Chairman's Opening Statement

Third Quarter 2015 Quarterly Banking Profile

November 24, 2015

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

Most performance indicators continued to show improvement. Earnings were up from a year ago, loan portfolios grew, asset quality improved, the number of problem banks declined, and only one insured institution failed.

Community banks also had a strong quarter. Their revenue and income growth outpaced the rest of the industry, and loan portfolios at community banks grew at a faster rate than at larger institutions.

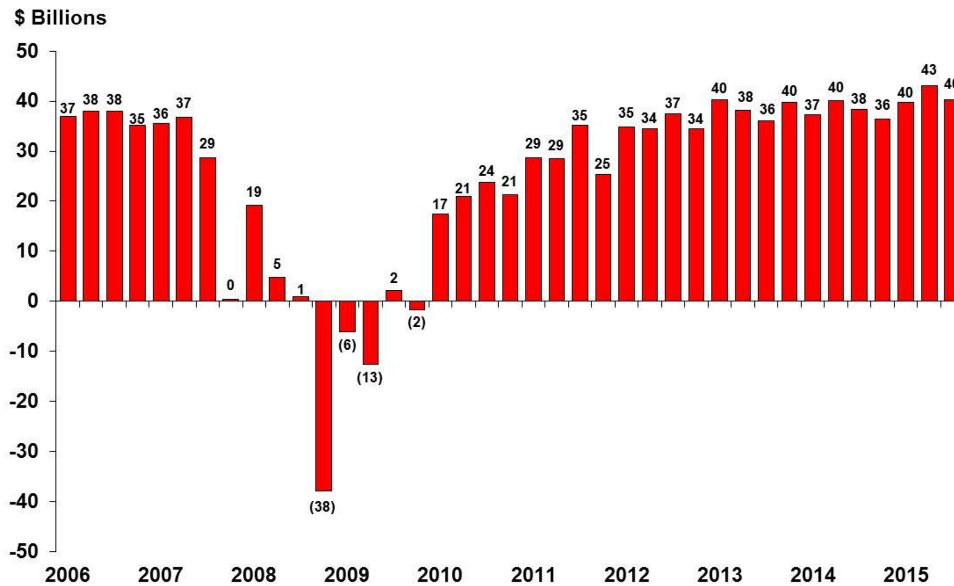
While the banking industry had another positive quarter, there are signs of growing interest-rate risk and credit risk that warrant attention. In order to mitigate the impact of low rates on net interest margins, banks have been going out further on the yield curve and increasing the mismatch between 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.

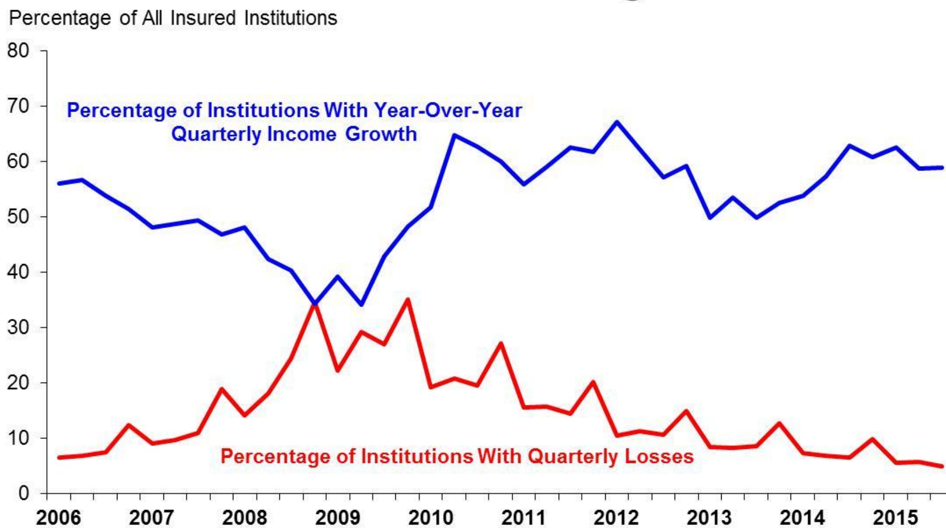
Chart 1



Our first chart shows that net income was 40.4 billion dollars in the third quarter. This is more than 5 percent higher than a year ago. Most of the year-over-year improvement in industry earnings came from a 2.7 billion dollar decline in litigation expenses at a few large banks.

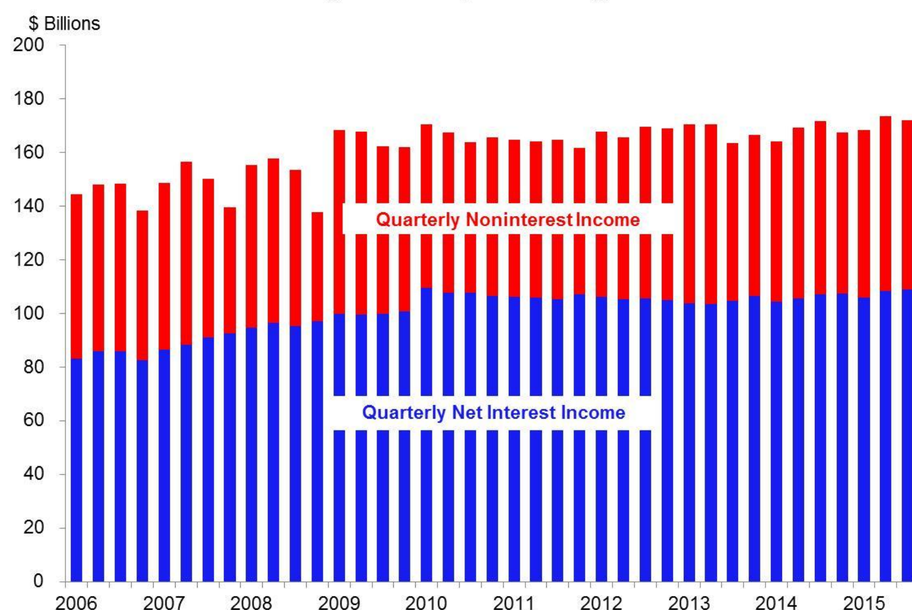
Community banks reported net income of 5.2 billion dollars, which is 7.5 percent higher than a year ago. Community banks benefited from strong growth in both net interest income and noninterest income.

Chart 2



You can see in Chart 2 that the increase in earnings remains broad-based. Nearly 60 percent of all banks reported year-over-year growth in their quarterly net income, and only 5 percent reported a net loss for the quarter.

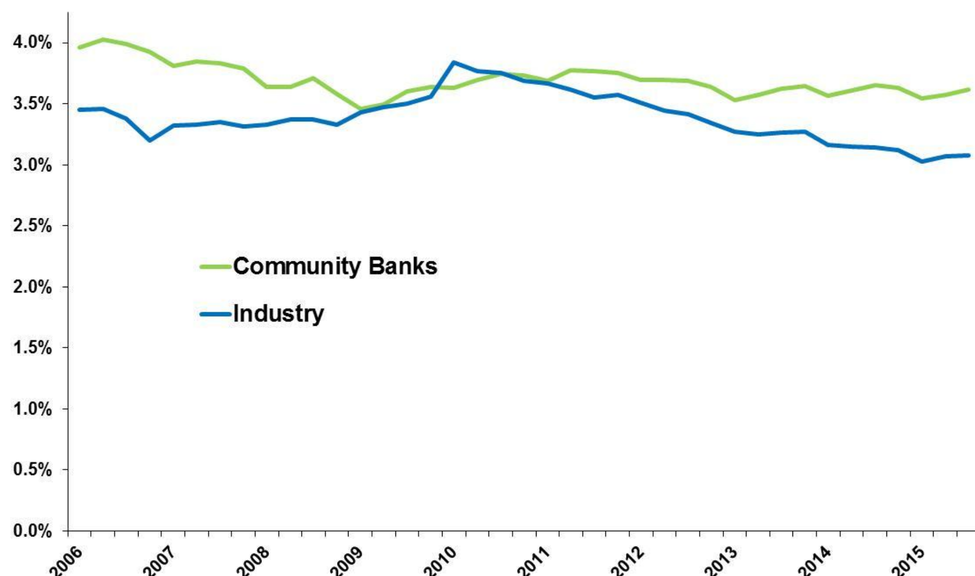
Chart 3



Our next chart shows that net operating revenue grew by only 0.3 percent from a year ago. Net interest income was 1.7 percent higher, while noninterest income declined by 2 percent. Most of the decline in noninterest income was concentrated among the largest banks and was due to lower income from securitization and servicing, and reduced trading revenue.

More than two-thirds of all banks reported year-over-year growth in net operating revenue, and the median growth rate was 3.6 percent. However, revenue growth for the industry as a whole has been modest since 2009. This is partly a reflection of the challenging interest-rate environment.

Chart 4



Net interest margins have been under pressure as higher-yielding assets mature and are replaced by lower-yielding investments.

Chart 4 shows that the average net interest margin for the industry has trended down by nearly 80 basis points since 2009. Since falling to a 30-year low in the first quarter of this year, it has increased only slightly during the past two quarters.

Community banks have avoided much of the decline in margins experienced by larger banks by extending asset maturities. The average net interest margin at community banks is more than 50 basis points higher than the industry average.

Chart 5

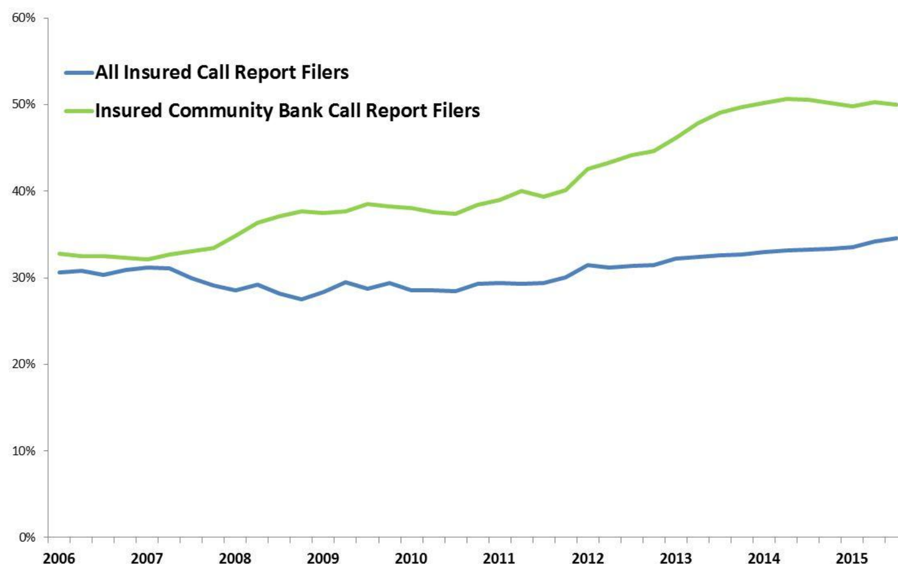


Chart 5 shows that longer-term assets have been growing as a share of total assets since 2009, and that community banks have seen their share of longer-term assets rise at a faster pace than the rest of the industry.

While asset maturities have been trending up steadily across the industry since 2009, there has been no comparable increase in the share of longer-term funding. The growing mismatch between asset and funding maturities has left banks more vulnerable to rising interest rates.

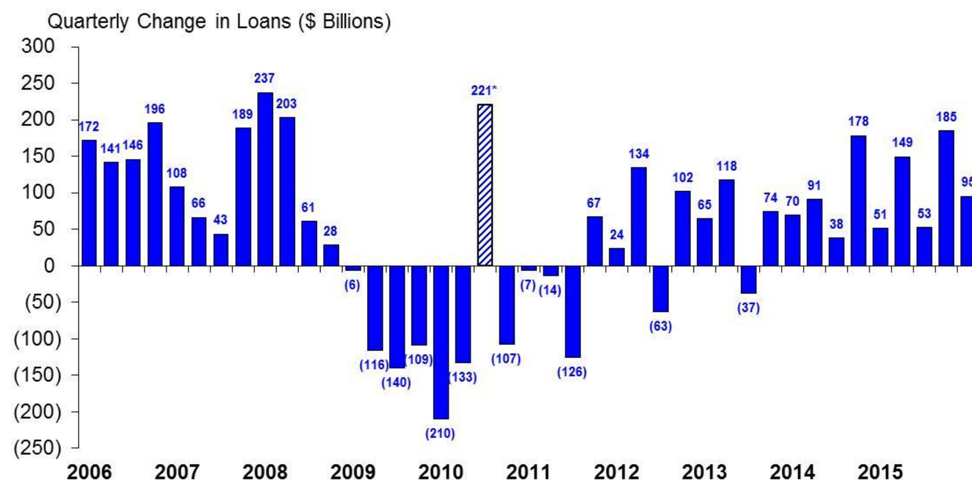
Credit risk is also a growing concern. As loan growth has picked up, supervisory surveys have noted a relaxation in underwriting standards in some loan portfolios, including auto and multifamily housing portfolios. We

also have seen growth in riskier loan categories, such as loans to leveraged commercial borrowers.

The most recent Shared National Credits Review indicated that credit risk in large syndicated loans remains high. It noted a significant increase in leveraged lending volumes and continued loose underwriting. It also noted that falling energy prices have the potential to adversely affect the performance of a growing number of loans to oil and gas explorers and producers.

Chart 6

Quarterly Change in Loan Balances



* 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.

Total loan balances rose by 95 billion dollars during the third quarter. This was led by a 58 billion dollar increase in commercial real estate loans, a 13.6 billion dollar increase in credit card balances, and a 10.8 billion dollar increase in auto loans.

Over the past 12 months, loan portfolios grew by 5.9 percent, with all major loan categories posting an increase.

Loan growth was even stronger at community banks, where loan portfolios grew by 8.5 percent over the past 12 months. Balances in all major loan categories were up from a year ago, led by growth in commercial real estate loans and 1-to-4 family residential mortgages.

Chart 7

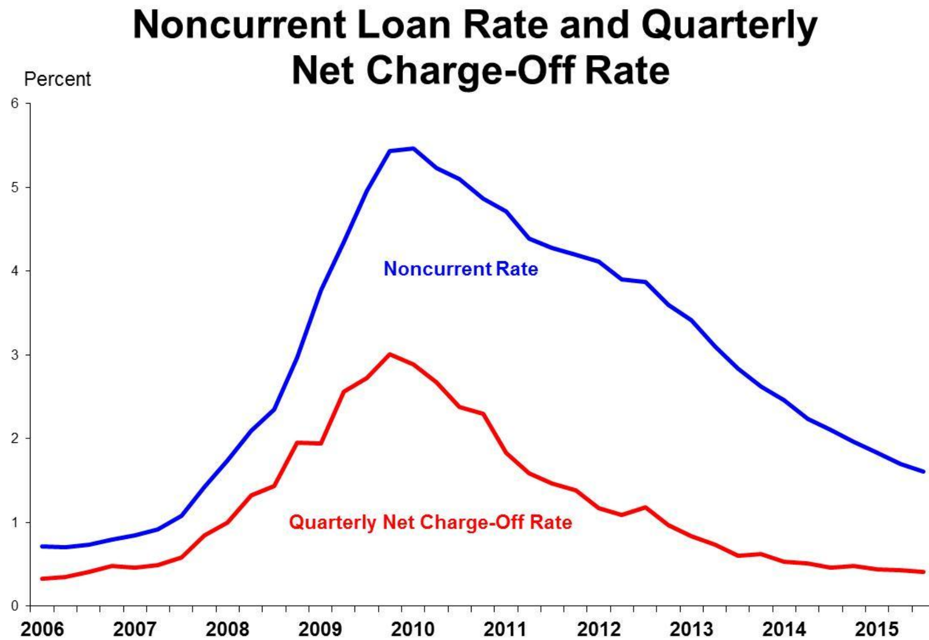


Chart 7 shows that asset quality continued to improve during the quarter. Noncurrent rates declined in all major loan categories during the quarter – with the exception of commercial and industrial loans, which rose only slightly. The net charge-off rate is now at its lowest level since the third quarter of 2006.

Chart 8

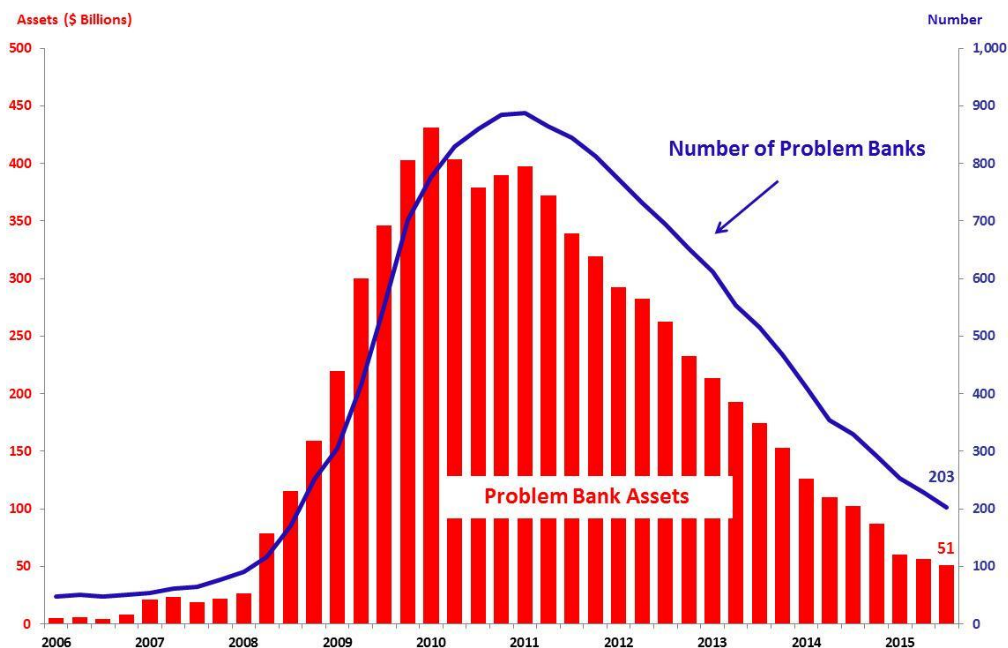
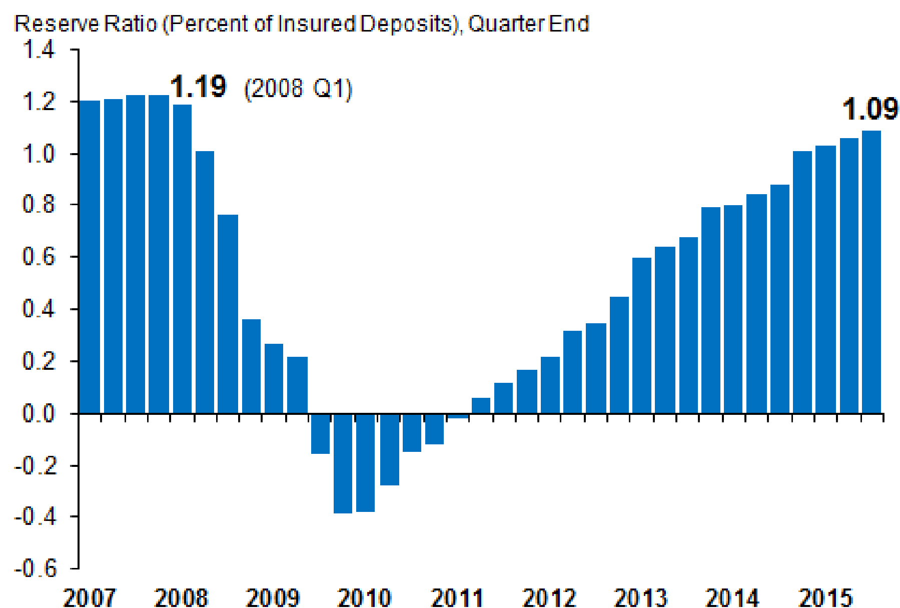


Chart 8 shows that the number of banks on the "Problem List" fell to 203 during the third quarter. This is the fewest since third quarter 2008, and it is less than one-quarter the 888 problem banks at the last peak in early 2011.

Only one insured institution failed during the third quarter. This is the second quarter in a row with only one failure.

Through the first nine months of 2015, there were 6 bank failures. This is down from 14 bank failures during the first nine months of 2014.

Chart 9



The Deposit Insurance Fund balance was 70.1 billion dollars on September 30, 2.5 billion dollars higher than the balance at June 30. Revenues from assessments were primarily responsible for the increase.

Estimated insured deposits rose to 6.42[1] trillion dollars at the end of September, an increase of 1.1 percent over the quarter.

[1] Updated at 11:15 am on November 24, 2015

Chart 9 shows that the reserve ratio, which is the Fund balance as a percentage of estimated insured deposits, increased to 1.09 percent on September 30.

As required by law, the Deposit Insurance Fund must achieve a minimum reserve ratio of 1.35 percent by September 30, 2020. We are on track to achieve this.

In conclusion, we saw a continuation of positive trends in the third quarter. Income growth was broad-based, asset quality improved, loan balances increased, there were fewer problem banks, and only one bank failed during the quarter.

However, the banking industry faces challenges. While earnings and capital have risen since the financial crisis, revenue has been relatively flat despite increased lending activity. And interest-rate risk and credit risk have increased in this low-rate environment with competitive lending conditions. As I have stated previously, these risks will be a focus of ongoing supervisory attention.

Thank you.

I am happy to take your questions.