First Glance 12L (3Q13)
Banking Recovery – Slow and Steady

A First Look at the Financial Performance of Banks* Headquartered within “12L”
(the 12th Federal Reserve District)

Based on Preliminary 3Q2013 Call & Income Report Data

November 27, 2013

* The main section of this report addresses the performance and condition of 12th District commercial banks. District industrial banks and savings institutions are covered separately in Section 3.

This report has been prepared to provide a quick snapshot of banking conditions for use primarily by bank supervisors and bankers. Analysis and opinions are those of the authors and do not necessarily reflect the views of the Federal Reserve Bank of San Francisco.

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http://www.frbsf.org/banking-supervision/publications/
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**Profitability—Slow Improvement:** District earnings have yet to recover to the pre-crisis levels, though year-to-date average ROAA was slightly improved from a year ago (Slide 11; right). Earnings in most District states showed an improvement year-over-year as well (Slide 12). Record low loss provisions continued to contribute positively to earnings with roughly half of all District banks taking zero or negative provisions thus far in 2013 (Slide 14). Falling net interest margins remained an impediment to a full earnings recovery (Slide 19). Despite a challenging environment, average overhead ratios edged down while noninterest revenue ratios grew slightly, helping to offset lower NIMs (Slides 17–18).

**Credit Quality—Steady Recovery:** The 12th District bank average noncurrent loan & lease rate continued to drop to a level nearly matching the national average while early-delinquency rates remained at 20+ year lows (Slide 22). Larger banks have lowered noncurrent rates at a faster pace than small banks overall (Slide 23). The average net charge-off rate among District banks continued to trend down to 0.2% (year-to-date annualized) through 9/2013. This marks the lowest rate since 2007 (Slide 28).

**Capital & Liquidity—Peaking:** District bank capital ratios and balance sheet liquidity ratios remain strong, although both appear at a turning point as banks’ asset mix is changing more toward loans from securities and temporary investments (Slides 29–33).

**Loan Growth—Accelerating:** Average loan growth in the District climbed to nearly 7% YoY, double the national average, but still well under the 14% average rate experienced from 2001–2008. The strongest loan growth rates were at $1B–$10B sized banks, which grew by 12% on average (Slide 34; right). Banks in good overall condition, based on their CAMELS ratings, also had a strong pace of loan growth at 11% on average (Slide 35).
CAMELS* Ratings—Rating Components Reflect Steady Recovery: Average ratings in every CAMELS component have continued to improve with the most improvement over the past year in Asset Quality and the least in Sensitivity to Market Risk (slide 45; right). The percentage of District banks in less-than-satisfactory overall condition (CAMELS Composite Ratings of 3, 4, or 5) continued to fall, but at 33%, this remained well above the 18% percentage for the nation (Slide 44).

Overall—Slow and Steady Recovery: The positive trends in recent quarters for District banks continued into the third quarter 2013, particularly in the areas of credit quality and loan growth. However, earnings remained under pressure from the low interest rate environment and relatively high overhead expenses. Although overall trends remain positive, District banks continue to face more risks and challenges going forward (e.g., see Bank Supervisors’ Hot Topics).

Hot Topics: The following are some supervisory hot topics—issues on bank supervisors’ radar screens that tend to be a focus of attention during on-site examinations and off-site monitoring. These issues, starting on Slide 52, are not an exhaustive list of Hot Topics and are not prioritized in any way.

1. Interest Rate Risk
2. Cybersecurity
3. Leveraged Lending
4. Underwriting Risk in Rapid Loan Growth Areas
5. Managing Outsourcing Risks
7. Model Risk Management
8. Maintaining Compliance with Laws and Regulations

Section 1
Economic Highlights

This section provides a high-level look at economic conditions focusing on degree of recovery from the recession. It covers state-by-state job growth and home price changes, two key metrics that are closely related with banking conditions.

Additional 12th District economic trends:
12th District Jobs
The 12th District has recovered 62% of the jobs lost during the recession, compared to 79% for the nation.

Total Nonfarm Jobs within the 12th District (in Millions)

- **2008** (20.8)
- **2009** (20.5)
- **2010** (20.3)
- **2011** (20.1)
- **2012** (20.5)
- **2013** (20.8)

The 12th District has added 1.4 million jobs since the recession.

<table>
<thead>
<tr>
<th>District</th>
<th>% of Jobs Lost</th>
<th>% of Lost Jobs Recovered</th>
<th>YoY Job Growth</th>
</tr>
</thead>
<tbody>
<tr>
<td>Region</td>
<td>8.7%</td>
<td>62%</td>
<td>1.7%</td>
</tr>
<tr>
<td>Nation</td>
<td>6.3%</td>
<td>79%</td>
<td>1.7%</td>
</tr>
</tbody>
</table>

Employment Situation in the 12th District
Only two states have recovered all jobs lost in the recession – AK and UT; another five have recovered more than half the jobs they lost – CA, HI, ID, OR, and WA.

Housing Recovery: Tailwind for District Banks
Mountain and Pacific Region home price declines were more severe than most parts of the Nation, but recovery has gained momentum.

Median Home Price Indices

1-Year Home Price Change by State (September 2013)

- **Pacific**
  - **2003**: 122%
  - **2004**: 115%
  - **2005**: 108%
  - **2006**: 101%
  - **2007**: 94%
  - **2008**: 87%
  - **2009**: 80%
  - **2010**: 73%
  - **2011**: 66%
  - **2012**: 59%

- **Mountain**
  - **2003**: 112%
  - **2004**: 105%
  - **2005**: 98%
  - **2006**: 91%
  - **2007**: 84%
  - **2008**: 77%
  - **2009**: 70%
  - **2010**: 63%
  - **2011**: 56%
  - **2012**: 49%

- **Nation**
  - **2003**: 106%
  - **2004**: 99%
  - **2005**: 92%
  - **2006**: 85%
  - **2007**: 78%
  - **2008**: 71%
  - **2009**: 64%
  - **2010**: 57%
  - **2011**: 50%
  - **2012**: 43%

Housing Situation in the 12th District
Home prices climbed significantly since 2011, but median prices remain below pre-crisis peaks in all states except Alaska.

CoreLogic Home Price Indices – % Change from Each State’s Pre-Recession Peak through September 2013

- **AK**: -10%
- **HI**: -9%
- **UT**: -15%
- **WA**: -15%
- **CA**: -16%
- **AZ**: -19%
- **NV**: -22%
- **US**: -32%

The pre-recession peak and trough dates are unique for each state based on monthly HPI. Source: CoreLogic Home Price Indices for all single-family homes through September 2013.
Section 2
Commercial Bank Performance

Slides in this section focus on trends among the 376 commercial banks headquartered within the 12th Federal Reserve District.

See Section 3 for coverage of savings institutions and industrial banks.
**Earnings: District Profitability Improving Slowly; Still Well Below Pre-Crisis Averages**

Average Return on Average Assets – Annualized (%)

![Graph showing average return on average assets over time for District and Nation banks.](image)

FRB-SF

Based on commercial banks, excluding De Novos; trimmed mean ratios; preliminary 9/30/13 data

**Average ROAs Improved in 7 of 9 States**

NV and AZ banks had the strongest turnaround.

Average Return on Average Assets YTD Annualized (%)

![Bar chart showing average return on average assets year-to-date for different states.](image)

FRB-SF

Based on commercial banks, excluding De Novos; trimmed mean ratios, preliminary 9/30/13 data – *NV: excludes credit card and zero-loan banks

**Large & Mid-Sized Banks Remained Most Profitable**

The Small Bank average ROAA climbed 20 basis points in the past year.

Average Return on Average Assets – 12th District Commercial Banks (%)

![Graph showing average return on average assets for different bank sizes.](image)

FRB-SF

Based on commercial banks, excluding De Novos; trimmed means; September ratios are year-to-date annualized; preliminary 9/30/13 data

**Boosting Earnings, Loan Loss Provisions Declined to New 20+ Year Lows**

Close to 50% of District banks took zero or negative provisions year-to-date.

Loan Loss Provisions/Average Assets (% - Adjusted Averages)

![Graph showing loan loss provisions to average assets for different years.](image)

FRB-SF

Based on commercial banks, excluding De Novos; trimmed means; September ratios are annualized; preliminary 9/30/13 data

Through 9/2013 YTD, Percent of Commercial Banks with:

<table>
<thead>
<tr>
<th>Category</th>
<th>District</th>
<th>U.S.</th>
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<tbody>
<tr>
<td>Negative loss provisions</td>
<td>14%</td>
<td>6%</td>
</tr>
<tr>
<td>Zero loss provisions</td>
<td>35%</td>
<td>23%</td>
</tr>
<tr>
<td>Lowered ALLL / Loan Ratios</td>
<td>66%</td>
<td>56%</td>
</tr>
</tbody>
</table>
ALLL a Relatively High 2.1% of Loans on Average Despite Declines in Provisions

Average Allowance for Loan and Lease Losses Coverage Ratios – 12th Dist. Bks

From 2004-2006, noncurrent loans were close to zero, causing the ALLL/noncurrents ratio to balloon.

Noninterest Expense Ratios Dropped Slightly (for small & mid-sized banks) While Noninterest Income Ratios Grew Slightly (including at small banks)

Average District Bank Efficiency Measure Remained Elevated, but Has Improved Slowly

New Reporting of ALLL by Loan Type: Reserving Reflects Credit Risk by Loan Type

Aggregate Allowance for Loan & Lease Losses / Loans & Leases (%) 9/30/13

Reserving is Considerably Higher at Mid-Sized Banks for C&I, Other Consumer, and C&LD
However, District Bank Net Interest Margins Have Weakened in 2013. Interest rate environment remains challenging.

Net Interest Income (tax equiv) / Average Earning Assets (NIM) 12th District Commercial Banks

<table>
<thead>
<tr>
<th>District</th>
<th>Nation</th>
<th>9/12</th>
<th>9/13</th>
</tr>
</thead>
<tbody>
<tr>
<td>Small (&lt;$1B)</td>
<td>4.5%</td>
<td>4.8%</td>
<td>3.7%</td>
</tr>
<tr>
<td>Mid-Sized ($1B-$10B)</td>
<td>4.1%</td>
<td>4.0%</td>
<td>3.4%</td>
</tr>
<tr>
<td>Large (&gt; $10B)</td>
<td>4.0%</td>
<td>4.1%</td>
<td>3.6%</td>
</tr>
</tbody>
</table>

Average NIM YTD Annualized – All Banks

- 1Q13: 4.0%
- 2Q13: 4.0%
- 3Q13: 4.0%
- 4Q13: 4.0%

Net Interest Income (tax equiv) / Average Earning Assets (NIM) 12th District Commercial Banks

- '04: 5.3%
- '05: 4.8%
- '06: 4.0%
- '07: 4.0%
- '08: 3.7%
- '09: 3.4%
- '10: 3.6%
- '11: 3.4%
- '12: 3.5%
- 9/13: 3.0%

Yields – Nationwide Banks (%)

- Loans & Investment Securities Yields Continued to Fall

- Large banks have lower loan yields and higher securities yields than small banks.

Based on aggregate nationwide commercial and industrial banks; preliminary 9/30/13 data

Credit Quality: Average 12th District Bank Noncurrent Rate Close to the Nationwide Rate

- 30-89 day past due rate below pre-crisis lows

Core Profitability Flat in 2013 on Average

Levels for Small Banks Remain Lackluster But Up, While Other Groups Drop

Core Profitability

(Pre-tax pre-provision income/average assets)

- Average District Core Profitability YTD Annualized

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<thead>
<tr>
<th>Group</th>
<th>9/12</th>
<th>9/13</th>
</tr>
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<tbody>
<tr>
<td>Small (&lt;$1B)</td>
<td>0.93%</td>
<td>0.96%</td>
</tr>
<tr>
<td>Mid ($1B-$10B)</td>
<td>1.65%</td>
<td>1.58%</td>
</tr>
<tr>
<td>Large (&gt; $10B)</td>
<td>2.02%</td>
<td>1.75%</td>
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</tbody>
</table>

Average District Core Profitability YTD Annualized

- 2001: 1.30%
- 2002: 1.20%
- 2003: 1.10%
- 2004: 1.08%
- 2005: 1.00%
- 2006: 0.97%
- 2007: 0.95%
- 2008: 0.95%
- 2009: 0.95%
- 2010: 0.95%
- 2011: 0.95%
- 2012: 0.95%
- 9/13: 0.95%

Average Past Due 30-89 Day Loans + Leases / Total Loans + Leases

- September 2001: 0.8%
- September 2002: 0.8%
- September 2003: 0.8%
- September 2004: 0.8%
- September 2005: 0.8%
- September 2006: 0.8%
- September 2007: 0.8%
- September 2008: 0.8%
- September 2009: 0.8%
- September 2010: 0.8%
- September 2011: 0.8%
- September 2012: 0.8%

Loan & Investment Securities Yields Continued to Fall

Large banks have lower loan yields and higher securities yields than small banks.

Based on commercial banks, excluding De Novos; trimmed means; preliminary 9/30/13 data

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Noncurrent Rates Trending Down in All Size Groups; Small Banks Still Have Highest Rates

Average 12th District Bank Noncurrent Loan + Lease Rates (% of total loans + leases)

- Small (< $1B): 1.8%
- Mid-Sized ($1B - $10B): 4.1%
- Large (> $10B): 4.9%

Average 12th District Bank Noncurrent Loan + Lease Rates (% of total loans + leases)

- All Loans: 4.7%
- Const. & Land Development: 2.4%
- Other: 1.7%

By State: Noncurrent Rates Dropped Most in Nevada and Arizona

- NV: 0.9%
- ID: 2.1%
- CA: 1.8%
- AZ: 1.7%
- WA: 1.6%
- OR: 1.6%
- UT: 1.4%
- AK: 0.8%
- HI: 0.7%

Average “Texas Ratios” Each State’s Recession Peak vs. Now

- Peak*: Average 49%
- Sept. 2013: Average 14%

Average Noncurrent Rates Improving Across All Major Loan Types

Note: C&LD rates are shown in inset chart

Average Noncurrent Rates Improving Across All Major Loan Types

- All Loans: 4.7%
- Nonfarm Nonresidential: 4.7%
- Single-family/Multifamily Resid.: 4.7%
- C&I: 4.7%
- Consumer: 4.7%
- Ag: 4.7%

Average Noncurrent Rates Improving Across All Major Loan Types

- Const. & Land Development: 2.4%
- Other: 1.7%

Average Noncurrent Rates Improving Across All Major Loan Types

- Sept. 2013: Average 14%
Troubled Debt Restructurings Continue Steady Decline

12th District Bank Restructured Loans as a Percentage (%) of Total Loans

- Other Restructured Lns
- Noncurrent Restructured Lns

Other Restructured Lns: 1.6%
Noncurrent Restructured Lns: 2.5%

Average District Bank Net Charge-Off Rate Has Dropped to its Lowest Since 2007

Average Ratio of Net Charge-Offs / Average Loans

- Avg. NCO Rate - District
- Avg. NCO Rate - Nation

Average District Bank Net Charge-Off Rate Has Dropped to its Lowest Since 2007

Capital Adequacy: Average District Risk-Based Capital Ratios Edged Down in 2013

This was due to change in asset mix towards loans and away from lower-risk assets; the average tier 1 leverage ratio continued to rise

Tier 1 Common Equity Ratios Appear to be at a Turning Point as Loan Growth Accelerates

Average District Bank Tier 1 Common Equity / Risk-Weighted Assets Ratios

- Small (< $1B)
- Mid-Sized ($1B - $10B)
- Large (> $10B)
Number of District Banks Paying Common Dividends Continued to Rise

S-Corps vs. C-Corps
At 9/30/13, there were 40 District S-Corps and 332 C-Corps (commercial banks only, excluding De Novos)

C-Corp: 30% 55%
S-Corp: 75% 64%

Pct (and #) of District Banks that Paid a Common Stock Dividend

Liquidity: Traditional Balance Sheet Liquidity Ratios Remain Strong
Loan growth has outpaced other earning asset growth thus far in 2013

Short-Term Investments/Assets (adjusted average %)

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<th>District</th>
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Loans & Leases/Assets (adjusted average %)

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<thead>
<tr>
<th>Year</th>
<th>District</th>
<th>Nation</th>
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<tbody>
<tr>
<td>'01</td>
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<tr>
<td>'04-13</td>
<td>12.9%</td>
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Average Bank Reliance on Noncore Funding Remains Low, But Rising at Large Banks

Noncore Liabilities / Assets (Adjusted Average %)

<table>
<thead>
<tr>
<th>Year</th>
<th>District</th>
<th>Nation</th>
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<tr>
<td>'01</td>
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<td>'04-13</td>
<td>19.6%</td>
<td>17.9%</td>
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Loan Growth: Turnaround Accelerated
Avg. loan & lease growth 6.9% YoY with strongest growth at mid-sized banks

Average YOY Loan Growth Rates (%)

<table>
<thead>
<tr>
<th>Year</th>
<th>District Bank Average: 14.1%</th>
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<tbody>
<tr>
<td>'04</td>
<td>21.6%</td>
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<tr>
<td>'05</td>
<td>13.6%</td>
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<td>'06</td>
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<td>17.9%</td>
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<tr>
<td>'04-13</td>
<td>17.9%</td>
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Loan Growth Rates Have Varied Depending on Bank Condition (i.e., by CAMELS Ratings)

Loan Growth Rates – Year-over-Year
Averages within CAMELS Rating Groups – 12th District Banks

<table>
<thead>
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<th>CAMELS 1 / 2</th>
<th>CAMELS 3</th>
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<tbody>
<tr>
<td>12%</td>
<td>1%</td>
<td>-13%</td>
</tr>
<tr>
<td>3%</td>
<td>0%</td>
<td>-15%</td>
</tr>
<tr>
<td>5%</td>
<td>-3%</td>
<td>-15%</td>
</tr>
<tr>
<td>2%</td>
<td>-7%</td>
<td>-10%</td>
</tr>
<tr>
<td>8%</td>
<td>-4%</td>
<td>-2%</td>
</tr>
</tbody>
</table>

Based on commercial banks, excluding De Novos; trimmed means; preliminary 9/30/13 data; CAMELS is the bank rating system used by regulators: 1=strong; 5=poor.

Loan Growth Rates Picked Up Across the West
AZ, CA, NV, & WA are in the top 10 nationwide for average loan growth

12th District Average Year-over-Year Loan Growth through June 2013

<table>
<thead>
<tr>
<th>District: 6.9%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Nation: 3.5%</td>
</tr>
</tbody>
</table>

Based on commercial banks excluding De Novos; trimmed means; preliminary 9/30/13 data.

Loan Growth Rates Have Varied Depending on Bank Condition

Loan Growth Rates Picked Up Across the West

Nonfarm Nonresidential Loans Accounted for Over Half of all Loan Growth at Small and Mid-Sized Banks

While growth rates for NFNR secured loans has been modest, these loans account for the majority of the growth at small and mid-sized banks.

Shaded cells highlight loan categories accounting for 25%+ of total loan growth in the past year.

Nonfarm Nonresidential Loans Accounted for Over Half of all Loan Growth at Small and Mid-Sized Banks

While growth rates for NFNR secured loans has been modest, these loans account for the majority of the growth at small and mid-sized banks.

| Shaded cells highlight loan categories accounting for 25%+ of total loan growth in the past year |
Percent of Banks with High Loan Growth Rates

Nearly half the multifamily lenders grew these loans by 20%+ YoY; a third of the C&LD lenders expanded these loans by 20%+

Based on a panel of 335 District commercial banks without significant mergers, loan sales or loan purchases over the period. Each bar above is based on banks with at least 4% of loans in the particular loan type; preliminary 9/30/13 data.

**% of District Banks* With >20% YoY Growth by Loan Type – 9/30/13**

- Multifamily: 49%
- Farm+Ag: 36%
- Constr & Land Dev: 31%
- 1-4 Fam. 1st Lien: 30%
- Comm & Indust: 26%
- Consumer: 24%
- Nonfarm Nonresid: 19%
- HELOC+Jr Lien: 12%

Interest Rate Risk: District Banks Extended Asset Maturities in Recent Years, Seeking Yield

Based on aggregate data for all 12th District commercial banks active as of and grouped into peer groups as of 9/30/13.

**12th District Banks: Loans & Securities Maturing or Repricing > 5 Years / Assets**

- Dec-01: 14.1%
- Dec-02: 17.9%
- Dec-03: 19.1%
- Dec-04: 22.4%
- Dec-05: 26.4%
- Dec-06: 30.8%
- Dec-07: 20.3%
- Dec-08: 26.4%
- Sep-09: 30.8%
- Dec-10: 26.4%
- Dec-11: 25.5%
- Sep-12: 30.8%
- Sep-13: 30.8%

Rising Rates Already Leading to Net Unrealized Losses on Securities Across Banks of All Sizes

**Unrealized Gains (Losses) on all Securities / Equity – District Banks in Aggregate**

- 10-Year Treasury Rate: Approximate pre-surge average 43%
- Small (< $1B): 63.4%
- Mid-Sized ($1B - $10B): 56.0%
- Large (> $10B, excluding Wells Fargo): 44.0%

Interest Rate Risk Analysis Needs to Consider Likely Outflows of Non–Maturity Deposits as Rates Rise

**Non–Maturity Deposits / Total Assets – Nationwide Bank Aggregates**

- Sep-13: 34.6%
- Dec-12: 38.3%
- Dec-08: 39.1%
- Dec-04: 34.4%
- Dec-00: 39.1%
- Dec-98: 43.7%
- Dec-96: 46.6%
- Dec-94: 48.1%
- Dec-92: 51.5%
- Dec-90: 55.0%
- Dec-88: 58.3%
- Dec-86: 61.4%
- Dec-84: 64.6%
- Dec-82: 67.9%
- Dec-80: 71.2%
- Dec-78: 74.4%
- Dec-76: 77.6%
- Dec-74: 80.8%
- Dec-72: 84.0%
- Dec-70: 87.2%
- Dec-68: 90.4%
- Dec-66: 93.6%
- Dec-64: 96.8%
- Dec-62: 100.0%

Based on a panel of commercial banks active over this period, excluding De Novos; preliminary 9/30/13 data; 10-yr treasury constant maturity rate on last day of each qtr.
CAMELS Rating Components Continue to Improve
Asset quality & earnings ratings improved most YoY; sensitivity ratings remained pressured by interest rate risk concerns.

Average CAMELS Component Ratings for 12th District Banks
(1: strong; 2: satisfactory; 3–5: less than satisfactory)

Recession

Earnings
Asset Quality Management
Capital Sensitivity*
Liquidity

* Sensitivity to Market Risk

District Bank Consumer Ratings Improving with CRA Ratings Holding Steady
Percentage of District Banks with Less-than-Satisfactory Ratings

Percentage of Banks Rated CAMELS 3, 4, or 5
Continued to Fall

Pct. of 12th District Exams Each Quarter that Resulted in CAMELS Composite Rating Upgrade or Downgrade (downgrades are shown as negative percentages)
Section 3 – Savings Institution and Industrial Bank Performance

Slides in this section focus on trends among the 46 savings institutions and 30 industrial banks headquartered within the 12th Federal Reserve District.

The savings institutions represent a combined population of District savings & loan associations plus savings banks – regardless of whether they filed the thrift Call Report or the bank Call Report. Starting March 2012, all savings institutions file the bank Call Report.
District Industrial Bank Profitability Remains Far Higher than that of Commercial Banks and Savings Institutions

Industrials typically conduct nationwide consumer or C&I lending (contributing to strong loan yields) from one office (limiting overhead expenses)

District Return on Average Assets – Averages (%)

District Industrial Bank Profitability Remains Far Higher than that of Commercial Banks and Savings Institutions on Average

Loan Quality: District Industrial Bank Noncurrent Ratios Remain Lower than Those of Commercial and Savings Institutions on Average

Equity/Assets Ratios Appear to be Peaking For Commercial & Savings Institutions; Ratios at Industrial Banks Continue to Rise

Percent Rated CAMELS 3, 4, or 5 Down for All Institution Groups; Commercial Banks Continue to Lag
Section 4
Bank Supervisors’ Hot Topics

Supervisory hot topics are a sampling of issues on bank supervisors’ radar screens that tend to be a focus of attention during on-site examinations or off-site reviews.

1. Interest Rate Risk
2. Cybersecurity
3. Leveraged Lending
4. Underwriting Risk in Rapid Loan Growth Areas
5. Managing Outsourcing Risk
6. Capital Planning and Stress Testing Expectations
7. Model Risk Management
8. Maintaining Compliance with Laws and Regulations
**Bank Supervisors’ Hot Topics**

### 1 – Interest Rate Risk

With an extended period of low short-term interest rates, many banks expanded their investments in higher-yielding, longer-dated loans and securities. Over a quarter of District bank assets are loans and securities maturing or repricing more than 5 years out (see section starting slide 40). With the recent rise in longer-term rates, District banks in general have unrealized losses in securities portfolios. As banks conduct interest rate sensitivity analyses, potential outflows of non-maturity deposit balances need to be considered. A “Call the Fed” audio conference on “Managing Interest Rate Risk in a Rising Rate Environment” is scheduled for 12/5/13. For more information and to register, see: http://www.frbsf.org/banking-supervision/programs/call-the-fed-2013/december/interest-rate-risk-management/

### 2 – Cybersecurity

Cybersecurity remains a top concern for banks to protect the confidentiality, integrity and availability of bank data and services and circumvent criminal efforts to steal funds or data. Concerns include distributed denial of service attacks; evolution of malicious software, including software targeting mobile devices; account takeovers/fraudulent funds transfers; coordinated ATM cash-out attacks; vendor security and resiliency; and, targeted attacks against bank employees to steal or destroy data, or disable systems. Additionally, banks, vendors and customers using Windows XP may be at heightened risk from cyber-attacks after April 2014, when Microsoft ends support for this popular software. Banks need tools to effectively monitor for anomalous activity and documented crisis management plans for such events, but the additional tools may increase operating expenses.

### 3 – Leveraged Lending

Regulatory agencies have become increasingly concerned with the quality of loans provided to highly-leveraged borrowers. Leveraged lending volumes have grown sharply and the agencies have noted concerns regarding underwriting and broader credit risk management. In March 2013, the agencies issued guidance that describes expectations for the sound risk management of leveraged lending activities and addresses issues such as pipeline management, underwriting, stress testing, risk management, and reporting. Supervised firms need to properly evaluate and monitor credit risks in their leveraged loan commitments and ensure borrowers have sustainable capital structures – see http://www.federalreserve.gov/bankinf/rg/srletters/sr1303.htm.

### 4 – Underwriting Risk in Rapid Loan Growth Areas

Loan growth is a welcome sign of the strengthening economic recovery. While overall loan growth is not fully recovered, many banks are experiencing fairly rapid growth in certain lending areas, such as C&I, 1-4 family residential, and multifamily (see Slides 34-39). Concerns include 1) loan growth pressures may be pushing institutions to take on greater interest rate and credit risk with relaxed underwriting terms and aggressive pricing and 2) expertise in new lending areas may be lacking. Management must maintain robust risk management processes around all products and credit concentrations; rapid growth must be considered in ALLL methodologies.

### 5 – Managing Outsourcing Risk

Vendor Management – Institutions need to have risk assessment processes for outsourced activities and appropriate monitoring procedures consistent with their size, risk, and complexity.

### 6 – Capital Planning and Stress Testing Expectations


### 7 – Model Risk Management

Reliance on complex models to manage risks and operations requires strong governance. Risks include the appropriateness of the model for the purpose intended as well as the accuracy of model inputs and assumptions, model implementation, and interpretation of model outputs. Erroinous or misused model results can have significant potential for adverse consequences and / or financial loss.

### 8 – Maintaining Compliance with Laws and Regulations

Banks are facing a host of new rules and regulations. Many of these stem from the Dodd-Frank Act, such as the CFPB’s “Ability-to-Repay Rule” for mortgage lending. However, regulators also remain focused on legacy laws and regulations in areas such as BSA/AML compliance and foreign wire transfer activities. Management must evaluate the applicability of new and existing rules, particularly as the bank’s products and services evolve; implement appropriate processes and controls, including internal audit coverage; and develop effective staff training programs.

A Federal Reserve “Outlook Live” webcast on “Small Creditor Qualified Mortgages” will discuss the Ability-to-Repay / Qualified Mortgage Rule provisions and the exemption applicable to small creditors. See: http://www.philadelphiafed.org/bank-resources/publications/consumer-compliance-outlook/outlook-live/
Appendices

Appendix 1

12th District Bank Aggregate Net Charge-Off Rates

NCO rates declined significantly year-over-year

<table>
<thead>
<tr>
<th>Aggregate District Commercial Bank Net Charge-Off Rates (%)</th>
<th>All Banks</th>
<th>Small Bks (&lt;$1 Billion)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>09/12</td>
<td>09/13</td>
</tr>
<tr>
<td>Construction &amp; Land Development</td>
<td>1.02</td>
<td>(0.55)</td>
</tr>
<tr>
<td>Residential Construction</td>
<td>0.44</td>
<td>(0.45)</td>
</tr>
<tr>
<td>Other C&amp;LD</td>
<td>1.17</td>
<td>(0.57)</td>
</tr>
<tr>
<td>CRE - Nonfarm Nonresidential Loans</td>
<td>0.33</td>
<td>0.08</td>
</tr>
<tr>
<td>Owner-Occupied</td>
<td>0.37</td>
<td>0.10</td>
</tr>
<tr>
<td>Nonowner-Occupied</td>
<td>0.30</td>
<td>0.07</td>
</tr>
<tr>
<td>Residential Closed-End Loans</td>
<td>0.97</td>
<td>0.40</td>
</tr>
<tr>
<td>Home Equity Loans</td>
<td>2.42</td>
<td>1.17</td>
</tr>
<tr>
<td>Multifamily Loans</td>
<td>0.03</td>
<td>(0.02)</td>
</tr>
<tr>
<td>Commercial &amp; Industrial Loans</td>
<td>0.44</td>
<td>0.17</td>
</tr>
<tr>
<td>Agricultural Loans</td>
<td>0.80</td>
<td>(0.26)</td>
</tr>
<tr>
<td>Farmland Secured</td>
<td>0.64</td>
<td>(0.26)</td>
</tr>
<tr>
<td>Credit Card Loans</td>
<td>4.08</td>
<td>3.64</td>
</tr>
<tr>
<td>Installment Loans</td>
<td>0.82</td>
<td>0.78</td>
</tr>
<tr>
<td>Total Loans</td>
<td>0.86</td>
<td>0.40</td>
</tr>
</tbody>
</table>

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Appendix 2 - Banks Covered in this Report

<table>
<thead>
<tr>
<th>Geography</th>
<th>Commercial Banks (De Novos) 09-12</th>
<th>09-13</th>
<th>Industrial Banks (De Novos) 09-12</th>
<th>09-13</th>
<th>Savings Institutions (De Novos) 09-12</th>
<th>09-13</th>
</tr>
</thead>
<tbody>
<tr>
<td>Alaska</td>
<td>4 (0)</td>
<td>4 (0)</td>
<td>-</td>
<td>-</td>
<td>2 (0)</td>
<td>2 (0)</td>
</tr>
<tr>
<td>Arizona</td>
<td>29 (0)</td>
<td>23 (0)</td>
<td>-</td>
<td>-</td>
<td>1 (0)</td>
<td>1 (0)</td>
</tr>
<tr>
<td>California</td>
<td>218 (15)</td>
<td>203 (3)</td>
<td>8 (1)</td>
<td>6 (0)</td>
<td>18 (2)</td>
<td>18 (1)</td>
</tr>
<tr>
<td>Guam</td>
<td>2 (0)</td>
<td>2 (0)</td>
<td>-</td>
<td>-</td>
<td>1 (0)</td>
<td>1 (0)</td>
</tr>
<tr>
<td>Hawaii</td>
<td>6 (0)</td>
<td>6 (0)</td>
<td>1 (0)</td>
<td>1 (0)</td>
<td>2 (0)</td>
<td>2 (0)</td>
</tr>
<tr>
<td>Idaho</td>
<td>15 (1)</td>
<td>15 (0)</td>
<td>-</td>
<td>-</td>
<td>1 (0)</td>
<td>1 (0)</td>
</tr>
<tr>
<td>Nevada</td>
<td>18 (2)</td>
<td>14 (0)</td>
<td>4 (0)</td>
<td>4 (0)</td>
<td>2 (0)</td>
<td>2 (0)</td>
</tr>
<tr>
<td>Oregon</td>
<td>30 (1)</td>
<td>25 (0)</td>
<td>-</td>
<td>-</td>
<td>3 (0)</td>
<td>3 (0)</td>
</tr>
<tr>
<td>Utah</td>
<td>32 (2)</td>
<td>32 (0)</td>
<td>19 (0)</td>
<td>19 (0)</td>
<td>4 (0)</td>
<td>4 (0)</td>
</tr>
<tr>
<td>Washington</td>
<td>57 (2)</td>
<td>52 (1)</td>
<td>-</td>
<td>-</td>
<td>14 (0)</td>
<td>12 (0)</td>
</tr>
<tr>
<td>12th District</td>
<td>411 (23)</td>
<td>376 (4)</td>
<td>32 (1)</td>
<td>30 (0)</td>
<td>48 (2)</td>
<td>46 (1)</td>
</tr>
<tr>
<td>Nation</td>
<td>6,110 (153)</td>
<td>5,871 (40)</td>
<td>34 (1)</td>
<td>32 (0)</td>
<td>1,035 (12)</td>
<td>983 (4)</td>
</tr>
</tbody>
</table>

Based on preliminary 9/30/13 data

Appendix 3 - Technical Information

This report focuses on the financial trends and performance of commercial banks headquartered within the 12th Federal Reserve District (“12L”). 12L includes 9 western states: AK, AZ, CA, HI, ID, NV, OR, UT, and WA, as well as Guam.

De Novos: Many of the charts exclude “De Novo” banks, or banks less than five years old.

Trimmed Mean (also referred to as “adjusted average” or “average”): Many of the charts present trends in ratio averages, adjusted for outliers. The method used is to eliminate or “trim” out the highest 10% and the lowest 10% of ratio values, and average the remaining values.

Aggregate: In some cases, the trimmed mean method is not appropriate (e.g., when many banks have zero values for a particular ratio or, for example, for some growth rates where there may be many highly positive and highly negative values). In these cases, District aggregates sometimes are computed (i.e., summing numerator values across all District banks and dividing by the sum of all denominator values), as opposed to averaging individual bank ratios). When an aggregate is used, it is indicated on the chart.

Industrial banks and savings institutions: The main focus of this report is on commercial banks. Industrial banks and savings institutions have different operating characteristics so are highlighted separately in Section 3. There, the saving institution data include institutions that file the bank Call Report plus those that, up until recently, filed the thrift Call Report.

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