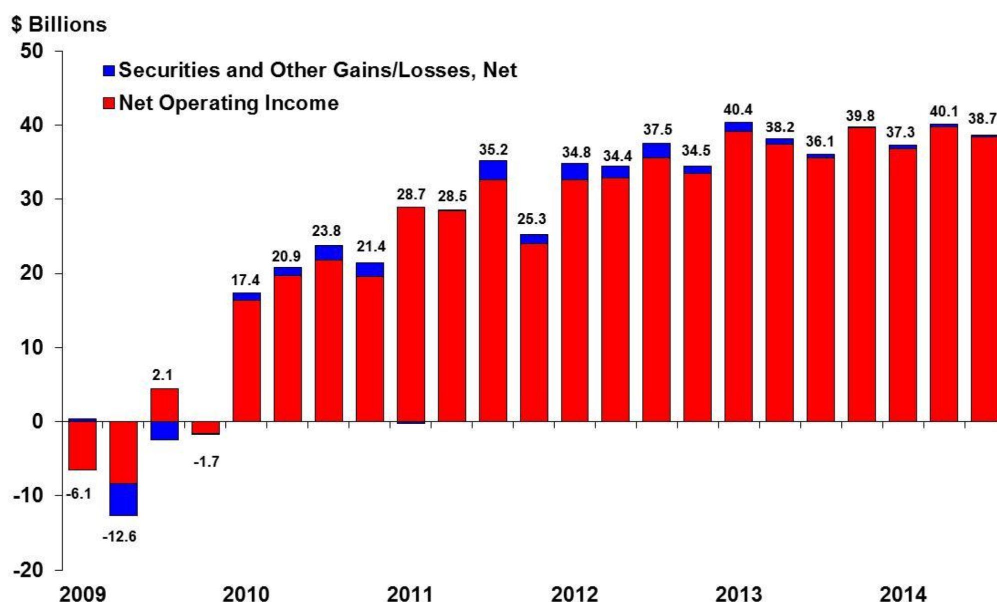
Opening Statement by FDIC Chairman Martin J. Gruenberg on the Third Quarter 2014 Quarterly Banking Profile
November 25, 2014

Good morning, and welcome to our release of third quarter results for FDIC-insured institutions. Overall, this was another positive quarter for the industry.

Earnings were higher, revenues were up at more institutions, asset quality continued to improve, and there were fewer unprofitable banks, “problem” banks, and bank failures. Meanwhile, community banks had stronger loan growth and higher net interest margins than the overall industry. However, the current operating environment remains challenging for banks. Low interest rates have put downward pressure on net interest margins, especially at larger banks. While the economy continues to recover, loan demand remains modest. And reductions in loan-loss provisions, which have supported earnings growth during the recovery, appear to be coming to an end.

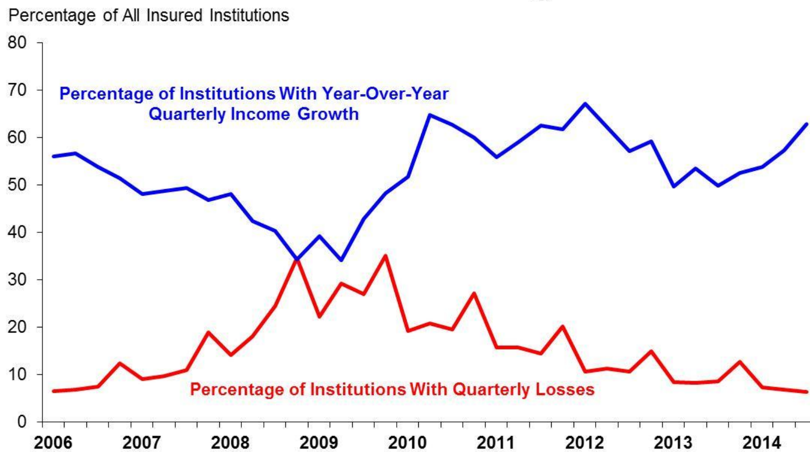
Chart 1:



Our first chart shows that insured institutions reported net income of 38.7 billion dollars in the third quarter. This is a 7 percent increase compared to a year ago and is the nineteenth increase in 21 quarters. Community banks earned 4.9 billion dollars during the quarter, which is up 11 percent from a year ago. Higher net interest income, increased noninterest income, and lower provision expenses were the primary drivers of stronger earnings at community banks.

Chart 2:

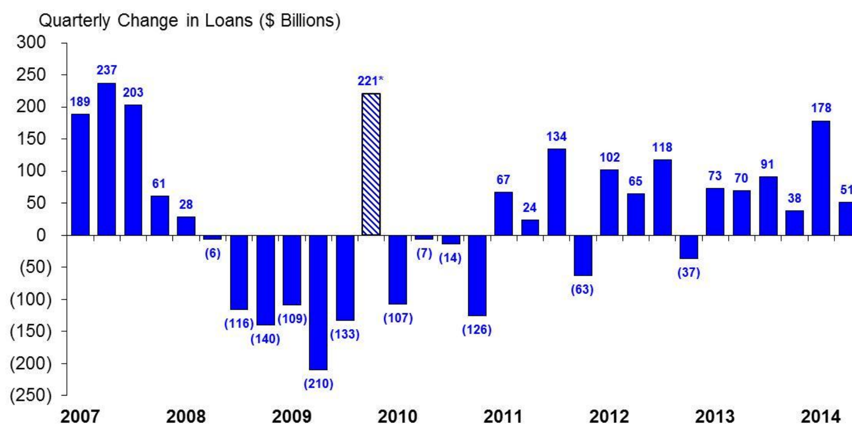
Unprofitable Institutions and Institutions With Increased Earnings



The next chart shows that the proportion of banks reporting year-over-year income growth continues to rise. Almost 63 percent of all institutions reported higher quarterly net income. You can also see that the proportion of unprofitable institutions continues to decline. Only 6.4 percent of all banks reported a net loss in the quarter. This is the smallest percentage in nine years.

Chart 3:

Quarterly Change in Loan Balances

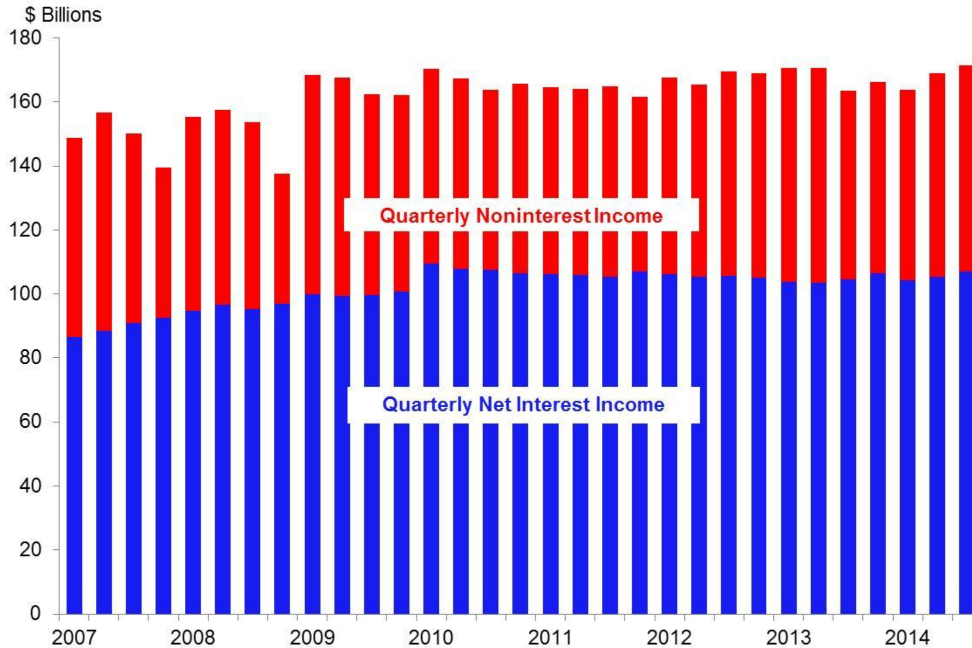


* FASB Statements 166 and 167 resulted in the consolidation of large amounts of securitized loan balances back onto banks' balance sheets in the first quarter of 2010. Although the total amount consolidated cannot be precisely quantified, the industry would have reported a decline in loan balances for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

Chart three shows that loan balances increased by 51 billion dollars during the quarter. While this is less than the large increase in the second quarter, loan balances are still 4.6 percent higher than a year ago. Almost all loan categories registered increased balances, and nearly three-quarters of all institutions reported higher total balances. Commercial and industrial loans continued to grow faster than any other loan category at 10 billion dollars. Auto loan balances rose by 9 billion dollars, but residential mortgages declined by 6.7 billion dollars, as banks reduced their inventories of mortgages held for sale.

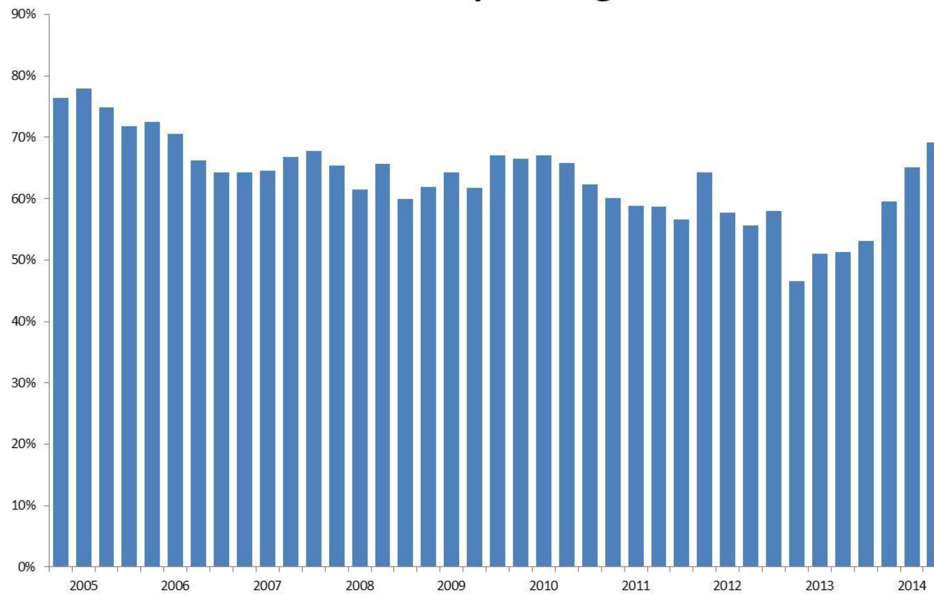
Meanwhile, loan growth was stronger at community banks. Their loan balances rose by 8 percent over the past year compared to 4.6 percent for the industry. Community banks reported growth in all major loan categories, including residential mortgages and loans to small businesses. They currently hold over 45 percent of the industry's small business loans.

Chart 4:



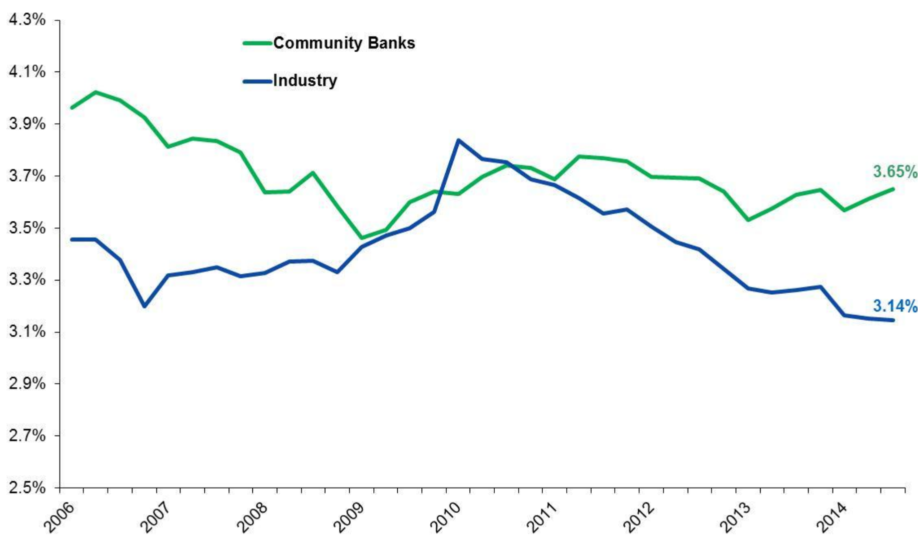
The next chart highlights one of the most positive developments in the third quarter. It shows that net operating revenue posted its first year-over-year increase in the last five quarters. Both net interest income and noninterest income were higher than a year ago. Net operating revenue was 4.8 percent higher than a year ago. This is the biggest increase since the fourth quarter of 2009.

Chart 5:



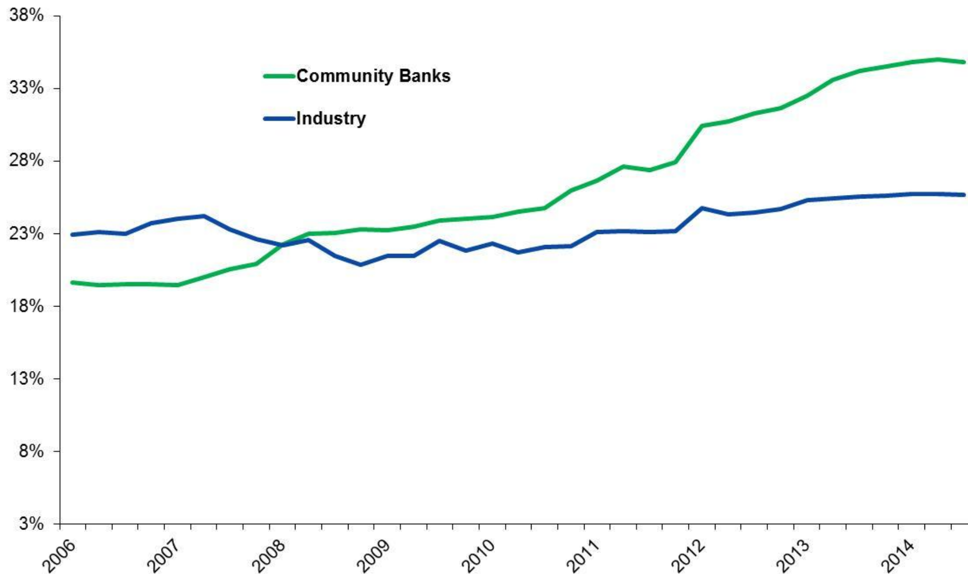
As you can see in this next chart, more institutions are reporting revenue growth. In the third quarter, almost 69 percent of all banks reported higher net operating revenue than a year ago. Net interest income was higher, and noninterest income increased year-over-year for the first time in the last 5 quarters. Higher income from trading and gains from loan sales contributed to the rise in noninterest income.

Chart 6:



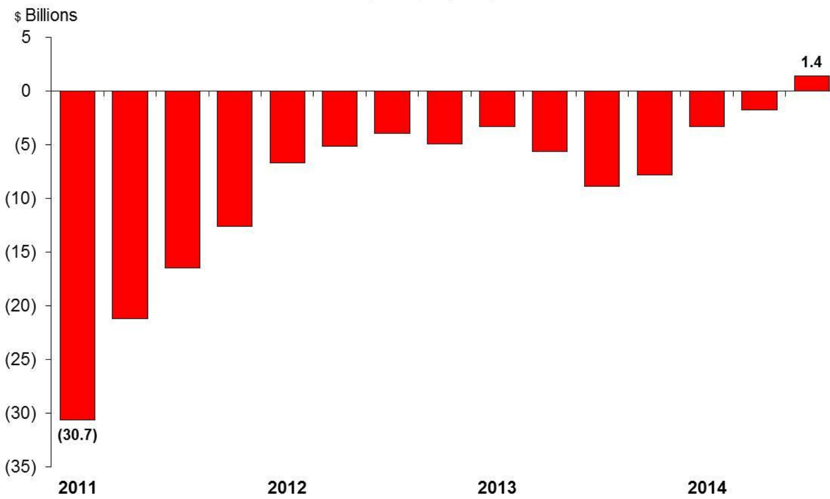
Meanwhile, net interest income increased modestly from a year ago, helped by the rise in longer-term interest rates in 2013. A steeper yield curve is favorable for institutions that fund at the short end of the yield curve and invest over the medium to long term. More than 71 percent of all banks reported higher net interest income than a year ago. As for community banks, they benefited the most over the past year from the steeper yield curve. Their average net interest margin rose 2 basis points from a year ago. In contrast, the industry's average margin fell by 12 basis points, as many of the largest banks increased their holdings of lower-yielding, short-term assets.

Chart 7:



The next chart shows that banks have been extending asset maturities as they reach for yield in this low interest rate environment. The percentage of industry assets that matures in 5 years or more has trended higher since 2009. Among community banks, the upward trend began earlier and is even more pronounced, rising by 15 percentage points since 2007. However, in the third quarter, long-term assets did not increase as a percentage of total assets at community banks or for the industry overall, as long-term assets and total assets both rose at the same pace. This increase in longer-term assets has helped margins at many institutions, and community banks in particular. But it has left them more vulnerable to interest rate risk as rates normalize and the yield curve flattens.

Chart 8:



For the past five years, reductions in loan-loss provisions have been the most consistent contributor to earnings growth. However, as this chart shows, third quarter earnings did not get a boost from lower provision expenses. Instead, loss provisions were 1.4 billion dollars higher than a year ago. This is the first year-over-year increase in quarterly loss provisions since the third quarter of 2009.

Chart 9:

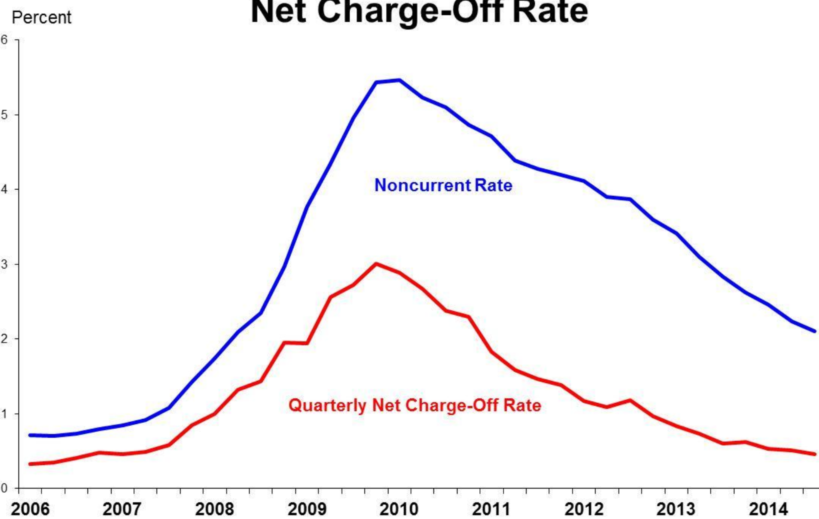
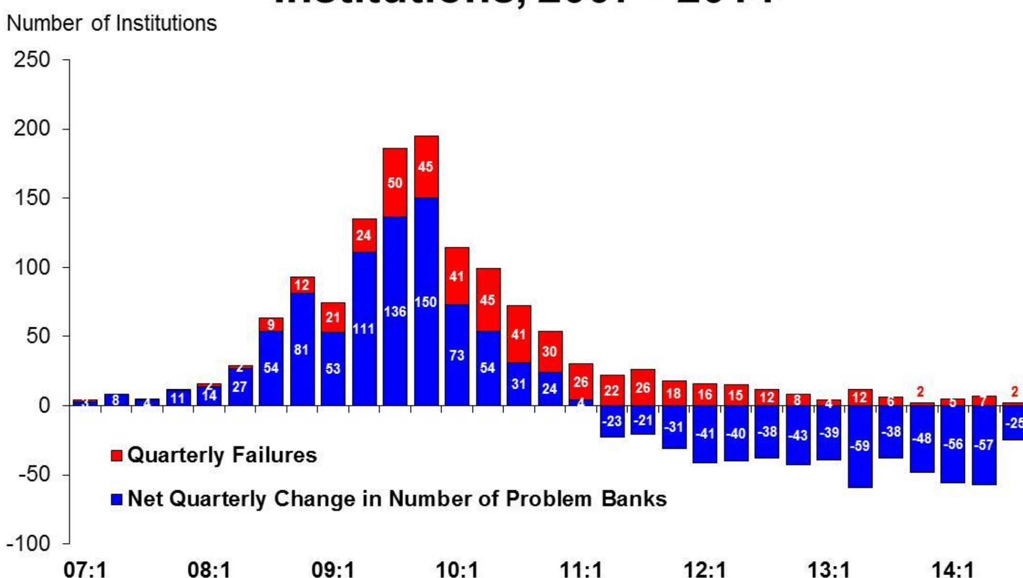


Chart nine shows that asset quality indicators continue getting stronger. The quarterly net charge-off rate fell to 0.45 percent, the lowest average since the first quarter of 2007. At the end of the third quarter, the noncurrent loan rate was 2.11 percent, which is the lowest rate since the second quarter of 2008.

Chart 10:

Quarterly Changes in the Number of Troubled Institutions, 2007 - 2014



Another positive for the quarter was a further decline in the number of banks on the “Problem List”. There are now 329 problem banks, down from 354 last quarter and down from a peak of 888 at the end of first quarter 2011. Three years ago, bank failures had a significant role in reducing the number of problem banks. Today, in contrast, banks are coming off the “Problem List” principally because of improved performance. Only two insured institutions failed during the quarter, down from six a year ago.

The Deposit Insurance Fund balance rose to a record 54.3 billion dollars as of September 30, up from 51.1 billion dollars at June 30, 2014. Assessment income, unanticipated recoveries from litigation settlements, and receivership asset recoveries that exceeded estimates drove the third-quarter increase in the Fund balance.

Estimated insured deposits were 6.1 trillion dollars, up 0.4 percent from June 30. The reserve ratio—which is the Fund balance as a percentage of estimated insured deposits—increased to 0.89 percent at September 30 from 0.84 percent at June 30. As required by law, the Deposit Insurance Fund must achieve a minimum reserve ratio of 1.35 percent by September 30, 2020. So, we are well on track to achieving that goal.

In summary, the banking industry had another positive quarter. Net income was up, revenue growth was relatively strong and broad-based, asset quality improved, and loan balances grew. Fewer institutions were unprofitable and there were fewer problem banks. Community banks, in particular, performed better than a year ago. Most importantly, third quarter income growth was based on revenue growth instead of lower loan-loss provisions. This can be a more sustainable foundation for continued earnings growth going forward.

Still, there are challenges ahead for the industry. Margins remain under pressure in this low interest rate environment. Institutions have responded by extending asset maturities, which raises concerns about interest-rate risk. And banks are increasing higher-risk loans to leveraged commercial borrowers. All of these issues continue to be matters of ongoing supervisory attention. Nevertheless, third quarter results were largely good news for community banks and for the entire banking industry.

Thank you. I am happy to take your questions.