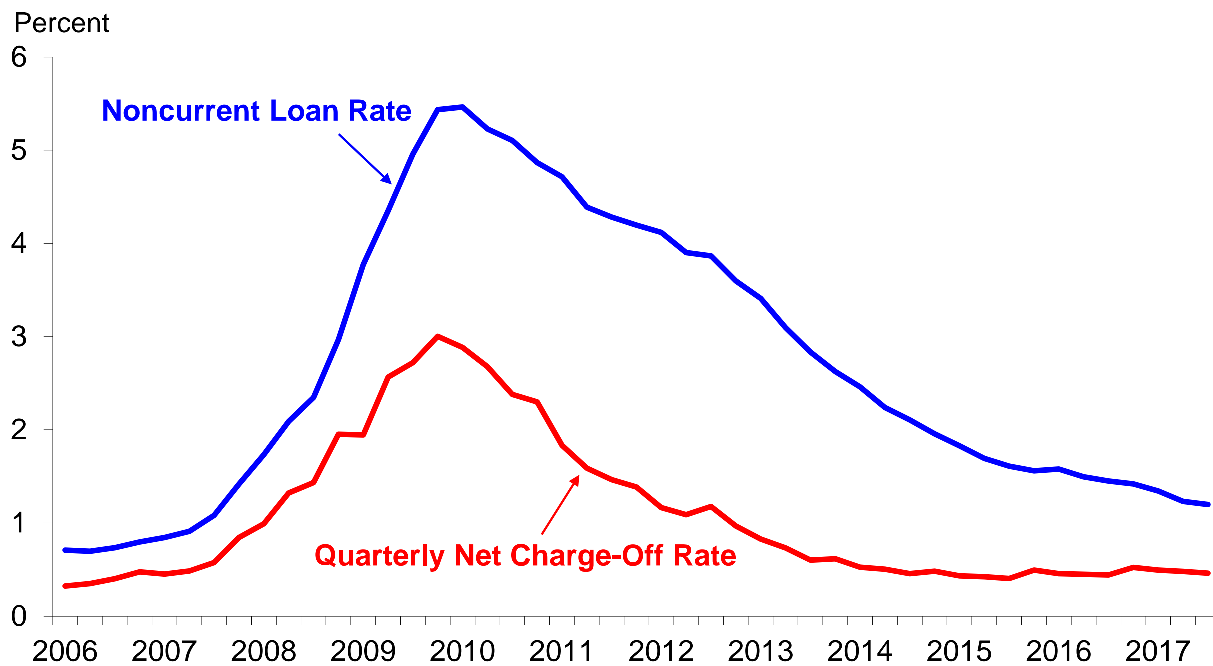
Loan balances rose 3.5 percent over the past year, down from a 3.7 percent increase last quarter. While a slowdown in loan growth is not unusual at this stage of the credit cycle, we are monitoring it closely.

Continuing a trend observed throughout much of the post-crisis period, loan growth in the third quarter was stronger at community banks than the rest of the industry. Loan growth at community banks was 7.3 percent over the past year.

**Chart 6:**

**Noncurrent Loan Rate and Quarterly Net Charge-Off Rate**

All FDIC-Insured Institutions




Source: FDIC.

Our next chart shows that overall asset quality remains strong. The noncurrent rate continued to fall in the third quarter, and the net charge-off rate remained near the cyclical low. While charge-offs have been declining in most loan categories, they were higher than a year earlier for credit cards and auto loans.

## Chart 7:

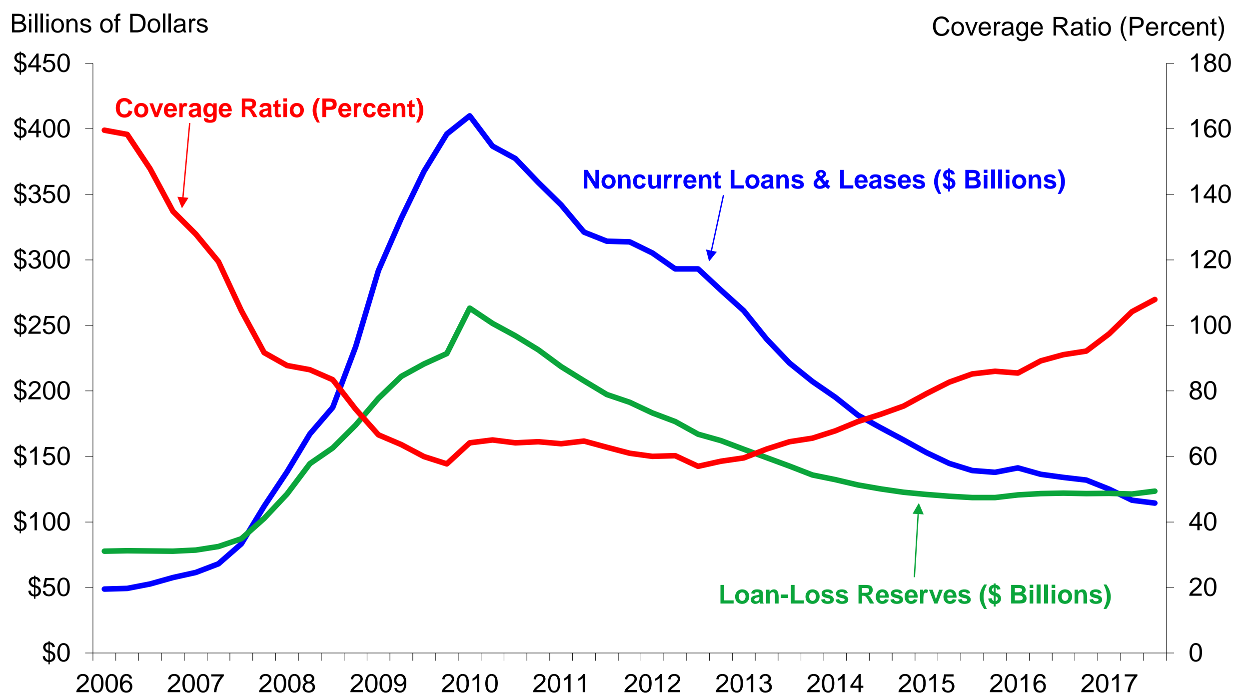



Chart 7 shows that the industry's reserve coverage ratio, which measures loan-loss reserves relative to total noncurrent loan balances, was 108 percent at the end of the third quarter. This is the highest level since the second quarter of 2007. The industry's capacity to absorb credit losses continues to improve as noncurrent loan balances decline and loan-loss reserves remain relatively stable.

**Chart 8:**

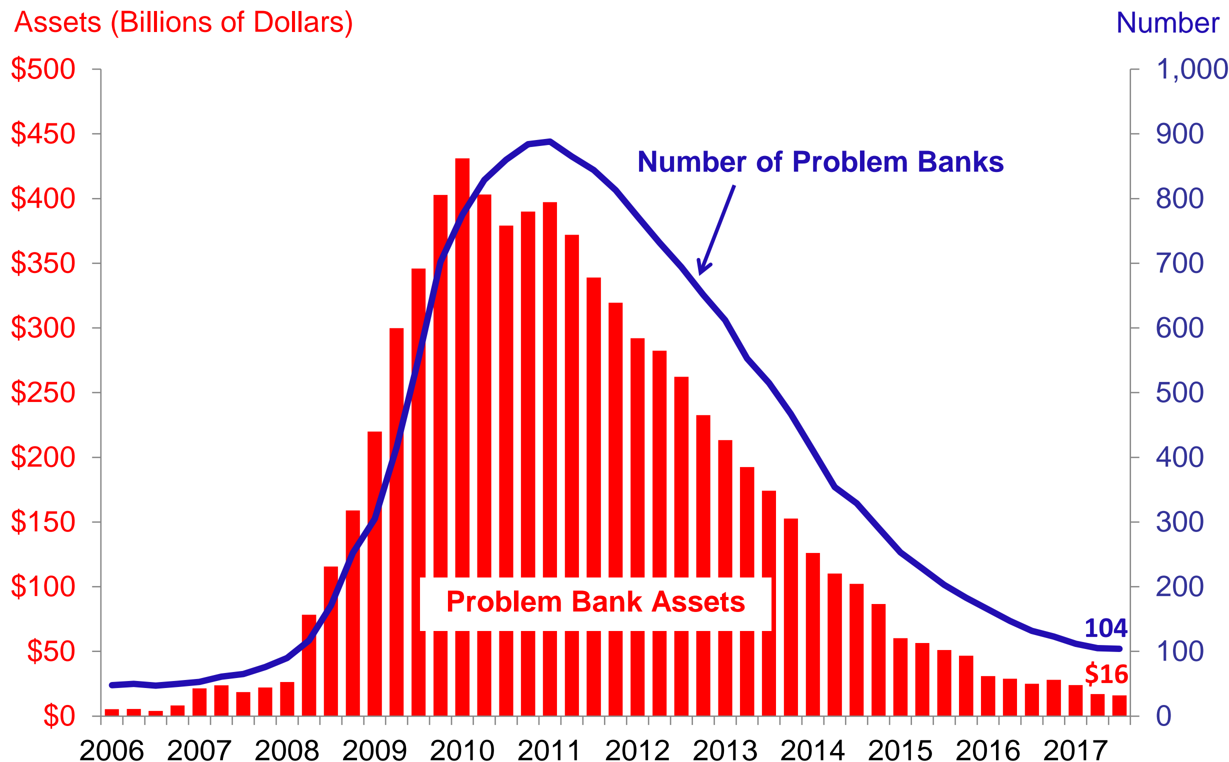
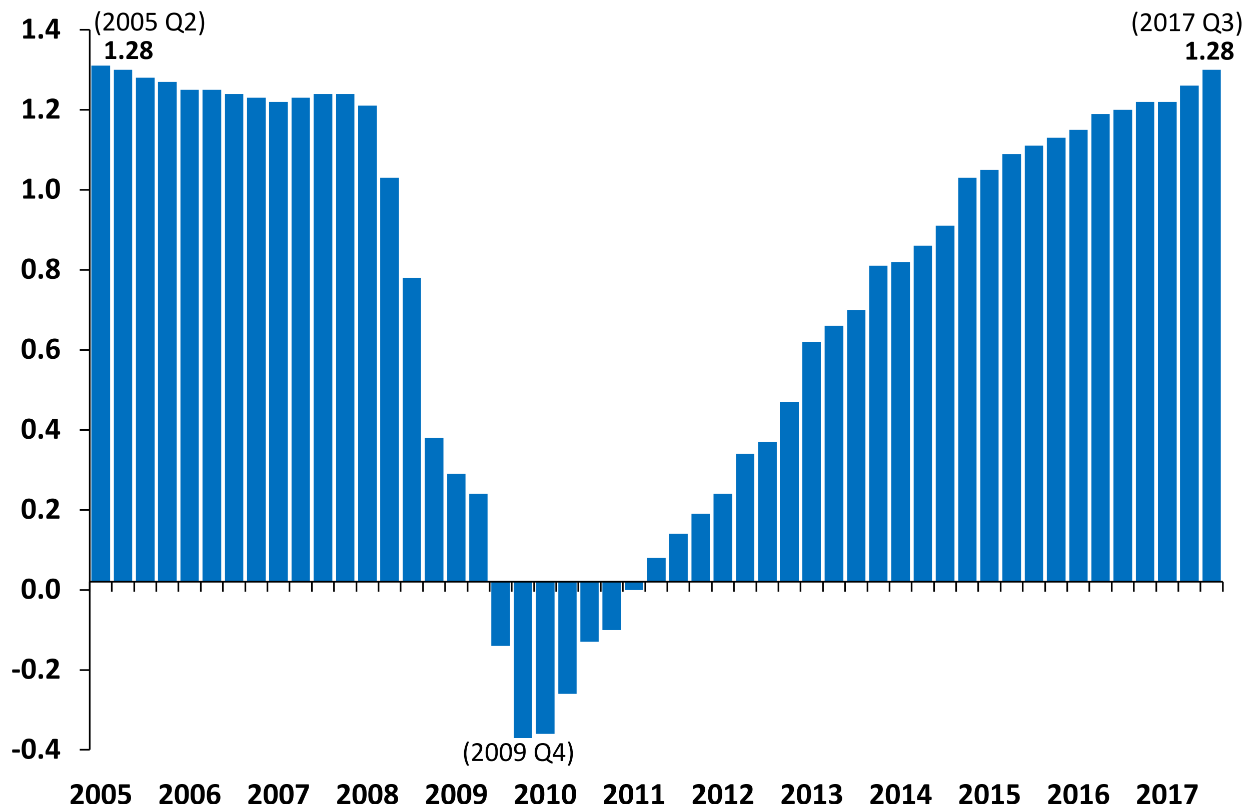



Chart 8 shows that the number of banks on the FDIC's "Problem Bank List" declined from 105 to 104 during the quarter. This is the smallest number of problem banks since the first quarter of 2008. No insured institutions failed during the third quarter.

## Chart 9:




The Deposit Insurance Fund balance was 90.5 billion dollars on September 30, up 2.9 billion dollars from June 30. Assessment income and a reduction in estimated losses from past failures drove the quarterly increase. Estimated insured deposits totaled 7.1 trillion dollars at the end of September, increasing 0.7 percent in the third quarter and 4.0 percent over four quarters.

Chart 9 shows that the reserve ratio—the amount in the Deposit Insurance Fund relative to insured deposits—was 1.28 percent on September 30, up

from 1.24 percent at the end of last quarter. This is the highest reserve ratio since the second quarter of 2005.

As required by law, the Deposit Insurance Fund must achieve a minimum reserve ratio of 1.35 percent by September 30, 2020.

We remain on track to meet this mandate.

In summary, third quarter results for the banking industry were largely positive. Revenue and net income were higher at most banks, net interest margin improvement was widespread, and the number of unprofitable banks and "problem banks" continued to fall. Community banks also reported another solid quarter of revenue, net income, and loan growth.

While the quarterly results were largely favorable, the industry continued to see a gradual slowdown in the annual rate of loan growth. This reflects an economic expansion that is in its $9^{th}$ year. It appears to be more a function of the demand for credit rather than the supply.

In addition, the operating environment for banks remains challenging. An extended period of low interest rates and an increasingly competitive lending environment have led some institutions to reach for yield. This has led to heightened exposure to interest-rate risk, liquidity risk, and credit risk. These risks must be managed prudently for the industry to continue to grow on a long-run, sustainable path.

Before I conclude my remarks today, I would like to say a word about the recent hurricanes that have devastated parts of mainland United States, Puerto Rico, and the Virgin Islands. The FDIC and other banking regulators

have been providing assistance to financial institutions that were adversely affected by the hurricanes, and we are encouraging banks to work closely with their customers to facilitate recovery. Based on our prior experience with natural disasters, it will take some time for the full impact of the hurricanes on FDIC-insured institutions to be seen. We will continue to monitor the recovery process closely, and we will continue to address the needs of affected depository institutions and their customers.

One final note: I would like to mark a milestone in the history of the FDIC's *Quarterly Banking Profile*.

Today's report marks the final release by one of the original founders of the QBP, FDIC Senior Banking Analyst Ross Waldrop, who is scheduled to retire early next year.

Ross's contribution to the QBP cannot be overstated.

Established in 1986, the QBP has served four times each year as a comprehensive report card on the financial performance and condition of FDIC-insured institutions. It is relied on with confidence by industry analysts, researchers, bankers, policymakers, the news media, and the public.

Under Ross's leadership, the QBP has set high standards for consistency, accuracy, and rigor. It has implemented several important innovations including online data tools, and new reports that address off-balance-sheet positions and community bank performance.

Ross – on behalf of your colleagues and the many readers of the QBP – thank you for your service and a job well done.

I'll now be glad to respond to questions.