

## **Chairman Jelena McWilliams' Opening Statement**

### **Second Quarter 2018 Quarterly Banking Profile**

**August 23, 2018**

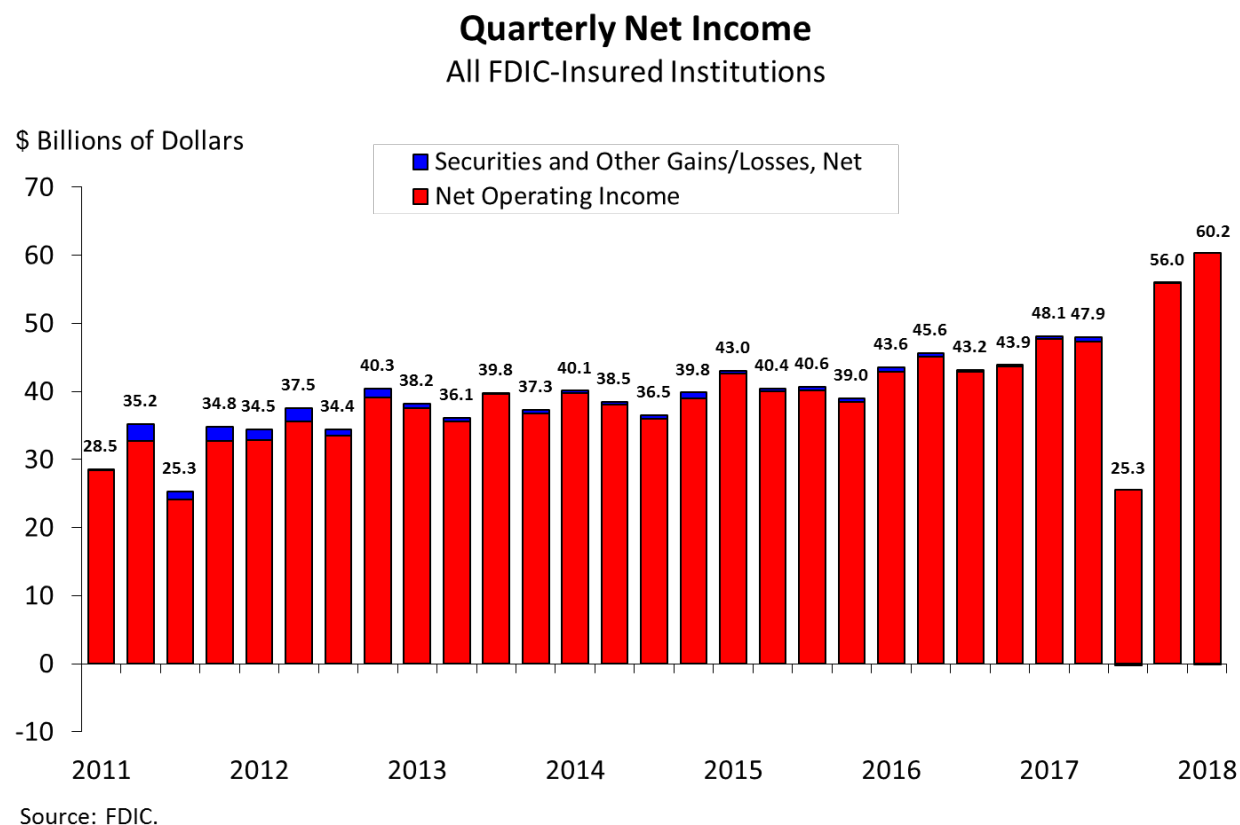
Good morning, and welcome to our release of second quarter 2018 results for FDIC-insured institutions.

The banking industry reported another positive quarter. Net income increased on higher net operating revenue and a lower effective tax rate. Loan balances continued to rise, net interest margins improved, and the number of “problem banks” continued to fall.

Community banks also reported another solid quarter. Their net income benefitted from higher revenue and a lower effective tax rate, and loan growth that was stronger than the overall industry.

It is worth noting that the current economic expansion is the second longest on record, and the nation's banks are stronger as a result. The competition to attract loan customers will be intense, and it will remain important for banks to maintain their underwriting discipline and credit standards.

Prudent management of credit risk in this economic environment will continue to be an FDIC priority.

**Chart 1:**

Our first chart shows that net income for the industry was 60.2 billion dollars in the second quarter, up 25.1 percent from a year ago.

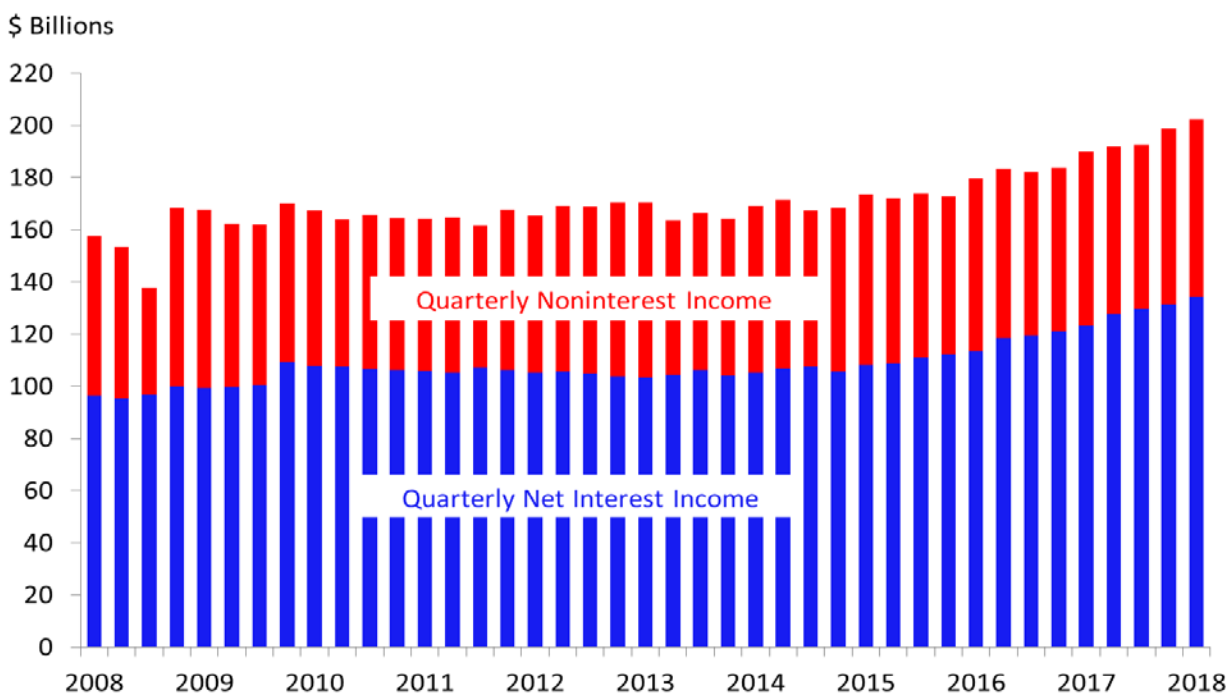
A little more than half of the dollar increase in net income was attributable to tax reform. Assuming the effective tax rate for the banking industry prior to the new tax law, we estimate that quarterly net income would have been 53.8 billion dollars, or 11.7 percent higher than second quarter 2017.

Community banks reported net income of 6.5 billion dollars in the second quarter, an increase of 21.1 percent from a year earlier. Assuming the

effective tax rate for community banks prior to the new tax law, we estimate that quarterly net income would have been 6.1 billion dollars, an increase of 15.4 percent over second quarter 2017.

## Chart 2:

### Quarterly Net Operating Revenue



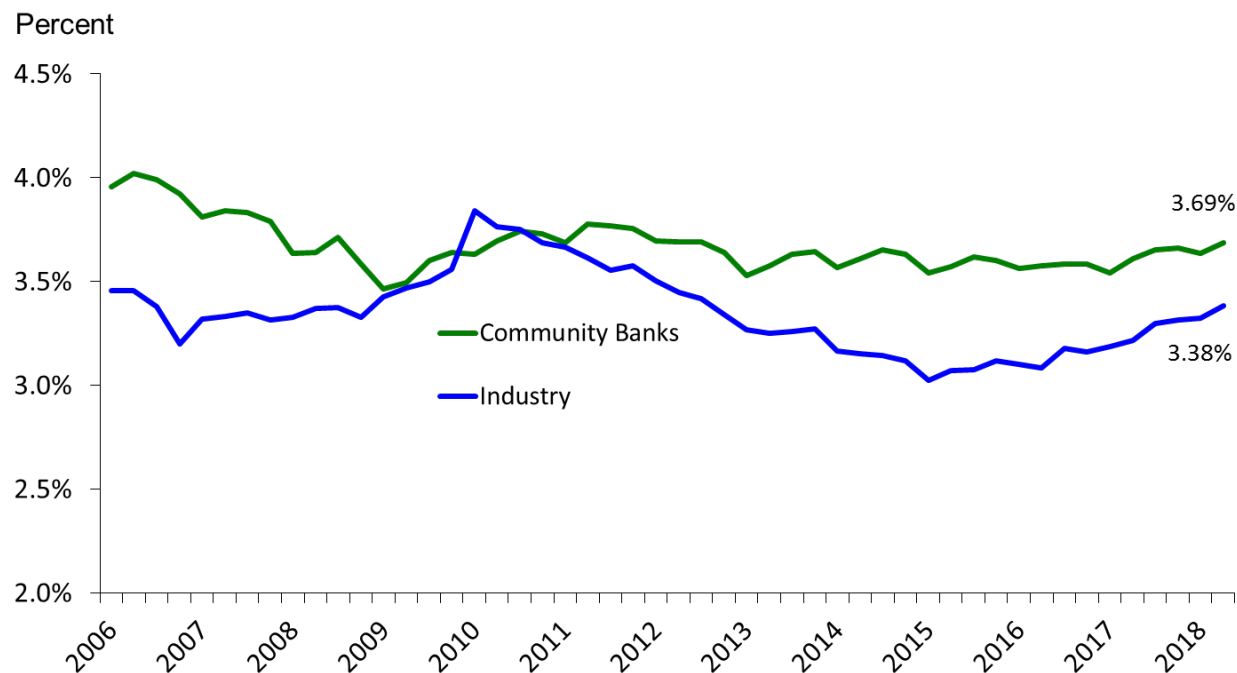
Source: FDIC.

Our next chart shows that net operating revenue totaled 202.2 billion dollars in the second quarter, an increase of 6.3 percent from a year ago. The increase in revenue was broad-based across the industry, as over 80 percent of all banks reported higher revenue from a year earlier.

The growth in revenue was driven by higher net interest income and higher noninterest income. Net interest income grew by 8.7 percent from a year ago due to loan growth and improved net interest margins. Noninterest income rose by 2 percent from a year ago due to higher servicing fees, fiduciary activities, and net gains on sale of other assets.

### Chart 3:

**Quarterly Average Net Interest Margin (NIM)**



Source: FDIC.

Chart 3 shows that the average net interest margin for the industry was 3.38 percent in the second quarter, up from 3.22 percent a year earlier.

Community banks continue to report a higher average net interest margin than the overall industry. However, the gap has been narrowing. 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:

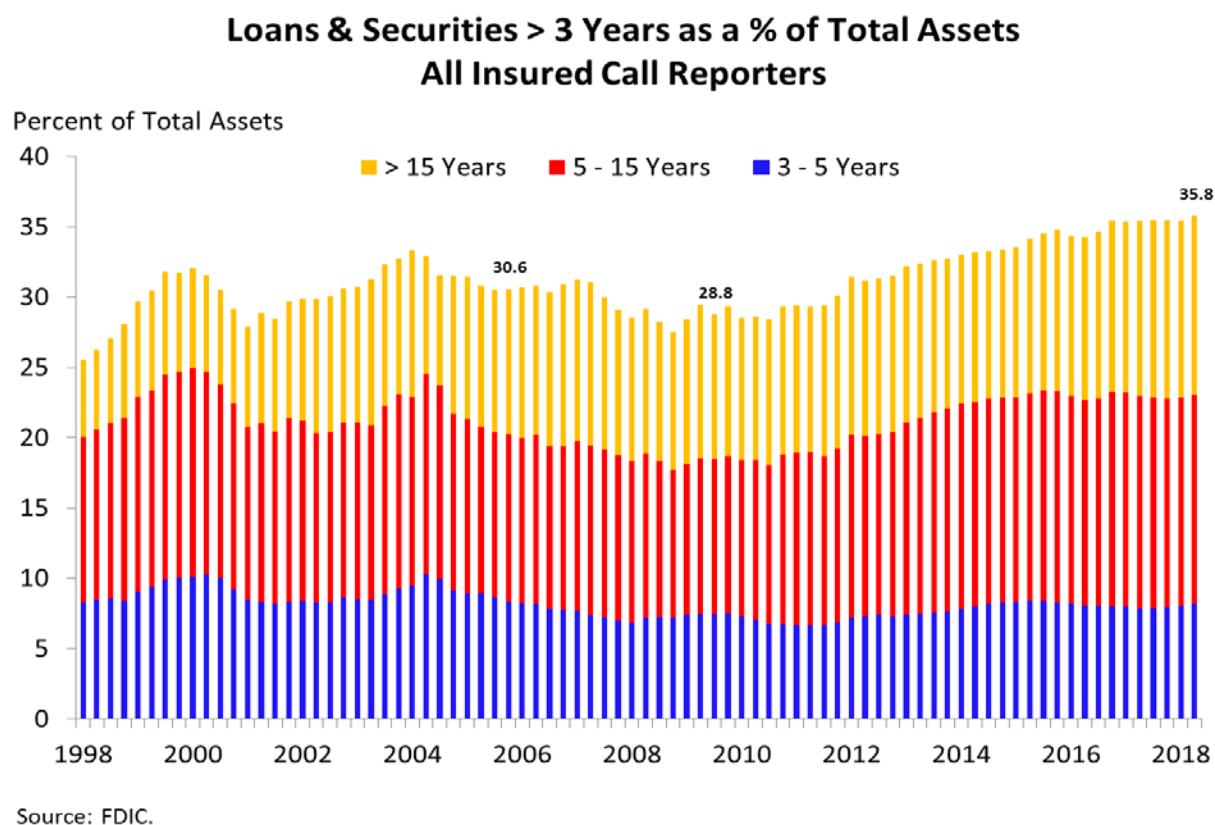


Chart 4 shows that the share of longer-term assets relative to total industry assets remains at its highest level since the data has been collected, with over a third of industry assets maturing or repricing in three or more years.

Some banks responded to low interest rates by “reaching for yield” through investments in longer-term assets, while other banks reduced on-balance

sheet liquidity – cash, federal funds – to increase overall yields on earning assets and maintain net interest margins.

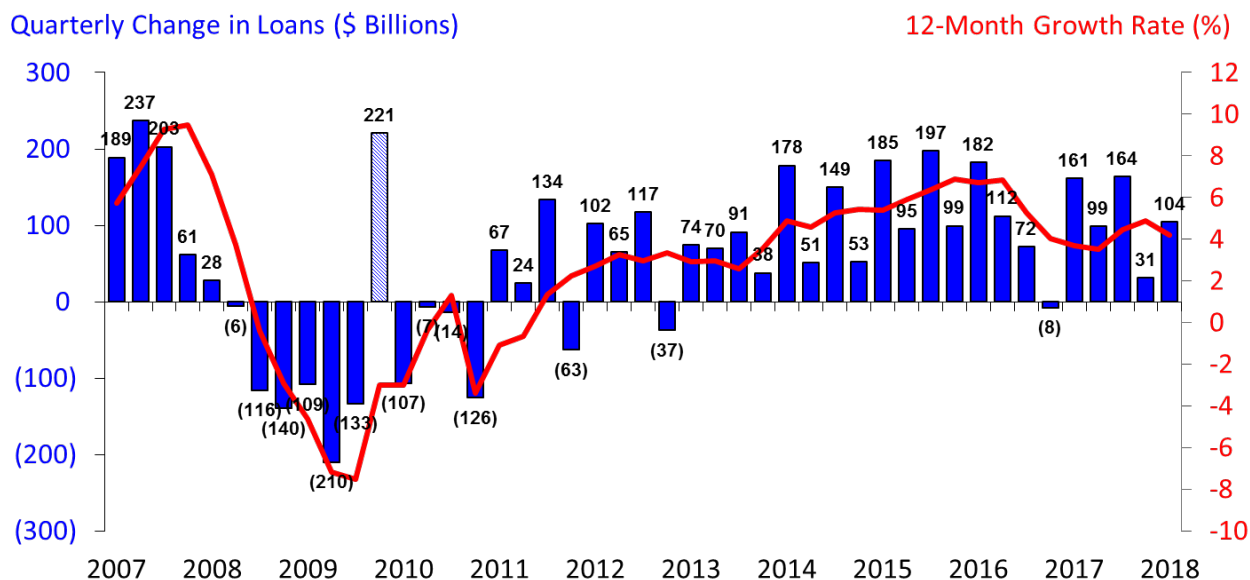
The flattening of the yield curve in conjunction with banks having increased their proportion of long-term assets could act as a headwind in the future.

So far, increases in interest rates have been largely beneficial to most banks as assets have repriced at a faster rate and in a greater amount than liabilities. Repricing of deposits due to depositor demands for increased rates could result in earnings pressure for banks, particularly those that have a significant amount of long-term assets or those that are reliant on rate sensitive deposits.

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

Chart 5:

## Quarterly Change in Loan Balances



Source: FDIC.

Note: 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 by 104.3 billion dollars during the second quarter, as all major loan categories registered growth. The largest increases were in commercial and industrial loans, nonfarm nonresidential real-estate loans, residential mortgage loans, and credit card balances.

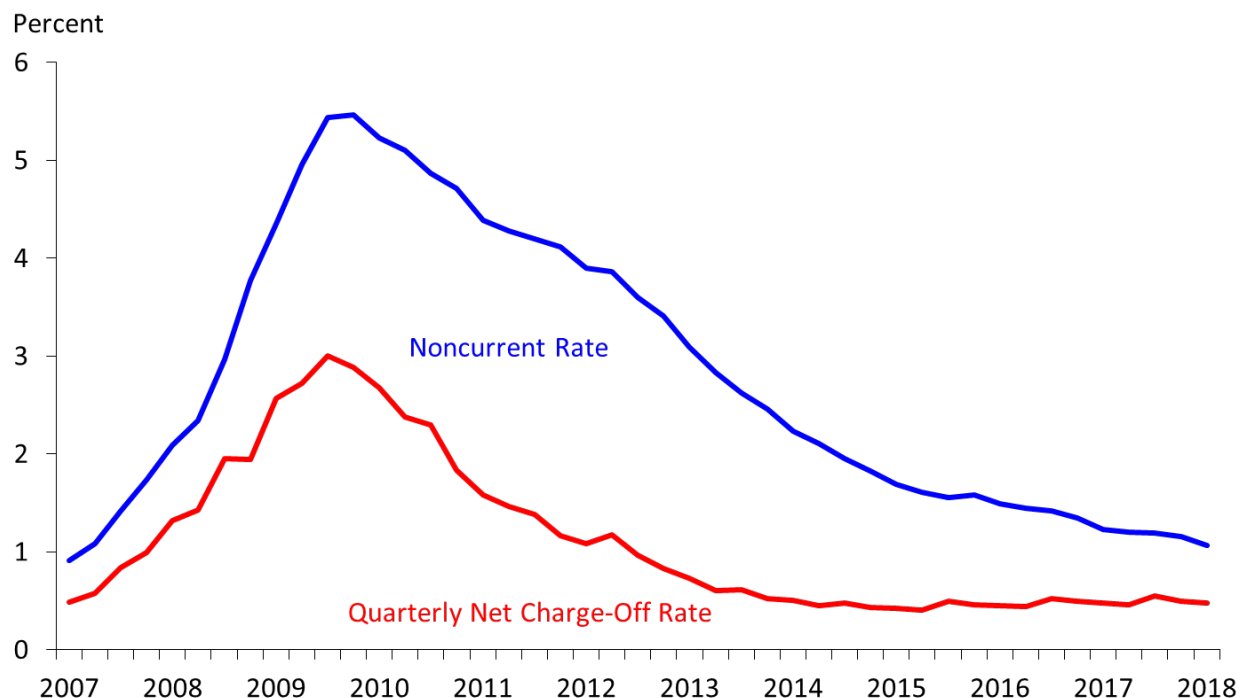
Over the past year, loan balances rose by 4.2 percent. This is a slight decline from the 4.9 percent annual growth rate reported last quarter.

Loan growth at community banks was stronger than the overall industry, growing 7 percent for the past twelve months, led by growth in commercial

real estate loans, residential mortgages, and commercial and industrial loans.

### Chart 6:

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



Source: FDIC.

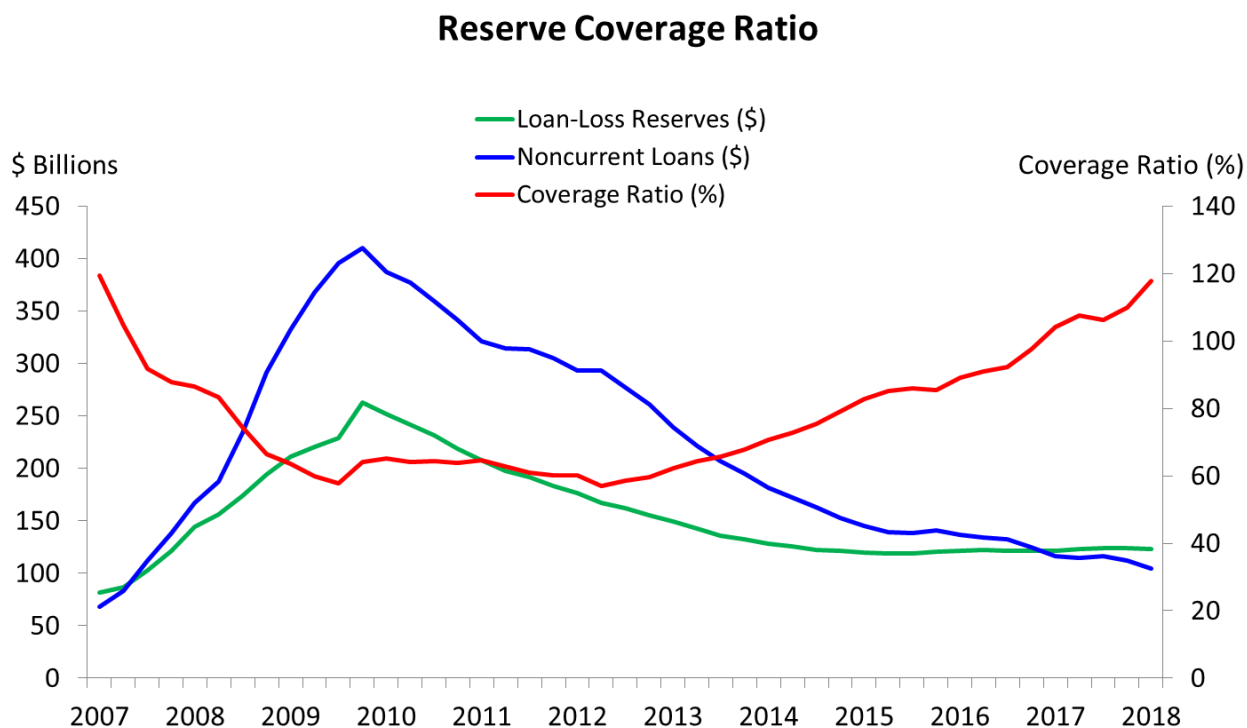
Our next chart shows that overall asset quality indicators remain strong.

The noncurrent rate declined from the previous quarter, and the net charge-off rate remained stable from a year ago. Credit card balances registered the largest dollar increase among the major loan categories in net charge offs this quarter yet net charge off rates remain below crisis levels.



We continue to monitor trends in the agricultural sector. Commodity prices remain low and net farm income has declined by roughly 50 percent since reaching its peak in 2013. Agricultural loan delinquencies have ticked up but remain relatively low as many farmers have significant farmland equity to support shortfalls in revolving lines of credit. We will continue to monitor possible sector weaknesses, particularly at institutions with highly concentrated, sector-specific portfolios.

### Chart 7:



Source: FDIC.

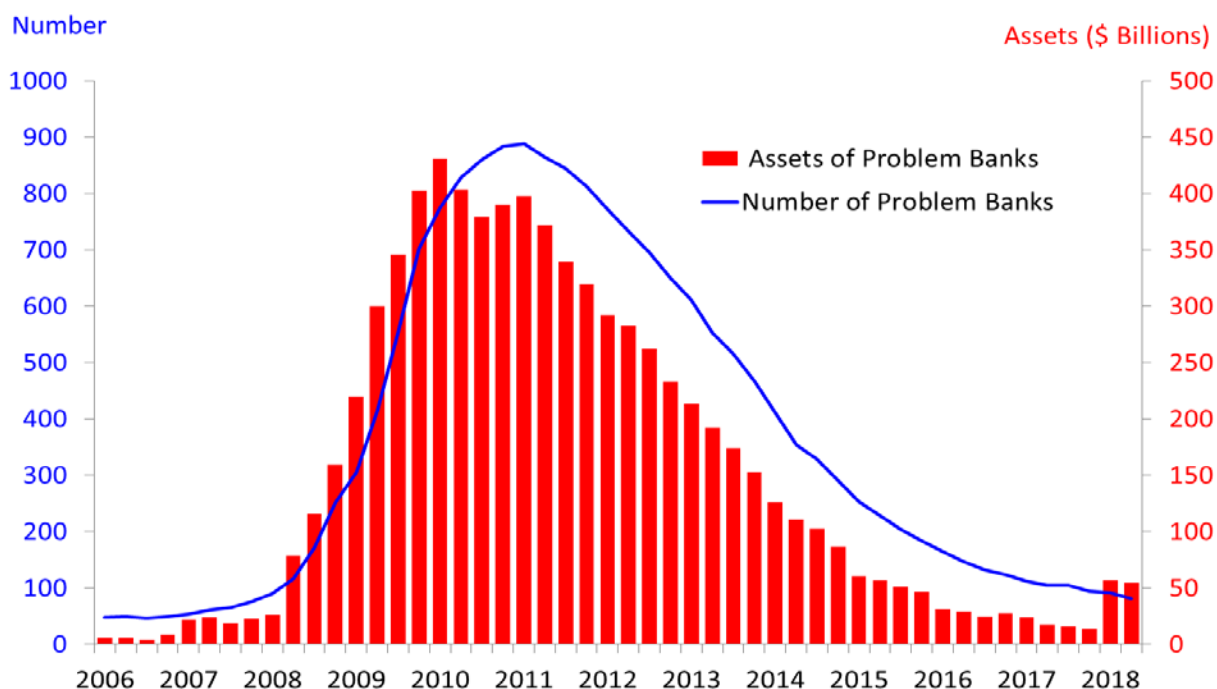
Note: Loan-loss reserves to noncurrent loans & leases.

Chart 7 shows that the industry's reserve coverage ratio, which measures loan-loss reserves relative to total noncurrent loan balances, increased to

117.7 percent at the end of the second quarter. The primary driver for the improvement in the reserve coverage ratio is the 7.7 billion dollar decline in noncurrent loans this quarter. This is the highest reserve coverage ratio since second quarter 2007.

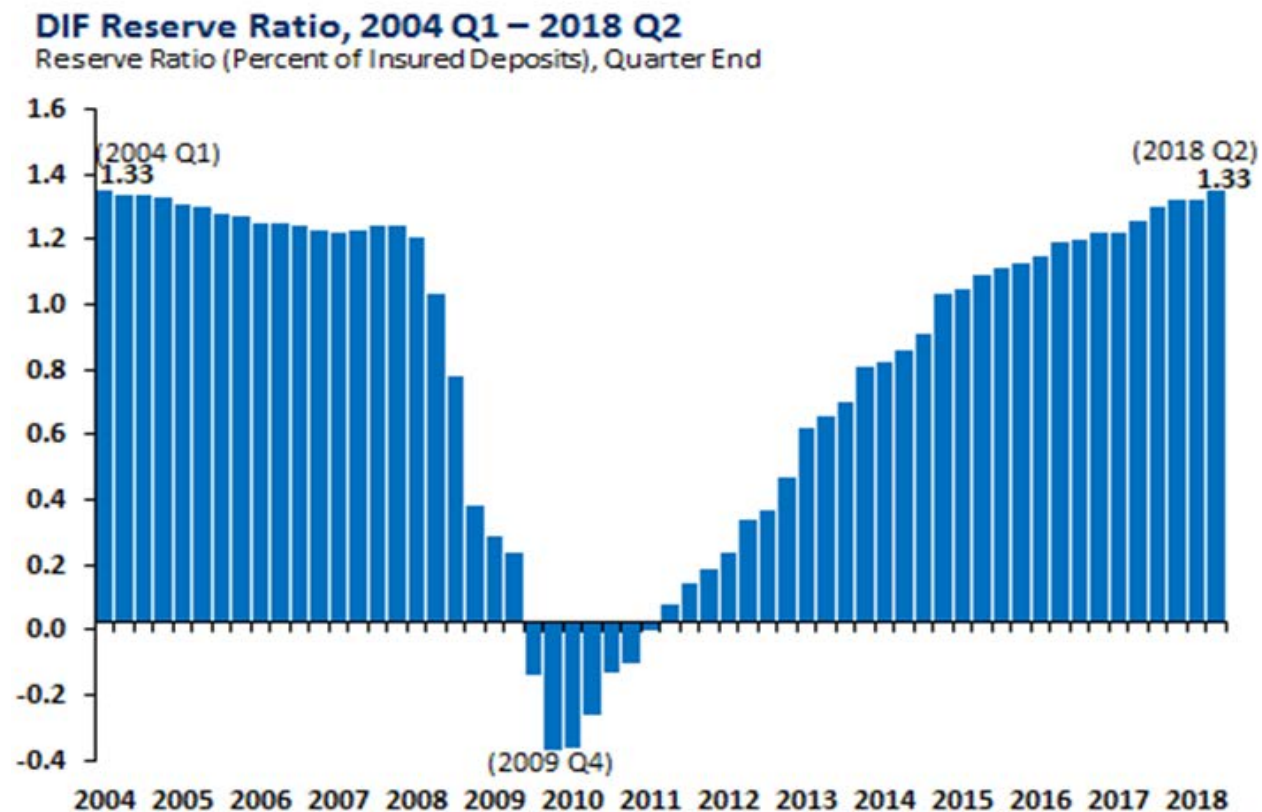
### Chart 8:

**Number and Assets of Banks on the "Problem Bank List"**



Source: FDIC.

Chart 8 shows that the number of banks on the FDIC's "Problem Bank List" declined from 92 to 82 during the quarter. This is the lowest number of problem banks since fourth quarter 2007. Two new banks opened, and no failures occurred in the second quarter.

**Chart 9:**

The Deposit Insurance Fund balance was 97.6 billion dollars on June 30, up 2.5 billion dollars from the end of last quarter. The increase in the fund was largely driven by assessment income. Estimated insured deposits totaled 7.4 trillion dollars at the end of June, increasing 0.3 percent in the second quarter and 4.5 percent over the past four quarters.

Chart 9 shows that the reserve ratio—the amount in the Deposit Insurance Fund relative to insured deposits—was 1.33 percent on June 30, up from 1.30 percent at the end of last quarter.

As required by law, the Deposit Insurance Fund must achieve a minimum reserve ratio of 1.35 percent by September 30, 2020, which we expect to reach this year.

In summary, the banking industry reported positive results for the quarter. Higher net operating revenue and a lower effective tax rate boosted net income. Loan balances grew, net interest margins improved, and the number of “problem banks” continued to decline.

Community banks also reported a solid quarter with net income benefiting from higher net operating revenue and a lower effective tax rate, and loan growth that exceeded the overall industry.

While results this quarter were positive, 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.

Attention to the prudent management of these risks will position banks to be resilient so that they can sustain lending through the economic cycle.

Thank you.