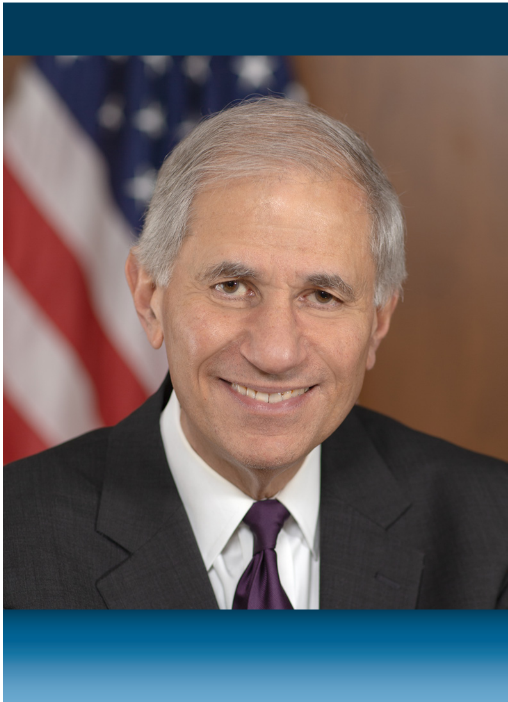
MESSAGE FROM THE CHAIRMAN



For nearly 90 years, the FDIC has carried out its mission of maintaining public confidence and stability in the U.S. financial system. This mission took on heightened importance during the COVID-19 pandemic. The publication of this report marks three years since the pandemic's onset. The continued challenges and uncertainties resulting from the pandemic through 2022 have impacted the banking system, consumers, and businesses large and small.

Despite the persistent challenges, the FDIC workforce has continued to carry out its mission-essential functions: insuring deposits; supervising and examining financial institutions for safety, soundness, and consumer protection; making large firms resolvable; and managing failed bank receiverships.

The nation's banks also have remained resilient, which has allowed for continued support for individuals and businesses.

The economic environment is now changing. Inflationary pressures, rising interest rates, slowing economic growth, and geopolitical events create a very uncertain economic outlook with significant downside risks to the banking industry. These downside risks have been, and will continue to be, a focus of the FDIC's supervisory attention.

In addition, the FDIC has pursued several key policy priorities over the past year, including strengthening the Community Reinvestment Act (CRA), reviewing the bank merger process, addressing the financial risks to the banking system resulting from climate change, evaluating and responding to the risks of crypto-assets, and finalizing the Basel III regulatory capital framework for large banking organizations.

Other areas of continued focus include the FDIC's efforts to support Minority Depository Institutions (MDIs) and Community Development Financial Institutions (CDFIs), promote a diverse and inclusive workplace at the FDIC, strengthen cybersecurity and information security within the banking industry, and manage the FDIC's return to in-person bank examinations and other in-person activities at the FDIC.

Following is an overview of the FDIC's progress in these areas over the past year, as well as the current economic and financial outlook, and the FDIC's operational status.

THE CURRENT OUTLOOK

At the end of September 2022, the FDIC insured deposits of $9.9 trillion in approximately 865 million accounts at 4,755 institutions, supervised 2,765 institutions, and managed 156 active receiverships with total assets of nearly $1.1 billion.

The banking industry reported generally positive results in 2022 amid continued economic uncertainty. Loan growth strengthened, net interest income grew, and most asset quality measures improved. Further, the industry remains well-capitalized and highly liquid. Fourteen new banks opened through October 2022, including the first mutual bank in 50 years, and there has not been a bank failure since October 2020.

At the end of the third quarter, the banking industry reported an increase in net income that more than offset an increase in provision expenses—the amount set aside by institutions to protect against future credit losses. However, rising interest rates have resulted in unrealized losses on investment securities held on bank balance sheets, and may erode the value of real estate and other assets, and affect borrowers' ability to repay loans.

The FDIC will continue to focus its attention on the significant downside risks the industry faces, including the effects of inflation, rising interest rates, slowing economic growth, and continuing geopolitical uncertainty. Taken together, these risks have the potential to reduce profitability, weaken credit quality and capital, and limit loan growth in coming quarters.

MANAGING THE DEPOSIT INSURANCE FUND

The pandemic and the government's response to it also affected the Deposit Insurance Fund (DIF). Monetary policy actions, direct government assistance to consumers and businesses, and an overall reduction in consumer spending due to the COVID-19 pandemic resulted in an unprecedented inflow of more than $1 trillion in estimated insured deposits in the first half of 2020. As a result, the reserve ratio of the DIF—the DIF balance as a percentage of the banking industry's estimated insured deposits—declined below the statutory minimum, and as of June 30, 2020, was at 1.30 percent. Insured deposits continued to grow—at times at unprecedented levels, which has caused the reserve ratio to remain low. As of the third quarter of 2022, the reserve ratio was 1.26 percent, well below the statutory minimum of 1.35 percent.

As required by the Federal Deposit Insurance Act, the FDIC Board adopted a new Restoration Plan in September 2020 to restore the DIF to at least 1.35 percent by September 30, 2028. To improve the likelihood that the reserve ratio will reach the statutory minimum within that timeframe, the FDIC Board amended the Restoration Plan in June 2022 to incorporate an

increase in assessment rate schedules of 2 basis points for all insured depository institutions. The new schedules are effective January 1, 2023. They are expected to have a very small effect on industry income and no impact on lending or credit availability.

As a result of the downside risks to the banking industry, the FDIC concluded it was better to take prudent but modest action now, rather than to delay and potentially have to consider a larger increase in assessments at a later time when banking and economic conditions may be less favorable.

STRENGTHENING THE COMMUNITY REINVESTMENT ACT

In 1977, the CRA was enacted based on a simple, but powerful premise - that banks have an affirmative obligation to serve the local communities in which they do business. That premise remains compelling 45 years later, yet the rule implementing the CRA has not undergone a major revision since 1995, despite the banking industry's dramatic evolution over that time.

This year, the FDIC partnered with the Board of Governors of the Federal Reserve System (FRB) and Office of the Comptroller of the Currency (OCC) on a Notice of Proposed Rulemaking (NPR) to adapt the CRA to that evolution and to strengthen and enhance its effectiveness in achieving its core mission.

The NPR would significantly expand the scope and rigor of the CRA and assure its continued relevance. Among other things, the NPR would:

- Establish new retail lending assessment areas to allow for CRA evaluation in communities where a bank may be engaging in significant lending activity but where the bank does not have a branch;
- Incorporate detailed metrics on bank lending activity. This provides an improved line of sight into bank lending and allows for the consideration of higher standards for bank lending performance under CRA. The objective here is to provide an incentive for increased bank lending to underserved communities. It also would allow for greater transparency and certainty for banking institutions in meeting their CRA responsibilities; and
- Raise the thresholds for "Small" and "Intermediate" banks, which will maintain or reduce requirements for hundreds of community banks with respect to their CRA requirements.

In addition, the proposed rule would provide greater transparency on lending to communities of color and enhanced incentives for banks to collaborate with MDIs and CDFIs, invest in disaster preparedness and climate resilience in low- and moderate-income neighborhoods, and provide lending, investment, and services in rural communities and Native lands.

Taken together, the NPR represents a major revision of the CRA intended to strengthen its impact and increase its transparency and predictability. The FDIC, along with the FRB and OCC, continue their review of approximately one thousand unique comments as they consider possible changes to the NPR in developing a final rule.

REVIEWING THE BANK MERGER PROCESS

The FDIC also identified the regulatory framework for implementing the Bank Merger Act of 1960 as timely for review in 2022.

The Bank Merger Act established a framework that generally requires approval by the FRB, OCC, or FDIC, as appropriate, for bank mergers after consideration of certain specific statutory factors. FDIC approval is also required for a bank merger with a non-insured entity.

Since the process was last reviewed 25 years ago, a great deal of consolidation has taken place in the banking sector, facilitated in part by mergers and acquisitions. The prospect for continued consolidation among both large and small banks remains significant. As a result, a review of the merger process is both timely and appropriate.

In March 2022, the FDIC issued a Request for Information (RFI) and Comment on Rules, Regulations, Guidance, and Statements of Policy Regarding Bank Merger Transactions. The RFI requested comment on the four statutory factors required to be considered under the Bank Merger Act: competition, prudential risk, the convenience and needs of the communities affected, and financial stability. The FDIC also formed an interdivisional working group to develop draft revisions to the Statement of Policy on Bank Merger Transactions to address legislative and other developments since the document was last updated in 1998, and make other content and structural enhancements.

The FDIC is considering updates to the Statement of Policy in light of the comments received in response to the RFI, and continues to collaborate with the other banking agencies and the Department of Justice on an interagency review of the bank merger application process.

ADDRESSING FINANCIAL RISKS POSED BY CLIMATE CHANGE

There is broad consensus among financial regulatory bodies, both domestically and abroad, that the effects of climate change and the transition to reduced reliance on carbon-emitting sources of energy present unique and significant economic and financial risks, and, therefore, an emerging risk to the financial system and the safety and soundness of financial institutions. Understanding and addressing the financial risks that climate change may pose to the banking system, and the extent to which those risks impact the FDIC’s core mission and responsibilities, are a top priority of the FDIC.

While the banking industry has always contended with severe weather events and, thus far, has handled these events well, changing climate conditions are producing disturbing trends, including rising sea levels, increases in the frequency and severity of extreme weather events, and other natural disasters. These trends challenge the future resiliency of the financial system and banking industry and, in some instances, may pose safety and soundness risks to individual banks. The goal of the FDIC's climate-related financial risk work is to ensure that the financial system remains resilient despite these rising risks.

To that end, in March 2022, the FDIC Board approved a proposed Statement of Principles for Climate-Related Financial Risk Management for Large Financial Institutions that provides a high-level framework for the safe and sound management of exposures to climate-related financial risks for large financial institutions.

The FDIC does not make climate policy and does not determine firms or business sectors with which financial institutions should do business. However, the FDIC does want financial institutions to fully consider climate-related financial risks—as they do all other risks—and continue to take a risk-based approach in assessing individual credit and investment decisions.

While the FDIC remains in the early stages of addressing climate-related financial risk, regulators need to work with the banking industry now to support financial institutions as they develop plans to identify, monitor, and manage the financial risks posed by climate change. This should be done in a manner that is flexible enough to allow for change as knowledge is gained, data is developed, and new methodologies and tools are explored.

Importantly, the FDIC will continue to encourage financial institutions to consider climate-related financial risks in a manner that allows banks to prudently meet the financial services needs of their communities.

PROVIDING REGULATORY RELIEF IN DISASTER AREAS

In 2022, the FDIC provided flexibility to financial institutions in 14 states and territories, where communities were affected by severe storms, flooding, tornadoes, wildfires, and other disasters. The FDIC supported financial institutions' efforts to meet customers' cash and financial needs by providing flexibility on appraisal requirements, lending and credit policies, and more. As these areas continue to recover, the FDIC encourages depository institutions to consider all reasonable and prudent steps to assist their customers, consistent with safe-and-sound banking practices.

EVALUATING AND ADDRESSING CRYPTO-ASSET RISKS TO THE BANKING SYSTEM

Recent growth in the crypto-asset industry has triggered increasing interest on the part of some banks to engage in crypto-asset-related activities. The risks associated with these activities are novel and complex, and may involve safety and soundness, consumer protection, anti-money laundering and the Bank Secrecy Act, and potentially financial stability issues. As a result, the FDIC has taken a deliberate and thoughtful approach to supervision in this area.

In April 2022, the FDIC issued a Financial Institution Letter, asking supervised banks to notify the FDIC if they are engaging in, or planning to engage in, crypto-asset-related activities. If so, the FDIC asked them to provide enough detail to allow the agency to work with them to assess the risk and the appropriateness of their proposed governance and risk management processes. This approach allows the FDIC to better understand the activity and provide the institution with case-specific supervisory feedback. The other federal banking agencies are taking a similar approach.

Bankruptcies and other disruption in the crypto-asset industry in 2022 highlighted the risks of these activities as well as consumer confusion regarding deposit insurance. For that reason, the FDIC reminded consumers and insured institutions of the need to be aware of how FDIC insurance operates with respect to these assets, as well as reiterated the need for insured institutions to assess, manage, and control risks arising from third-party relationships with crypto companies.

If a third party makes misrepresentations about the nature and scope of deposit insurance, it can lead to significant risks for banks. In July, the FDIC issued an advisory reminding insured banks of the risks that could arise due to misrepresentations of deposit insurance by crypto-asset companies. The FDIC also issued cease and desist letters to five crypto-asset companies for misleading statements regarding deposit insurance. In December, the FDIC Board adopted a notice of proposed rulemaking seeking comment on a number of proposed changes to the FDIC rules governing advertising, use of the FDIC logo, and misrepresentation of deposit insurance coverage.

The FDIC will continue to work with its supervised banks to ensure that any crypto-asset-related activities that they engage in are permissible banking activities that can be conducted in a safe and sound manner and in compliance with existing laws and regulations, including those related to consumer protection and anti-money laundering. In addition, the FDIC will continue to collaborate with its fellow banking agencies to better understand the risks associated with these products and activities and, as appropriate, expects to provide broader industry guidance on an interagency basis.

FINALIZING THE BASEL III CAPITAL RULES

The Basel Committee on Banking Supervision reached a final agreement on modifications to the Basel III international regulatory framework in December 2017. This final agreement would strengthen the regulatory framework for large banking organizations by strengthening capital requirements for market risk exposures, improving the capital requirement for financial derivatives, and simplifying the measurement of operational risk for regulatory capital purposes.

Strong capital requirements have proven to be a critical element of the bank regulatory framework, allowing the banking industry during times of economic stress to serve as a source of strength for the U.S. economy and to lend to creditworthy households and businesses.

Implementing the final agreement for large banking organizations is a priority for the federal banking agencies. The FDIC will continue to work with its fellow banking agencies to develop a proposed rulemaking that would seek comment on the implementation of the revised Basel III standards in the United States.

EXPANDING ACCESS TO BANKING SERVICES

Expanding access to mainstream banking services helps strengthen confidence in the nation's financial system—the FDIC's core mission. In October, the FDIC published the results of its most recent *National Survey of Unbanked and Underbanked Households*, which shows that, despite the economic challenges posed by the COVID-19 global pandemic, nearly 96 percent of U.S. households were banked in 2021. The survey also found that an estimated 4.5 percent of households lacked a bank or credit union account, representing the lowest national unbanked rate since the survey began in 2009.

Approximately 1.2 million households became banked since 2019 and nearly half of these households that received government payments said these payments contributed to their decision to open an account. This data demonstrates that safe and affordable bank accounts provide a channel to bring more Americans into the banking system and will continue to play an important role in advancing economic inclusion.

These results are encouraging, but the survey also showed that significant work remains to be done to address the large disparities that exist in the United States with regard to access to the banking system. In 2021, 11.3 percent of Black households and 9.3 percent of Hispanic households were unbanked, compared to 2.1 percent of White households. Other populations also have lower levels of bank engagement including lower-income households, households with lower levels of formal education, single mothers, and households headed by a working-age individual with a disability.

These populations can be reached by taking advantage of bankable moments and by ensuring that consumers are aware of, and able to locate and open, bank accounts that can meet their needs. For example, during the pandemic, the FDIC partnered with the Internal Revenue Service to support consumers as they opened accounts so that they could receive stimulus payments as a direct deposit in a secure and timely manner.

The FDIC will continue its educational and outreach efforts to help consumers understand the benefits of a bank account, and will continue to support efforts to connect consumers with products and services that address their needs and help them build and sustain banking relationships.

SUPPORTING MINORITY DEPOSITORY INSTITUTIONS AND COMMUNITY DEVELOPMENT FINANCIAL INSTITUTIONS

The preservation and promotion of MDIs and CDFIs remains a long-standing priority for the FDIC.[1] The FDIC's research study, *Minority Depository Institutions: Structure, Performance, and Social Impact*,[2] found that FDIC-insured MDIs have played a vital role in providing mortgage credit, small business lending, and other banking services to minority and low- and moderate-income communities. Similarly, banks designated as CDFIs by the Treasury's CDFI Fund provide financial services in low-income communities and to individuals and businesses that have traditionally lacked access to credit.

The FDIC supervises approximately two-thirds of the approximately 280 FDIC-insured MDIs and CDFIs. In addition to its supervisory activities, the FDIC's Office of Minority and Community Development Banking supports the agency's ongoing strategic and direct engagement with MDIs and CDFIs.

In support of its statutory requirement to encourage the creation of new MDIs, this past May the FDIC issued a Financial Institution Letter that outlines the process by which FDIC-supervised institutions or applicants for deposit insurance can make a request to be designated as an MDI.[3]

In 2021, the FDIC designated five new institutions as MDIs, and in 2022, one new FDIC-supervised *de novo* MDI opened for business. Three other existing institutions have been designated as MDIs, and the FDIC approved a conditional application for deposit insurance for a *de novo* MDI that is now raising capital.

Since 2020, significant new sources of private and public funding have become available to support FDIC-insured MDIs and CDFIs, known collectively as mission-driven banks. The FDIC issued a publication, *Investing in the Future of Mission-Driven Banks: A Guide to Facilitating New Partnerships*,[4] to connect those who wish to support and partner with these institutions. Numerous large banks, technology companies, and others have invested hundreds of millions of dollars into mission-driven banks over the past two years.

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[1] See Section 308 of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989, Pub. L. 101-73, title III, § 308. Aug 9, 1989, as amended by Pub. L. 11-203, title III, § 367(4), July 21, 2010, 124 Stat. 1556, codified at 12 U.S.C. 1463 note.

[2] See FDIC, *Minority Depository Institutions: Structure, Performance, and Social Impact*, available at https://www.fdic.gov/regulations/resources/minority/2019-mdi-study/full.pdf.

[3] See FDIC Financial Institution Letter, FIL-24-2022, *Minority Depository Institution (MDI) Designation* (May 19, 2022), available at https://www.fdic.gov/news/financial-institution-letters/2022/fil22024.html.

[4] See FDIC, *Investing in the Future of Mission-Driven Banks: A Guide to Facilitating New Partnerships,* available at https://www.fdic.gov/regulations/resources/minority/mission-driven/guide.html.

The federal government has provided new funding to these institutions through nearly $8.3 billion in the U.S. Treasury's Emergency Capital Investment Program (ECIP) and up to $3 billion in CDFI Fund programs, including up to $1.2 billion set aside for minority lending institutions. The banking agencies issued new regulations that revised capital rules to provide that Treasury's investments under the program qualify as regulatory capital of insured MDIs and CDFIs and holding companies.[5] The FDIC developed a Capital Estimator Tool and a Regulatory Capital Guide to enable mission-driven banks to approximate the impact of additional capital on various capital ratios. At the request of mission-driven banks, the FDIC developed a technical assistance program to help ECIP recipients understand supervisory expectations for the significant new growth that this capital will support over the coming years.

The FDIC also benefits from a number of MDI and CDFI bank executives serving on its Advisory Committee on Community Banking (CBAC), the MDI Subcommittee of the CBAC, and the Advisory Committee on Economic Inclusion. These bankers bring the voices of mission-driven banks to the FDIC Board and senior executives, and they have provided input on important policy initiatives.

SUPPORTING DIVERSITY, EQUITY, INCLUSION, AND ACCESSIBILITY

Diversity, equity, inclusion, and accessibility (DEIA) are fundamental aspects of the FDIC's work. In recognition of the role DEIA plays in the FDIC's ability to fulfill its mission, the FDIC established "promoting DEIA within the FDIC workforce and the broader financial industry" as one of seven FDIC Performance Goals in 2022.

Within its workforce, the FDIC continues to expand and support diversity and inclusion through recruitment and hiring initiatives, upward mobility opportunities for current employees, career development programs for the next generation of leaders, and improved employee engagement at all levels. The FDIC's senior-most leaders meet monthly through the Diversity and Inclusion Executive Advisory Council to evaluate the FDIC's progress on DEIA matters and identify areas and opportunities for improvement.

Despite seeing progress in its efforts to improve workforce diversity, the FDIC knows that there is more to do to ensure that the FDIC workforce better reflects the demographics of the civilian labor force. In particular, the FDIC is focused on improving the agency's representation of individuals who self-identify as Hispanic.

The FDIC's commitment to DEIA in the broader financial industry is reflected through its Financial Institution Diversity Self-Assessment program. This program supports the efforts of supervised institutions to create and grow their diversity programs, allowing them to build strong relationships with their clients and communities, maximize workforce representation, and develop and implement inclusion efforts. The FDIC has expanded its outreach with

[5] See FDIC press release, "Federal Bank Regulators Issue Rule Supporting Treasury's Investments in Minority Depository Institutions and Community Development Financial Institutions" (March 9, 2021), available at https://www.fdic.gov/news/press-releases/2021/pr21018.html.

banking organizations and individual banks and launched a social media campaign to increase awareness about the self-assessment and will continue to encourage supervised banks to take advantage of this opportunity to evaluate and improve their own DEIA performance.

CYBERSECURITY AND INFORMATION TECHNOLOGY

Threats from malicious cyber actors continue to be a significant and evolving risk for banks and their service providers. Evaluating cybersecurity practices continues to be a high-priority focus of the FDIC's supervision program.

In its 2022 *Report on Cybersecurity and Resilience*,[6] the FDIC highlighted several components of its cybersecurity program including relevant safety and soundness standards, periodic guidance, alerts and advisories, technical assistance, and other outreach efforts. The report also discussed the agency's efforts to enhance the cybersecurity education of its examination workforce and the creation of examiner work programs related to particular threats. The report also highlights interagency work related to cyber threats.

The FDIC recently examined ransomware attacks against FDIC-supervised institutions and their service providers to learn about the techniques that were most helpful in defending against those attacks. While the FDIC did not discover new categories of controls that need to be communicated to financial institutions, the examinations did reveal that those institutions that dedicate resources to implement appropriate controls can effectively defend against these attacks.

Examples of effective controls include high-quality, multi-factor authentication to control access to systems and network segmentation to limit the ability of a malicious actor to move laterally in a network. Where the FDIC finds these controls to be missing, a bank's or service provider's response to FDIC supervisory feedback could make a big difference in the company's cybersecurity effectiveness.

MANAGING FDIC RESOURCES AND OPERATIONS

Since the start of mandatory telework in March 2020, the FDIC has conducted a limited number of in-person examination activities. In September 2022, the FDIC moved to Phase 3 of its Return to the Office Plan and resumed having an in-person component for each safety and soundness and consumer compliance examination. Phase 3 institutes a hybrid work environment that allows examination team members to work from the field office or from home. In designing this new approach, the FDIC drew from lessons learned from its

[6] See FDIC, *2022 Report on Cybersecurity and Resilience*, available at https://www.fdic.gov/regulations/resources/cybersecurity/2022-cybersecurity-financial-system-resilience-report.pdf.

work during mandatory and maximum telework as well as through internal reviews and consideration of responses to a request for information from the banking industry.

In December, the FDIC Board adopted a 2023 Operating Budget of $2.41 billion, which represents a 6.5 percent increase over last year's budget. The budget included an increase in the authorized workforce of 220 full-time equivalent employees, primarily aimed at the FDIC's bank supervision and other core mission responsibilities, bringing the 2023 authorized staffing total to 6,310.

The additional resources in this budget are targeted at recruiting, hiring, and retaining the diverse pool of highly qualified people the agency needs to carry out its mission and making IT investments to meet the operational and information security needs of the FDIC. These resources also reflect the collective bargaining agreement with the NTEU on a new three-year Compensation Agreement that will increase compensation to reflect the impact higher inflation has had on current salaries. It will also help to maintain comparability of compensation for FDIC employees relative to other federal banking agencies, consistent with the Financial Institutions Reform, Recovery, and Enforcement Act of 1989.

In addition, the proposed budget continues the substantial investments the FDIC has been making for a number of years to modernize and enhance the FDIC's information technology infrastructure and protect the sensitive data the FDIC maintains.

Finally, the budget also includes funding for a public information campaign on deposit insurance next year when the FDIC celebrates its 90th anniversary. Particularly in light of some of the confusing claims that are being made about FDIC deposit insurance coverage of non-traditional assets, it is more important than ever that the American public understands clearly what is protected by deposit insurance.

CONCLUSION

During 2022, the U.S. banking industry continued to manage the impact of the COVID-19 global pandemic. Despite the uncertainty, the banking system has remained a source of strength for consumers, households, and businesses.

However, the economic environment is changing. Inflationary pressures, rising interest rates, slowing economic growth, and geopolitical events create a very uncertain economic outlook with significant downside risks to the banking industry.

In 2023, the FDIC will continue to carry out its mission to maintain public confidence and stability in the U.S. financial system and address these downside risks by maintaining a strong deposit insurance system, examining and supervising financial institutions for safety and soundness and consumer protection, making large and complex financial institutions resolvable, and managing receiverships.

The FDIC will also continue its policy initiatives to strengthen and modernize the Community Reinvestment Act, review the Bank Merger Act process, understand and respond to the risks posed by crypto-assets, provide guidance on the financial risks posed by climate change, and

strengthen capital requirements for large banking organizations.

As indicated, other areas of continued focus include the FDIC's efforts to support minority depository institutions and community development financial institutions, promote a diverse and inclusive workplace at the FDIC, strengthen cybersecurity and information security within the banking industry, and manage the return to in-person bank examinations and other in-person activities at the FDIC.

None of the accomplishments outlined in this report would be possible without the hard work and commitment of the FDIC workforce. They continue to serve the agency and the U.S. public with professionalism, proficiency, integrity, and resilience. I am grateful for their dedication to the mission of the FDIC.

Sincerely,

Martin J. Gruenberg