Safety and Soundness
Hot Topics
Agenda

• 2014 Community Bank Performance Indicators:
  ➢ Key financial and composite rating trends
  ➢ Risk management considerations
• 2014 Common Examination Issues
• Basel III and the New Capital Rule
• Cybersecurity
• Regulation II
• Reserve Bank Supervision Risk Council:
  ➢ Background
  ➢ Results
• 2014 Community Depository Institution Survey
• Outreach and Resources
2014 Bank Performance Indicators

Trend in Composite Ratings

(Tenth District State Member Banks)

% of SMBs

2007 2008 2009 2010 2011 2012 2013 2014**

1 Rated 2 Rated 3 Rated 4 & 5 Rated

* Most recent CAMELS ratings prior to each as-of date
** Total number of state member banks at year-end - 187
Source: National Examination Database
### 2014 Bank Performance Indicators

**Return on Average Assets and Net Interest Margin**

#### Graph:

- **ROAA (Left Scale)**
- **NIM (Right Scale)**

- **US Banks Under $5 Billion**
- **District Banks Under $5 Billion**

- **State Specific For District Banks Under $5 Billion**

#### Table:

<table>
<thead>
<tr>
<th>Year</th>
<th>ROAA</th>
<th>NIM</th>
</tr>
</thead>
<tbody>
<tr>
<td>2008</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2009</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2010</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2011</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2012</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2013</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2014</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

#### Source:

Reports of Condition and Income
2014 Bank Performance Indicators
Provisions and ALLL Coverage Ratio

Provision Expense*

% of Avg. Assets

2008 2009 2010 2011 2012 2013 2014

US Banks Under $5 Billion
Pre-Crisis Level***

ALLL**

% of Loans

2008 2009 2010 2011 2012 2013 2014

District Banks Under $5 Billion

* Loan Loss Provision Expense as a percentage of average assets
** Allowance for Loan and Lease Losses to Total Loans
*** Pre-crisis Level = Median for District banks under $5 billion from 1997 to 2007
Source: Reports of Condition and Income
2014 Bank Performance Indicators
Composition of Assets

* Loans (Left Scale) *
  - US Banks Under $5 Billion
  - District Banks Under $5 Billion

* Securities (Right Scale) *
  - US Banks Under $5 Billion
  - District Banks Under $5 Billion

* Total Loans and Total Securities as a percentage of assets
Source: Reports of Condition and Income
2014 Bank Performance Indicators
Weighted Average Maturity of Loans and Securities

![Graph of Weighted Average Maturity (WAM) of Loans and Securities](image)

*Pre-Crisis Level* = Median for District banks under $5 billion from 1997 to 2007

Source: Reports of Condition and Income
2014 Bank Performance Indicators
Interest Rate Risk Management Resources

• Supervision and Regulation Letter 10-1, Interagency Advisory on Interest Rate Risk Management:

• Supervision and Regulation Letter 12-2, Interagency Advisory on Interest Rate Risk Management FAQs:
  ➢ http://www.federalreserve.gov/bankinforeg/srletters/sr1202.htm

• Effective Asset/Liability Management: A View from the Top:

• Essentials of Effective Interest Rate Risk Management:
2014 Bank Performance Indicators
Loan Growth

High Loan Growth Banks* By Loan Category

High Loan Growth Banks* By Number of Loan Segments with Growth

* High Loan Growth Banks are those with a loan category that represents greater than 10% of total loans that also experiences growth greater than 15%

Source: Reports of Condition and Income
# 2014 Bank Performance Indicators
## Failed Banks vs Thriving Banks

<table>
<thead>
<tr>
<th>Ratio</th>
<th>2010-2012 Failed Banks</th>
<th>2007-2014 1 and 2 Rated Banks</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Performance as of YE 2007</strong></td>
<td><strong>Performance as of YE 2007</strong></td>
<td></td>
</tr>
<tr>
<td>5 Year Average Annual Loan Growth</td>
<td>20.98%</td>
<td>8.32%</td>
</tr>
<tr>
<td>CRE Concentration</td>
<td>475.71%</td>
<td>173.52%</td>
</tr>
<tr>
<td>CLD Concentration</td>
<td>242.69%</td>
<td>53.57%</td>
</tr>
<tr>
<td>Noncurrents/Loans+ORE</td>
<td>1.87%</td>
<td>0.68%</td>
</tr>
<tr>
<td>ALLL/Noncurrents</td>
<td>73.79%</td>
<td>181.55%</td>
</tr>
<tr>
<td>Noncore Funding Dependence</td>
<td>42.75%</td>
<td>21.78%</td>
</tr>
</tbody>
</table>
2014 Bank Performance Indicators

Concentration Risk Management Considerations

• Establish formal, board-approved risk limits for individual lending segments and funding sources
• Institute lending policies, underwriting standards, and funds management practices that reflect the board’s risk tolerance
• Develop reporting capabilities that fully quantify and capture the levels and types of credit and liquidity risk on the balance sheet
• Evaluate the bank’s various risk exposures on an ongoing basis and adjust lending and risk management practices as necessary
• Consider credit and liquidity risk exposures within the bank’s ALLL methodology and capital planning
## 2014 Common Examination Issues

<table>
<thead>
<tr>
<th>Category</th>
<th>Total Findings</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Information Technology</td>
<td>65</td>
<td>18%</td>
</tr>
<tr>
<td>Credit Risk</td>
<td>62</td>
<td>17%</td>
</tr>
<tr>
<td>Corporate Governance</td>
<td>51</td>
<td>14%</td>
</tr>
<tr>
<td>Bank Secrecy Act</td>
<td>29</td>
<td>8%</td>
</tr>
<tr>
<td>Fiduciary Risk Management</td>
<td>28</td>
<td>8%</td>
</tr>
</tbody>
</table>
**Basel III and the New Capital Rule (Regulation Q)**

<table>
<thead>
<tr>
<th>Changes in 2015</th>
<th>Changes in 2016 and Beyond</th>
</tr>
</thead>
<tbody>
<tr>
<td>• AOCl opt-out</td>
<td>• Phase-in of remaining capital reductions</td>
</tr>
<tr>
<td>• New Common Equity Tier 1 ratio</td>
<td>• Phase-in of capital conservation buffer</td>
</tr>
<tr>
<td>• New capital deductions:</td>
<td><strong>Informational Resources</strong></td>
</tr>
<tr>
<td>➢ Deferred Tax Assets</td>
<td><img src="image1.png" alt="Community Banking Connections" /></td>
</tr>
<tr>
<td>➢ Mortgage Servicing Assets</td>
<td><img src="image2.png" alt="FedLinks" /></td>
</tr>
<tr>
<td>• Asset Risk Weighting Changes:</td>
<td><img src="image3.png" alt="Ask the Fed" /></td>
</tr>
<tr>
<td>➢ High Volatility CRE loans</td>
<td><strong>Note:</strong> Based upon a bill signed on December 18, 2014, bank and savings and loan holding companies with less than $1 billion in consolidated assets are generally not subject to the new consolidated capital requirements unless designated differently for supervisory purposes.</td>
</tr>
<tr>
<td>➢ Assets 90 days past due or more</td>
<td></td>
</tr>
<tr>
<td>➢ Securitizations</td>
<td></td>
</tr>
</tbody>
</table>

- Changes in 2015:
  - AOCl opt-out
  - New Common Equity Tier 1 ratio
  - New capital deductions:
    - Deferred Tax Assets
    - Mortgage Servicing Assets
  - Asset Risk Weighting Changes:
    - High Volatility CRE loans
    - Assets 90 days past due or more
    - Securitizations

- Changes in 2016 and Beyond:
  - Phase-in of remaining capital reductions
  - Phase-in of capital conservation buffer
“Today’s financial institutions are critically dependent on IT to conduct business operations. This dependence, coupled with increasing sector interconnectedness and rapidly evolving cyber threats, reinforces the need for engagement by the board of directors and senior management, including understanding the institution’s cybersecurity inherent risk; routinely discussing cybersecurity issues in meetings; monitoring and maintaining sufficient awareness of threats and vulnerabilities; establishing and maintaining a dynamic control environment; managing connections to third parties; and developing and testing business continuity and disaster recovery plans that incorporate cyber incident scenarios.”

2014 FFIEC Cybersecurity Assessment General Observations

Regulation II-Durbin Amendment
Debit Card Interchange Fees and Routing

• Required by the Durbin Amendment to the Dodd-Frank Act
• Applicable to state member banks that authorize the use of debit cards in electronic transactions
• Exempt and non-exempt status is based upon asset size
• Both exempt and non-exempt organizations must meet certain requirements under the regulation
• Compliance now being assessed as part of safety and soundness examinations
• Additional information:
  ➢ http://www.federalreserve.gov/paymentsystems/regii-about.htm
  ➢ http://www.federalreserve.gov/bankinforeg/regiicg.htm
Reserve Bank Supervision Risk Council

Background

Purpose

- To identify banking risks of concern and determine actions that can be taken by the Reserve Bank to mitigate these risks

Composition

- Members include Supervision and Risk Management Division officers, risk and surveillance specialists, and central points of contact

Meeting Frequency

- Semi-annually, in conjunction with the production of a supervisory risks report that summarizes emerging bank supervision risks

Meeting Content

- Risks discussed at each meeting are based upon observations made during examinations, emerging trends recognized by central points of contact through financial monitoring and interactions with bankers, and themes identified by risk specialists and subject matter experts at the District and System levels
Reserve Bank Supervision Risk Council

Results

Identify Supervisory Risks

- Information Technology/Cybersecurity Risk
- Agricultural Risk
- Operational Risk
- Strategic Risk
- Commercial Real Estate Exposure

Influence Supervisory Efforts

- Provide guidance and direction to examiners
- Identify prospects for training and developing internal stakeholders
- Recognize opportunities for providing outreach and education to bankers
- Provide input to the Federal Reserve System’s Risk Council regarding the risks being monitored at the District level
Community Depository Institution Survey

- Survey results available:

- Key themes from the survey results included mergers and acquisitions and meeting regulatory requirements

- Merger and acquisition activities are expected to increase:
  - Supervision and Regulation Letter 14-2, Enhancing Transparency in the Federal Reserve’s Applications Process:
  - Semi-annual Report on Banking Applications Activity:

- Meeting regulatory requirements is the most significant concern
Outreach and Resources

• Newsletters:
  - Community Banking Connections
  - FedLinks Bulletin

Subscribe to both newsletters:
http://www.communitybankingconnections.org/subscribe.cfm

• Ask the Fed Teleconference Program:
http://www.askthefed.org/
Outreach and Resources (Cont’d)

- Online Director’s Training Resources:
  www.bankdirectorsdesktop.org
- On-site Director’s Training Program
- Comprehensive list of community banking resources is included in the appendix
Questions