Banking Conditions and Risks

Banking and the Economy: A Forum for Minority Bankers
Jeff Legette, Assistant Vice President
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*


All U.S. Banks  U.S. Banks < $1B  Minority Banks

*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

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

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<tbody>
<tr>
<td></td>
<td>Performance as of YE 2007</td>
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<td>5 Year Average Annual Loan Growth</td>
<td>17.16%</td>
<td>13.96%</td>
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<td>CRE Concentration</td>
<td>511.06%</td>
<td>124.58%</td>
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<td>CLD Concentration</td>
<td>245.58%</td>
<td>32.95%</td>
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<td>Texas Ratio*</td>
<td>26.03%</td>
<td>0.95%</td>
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<td>ALLL/Noncurrents</td>
<td>51.03%</td>
<td>141.82%</td>
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<td>Noncore Funding Dependence**</td>
<td>47.05%</td>
<td>27.95%</td>
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*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

- 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](http://www.fbi.gov)
  - [www.secretservice.gov](http://www.secretservice.gov)

- Ransomware represents an emerging threat
  - Smaller banks and credit unions are especially vulnerable

2016 Financial Services Incidents

- Hack or malware 40%
- Insider 7%
- Other/unknown 9%
- Payment card fraud 4%
- Physical loss 6%
- Portable device 6%

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)
**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