Highlight: Unrealized loss position improving in securities portfolios

December 19, 2024

Unrealized losses in the securities portfolios at community banks improve noticeably alongside a decrease in interest rates.

- In early 2022, a rapidly increasing interest rate environment caused securities that had been purchased at lower yields to experience substantial declines in value. Unrealized loss positions in available-for-sale (AFS) securities portfolios, reflected through accumulated other comprehensive income[1] (AOCI), grew considerably, peaking in 3Q 2022 at 23 percent of tier 1 capital for community banking organizations[2] (CBOs). While portfolio values fluctuated in 2023 and the first half of 2024, unrealized losses have continued to weigh on CBOs' securities portfolios.

- The target federal funds rate was lowered in September 2024 by the Federal Open Market Committee (FOMC) for the first time since the onset of the pandemic in March 2020. With declining market rates, unrealized losses on AFS securities improved five percentage points, falling to 11 percent of tier 1 capital at CBOs as of 3Q 2024.

- Recent improvements in AFS security values have alleviated downward pressure on tangible common equity[3] (TCE) as unrealized losses are reflected in AOCI, a component of TCE. TCE ratios improved for CBOs to 9.7 percent of average assets as of 3Q 2024, a 40 basis point increase quarter-over-quarter and the highest level since 2021. Only 2 percent of CBOs have a TCE ratio under 5 percent compared to a peak of 14 percent in 3Q 2022. Additionally, declines in unrealized losses on AFS securities improves asset-based liquidity as CBOs have a greater ability to liquidate securities at a reasonable cost.

Questions or comments? Please contact KC.SRM.SRA.CommunityBankingBulletin@kc.frb.org

Endnotes

[1] Held-to-maturity securities are carried at amortized cost, thus changes in fair value do not affect AOCI.

[2] Community banking organizations are defined as having less than $10 billion in total assets.

[3] Calculated as total equity capital, including AOCI less goodwill and other intangible assets.