

A close-up photograph of a classical architectural capital, likely a composite capital, featuring a prominent floral or acanthus leaf motif in the center. The stone is light-colored with some weathering and shadows. The capital is part of a larger structure, possibly a column or pediment.

## **Financial Services: Safer & Stronger in 2012**

Prepared by  
The Financial Services Roundtable  
January 2012

## Executive Summary

- Banks insured by the Federal Deposit Insurance Corporation have \$1.5 trillion in capital – the highest capital levels in the history of American banking.
- The largest U.S. banks have increased Tier 1 capital – the core measure of a bank's financial strength from a regulator's point of view – by nearly 50 percent over the last four years.
- Every single valid insurance policyholder claim was paid during and after the financial crisis, and not a single insurer became insolvent.
- The insurance sector remained strong throughout a decade when seven of the 10 most costly U.S. catastrophes for insurers occurred, such as Hurricane Katrina, Hurricane Ike, and the terrorist attacks of September 11, 2001.
- Executive compensation has been reformed significantly to align with long-term performance.
- Banks have developed fortress balance sheets, improving credit quality by 54 percent, increasing net income and, restoring aggregate lending to pre-crisis levels of nearly \$7 trillion.
- Banks will repay Troubled Asset Relief Program (TARP) investments with \$21 billion in profit to taxpayers.

# Safer & Stronger

*The financial services industry has made significant changes since the crisis and is safer and stronger as a result.*

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**January 2012**

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## Introduction by Steve Bartlett, President & CEO

It is widely known that some financial services companies made serious mistakes leading up to the financial crisis. Less discussed is how financial services companies have reformed their practices since that time.

This paper examines the many significant and positive changes that American financial services companies have made during the last three years, thanks to hard work by industry leaders and government officials. For example, financial institutions now maintain the highest capital levels in history. Strong underwriting standards have replaced “no-doc loans” and “exotic mortgages.” Insurers remained solvent throughout a decade with record catastrophes. Banks have stronger balance sheets. And U.S. taxpayers are protected from future bailouts.

In other words, the U.S. financial services industry is safer and stronger for the customers, taxpayers, and the economy.


***“The U.S. financial services industry  
is safer and stronger for customers,  
taxpayers, and the economy.”***

Strong financial services companies are critical to a healthy and robust American economy. They enable people to own a home, finance car purchases and attend college. They finance multi-billion dollar international businesses that, in turn, support millions of American jobs. They insure people and property against natural disasters and other catastrophes. And they protect retirement savings and investments for individuals and businesses alike.

As we head into 2012, the American financial services industry is safer and stronger to fuel the economy and serve the customers who depend on them.

I give special thanks to Abby McCloskey, the Roundtable's Director of Research, and to all others who contributed to this report. Please do not hesitate to contact me at [Steve@fsround.org](mailto:Steve@fsround.org), or Abby, at [Abby@fsround.org](mailto:Abby@fsround.org), if you have questions or comments.

Best regards,



Steve Bartlett  
President and CEO  
The Financial Services Roundtable

## Section 1: Capital

**U.S. financial services companies emerged from the global financial crisis with more than \$1.5 trillion in capital during 2011, the highest capital level in history.**

Capital – loosely defined as a bank’s assets minus its liabilities – determines the safety and soundness of the financial system. Strong capitalization levels ensure that financial institutions can withstand economic downturns and other challenges, such as the European Union’s current fiscal situation.

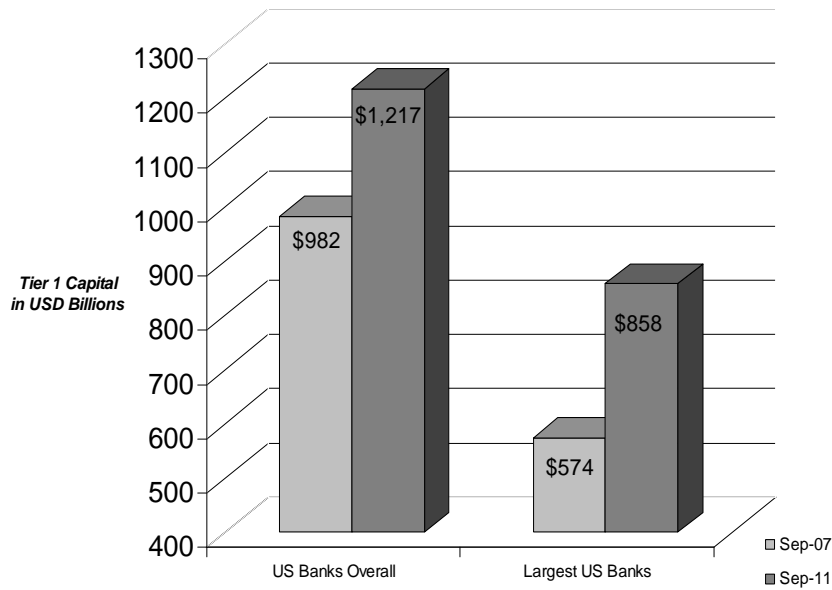
Banks have increased capital ratios substantially since the financial crisis by growing equity, increasing Treasury holdings and cash and reducing the riskiness of other assets. From September 2007 to September 2011, FDIC-insured U.S. banks increased Tier 1 capital by 24 percent, to \$1.217 trillion from \$982 billion. Tier 1 is considered the “safest” form of capital for a bank to have on its books, consisting primarily of common equity.

But the largest U.S. banks increased capital *by even more*. During the same four-year time period, U.S. banks with more than \$10 billion in assets increased Tier 1 capital to \$858 billion as of 2011 from \$574 billion – a significant 50 percent increase.

***The largest U.S. banks have increased Tier 1 capital levels by 50 percent since 2007.***

By the end of 2010, the average Tier 1 capital ratio (capital to risk-weighted assets) for the largest 18 U.S. banks was 12.2 percent – well above previous supervisory benchmarks, according to the Federal Reserve of San Francisco. The substantial increase in capital occurred without a regulatory requirement since the capital-related rulemakings in the Dodd-Frank Act and Basel III had yet to go into effect as of January 2012.

### Historic Increase in Bank Capital



Source: FDIC SDI Data

***Banks would not fail from lack of capital if the 2008 financial crisis occurred again.***

In fact, capital levels are such that if another financial crisis erupted, banks would not fail from lack of capital, concluded a Clearing House Association study.

The study analyzed capital levels of 123 large global banks during the 2008 financial crisis period and found *no* bank that met Basel III's 7 percent Tier 1 common-equity requirement (1) went bankrupt, (2) was taken over by the government, (3) was forced into a distressed takeover by another bank, or (4) received government assistance greater than 30 percent of its Tier 1 capital.

In November 2011, the Federal Reserve asked the largest 31 U.S. banks to test their capital levels against an *even more severe economic scenario than 2008*.

The Fed's prescribed scenario for the stress test was:

### The Federal Reserve's Stress Test Scenario

What would happen to bank capital if:

- **Growth in gross domestic product drops to negative 8 percent in Q1 2012.**
- **The Dow drops to 5,700 in Q4 2012.**
- **The unemployment rate jumps to 13 percent in 2013.**
- **Commercial real estate drops 23 percent by 2013.**
- **Housing prices fall 20 percent by 2014.**
- **Europe goes into a recession and growth in Asia dramatically slows**

In reality, the unemployment rate has never gone above 11 percent (let alone reach 13 percent) since the Great Depression and GDP has dropped by 8 percent or more only two times since 1947: Q4 2008 (minus 8.9%) and Q1 1958 (minus 10.4%). And the scenario, if it occurred, would prove catastrophic for nearly everyone. According to Moody's Analytics: 4.5 million additional jobs would be lost by the end of 2012; national debt would increase by an additional \$1 trillion by mid-2013; and retail sales would decline 10 percent by the end of 2012.

The Fed's scenario was designed to test the resilience of the financial services industry, even during the toughest of economic times, and give markets "peace of mind" about just how much economic pressure U.S. financial services companies can stand while maintaining a significant capital buffer. The results of this test will be one of the factors supervisors will use to determine companies' capacity to pay dividends and other capital distributions. The Fed is scheduled to release the results in April 2012.

## Section 2: Insurer Solvency

**“While the Great Recession and its aftermath forced hundreds of thousands of businesses to fail...not a single traditional property/casualty insurer failed as a result of the financial crisis and not a single valid claim went unpaid.” *Dr. Robert Hartwig, President of the Insurance Information Institute.***

The insurance industry remained solvent and strong during the financial crisis, and it has grown even stronger since.

One clear measure of insurer strength is “policyholders’ surplus,” the difference between its assets and liabilities and a measure of its financial strength and capacity to underwrite risks. In the U.S. property/casualty insurance industry, policyholders’ surplus rose by nearly 9 percent to reach a record \$556.9 billion at year-end 2010, (from \$511.4 billion at year-end 2009). As of September 30, 2011, the policyholders’ surplus was \$538.6 billion. While somewhat below 2010 levels, it still remains more than enough to cover 125 times the insured U.S. property losses from Hurricane Irene in 2011.

***Property/casualty insurers have a policyholders’ surplus of \$538.6 billion. This is 125 times all the direct insured losses to U.S. property from Hurricane Irene.***

As a testament to the strength of the property/casualty insurance sector, the industry remained solvent and strong throughout a decade with seven of the 10 most costly catastrophes sustained by the United States. These include Hurricane Katrina, Hurricane Ike and the terrorist attacks of September 11, 2001, reports the Insurance Information Institute. The industry maintained its strength in 2011, which saw record tornado and thunderstorm

losses that exceeded \$25 billion, including the events that devastated Tuscaloosa, Alabama and Joplin, Missouri.

### THE TEN MOST COSTLY U.S. CATASTROPHES

*(\$ millions)*

Rank	Date	Peril	Insured Property Losses in 2010 dollars
1	Aug. 2005	Hurricane Katrina	\$45,481
2	Sep. 2001	Fire, Explosion: World Trade Center, Pentagon terrorist attacks	22,924
3	Aug. 1992	Hurricane Andrew	22,412
4	Jan. 1994	Northridge, CA earthquake	17,318
5	Sep. 2008	Hurricane Ike	12,735
6	Oct. 2005	Hurricane Wilma	11,398
7	Aug. 2004	Hurricane Charley	8,548
8	Sep. 2004	Hurricane Ivan	8,130
9	Sep. 1989	Hurricane Hugo	6,678
10	Sep. 2005	Hurricane Rita	6,227

Source: Insurance Information Institute, 2012

***During the last decade, U.S. life insurers increased policy reserves by 50 percent.***

The U.S. life insurance industry has strengthened its policy reserves by more than 50 percent during the last decade, according to data from the American Council of Life Insurers. Life insurance companies had more than \$4 trillion in policy reserves at the end of 2010. As an extra safeguard for unexpected contingencies, life insurers carry surplus funds and capital stock, which amounted to \$319 billion at the end of 2010, 6 percent higher than 2009 levels.

Reserves are a clear measure of insurer strength, similar to bank capital. To determine insurer solvency, the risk-based capital ratio (RBC) is used, which compares reserve levels against the risks

inherent in an insurer's operations. In the U.S. life insurance industry, most companies consistently have had an RBC ratio above the regulatory minimum level of 100 percent, according to data from the American Council of Life Insurers. By year-end 2010, more than over 99 percent of the life insurance industry's assets were held by companies with RBC ratios of 200 percent or more.

***Reinsurers had nearly half a trillion dollars of capital on hand at the end of 2011.***

Despite the large international catastrophe losses of 2011, for which private reinsurers paid out more than \$100 billion in claims, reinsurers ended the year with nearly half a trillion dollars of capital on hand, as well as contingent capital resources. The reinsurance sector supplements the primary insurance industry. For example, international private reinsurers paid more than 60 percent of the insured losses arising from the World Trade Center disaster; more than 60 percent of the insured losses from Hurricanes Katrina, Rita and Wilma in 2005; and more than 90 percent of the capacity for Florida's hurricane risk.

The insurance industry's strength is critical to the U.S. economy and global competitiveness. The industry provides trillions of dollars to U.S. capital markets, including \$1.5 trillion in corporate stock holdings, \$4 trillion in credit market assets and \$2 trillion in corporate bonds. The industry invests billions of dollars of premiums into state and local public projects for schools and roads, among others. And the industry employs more than two million Americans and contributes more than \$400 billion to the nation's GDP annually.

## Section 3: Risky Practices Eliminated

**Banking practices that contributed to the 2008 crisis have been eliminated.**

The days of widespread “no-doc loans” and “exotic mortgages” are gone. The vast majority of mortgage lenders maintain strong underwriting standards and substantial capital to back the loans, and they require a material down payment from the borrower. Significant risk taking through proprietary trading largely has been curtailed.

Some of these changes reflect new rules, such as the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010. Others are voluntarily. The result is the same: a safer and stronger system.

Perhaps the single largest reform since 2007 involves executive compensation. The Federal Reserve’s October 2011 horizontal review of incentive compensation practices for financial institutions (as mandated by the Dodd-Frank Act) found that large banking organizations have made “significant progress toward enhancing their incentive compensation arrangements.” Already, many are at or above proposed guidelines to defer 50 percent of incentive compensation for three years, the Fed concluded. For example, senior financial executives have more than 60 percent of their incentive compensation deferred on average; some of the most senior executives have more than 80 percent deferred; and deferral periods generally range from three- to-five years, with three years being most common.

***Many banks already are at or above  
proposed guidelines to defer 50  
percent of incentive compensation  
for three years.***

In a targeted survey of Roundtable membership in May 2011, 100 percent of member companies reported enhancing their executive compensation practices since 2008. Many executive compensation reforms were made without legislative or regulatory requirements.

### Industry Changes Made to Executive Compensation

#### *Without Legislative or Regulatory Requirements:*

- Instituting maximum payout caps (87% of companies)
- Having claw back provisions in place (83% of companies)
- Improving risk management (77% of companies)
- Introducing new performance metrics (69% of companies)
- Restricting stock awards (52% of companies )
- Instituting new performance reviews (45% of companies )
- Creating stock holding requirements (41% of companies )
- Developing new bonus formulas (38% of companies )
- Increasing base salary and linking performance to stock (31% of companies )

Source: Financial Services Roundtable Membership Survey

These compensation changes align the long-term interests of the shareholders, company and customers, *benefiting all parties*. Focusing company performance on the long term is an important step to improving the safety and soundness of the financial system.

## Section 4: Strength of Banks

**Banks have developed well-fortified balance sheets by strengthening net income, capital, loans and credit quality. Strong banks are better able to provide services to communities, innovate products and services and offer affordable rates to customers.**

Net income has returned to pre-crisis levels for FDIC-insured institutions. According to the FDIC's Quarterly Banking Profile for the Third Quarter of 2011, earnings have improved year over year for nine quarters in a row, and only 14.3 percent of institutions reported a net loss for the third quarter of 2011, the smallest proportion since first quarter 2008. In the third quarter of 2011, the industry had the highest level of profits since the second quarter of 2007.

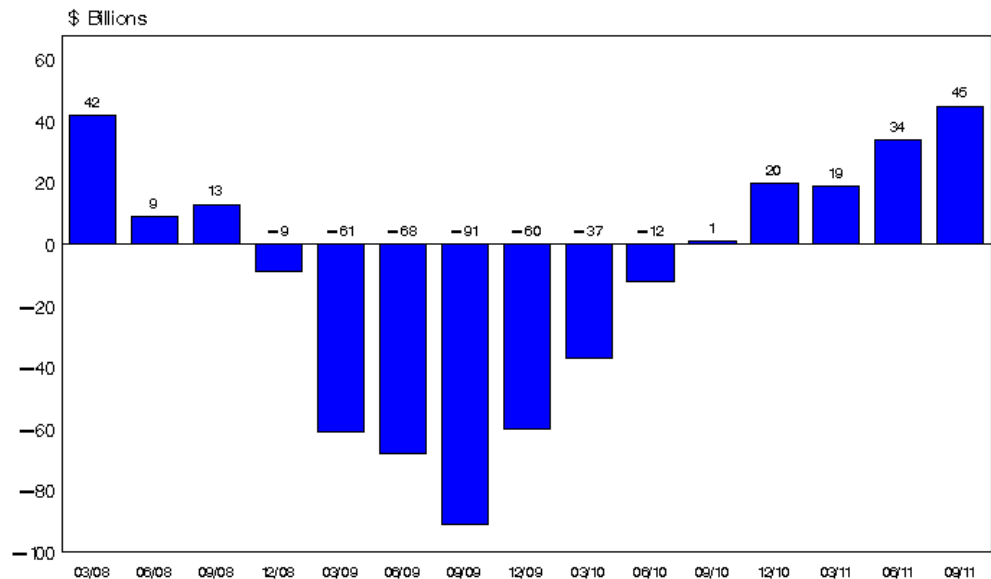
Why should people care if banks have a healthy net income? Net income allows banks to finance capital purchases. Capital, as discussed in Section 1, is fundamental to a safer and stronger system. But capital also supports loan activity. At the risk of oversimplification, every dollar in capital supports about \$10 in loans, a significant multiplier effect.

As bank balance sheets have improved, lending has returned to pre-crisis levels of nearly \$7 trillion. Net loans and leases held by U.S. commercial banks were \$6.944 trillion in November 2011. This is \$187 billion above November 2007 levels, according to the Federal Reserve's H.8 report.

Business lending grew by 8 percent during 2011 alone. Commercial banks had \$1.34 trillion in loans extended to businesses of all sizes at the close of 2011, which is \$100 billion more than at the end of 2010, according to FDIC data. Business lending has increased consecutively for the last five quarters.

***Banks have restored lending to pre-crisis levels. Nearly \$7 trillion of credit was extended to consumers and businesses in 2011.***

## Quarterly Growth in Business Lending 2008-2011



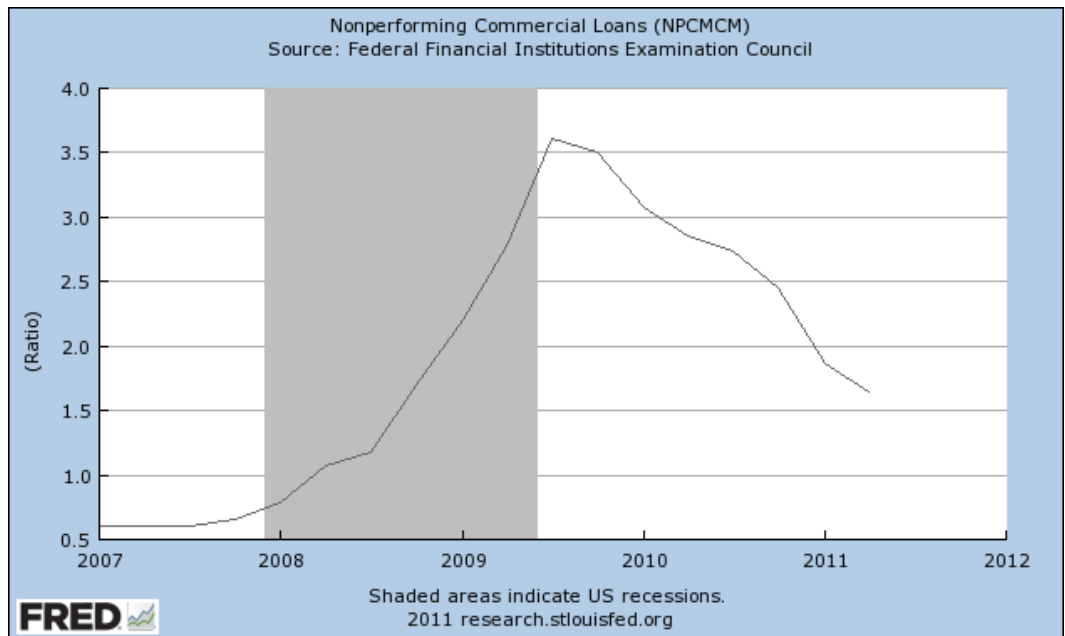
Source: FDIC, SDI

Small-business lending is no exception. Small-business borrowing hit a four-year high in November 2011 on the Thomson Reuters/PayNet Small Business Lending Index. The index was up 18 percent from November 2010. In total, more than \$600 billion in small-business loans were extended in 2011, and the largest banks pledged \$100 billion more over the next following years.

***Business lending grew by 8 percent from 2010 to 2011. Banks lent \$100 billion more to businesses of all sizes***

Additionally, consumer credit surged by the most in a decade at the close of 2011. Credit jumped to \$2.48 trillion in November 2011 in the biggest gain since November 2001. The advance was almost twice as big as the highest forecast of 31 economists surveyed by Bloomberg News.

The credit quality of loans on the books also has improved significantly. St. Louis Federal Reserve Bank data show the ratio of nonperforming commercial loans to commercial loans has decreased by 54 percent from the height of the crisis in July 2009 to 2011. During 2009, for every performing commercial loan on a bank's books, there were 3.5 nonperforming ones, on average. Now, the ratio of performing loans to nonperforming ones is 1 to 1.



The amount of noncurrent loans (90 days or more past due) has fallen for six consecutive quarters, as of the third quarter of 2011. The FDIC reports decreased noncurrent loans across every major lending category in its third quarter report.

## Section 5: The End of Bailouts

**As the financial services industry has become safer and stronger, bailouts have been repaid and eliminated. Treasury expects to earn \$21.71 billion of profit from the Troubled Asset Relief Program (TARP) banking program.**

Today, banks are strong and healthy as a result of more capital, stronger underwriting standards, increased net income and the beginning of a modest economic recovery. In terms of bailouts, this means that fewer banks are in a position to need government support.

***Banks will repay TARP with more than \$20 billion in profit to U.S. taxpayers.***

### TARP Allocation

*As of August 31, 2011, in billions of dollars*

	<b>Total Spent</b>	<b>Estimated Lifetime Gain (Cost)</b>
<b>Banking Program</b>	\$245.10	\$21.71
<i>Compared with other Programs</i>		
<b>Automotive Industry Financing Program</b>	\$79.69	(\$14.33)
<b>American International Group</b>	\$67.84	(\$17.30)
<b>Treasury Housing Program</b>	\$2.23	(\$45.60)
<b>Total for TARP Programs</b>	\$412.73	(\$53.17)
<b>Additional AIG Common Shares Held by Treasury</b>		\$16.48
<b>Total with Additional AIG Common Shares</b>	\$412.73	(\$36.69)

Source: Treasury Department, Three Year Anniversary of TARP

The Federal Deposit Insurance Corporation (FDIC) releases a “problem bank list” each quarter, defining problem banks as those institutions that could be in a position to fail, although few rarely do. In the third quarter of 2011, the FDIC reported 844 problem banks; this is 21 fewer banks than were identified in the previous quarter and the third straight quarter where the number of identified problem banks has declined. The number of *actual bank failures* is much smaller and also has been declining. For example, from January 2011 to September 2011, 90 banks failed, compared to 149 during the year-earlier period.

***The number of “problem banks”  
identified by the FDIC has fallen for  
three consecutive quarters.***

The resolution processes put in place by the Dodd-Frank Act will play a significant role in preventing future bailouts. During the last crisis, the federal statutory authority to provide an orderly closing to a large, complex, nonbank financial institution was unclear and company failures were dealt with on a case-by-case basis. Responses varied – from Lehman Brothers shedding its assets and AIG requiring government funding so it became a “zombie” institution to Wachovia’s sales in a bidding war between Citi and Wells and CIT going bankrupt, only to emerge from bankruptcy not long after.

The Financial Stability Oversight Council (FSOC), as created by the Dodd-Frank Act, now monitors the systemic risk of the financial system and recommends policy action to reduce such risk. Banks with more than \$50 billion and nonbanks supervised as systemically important institutions by FSOC are required to submit a plan for rapid and orderly resolution so that both regulators and companies themselves understand the structure of the company.

In the next economic crisis, should the failure occur of a systemically important firm – one that could compromise the entire

financial system – the Treasury and banking regulators can now close it, fire management, repay creditors and protect taxpayers. However, record capital levels, strong balance sheets for insurers and banks alike, systemic risk supervision and the end of many risky practices make that event highly unlikely, indeed.

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## About the Roundtable

The Financial Services Roundtable represents 100 of the largest integrated financial services companies providing banking, insurance, and investment products and services to the American consumer. The mission of The Financial Services Roundtable is to protect and promote the economic vitality and integrity of its members and the United States financial system. Roundtable member companies provide fuel for America's economic engine, accounting directly for \$92.7 trillion in managed assets, \$1.2 trillion in revenue, and 2.3 million jobs.

More information about the Roundtable and its research can be accessed at [www.fsround.org](http://www.fsround.org).

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