

BANKING CONDITIONS AND RISKS

Banking and the Economy: A Forum for Minority Bankers

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Supervision and Risk Management

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FEDERAL RESERVE BANK *of* KANSAS CITY

TOPICS OF DISCUSSION



Financial Industry
Trends



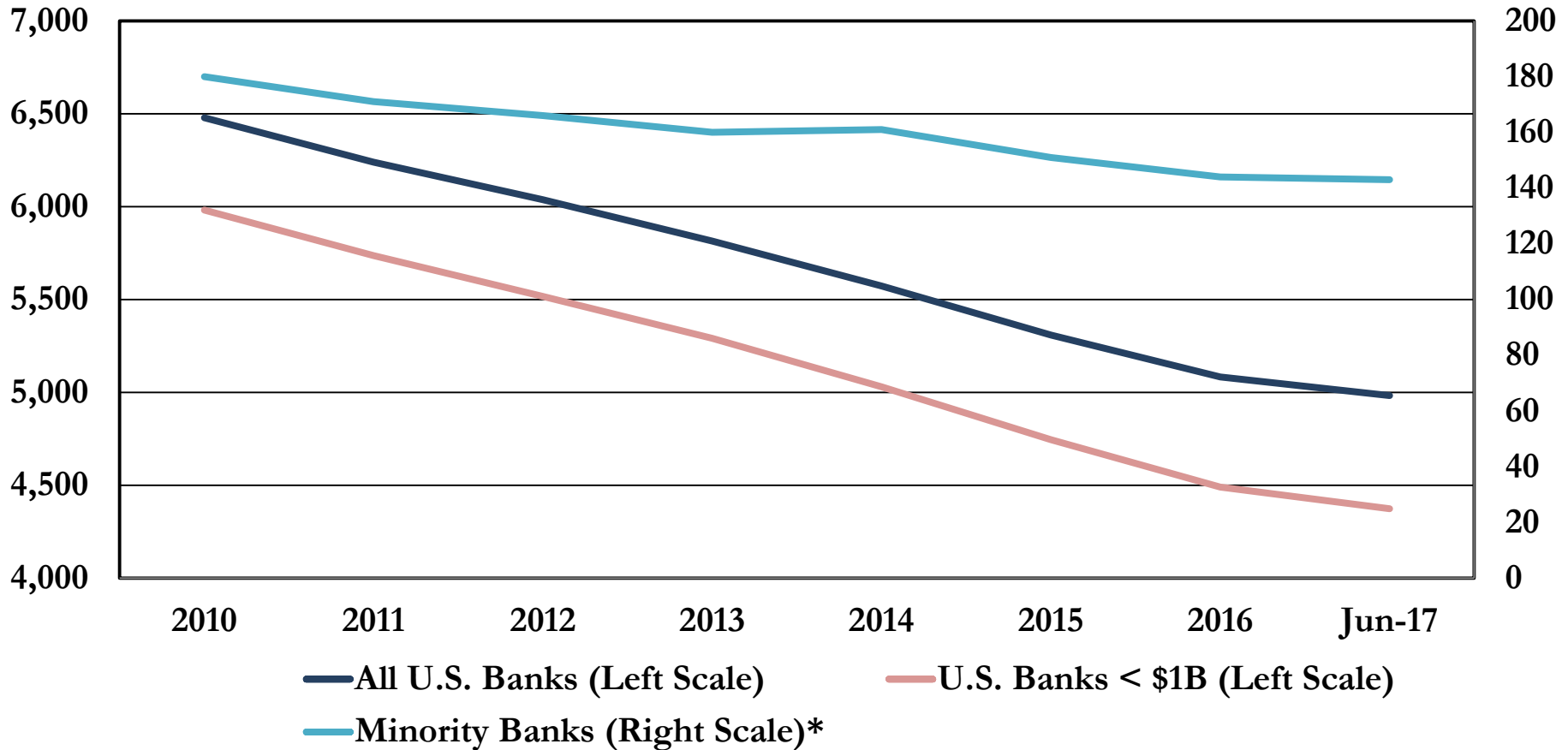
Supervisory and
Compliance Risks



Financial Industry Trends

Bank Structure and Performance

NUMBER OF U.S. BANKS DECLINING



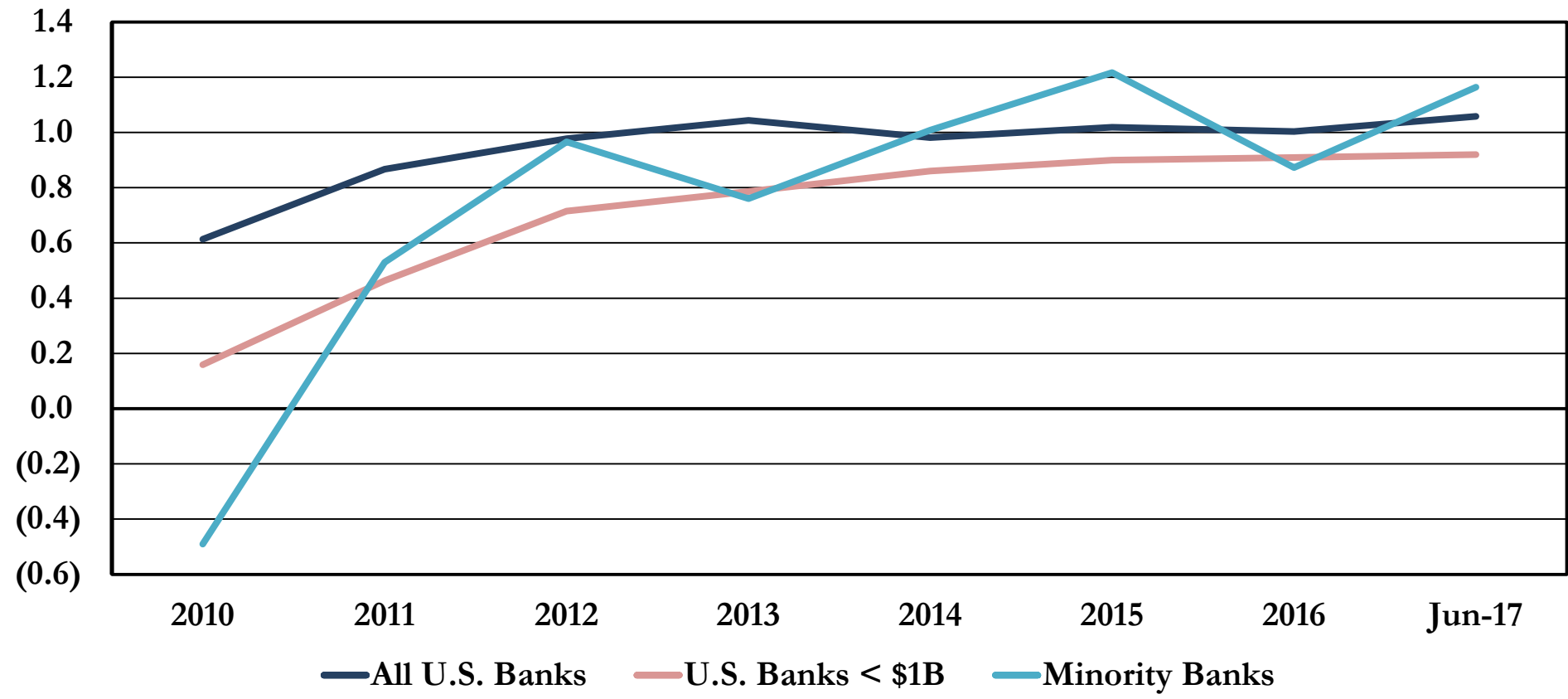
**Concentration of ownership among members of a certain minority group (51% or more) or a concentration of Board membership among that minority group by an institution that primarily serves that minority group*

*Source: Reports of Condition and Income,
Federal Deposit Insurance Corporation - Summary of Deposits*



EARNINGS INCREASING BUT VOLATILE FOR MINORITY BANKS

% of Avg. Assets*

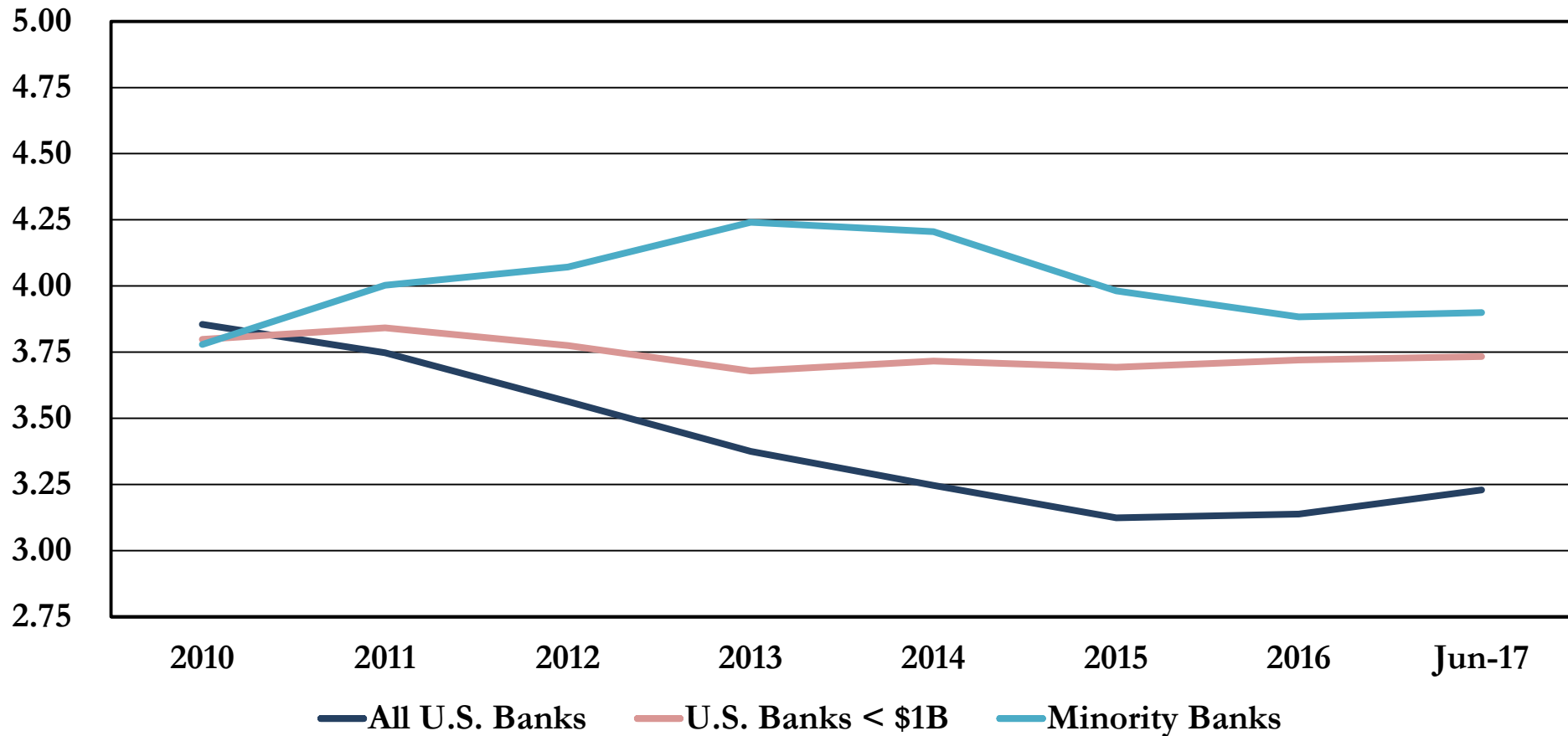


* YTD = Net Income (YTD), as a percentage of average assets - Annualized
 Note: Sub S adjusted Net Income
 Source: Reports of Condition and Income



MARGINS REMAIN FLAT IN LOW-INTEREST RATE ENVIRONMENT

% of Avg. Earning Assets*



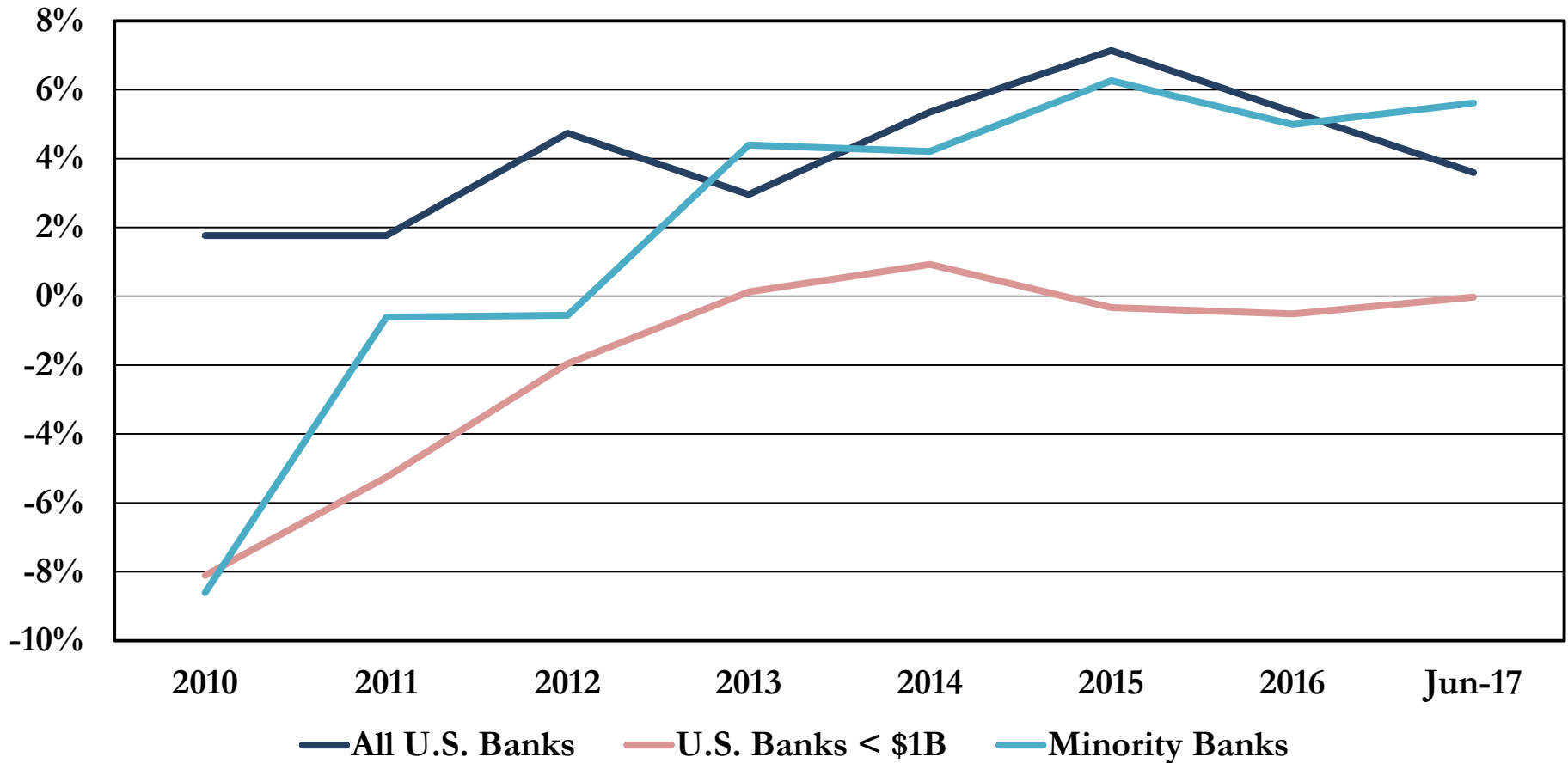
* YTD = Interest Income Net of Interest Expense (YTD), as a percentage of average earning assets - Annualized

Source: Reports of Condition and Income



LOAN GROWTH STRONG FOR MINORITY BANKS

Annual Percentage Change in Loans*



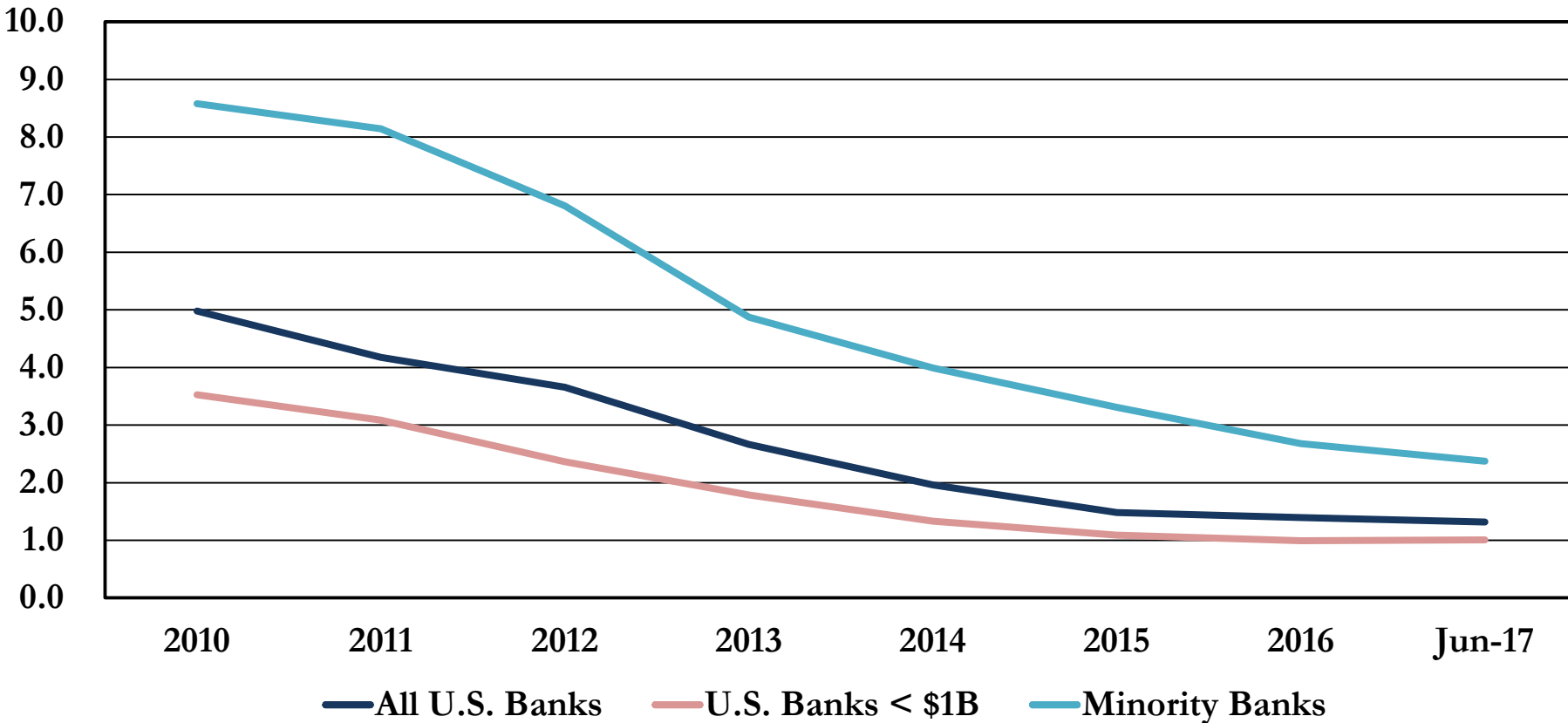
* YTD = Total Loans minus previous year's total loans, as a percentage of previous year's total loans- Annualized

Source: Reports of Condition and Income



NONCURRENT LOANS REMAIN AT POST-CRISIS LOWS

% of Total Loans*



*Noncurrent Loans to Loans

Note: Noncurrent includes loans 90+ days past due or on nonaccrual

Source: Reports of Condition and Income



Supervisory and Compliance Risks

Loan Concentrations

Liquidity

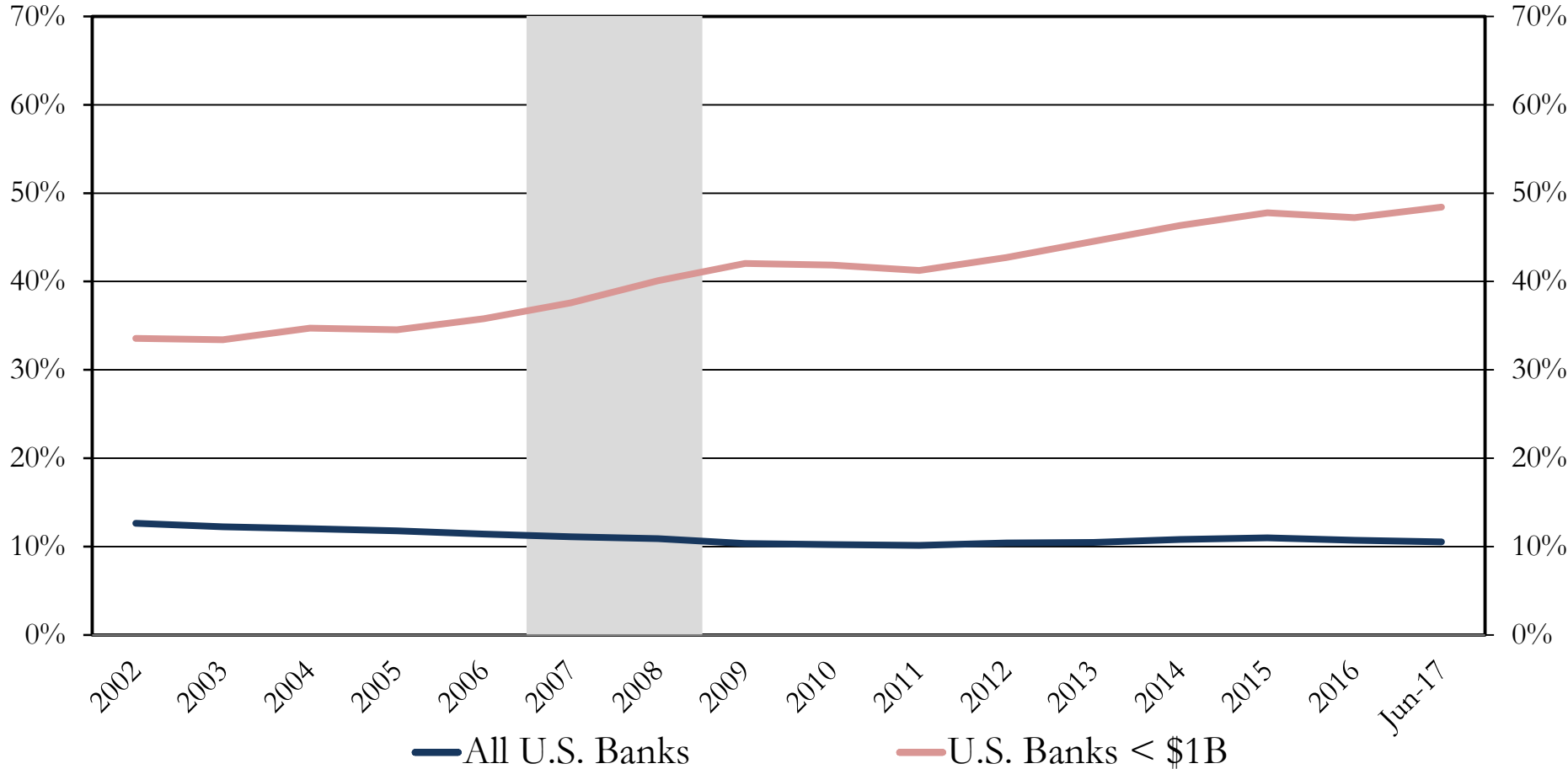
Cybersecurity

Regulatory Compliance

FinTech

AGRICULTURAL CONCENTRATIONS HAVE STABILIZED BUT AT PEAK LEVELS

Total Agricultural Loans as a Percentage of Risk-Based Capital

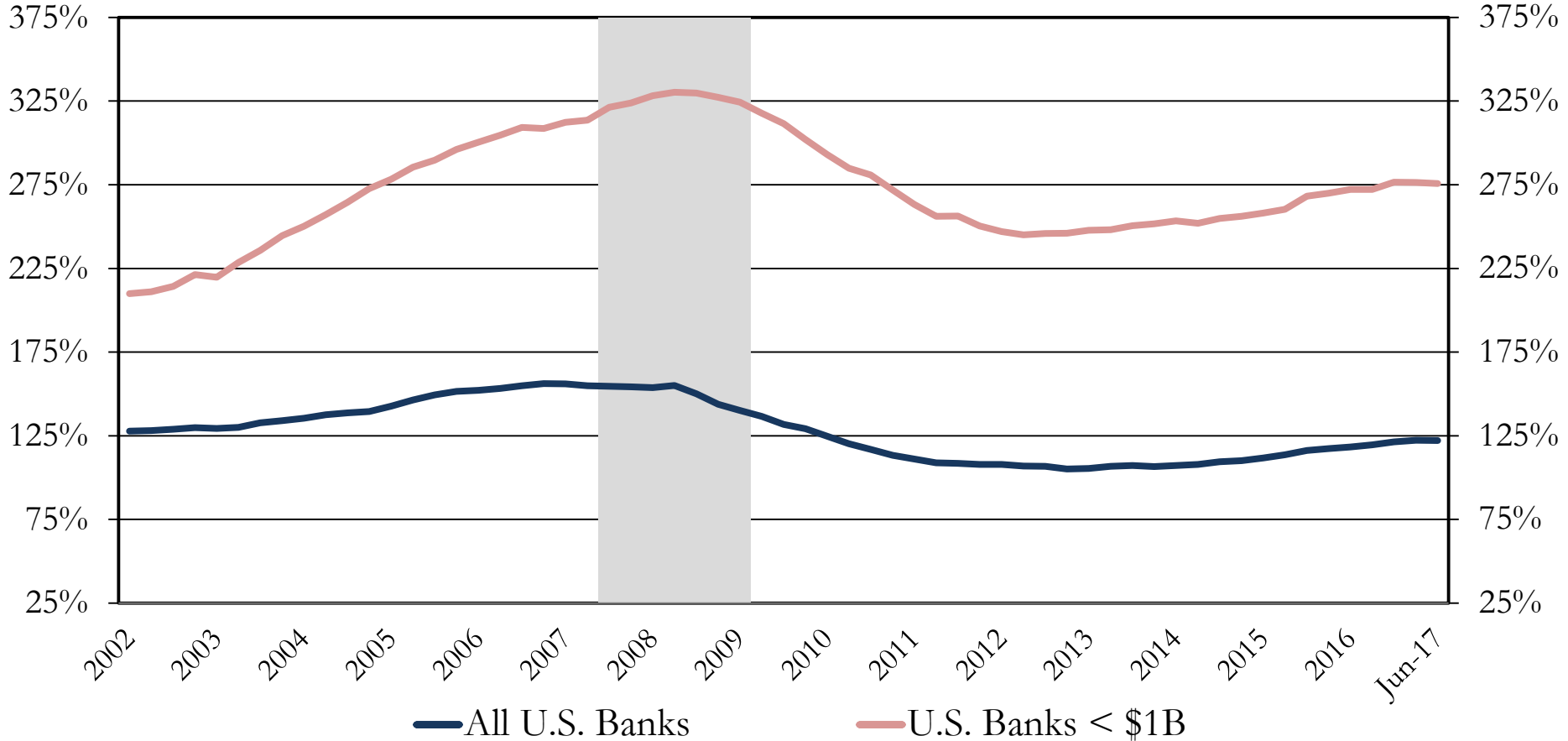


Source: Reports of Condition and Income



CRE CONCENTRATIONS ARE BELOW PRE-CRISIS LEVELS BUT ARE INCREASING

Commercial Real Estate Loans as a Percentage of Risk-Based Capital

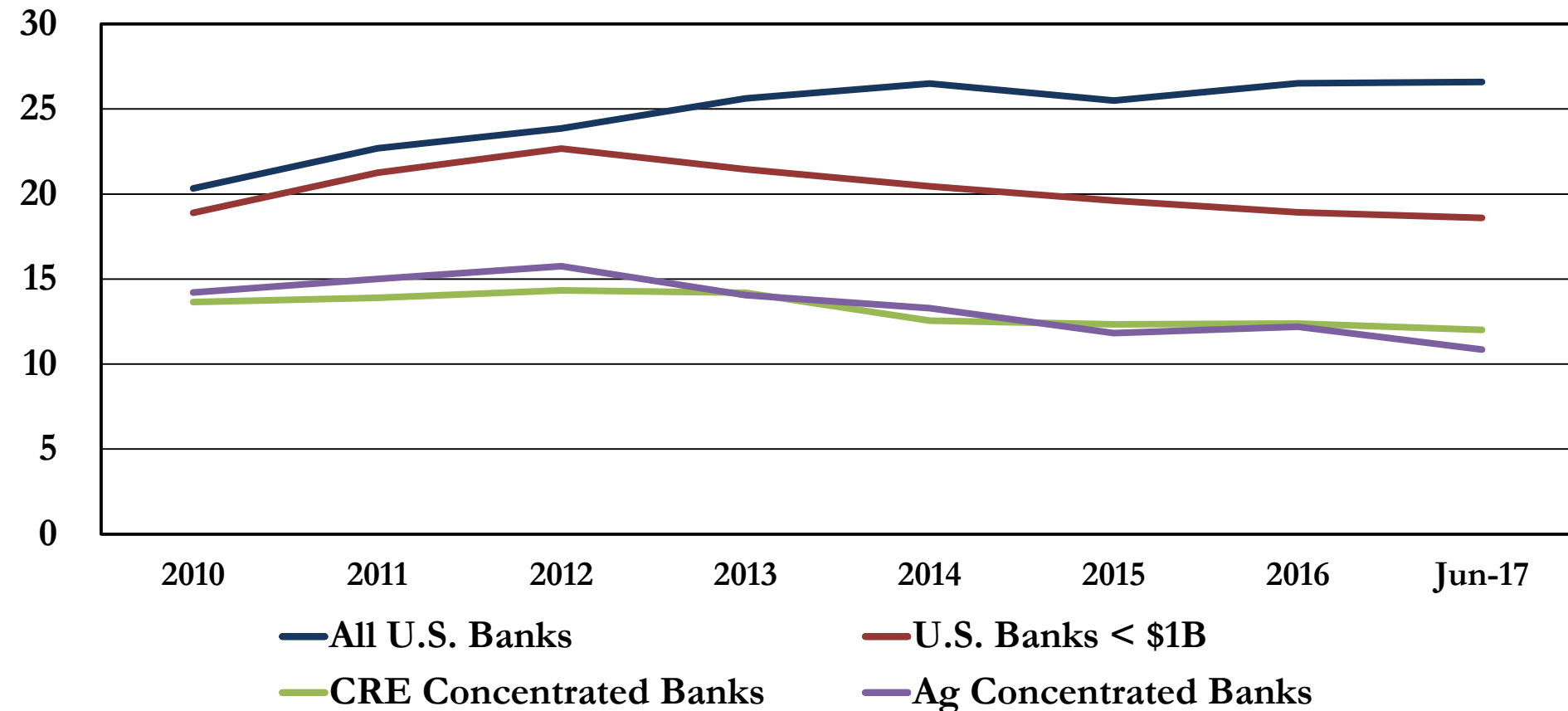


Source: Reports of Condition and Income



LIQUIDITY HAS DECLINED FOR CONCENTRATED BANKS

% of Assets



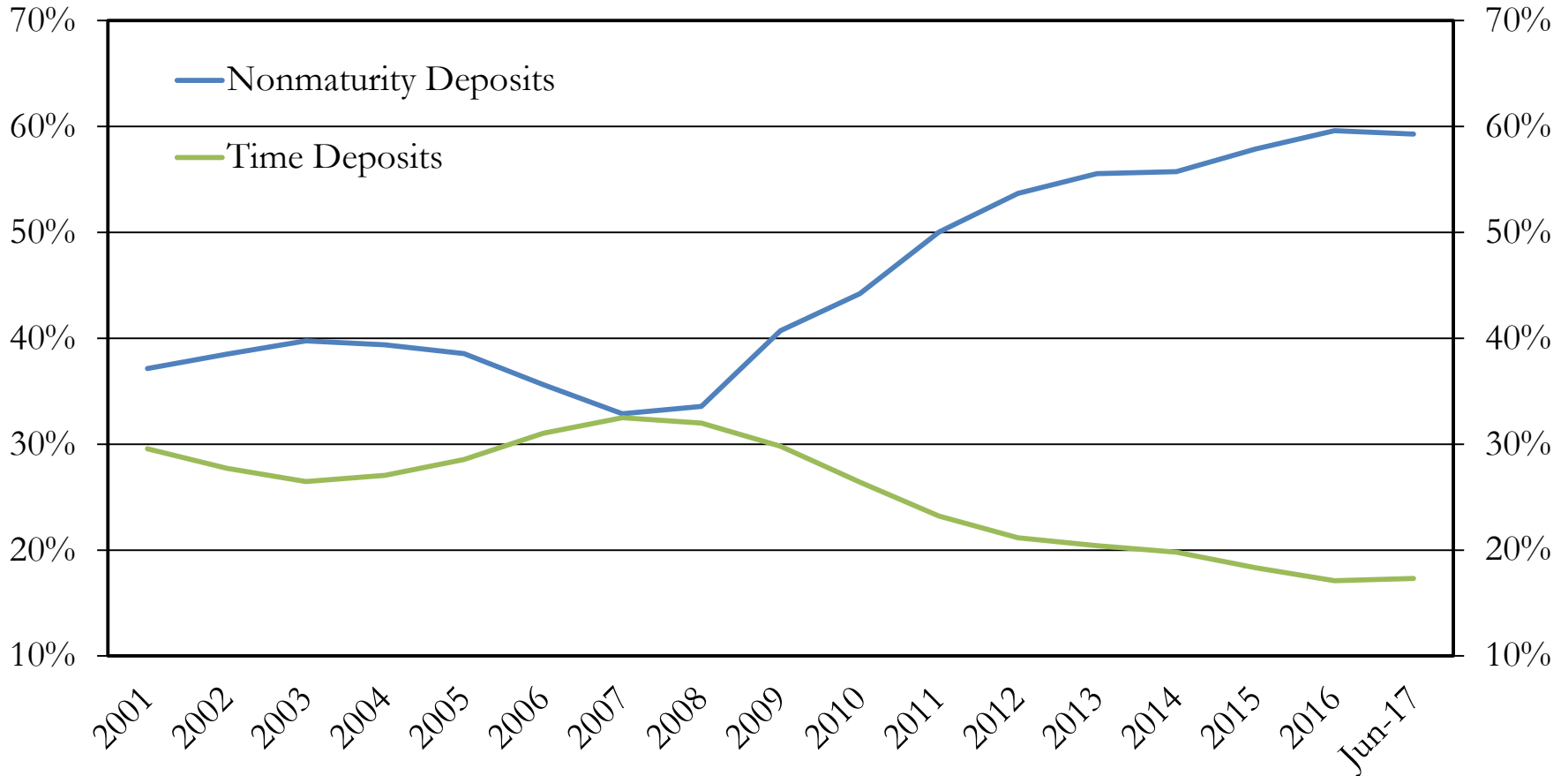
Note: Interest bearing bank balances + Federal funds sold + securities purchased under agreement to resell + total investment securities – pledged securities, as a percentage of total assets

Source: Reports of Condition and Income



WHAT WILL DEPOSITS DO AS RATES RISE?

Deposit Type as a Percentage of Assets



Source: Reports of Condition and Income



CONCENTRATION RISK: HISTORICAL PERSPECTIVE

	Failed Banks (2010 – 2012)	Healthy Banks 1 and 2 Rated (2007 – 2017)
Performance Indicator	Performance as of YE 2007	Performance as of YE 2007
5 Year Average Annual Loan Growth	17.16%	13.96%
CRE Concentration	511.06%	124.58%
CLD Concentration	245.58%	32.95%
Texas Ratio*	26.03%	0.95%
ALLL/Noncurrents	51.03%	141.82%
Noncore Funding Dependence**	47.05%	27.95%

*Restructured loans, nonaccrual loans, and OREO to equity capital and allowance for loan and lease losses (ALLL)

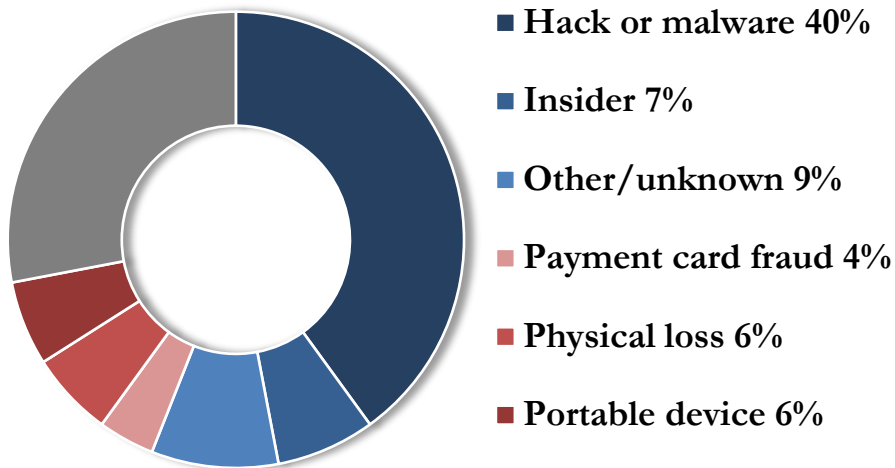
** Total time deposits of more than \$250,000 + other borrowed money + foreign office deposits + securities sold under agreements to repurchase + federal funds purchased + insured brokered deposits less than \$100,000 + insured brokered deposits of \$100,000 divided by long-term assets

Source: Reports of Condition and Income



CYBERSECURITY RISKS CONTINUE

2016 Financial Services Incidents



- Wire Fraud continues to be a primary concern for banks
 - Business email compromises of bank executive or customer accounts
 - Banks need strong wire transfer procedures and well-trained staff that follows procedures
 - www.fbi.gov
 - www.secretservice.gov
- Ransomware represents an emerging threat
 - Smaller banks and credit unions are especially vulnerable

Source: Beazley Breach Insights – January 2017



CONSUMER COMPLIANCE CONCERNS

Fair Lending



UDAP



Flood Insurance



Mortgage Rules



Picture sources: Sonus umbra, Cline&Associates/Steve Pillitu Graphic Design, CNN, Pinterest



FINANCIAL TECHNOLOGY (FINTECH)

Payments

Wallets

Payments gateways

Payments solutions



Lending

Peer-to-peer lending

Crowd funding

Digital credit

Loan marketplace



Personal Finance

Investment

Insurance

Money management



FINTECH CHALLENGES

Banks' biggest challenges vetting potential fintech partners...



Cybersecurity
due diligence



Financial
analyses



Legal/regulatory
due diligence

*Source: October 2016 "Growing Together: Collaboration Between Regional and Community Banks and Fintech" Report
(Manatt, Phelps & Phillips, LLP and Mergermarket)*



SUMMARY

- Banking financial conditions remain healthy
- Earnings mostly steady
- Credit concentrations bear watching
- Cyber risks continue to evolve so banks need to remain vigilant in cybersecurity
- Fair lending and UDAP are significant compliance concerns
- FinTech represents potential benefits and threats to banking industry



RESOURCES

- Partnership for Progress Program
 - <http://www.fedpartnership.gov>
- Cybersecurity
 - www.fbi.gov
 - www.secretservice.gov



Questions
