Opening Statement by FDIC Chairman Martin J. Gruenberg on the Second Quarter 2014 Quarterly Banking Profile

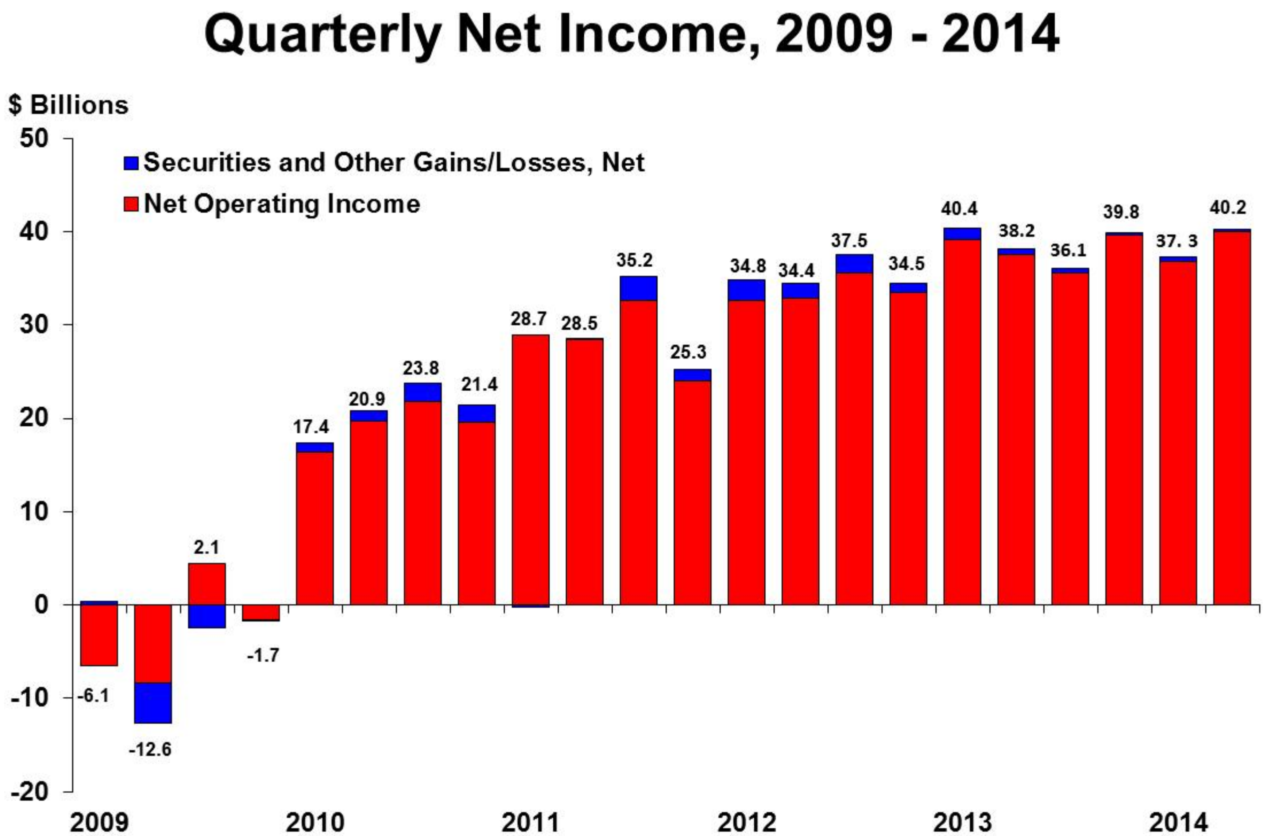
August 28, 2014

Good morning, and welcome to our release of second quarter 2014 results for FDIC-insured institutions.

Overall, the condition of the banking industry continues to improve. Net income was up, asset quality improved, and loan balances grew at their fastest pace since before the crisis. The number of problem banks is now 60 percent below the peak in 2011, and the number of bank failures continues to trend down. However, there are still challenges facing the industry. Revenue continues to be held back by narrow interest margins and lower mortgage-related income. And the interest rate environment has led institutions to reach for yield, thereby raising concerns about interest rate risk.

Community banks—as we have defined them in the FDIC *Community Banking Study*—also continue to show improved performance. In addition to reflecting the favorable industry trends, the rate of loan growth at community banks outpaced the industry, and net interest margins at community banks are trending up in contrast to the industry as a whole.

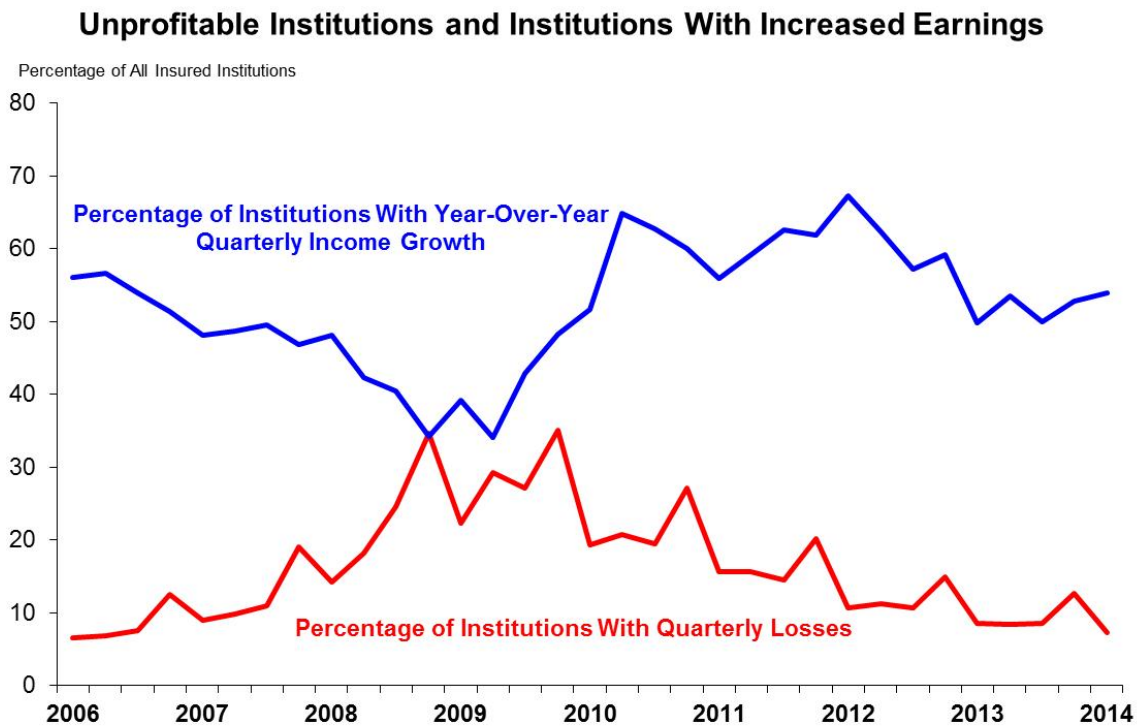
Chart 1:



Our first chart shows that insured institutions reported net income of 40.2 billion dollars in the second quarter. This is the second highest quarterly income recorded by the industry and the eighteenth quarter in the past twenty that earnings have posted a year-over-year increase.

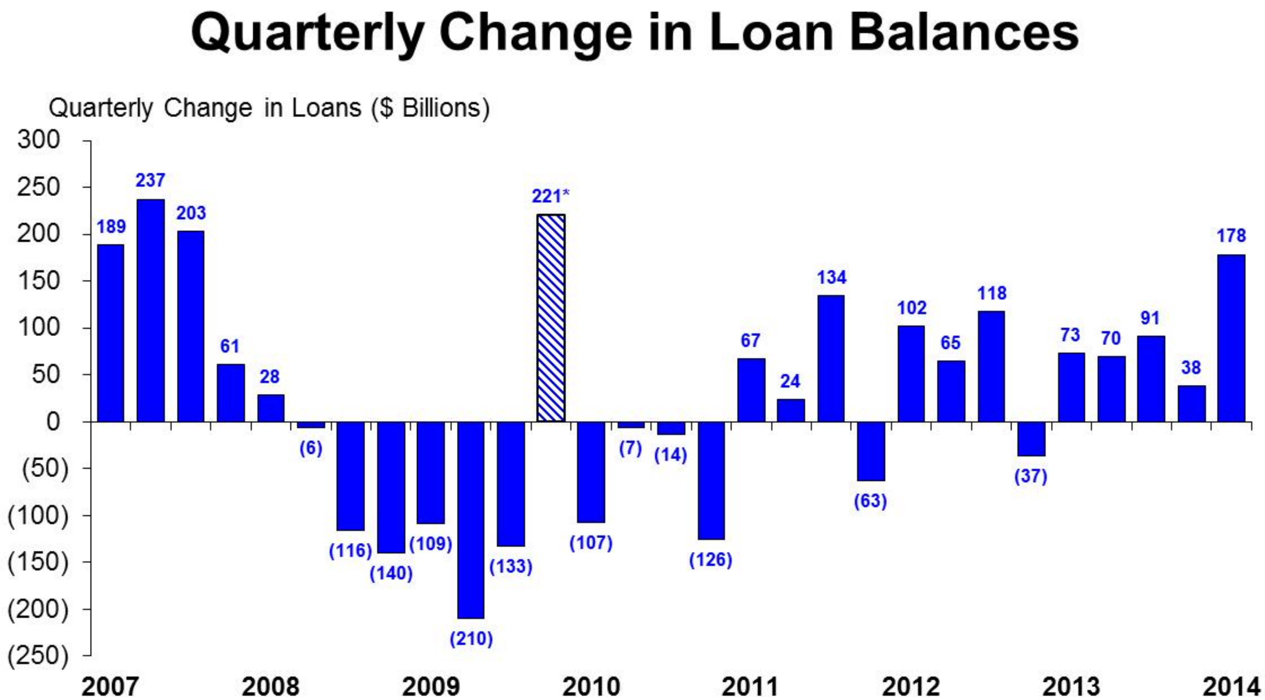
Community banks earned 4.9 billion dollars during the quarter, which is up 3.5 percent from a year ago. Higher net interest income and lower provision expenses were the primary drivers of higher earnings at community banks.

Chart 2:



The next chart shows that a majority of banks reported higher earnings than a year ago. It also shows that the number of unprofitable institutions fell to the lowest level in eight years.

Chart 3:



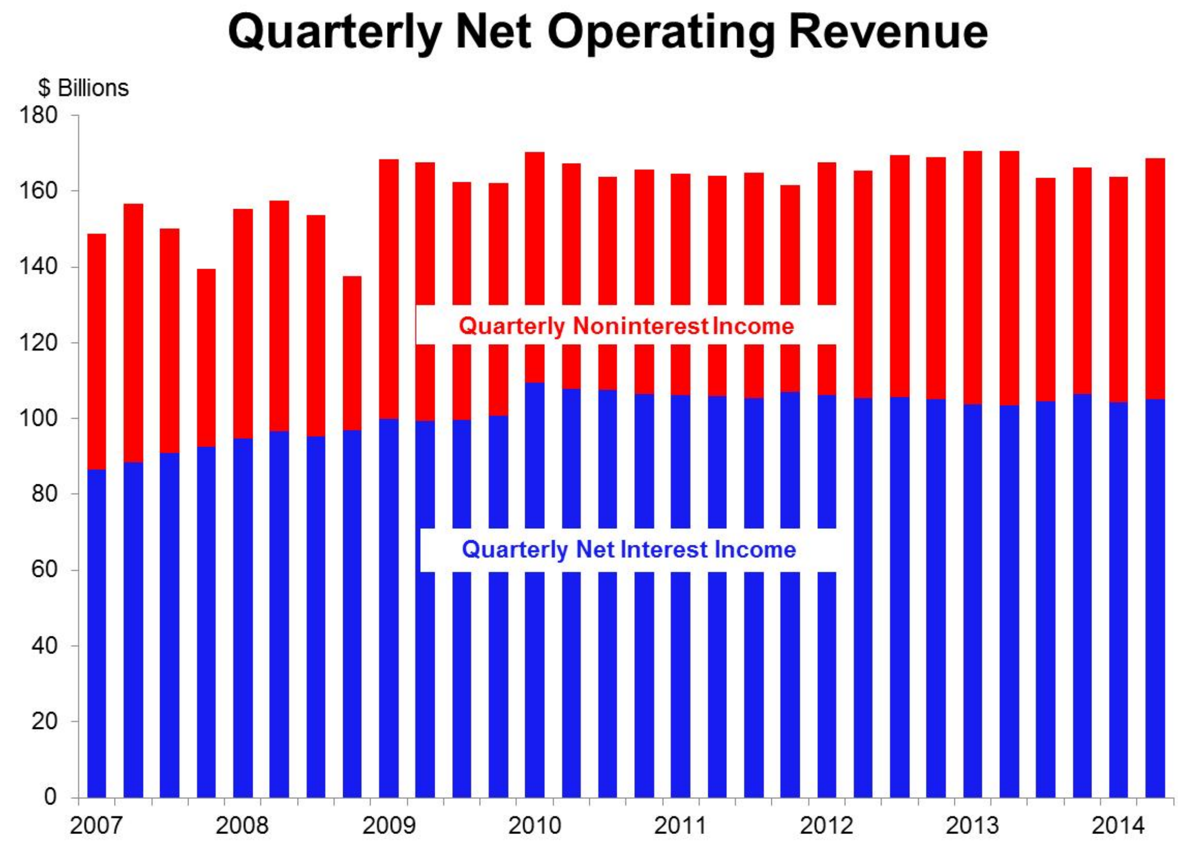
* FASB Statements 166 and 167 resulted in the consolidation of large amounts of securitized loan balances back onto banks' balance sheets in the first quarter of 2010. Although the total amount consolidated cannot be precisely quantified, the industry would have reported a decline in loan balances for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

Chart three shows that loan balances increased by 178 billion dollars during the quarter. This is the largest increase since 2007, excluding first quarter 2010 when there was an accounting change. It also represents a continuation of the upward trend in loan balances that we have noted in recent quarters. Loan growth during the quarter was broad-based. Almost all loan categories registered an increase, and almost three-quarters of all institutions reported higher loan balances.

Commercial and industrial loans, which include higher-risk loans to leveraged commercial borrowers, continued to have the strongest growth of any loan category at 50 billion dollars. Credit card balances rose by 20 billion dollars, auto lending remained strong, and there was a seasonal rise in agricultural loans.

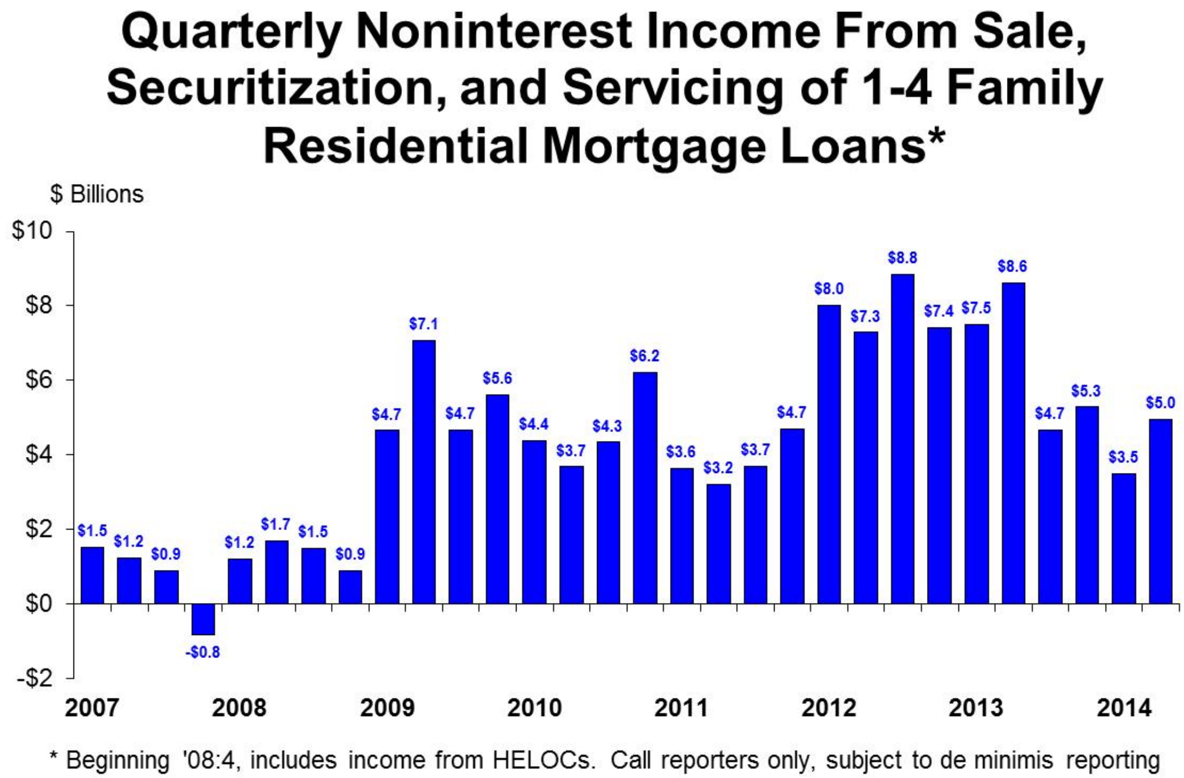
Loan growth was even stronger at community banks. Loan balances have risen by 7.6 percent over the past year at community banks compared to 4.9 percent for the industry. All major loan categories saw an increase, including loans to small businesses. Community banks currently hold 45 percent of the industry's small business loans.

Chart 4:



The next chart highlights one of the challenges facing the industry. Net operating revenue—which is the sum of net interest income in blue and noninterest income in red—has not grown since the financial crisis. Noninterest income has been below its level from a year ago for the past four quarters. However, steady improvement in loan balances in recent quarters has contributed to a modest rise in net interest income.

Chart 5:



Much of the decline in noninterest income over the past four quarters stems from reduced mortgage-related activities, primarily the origination, sale, and servicing of new and refinanced mortgages. Since longer-term interest rates rose in second quarter 2013, refinancing activity has dropped sharply. Income from mortgage-related activities has been about half of what it was in the six quarters before interest rates rose.

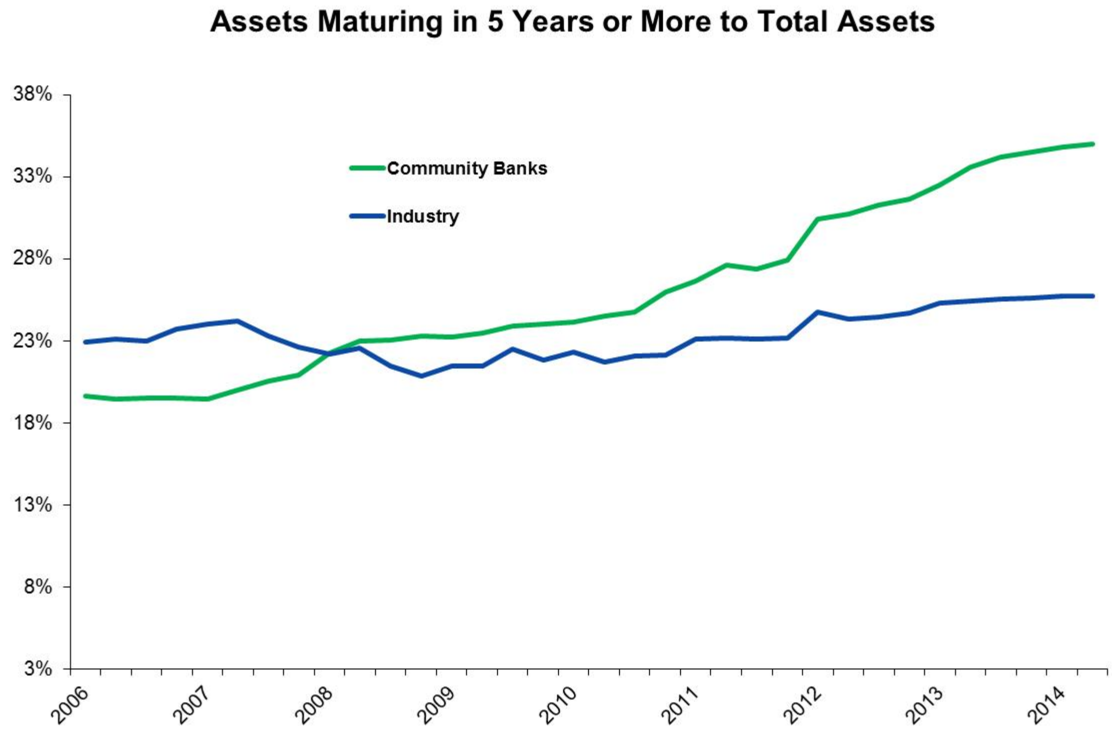
Additionally, lower revenue from trading activity has affected noninterest income, as lower volatility in financial markets has reduced trading volume.

Chart 6:

Net interest income increased modestly from a year ago, which is a positive effect of 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. Almost three-quarters of all banks reported higher net interest income than a year ago.

Community banks have benefited the most over the past year from the steeper yield curve, as their average net interest margin rose 4 basis points from a year ago. In contrast, the industry saw its average margin fall by 10 basis points, as many of the largest banks have increased their holdings of lower-yielding, short-term assets.

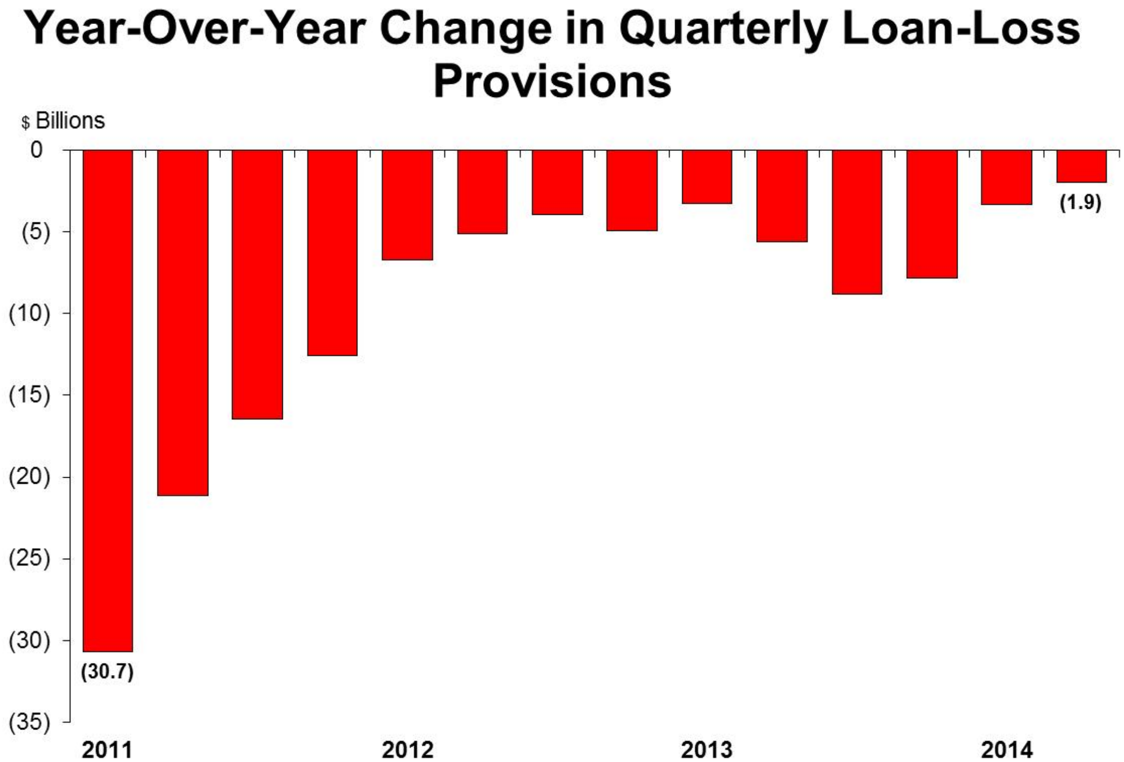
Chart 7:



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 mature in 5 years or more has trended up since 2009. Among community banks, the upward trend began earlier and is even more pronounced, having risen 15 percentage points since 2007.

This increase in longer-term assets has helped margins at many institutions, community banks in particular. But it has left banks more vulnerable to interest rate risk as rates normalize and the yield curve flattens.

Chart 8:



The most consistent contributor to earnings growth continues to be the reduction in loan-loss provisions. However, as this chart shows, the benefits to earnings from lower provision expenses are diminishing. Going forward, earnings growth will be increasingly dependent on sources other than lower loan-loss provisions.

Chart 9:

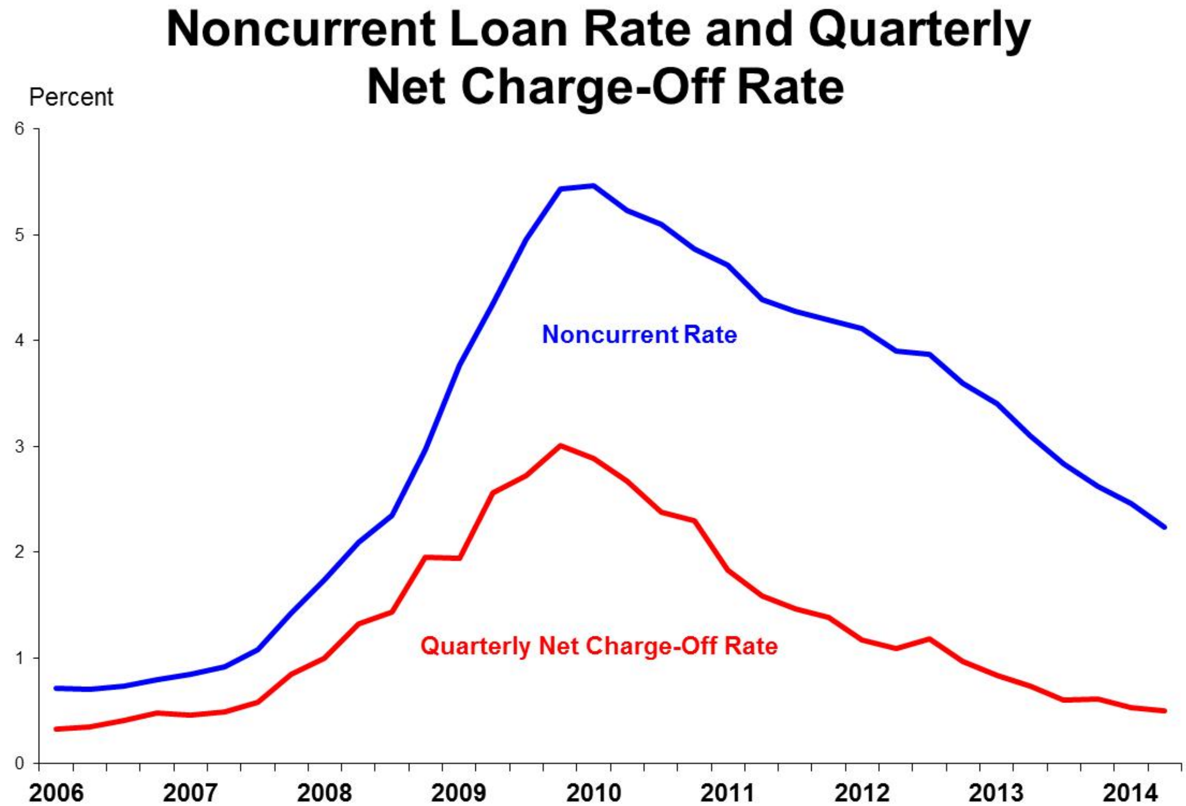
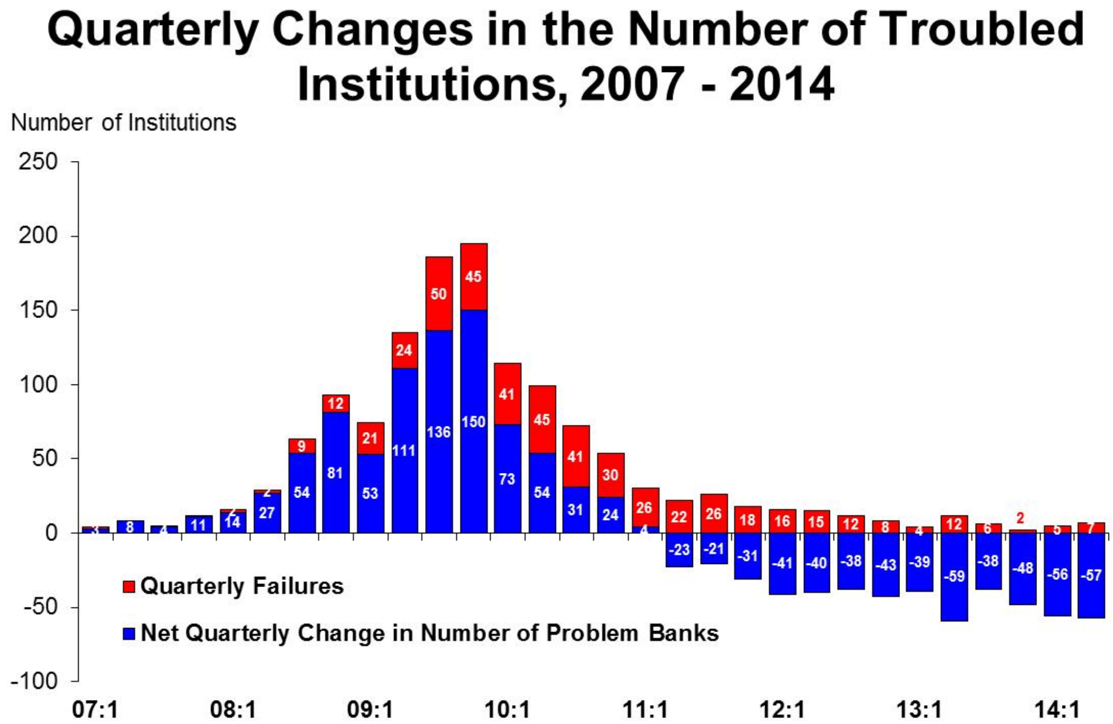


Chart nine shows continued improvement in asset quality. The noncurrent rate and net charge-off rate both continued to decline, and the industry's net charge-off rate now is close to its pre-crisis level.

Chart 10:



We saw a further decline in the number of banks on the "Problem List". There are now 354 problem banks, down from 411 last quarter and down from a peak of 888 three years ago.

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" because of improved performance. Only seven insured institutions failed during the quarter, down from 12 a year ago.

The Deposit Insurance Fund balance rose to 51.1 billion dollars as of June 30, up from 48.9 billion dollars at March 31, 2014. Assessment income drove the second-quarter increase in the Fund balance.

Estimated insured deposits were 6.1 trillion dollars, down 0.2 percent. The combination of a higher Fund balance and slightly lower insured deposits raised the reserve ratio—which is the Fund balance as a percentage of estimated insured deposits—to 0.84 percent at June 30 from 0.80 percent at March 31. A year ago, the reserve ratio was 0.64 percent. As required by law, the Deposit Insurance Fund must achieve a minimum reserve ratio of 1.35 percent by 2020.

In summary, we saw further improvement in the banking industry during the second quarter. Net income was up, asset quality improved, loan balances grew at their fastest pace since 2007, and loan growth was broad-based across institutions and loan types. We also saw a large decline in the number of problem banks. However, challenges remain. Industry revenue has been under pressure from narrow net interest margins and lower mortgage-related income. Institutions have been extending asset maturities, which is raising concerns about interest-rate risk. And banks have been increasing higher-risk loans to leveraged commercial borrowers. These issues are matters of ongoing supervisory attention. Nonetheless, on balance, results from the second quarter reflect a stronger banking industry and stronger community banks.

Thank you.

I am happy to take your questions.