First Glance 12L (2Q13)

Banking Recovery – Liquidity Buildup and Deleveraging May be Over

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

Based on Preliminary 2Q2013 Call & Income Report Data

August 22, 2013

12th District

* 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.

Authors: Gary Palmer - gary.palmer@sf.frb.org
Colin Perez - colin.perez@sf.frb.org

Press Inquiries: please contact Media Relations at www.frbsf.org/news/contacts/index.html

Contributors: Cynthia Course, Tom Cunningham, David Doyle, Martin Karpuk, Gene Lilienthal, Marty Tunnell

http://www.frbsf.org/banking-supervision/publications/

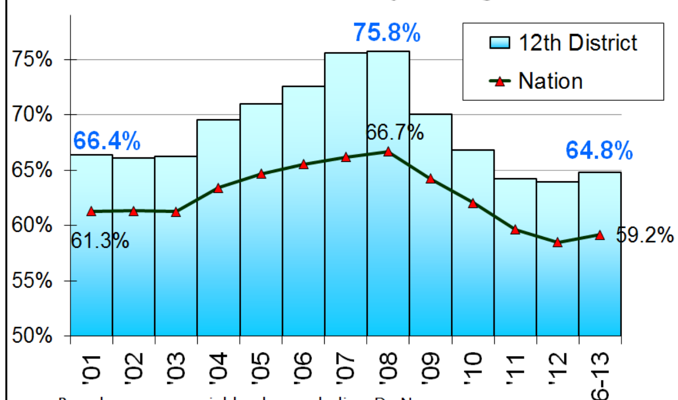
First Glance 12L (2Q13)

Contents

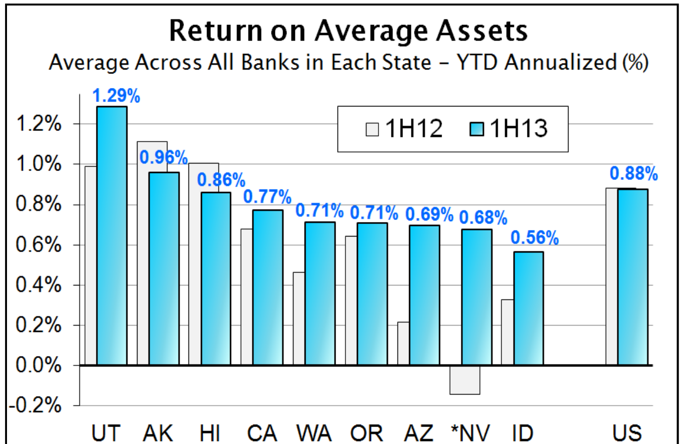
First Glance 12L – Second Quarter 2013

Banking Recovery – Liquidity Buildup and Deleveraging May be Over

- <u>Liquidity/Capital—Buildups Ending:</u> Loan growth has replaced securities purchases as the main focus of earning asset growth. The District bank average loan-to-asset ratio rose for the first time in six years (at right and Slide 11). Nonetheless, balance sheet liquidity remains strong. There also are signs that deleveraging is ending with average risk-based capital ratios edging down, and tier 1 leverage ratios plateauing. Capital ratios nonetheless, remain at historically high levels (Slide 13-14)
- <u>Loan Growth—Further Increased:</u> Year-over-year loan growth for District banks climbed to 6.1% on average, led by gains at mid-sized banks (Slide 16). The fastest growing loans, in aggregate percentage terms, were C&I (at large banks) and multifamily (at mid-sized and small banks-Slide 18). Many banks had significant growth in their C&I or 1-4 family residential loans over the year (Slide 19).
- <u>Rising Interest Rates—A Concern:</u> Banks have extended earning asset maturities in recent years, raising the possibility that some are vulnerable to rising rates (Slide 22). The rise in rates that already has occurred resulted in net unrealized losses in bank securities portfolios (Slide 23).
- <u>Profitability—Continued to Improve:</u> Weak net interest margins remained an impediment to a full earnings recovery (Slide 26). However, average profitability reached a five-year high in 1H13 (ROAA of 0.78%) bolstered by improved overhead and sharply lower credit loss provisions (Slides 28, 31-32). Average ROAAs surpassed an annualized 50 basis points in every state in the District for the first time since the recession (at right and Slide 30).
- <u>Credit Quality—Steady Recovery:</u> The 12th District bank avg. noncurrent loan rate dipped below 2% for the first time in five years, reaching 1.9% (Slide 33). Small bank noncurrent rates remain highest on average (Slide 34). Net charge-off rates continued to fall with the 1H13 annualized rate of 0.20%; and recoveries of prior period losses rose to a respectable level of 21%, up from 13% a year earlier (Slide 38).



Based on commercial banks, excluding De Novos; trimmed means; preliminary 6/30/13 data



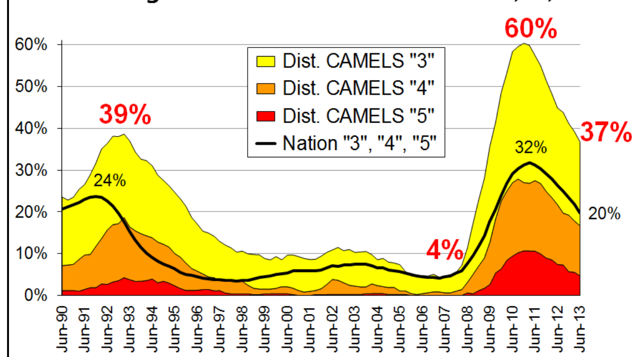
Based on commercial banks, excluding De Novos; trimmed mean ratios, preliminary 2Q13 data; *NV: excludes credit card and zero-loan banks

First Glance 12L – Second Quarter 2013

- **CAMELS Ratings—Reflect Recovery:** The percentage of District banks with adverse CAMELS* ratings has fallen for ten consecutive quarters. But at 37%, this percentage remains well above the national percentage of 20%, and far from a typical healthy banking environment where we would expect percentages of less than 10% (see at right and Slide 40). Based on the average of CAMELS component ratings, the areas most improved over the past year are asset quality and earnings (Slide 41).

- **Overall--Slow Steady Recovery:** With loan growth picking up, the extended post-crisis period of liquidity build-up and deleveraging appears to be ending. Problem loans are being worked down and earnings are much improved. Net interest margin challenges likely will remain in the intermediate-term, but the overall outlook for District banks is positive.

Percentage of Banks Rated CAMELS 3, 4, or 5



Trends for all commercial banks based on examination completion dates (mail dates); preliminary 6/30/13 figures; updated 8/14/13

* CAMELS = rating system used by bank supervisors: Capital, Asset Quality, Management, Earnings, Liquidity, Sensitivity to Market Risk.

Bank Supervisors' Hot Topics

- **Hot Topics:** The following are some supervisory hot topics—issues on bank supervisors' radar screens. This quarter, we highlight issues of concern identified at a recent top bank supervisors meeting (see Slides 48-52).

  1. Rising Interest Rates: Many banks have extended the duration of their earning assets, potentially making them vulnerable to rising rates; the rise in longer term rates in 2Q13 already resulted in net unrealized losses on securities for many banks (Slide 50).
  2. Cyber-Security: Banks are potentially vulnerable to various cyber threats, such as distributed denial of service attacks (Slide 50).
  3. Operational or Compliance Issues: Compliance challenges and costs faced by banks and other operational risks (Slide 51).
  4. Another Economic Shock: Sources could include impact of Sequestration / U.S. debt ceiling issues, impacts from stimulative monetary policy or overly tightening policy, geopolitical issues, etc. (Slide 51).
  5. Credit Losses in Areas of Rapid Loan Growth: Some banks are expanding rapidly into areas such as C&I, 1-4 family first liens, and multifamily loans; banks need to maintain conservative underwriting practices, sound ALLL methodologies, and prudent limits and controls (Slide 52).
  6. Other Issues (Slide 52):
     - Junior Lien Mortgages
     - CRE Income Property Loans Originated Near Market Peaks

Section 1
Economic Highlights

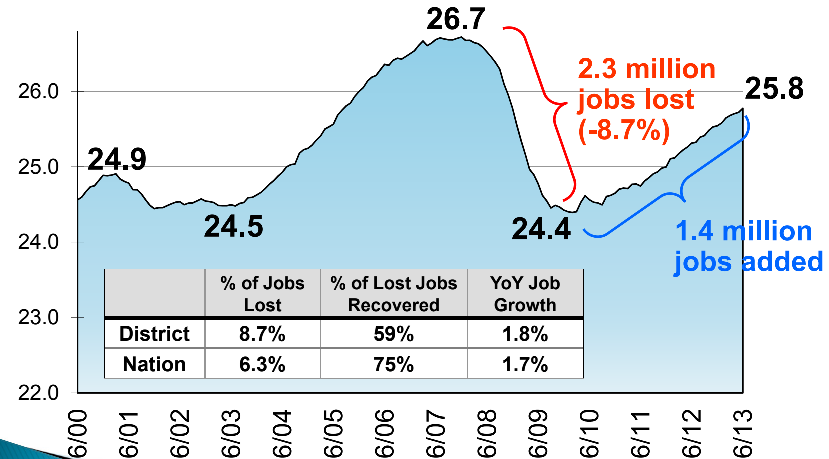
Section provides a very high level look at economic conditions focusing on degree of recovery from the recession. It covers state by state job growth and home price changes, two key metrics that are closely related with banking conditions.

Additional 12th District economic trends:
http://www.frbsf.org/economic-research/files/SFFedEconomicTrends.pdf

12th District Nonfarm Jobs

Although the District has recovered just 59% of the jobs lost during the recession (nation: 75%), the recent job growth rate has surpassed the Nation

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



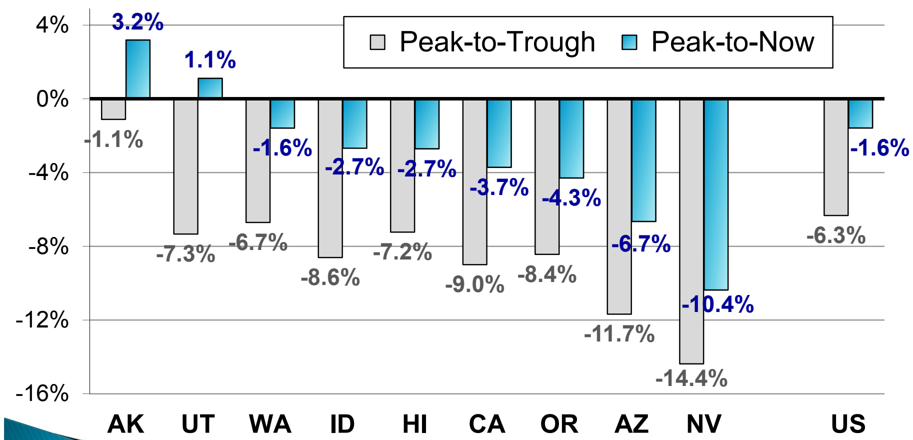
	% of Jobs Lost	% of Lost Jobs Recovered	YoY Job Growth
District	8.7%	59%	1.8%
Nation	6.3%	75%	1.7%

Source: Bureau of Labor Statistics, Haver Analytics

Employment Situation in the 12th District

Only two states have recovered all jobs lost in recession – AK and UT; another four have recovered more than half the jobs they lost – CA, HI, ID, and WA

Nonfarm jobs – % Change from Pre-Recession Peaks through June 2013

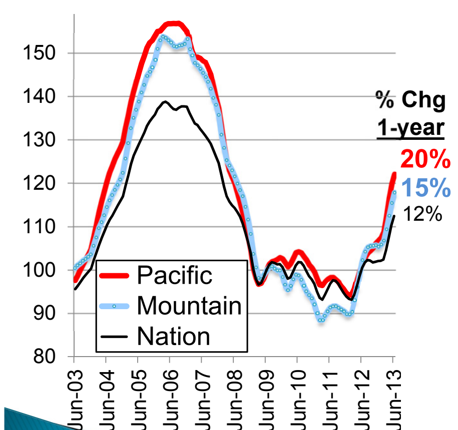


The pre-Recession peak and trough dates are unique for each state based on monthly nonfarm jobs data. Sources: Bureau of Labor Statistics, Haver Analytics; data through June '13

Housing Recovery: Tailwind for District Banks

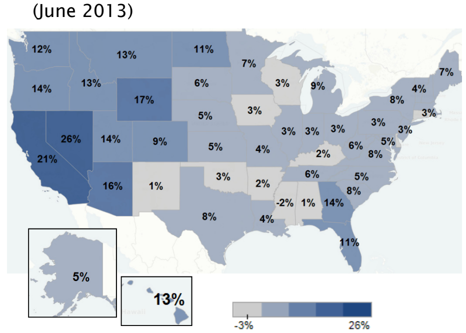
Mountain and Pacific Region home price declines were more severe than the Nation, but recovery has gained momentum

Median Home Price Indices



1-Year Home Price Change by State

(June 2013)

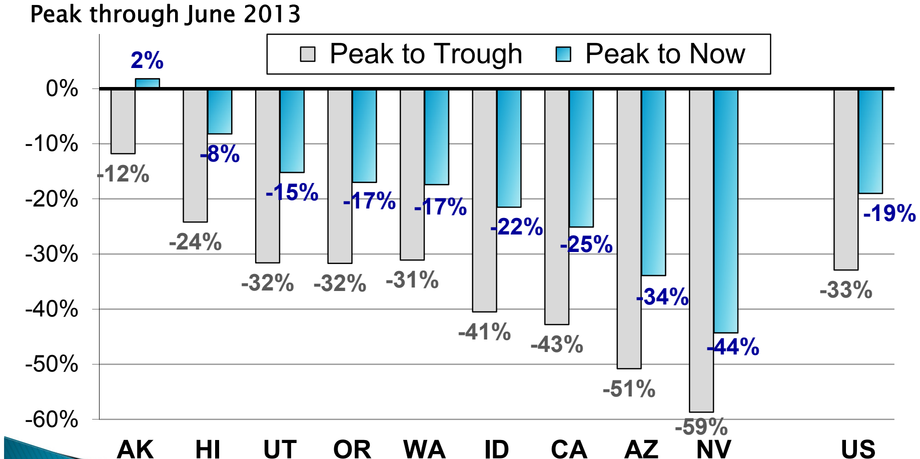


Source: CoreLogic Home Price Indices, indexed to 100 at 6/09; Mountain: AZ, ID, MT, NM, NV, UT, WY; Pacific: AK, CA, HI, OR, WA

Housing Situation in the 12th District

Although home prices climbed over the past 18 months, they remain well below 2006/2007 peaks in most areas of the District

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



Recession trough is unique for each state based on monthly HPI; Source: CoreLogic Home Price Indices for all single family homes through June 2013

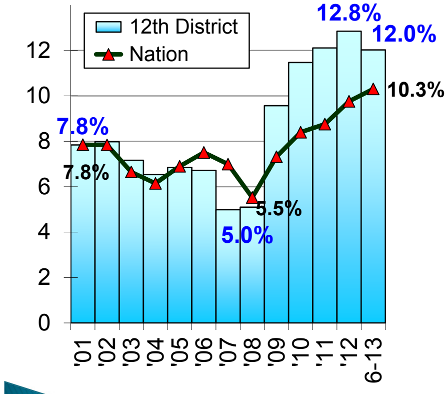
Section 2
Commercial Bank Performance

Slides in this section focus on trends among the 383 commercial banks headquartered within the 12th Federal Reserve District.

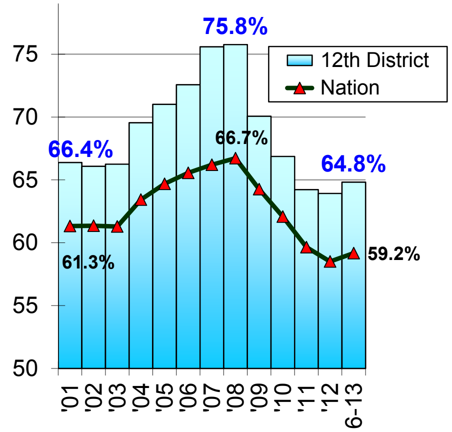
See Section 3 for coverage of savings institutions and industrial banks.

Liquidity: Bank Liquidity Build-Up Appears to be Over with Stronger Loan Growth Through 2Q13

Short-Term Investments/Assets (average %)



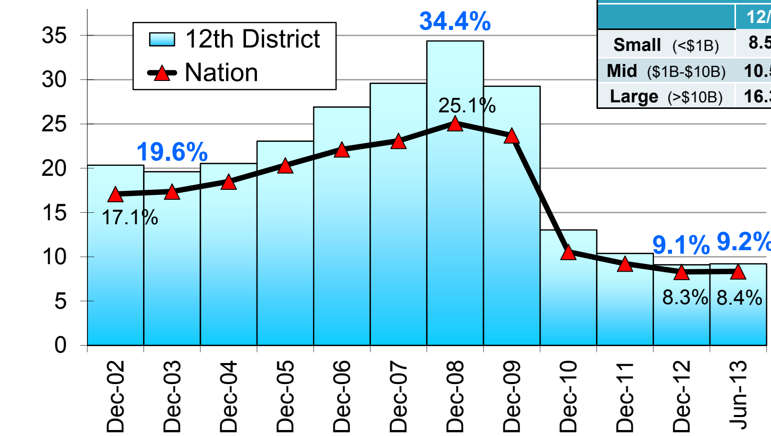
Loans/Assets (adj. average %)



Based on commercial banks, excluding De Novos; trimmed means; preliminary 6/30/13 data

Average Bank Reliance on Noncore Funding Remains Low, But is Starting to Rise

Noncore Liabilities / Assets (Adjusted Average %)



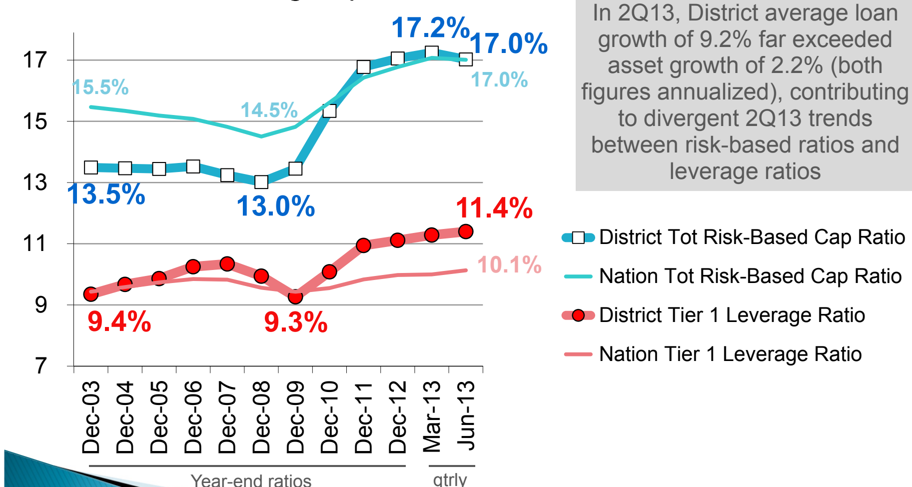
Avg. District Noncore Liabilities/Assets by Bank Size	12/12	6/13
Small (<$1B)	8.5%	8.6%
Mid ($1B-$10B)	10.5%	10.7%
Large (>$10B)	16.3%	18.3%

Noncore includes borrowed funds, brokered deposits and CDs>250K; Based on commercial banks, excluding De Novos; trimmed means; preliminary 6/30/13 data

Capital Adequacy: District Risk-Based Capital Ratios Edged Down in 2Q13, on Average

The slowing climb of tier 1 leverage ratios suggests plateauing of this metric

12th District bank average capital ratios (%)

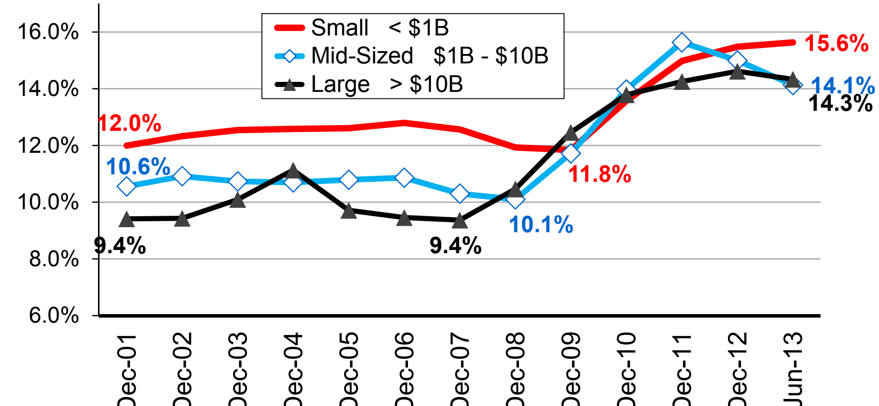


In 2Q13, District average loan growth of 9.2% far exceeded asset growth of 2.2% (both figures annualized), contributing to divergent 2Q13 trends between risk-based ratios and leverage ratios

Based on commercial banks, excluding De Novos; trimmed means; preliminary 6/30/13 data

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

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

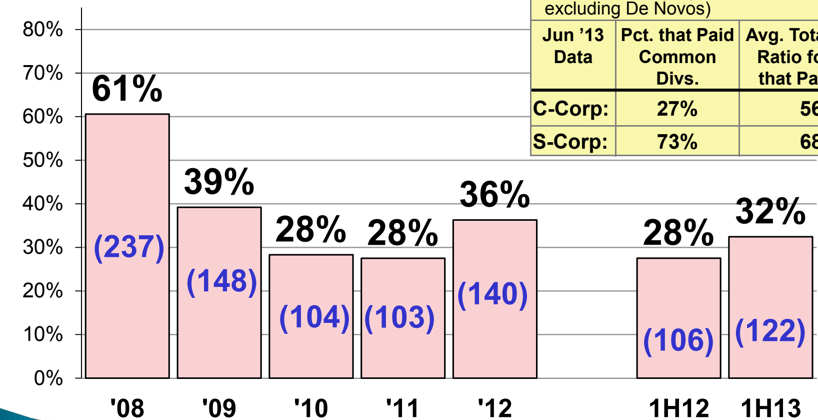


Based on commercial banks, excluding De Novos; trimmed means; preliminary 6/30/13 data

Number of District Banks Paying Common Dividends Continued to Rise

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

S-Corps vs. C-Corps		
At 6/30/13, there were 41 District S-Corps and 335 C-Corps (commercial banks only, excluding De Novos)		
Jun '13 Data	Pct. that Paid Common Divs.	Avg. Total Payout Ratio for those that Paid Divs.
C-Corp:	27%	56%
S-Corp:	73%	68%



FRB-SF

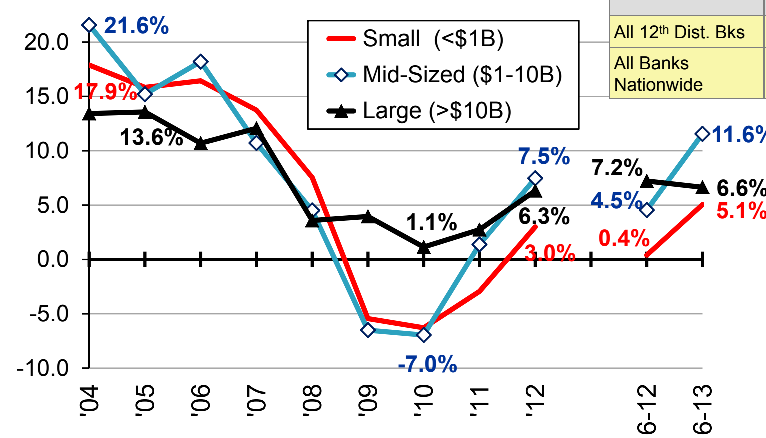
Based on commercial banks, excluding De Novos; averages are trimmed means; preliminary 2Q13 data

Loan Growth: Turnaround Continued

Avg. loan growth 6.1% YoY with fastest growth at mid-sized banks

Avg. District Year-Over-Year Loan Growth Rates (%)

Avg. Annual Loan Growth		
	Jun12	Jun13
All 12th Dist. Bks	1.4%	6.1%
All Banks Nationwide	0.8%	2.7%

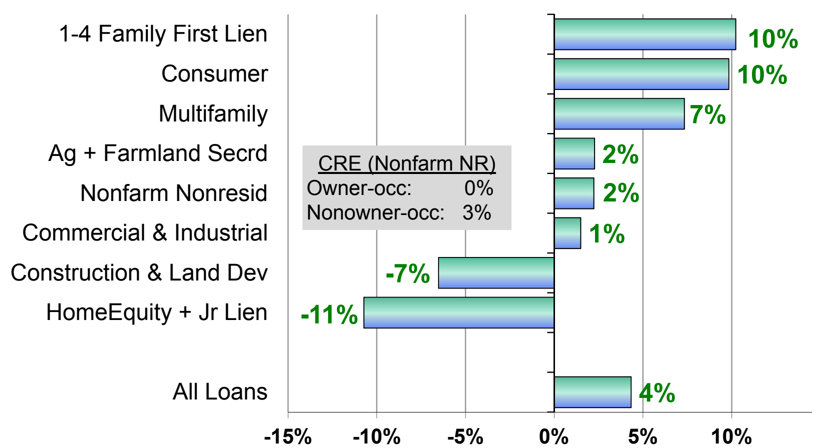


FRB-SF

Based on commercial banks, excluding De Novos; large bank statistics prior to 2006 reflect nationwide data as there were too few District banks; trimmed means; preliminary 6/30/13 data

Switching to Loan Growth Aggregates: 1-4 Family and Consumer Strongest YoY Growth; HELOC and C&LD Weakest

12th District Bank Aggregate Loan Growth Rates - 2Q13 Year-Over-Year



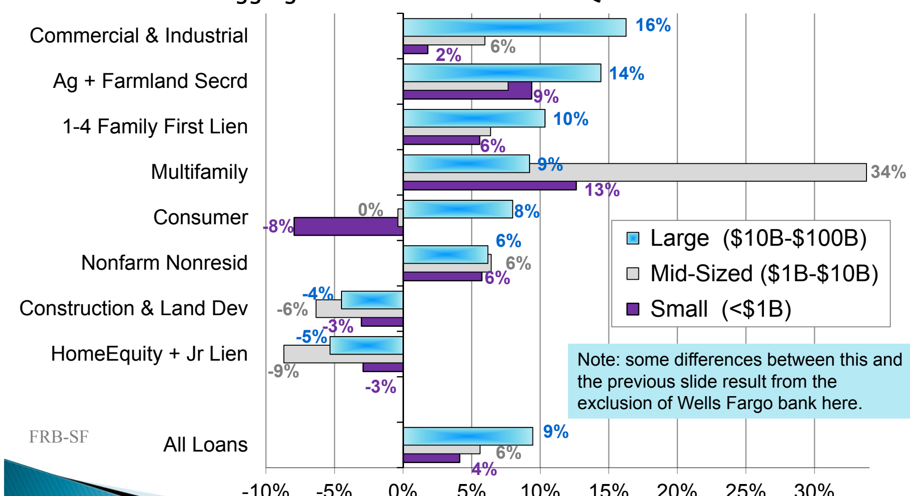
FRB-SF

Based on a panel of District commercial banks active at 2Q13; excludes banks with significant mergers, loan sales, or loan purchases over the period; prelim. 6/30/13 data

Loan Growth Emphasis Varied by Bank Size

Main emphasis of large banks: C&I; mid-sized and small banks: multifamily; Ag/farmland secured growth strong for all groups, but from a low base

12th District Bank Aggregate Loan Growth Rates - 2Q13 Year-Over-Year



Note: some differences between this and the previous slide result from the exclusion of Wells Fargo bank here.

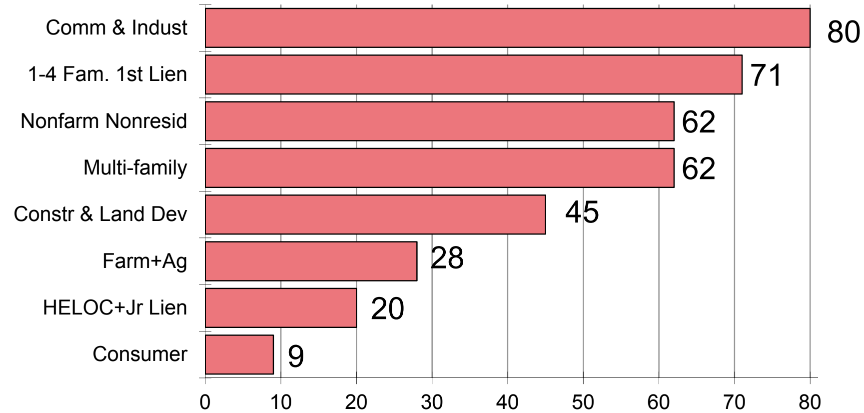
FRB-SF

Based on a panel of District commercial banks with assets <$100B; excludes banks with significant mergers, loan sales or loan purchases over the period; prelim. 6/30/13 data

Number of Banks with High Loan Growth Rates

Significant number of banks with high growth rates in different lending areas: C&I and 1-4 family residential, in particular

# of District Banks* With >20% YoY Growth by Loan Type – 6/30/13



* Based on a panel of 341 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; prelim. 6/30/13 data

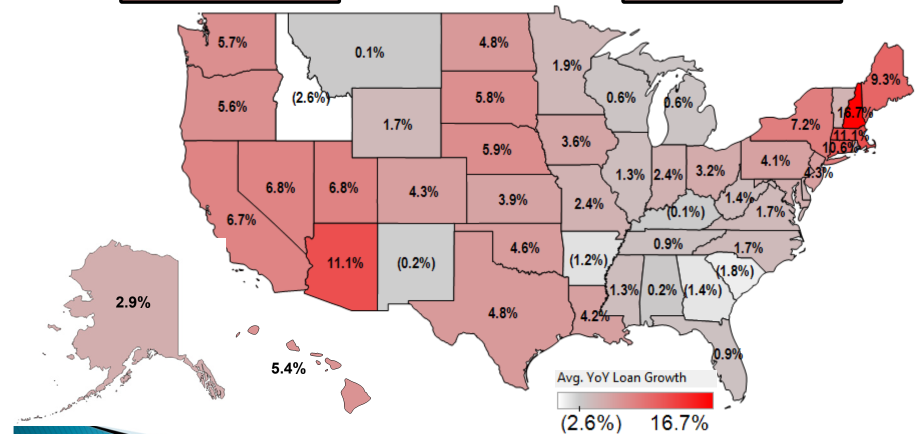
Loan Growth Has Picked up Broadly

AZ, CA, NV, & UT are in the top 10 nationwide for average loan growth

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

12th District: 6.1%

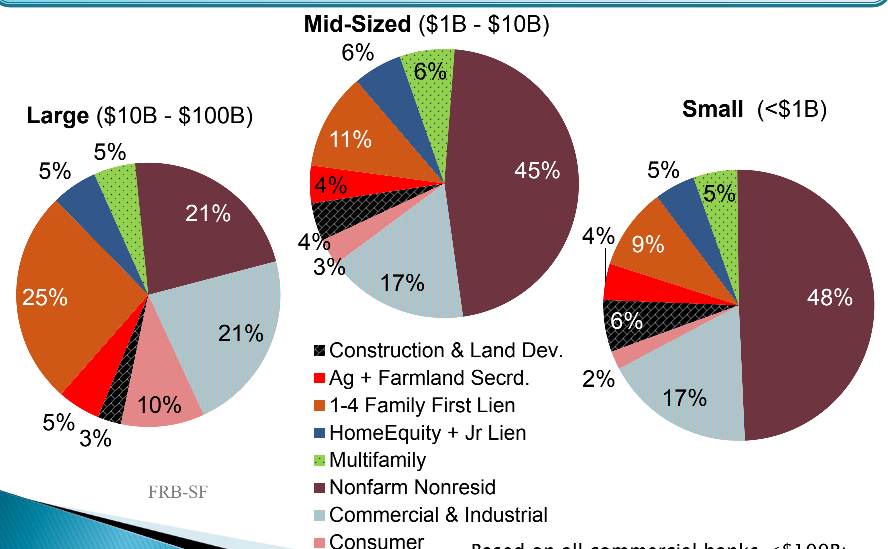
Nation: 2.7%



Based on commercial banks excluding De Novos; trimmed means; preliminary 6/30/13 data

District Bank Aggregate Loan Mix by Size

While nonfarm nonresidential secured and C&I loans dominate portfolios of small and mid-sized banks, large banks have relatively more 1-4 family residential and consumer loans

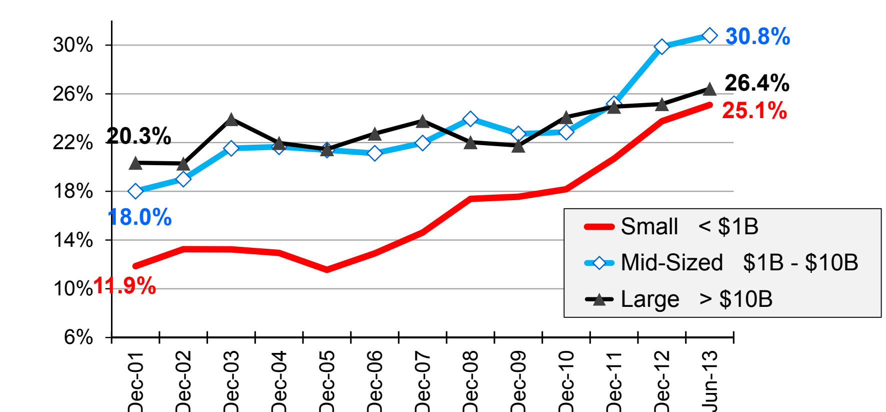


Based on all commercial banks <$100B; prelim 6/30/13 data

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

A concern mainly when a bank's overall balance sheet is vulnerable to rising rates

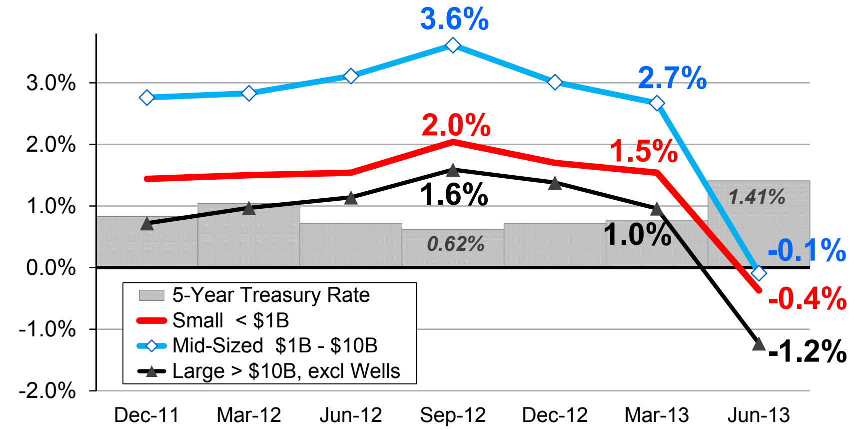
12th District Banks: Loans & Securities Maturing or Repricing > 5 Years / Assets



Based on aggregate data for all 12th District commercial banks active as of, and grouped into peer groups as of 6/30/13, with their information back in time

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

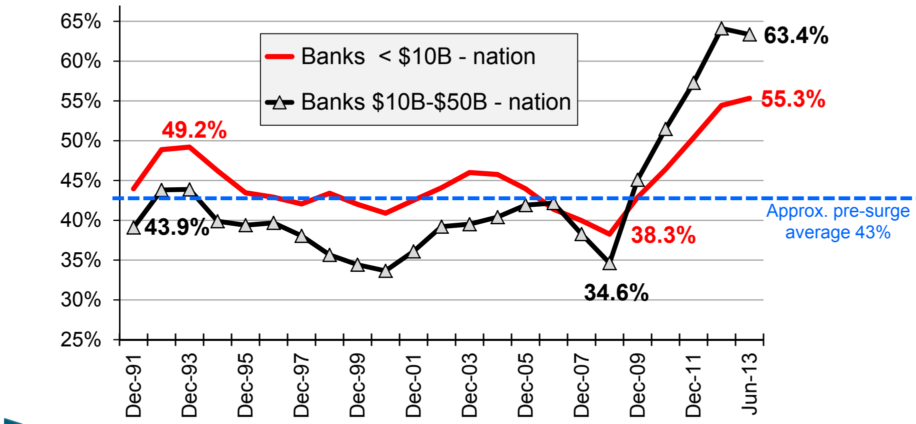
Unrealized Gains (Losses) on all Securities / Equity – District Banks in Aggregate



Based on a panel of commercial banks active over this period, excluding De Novos; preliminary 6/30/13 data; 5-yr treasury constant maturity rate on last day of each qtr.

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

Non-Maturity Deposits / Total Assets – Nationwide Bank Aggregates

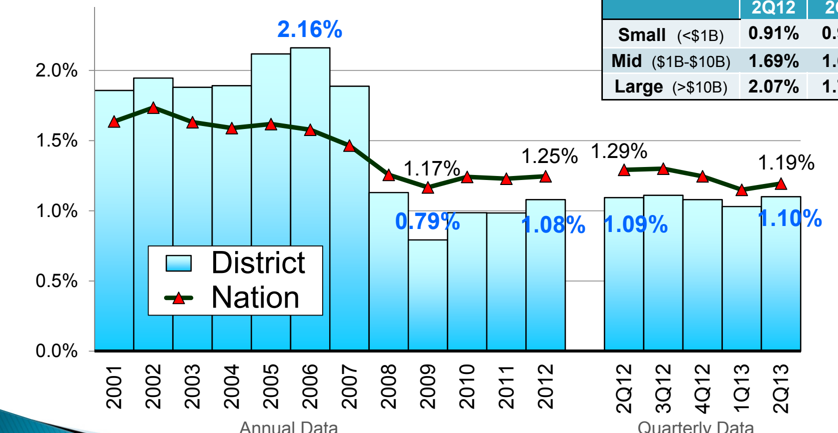


Based on aggregate nationwide commercial and industrial banks; preliminary 6/30/13 data

Earnings: Core Profitability Edged Up in 2Q13 on Average, but Levels for Small Banks Remain Lackluster

Core Profitability
(Pre-tax pre-provision income/avg. assets)

Avg. District Core Profitability by Bank Size	2Q12	2Q13
Small (<$1B)	0.91%	0.97%
Mid ($1B-$10B)	1.69%	1.61%
Large (>$10B)	2.07%	1.78%

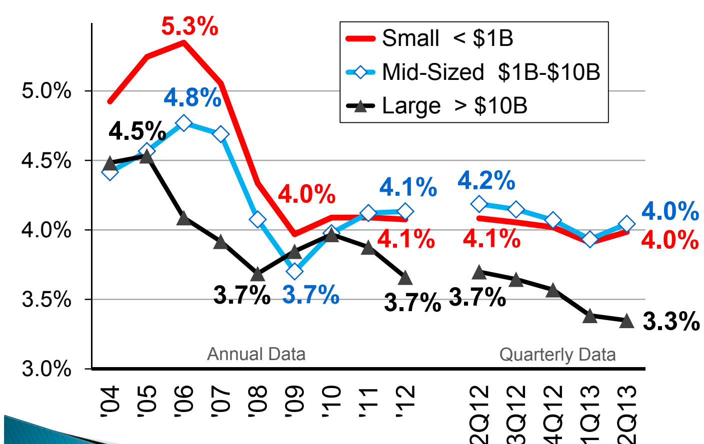


Based on commercial banks, excluding De Novos; trimmed means; quarterly ratios are annualized; preliminary 2Q13 data

Net Interest Margins Remained Narrow

Large bank NIMs fell further in 2Q13

Net interest income (tax equiv) **/ average earning assets** (NIM)
12th District Commercial Banks

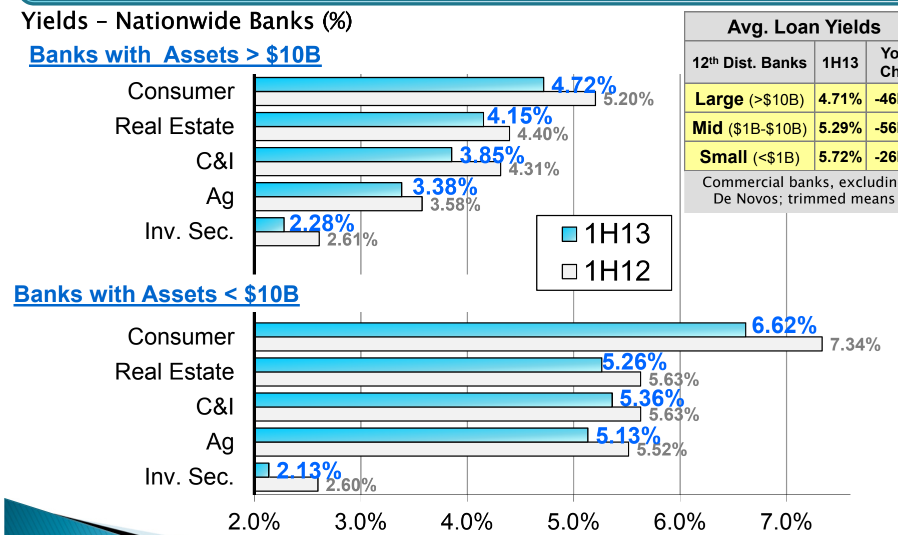


Avg. 12th NIM 1H13	
Dist. Commc'l Banks	3.9%
Nationwide Commc'l Bks	3.7%
Dist. Industrial Banks	7.5%
Dist. Savings Banks	3.6%

Based on commercial banks, excluding De Novos; trimmed means; 1H13 and quarterly ratios are annualized; preliminary 2Q13 data

Average Yields Continued to Fall

Large banks: lower loan yields, higher securities yields than smaller banks

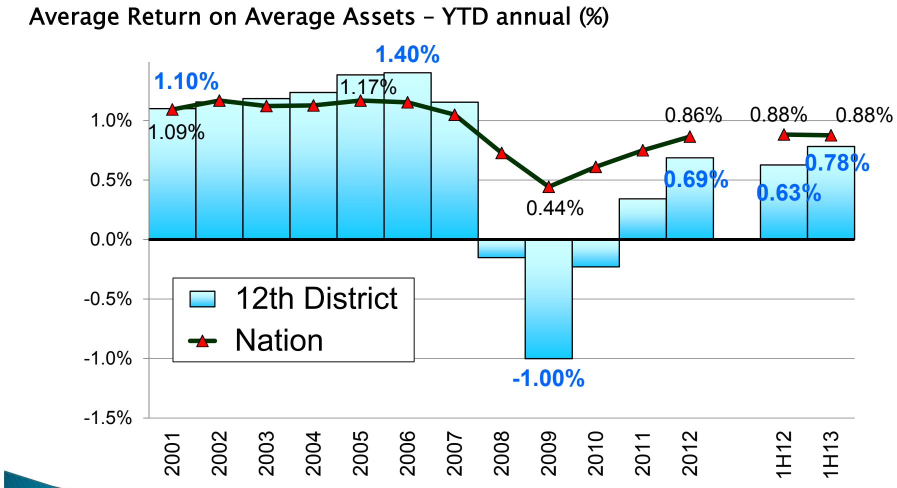


Avg. Loan Yields		
12th Dist. Banks	1H13	YoY Chg
Large (>$10B)	4.71%	-46bp
Mid ($1B-$10B)	5.29%	-56bp
Small (<$1B)	5.72%	-26bp

Commercial banks, excluding De Novos; trimmed means

Based on aggregate nationwide commercial and industrial banks; preliminary 2Q13 data

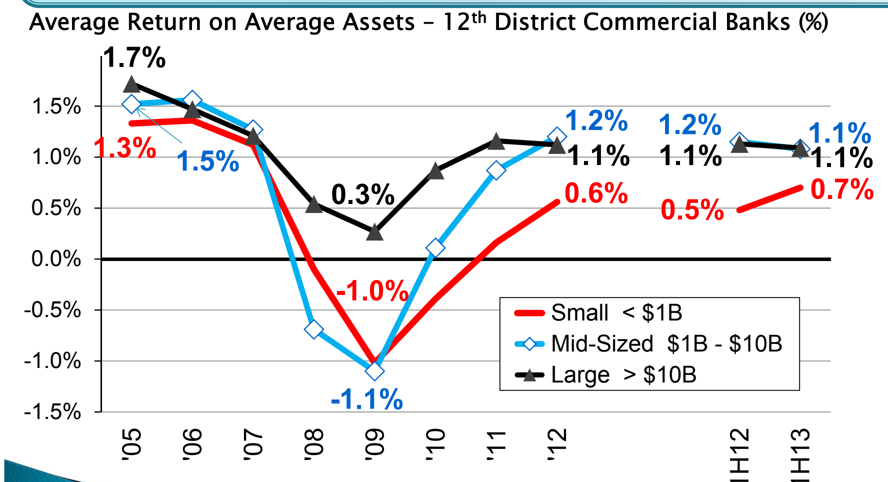
2Q13 Bottom Line Profitability Was Improved From the Year-Ago Period (from Lower Loss Provisions)



Based on commercial banks, excluding De Novos; trimmed means; 1H ratios are annualized; preliminary 2Q13 data

Larger Banks Remained Most Profitable

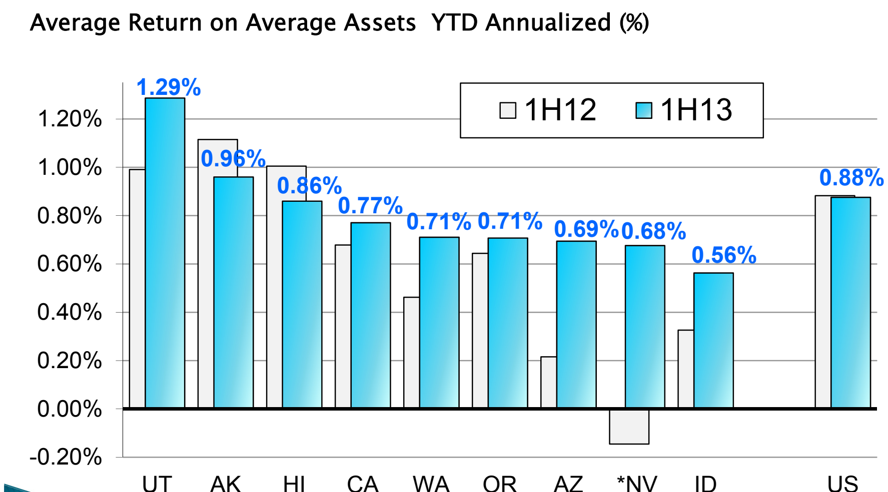
Small banks lag: 1) historical advantage in NIMs is no longer the case; 2) relatively high overhead expense ratios



Based on commercial banks, excluding De Novos; trimmed means; 1H ratios are annualized; preliminary 2Q13 data

Avg. ROAAs Improved in 7 of 9 States

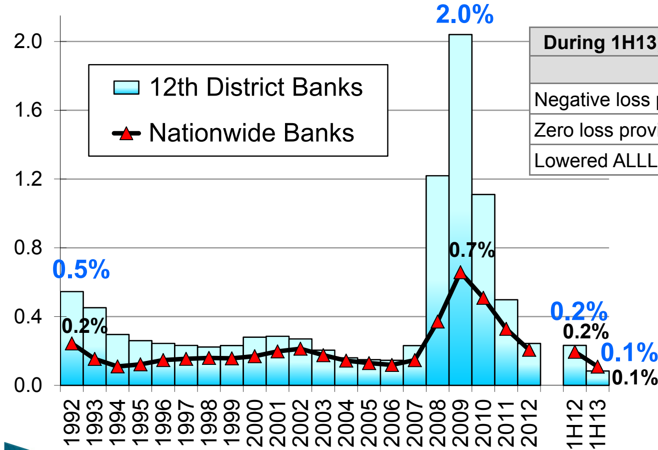
NV and AZ banks had the strongest turnaround



Based on commercial banks, excluding De Novos; trimmed mean ratios, preliminary 2Q13 data – *NV: excludes credit card and zero-loan banks

Boosting Bottom Lines, Loan Loss Provisions Dropped to 20+ Year Lows, on Average

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



During 1H13, Pct. of Commercial Banks		
	Dist.	U.S.
Negative loss provisions	12%	5%
Zero loss provisions	30%	27%
Lowered ALLL / Loan Ratios	62%	50%

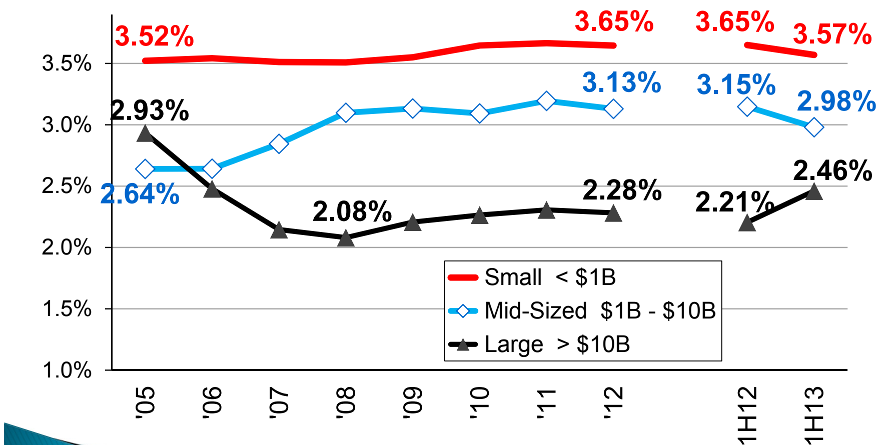
Avg. 12th District Loss Provisions/Avg. Assets 1H13	
Industrial Banks	0.6%
Savings Banks	0.2%

FRB-SF

Based on commercial banks, excluding De Novos; trimmed means; 1H ratios are annualized; preliminary 2Q13 data

Overhead Expense Ratios Edged Down in 1H13 for Small and Mid-Sized Banks

Noninterest Expense / Avg. Assets – District Commercial Bank Averages (%)



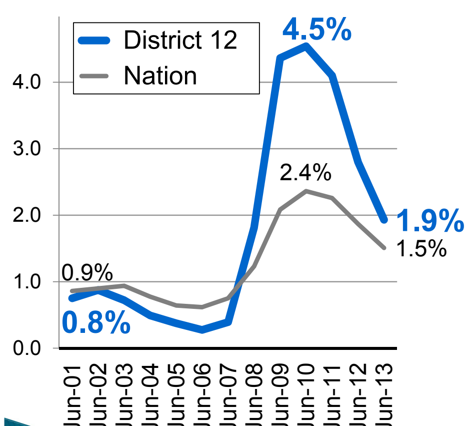
FRB-SF

Based on commercial banks, excluding De Novos; trimmed means; 1H ratios are annualized; preliminary 2Q13 data

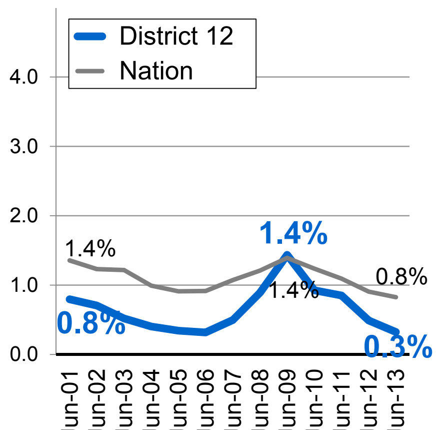
Credit Quality: Average 12th District Bank Noncurrent Loan Rate Close to the Nation

30-89 day past due loan rate at pre-crisis lows

Average Noncurrent Loan Rates



Avg. Past Due 30-89 Day Loan Rates

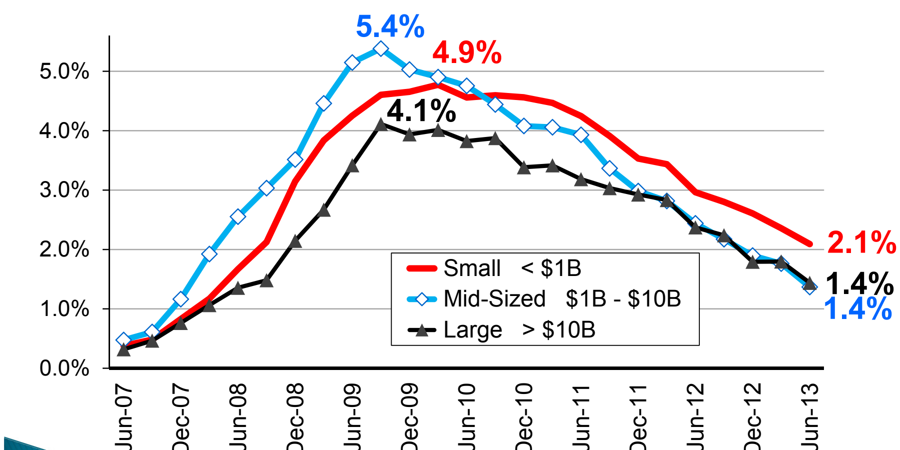


FRB-SF

Based on commercial banks, excluding De Novos; trimmed means; Noncurrent = 90 Days past due or on nonaccrual; preliminary 6/30/13 data

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

Average 12th District Bank Noncurrent Loan Rates

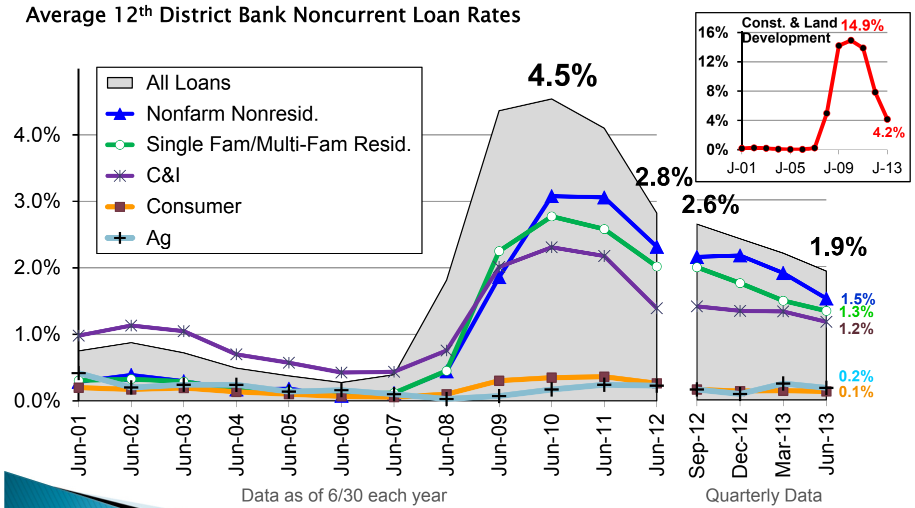


FRB-SF

Based on commercial banks, excluding De Novos; trimmed means; Noncurrent = 90 Days past due or on nonaccrual; preliminary 6/30/13 data

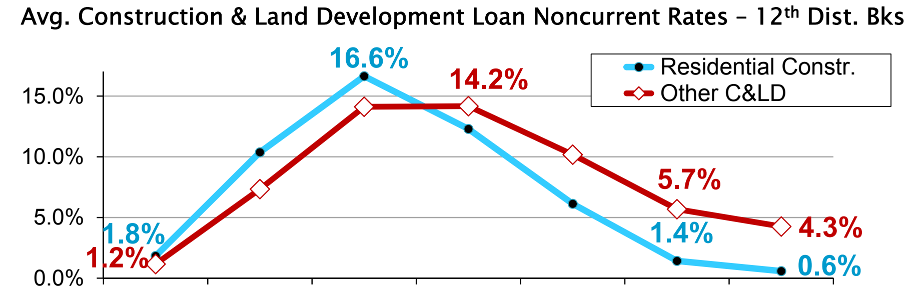
Avg. Noncurrent Rates by Loan Type

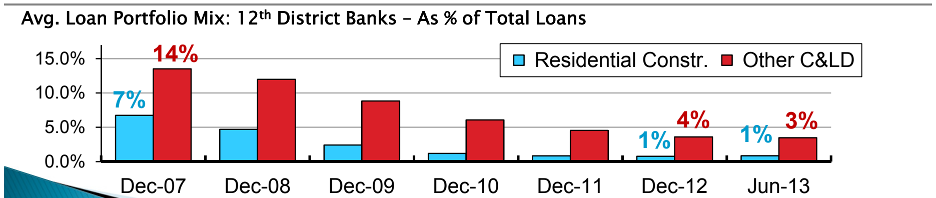
All improving; note: C&LD noncurrent rates are shown in inset chart



FRB-SF Based on commercial banks excluding De Novos; trimmed means; Noncurrent = Pct. of loans 90+ days past due or on nonaccrual; preliminary 6/30/13 data

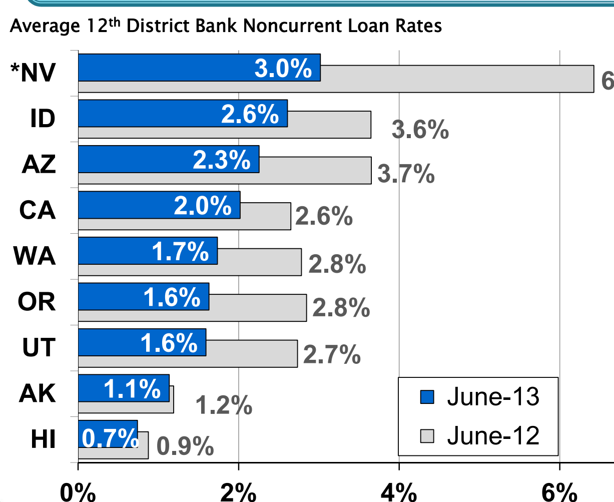
C&LD: Residential Construction Loan Noncurrent Rate Fell Below 1%





FRB-SF Based on commercial banks, excluding De Novos; trimmed means; preliminary 6/30/13 data

By State: Noncurrent Loan Rates Dropped Most in Nevada, Arizona, & Oregon

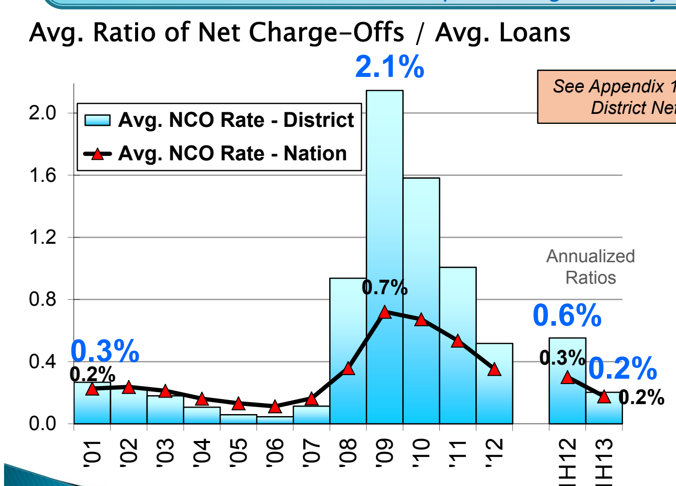


Other High Noncurrent Loan Rates	06/12	06/13
GA	5.3%	3.6%
FL	4.6%	3.1%
SC	3.7%	2.6%
MD	3.0%	2.5%
CT	2.8%	2.4%
Nation	1.9%	1.5%

FRB-SF Based on commercial banks, excl. De Novos; trimmed means; Noncurrent = 90+ days past due or on nonaccrual; preliminary 6/30/13 data.
*NV: excludes credit card and zero-loan banks

District Bank Net Charge-Off Rates Near Pre-Recession Levels

Recoveries improved significantly



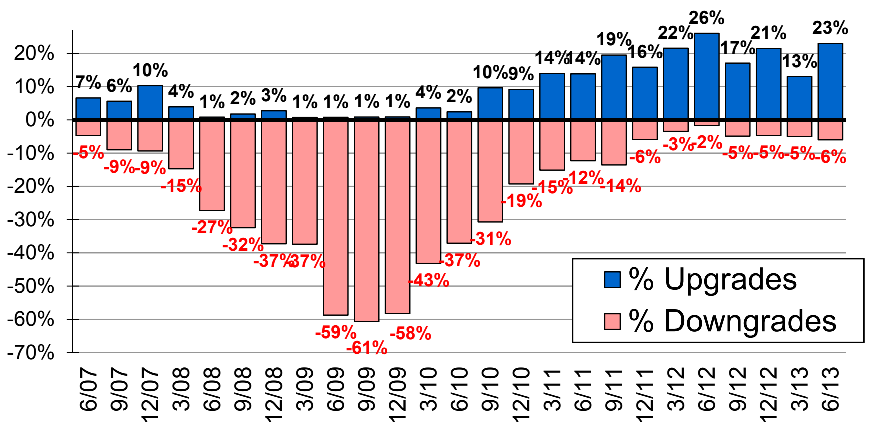
See Appendix 1 for Detailed Aggregate District Net Charge-Off Rates

Recoveries of Prior Period Gross Charge-Offs 12th District Bank Avg.	
1H13	21%
1H12	13%
1H11	8%
Avg '01-'08	33%

FRB-SF Based on commercial banks excluding De Novos; trimmed means; 1H ratios are annualized; preliminary 2Q13 data

Regulatory Ratings: CAMELS Upgrades Outpaced Downgrades for the Past 9 Quarters

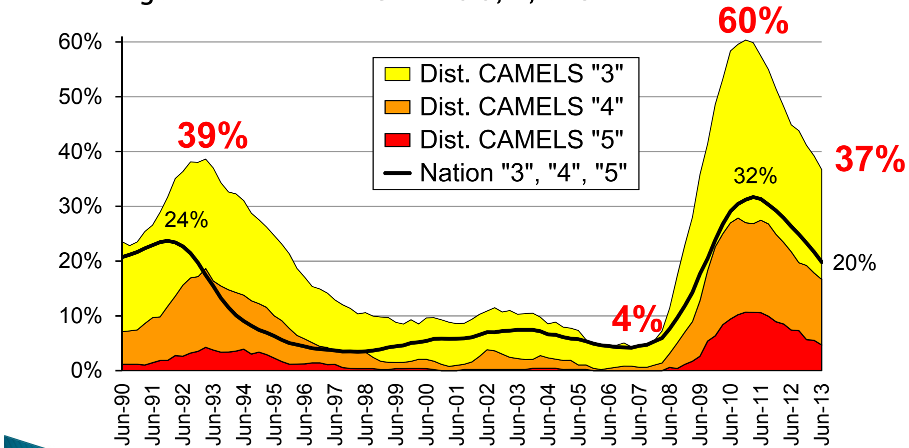
Pct. of 12th District Exams Each Quarter that Resulted in CAMELS Composite Rating Upgrade or Downgrade (downgrades are shown as negative percentages)



Includes any change in composite CAMELS rating for commercial banks; quarterly trends based on examination completion dates (mail dates); preliminary 6/30/13 figures; updated 08/14/13

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

Percentage of Banks Rated CAMELS 3, 4, or 5

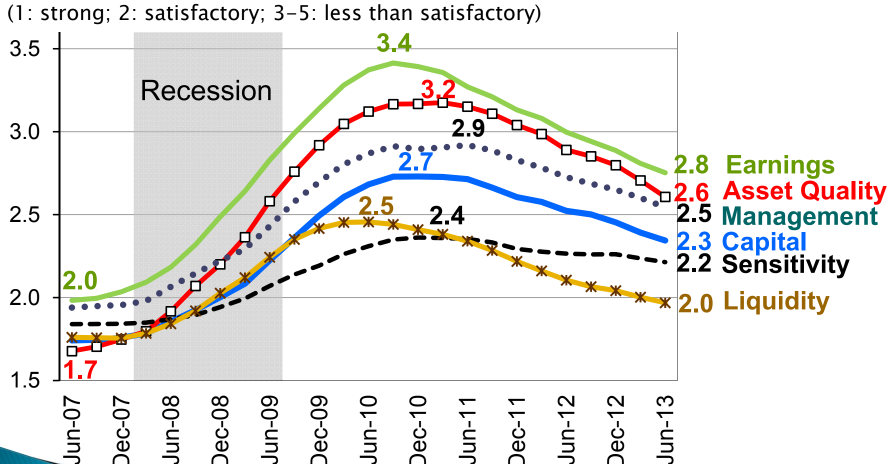


Trends for all commercial banks based on examination completion dates (mail dates); preliminary 6/30/13 figures; updated 8/14/13

CAMELS Rating Components Continue to Improve

Asset quality & earnings ratings improved most YoY; sensitivity ratings pressured by interest rate risk concerns

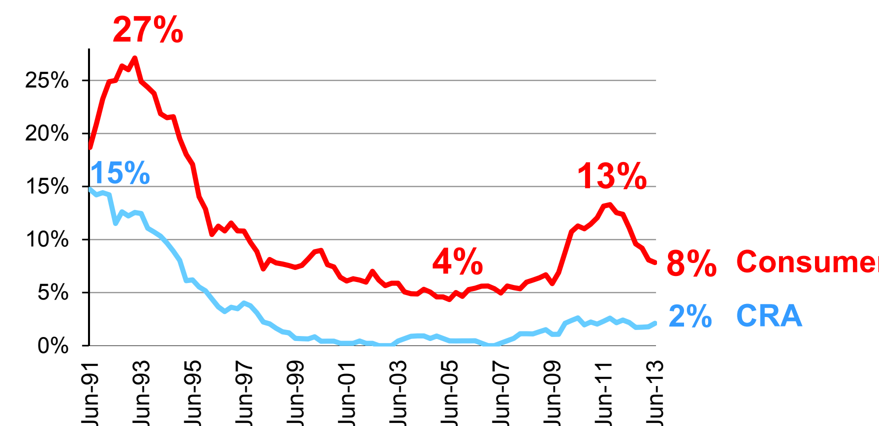
Average CAMELS Component Ratings for 12th District Banks
(1: strong; 2: satisfactory; 3-5: less than satisfactory)



Trends for all commercial banks based on examination completion dates (mail dates); preliminary 6/30/13 figures; updated 8/14/13

District Bank Consumer Ratings Improving with CRA Ratings Holding Steady

Percentage of District Banks with Less-than-Satisfactory Ratings



Trends for all commercial banks based on examination completion dates (mail dates); CRA = Community Reinvestment Act; prelim. 6/30/13 figures; updated 8/14/13

Section 3 – Savings Institution and Industrial Bank Performance

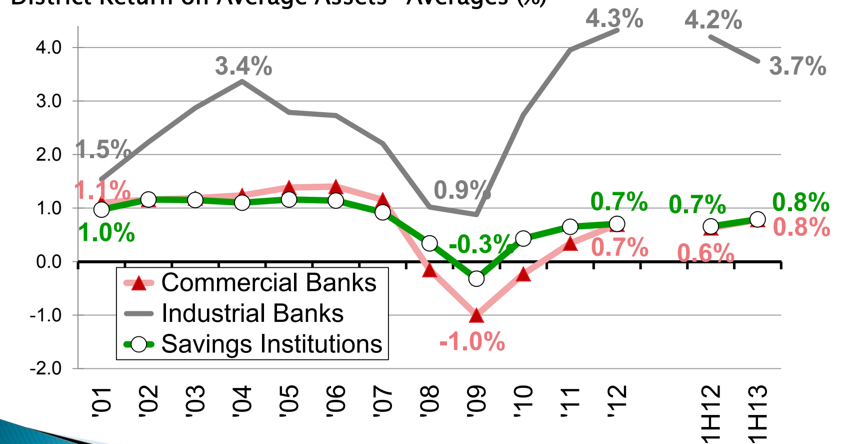
Slides in this section focus on trends among the 47 savings institutions and 30 industrial banks headquartered within the 12th Federal Reserve District.

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) and from one office (limiting overhead expenses)

District Return on Average Assets –Averages (%)

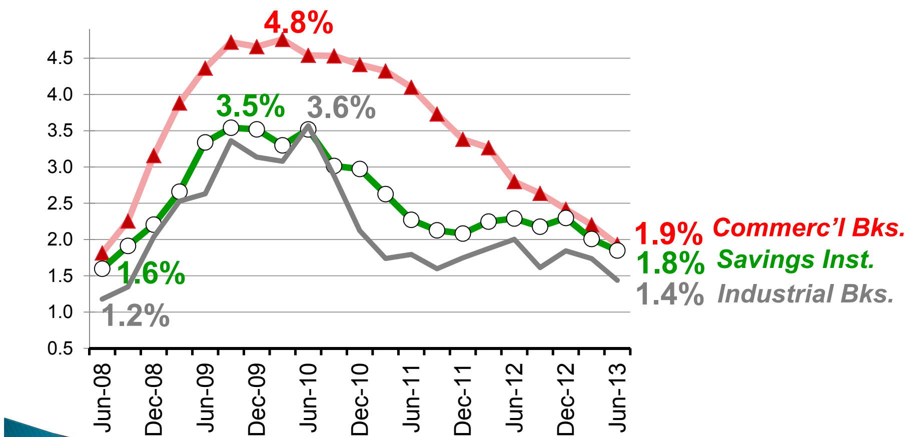


FRB-SF

Based on District commercial banks, savings institutions, and industrial banks; excluding De Novos; trimmed means; 1H ratios annualized; prelim 6/30/13 data

Loan Quality: District Industrial Bank Noncurrent Ratios Remain Lower than Commercial and Savings Institution Ratios on Avg.

Average 12th District Noncurrent loans / Total Loans – quarterly (%)

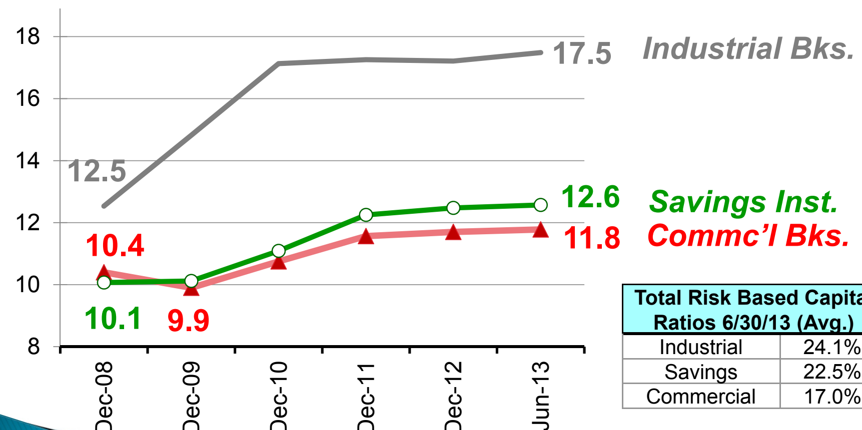


FRB-SF

Based on District commercial banks, savings institutions and industrial banks; excluding De Novos; trimmed means; Noncurrent = 90+ days past due or on nonaccrual; preliminary 6/30/13 data

Equity/Assets Ratios Appear to be Peaking with Highest Ratios at Industrial Banks

Average 12th District Institution Equity/Assets Ratios



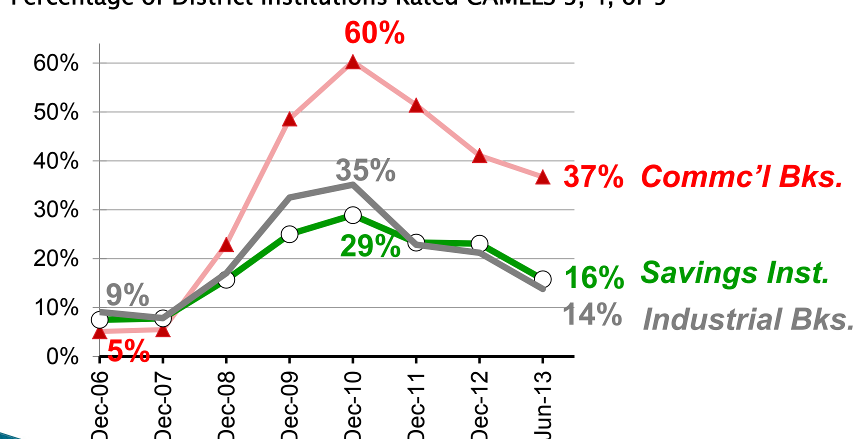
Total Risk Based Capital Ratios 6/30/13 (Avg.)	
Industrial	24.1%
Savings	22.5%
Commercial	17.0%

FRB-SF

Based on District banks and savings institutions; excluding De Novos; trimmed means; preliminary 6/30/13 data

Percent Rated CAMELS 3, 4, or 5 Down for All Institution Groups; Commercial Banks Continue to Lag

Percentage of District Institutions Rated CAMELS 3, 4, or 5



FRB-SF

Trends for all institutions based on examination completion dates (mail dates); preliminary 6/30/13 figures; updated 8/15/13

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.

Bank Supervisors' Hot Topics

A recent interagency meeting of top bank supervisors in the west included an instant poll of issues of concern

Ranking of Top Issues:

1. *Rising Interest Rates*
2. *Cyber-Security*
3. *Operational or Compliance Issues*
4. *Another Economic Shock*
5. *Credit Losses in Areas of Rapid Loan Growth*

These will be highlighted on the next slides

Bank Supervisors' Hot Topics

1 - Rising Interest Rates

- With an extended period of extremely low short-term interest rates, some banks boosted their investment in higher-yielding, longer-dated securities (see section starting slide 22); some banks may be vulnerable to rising interest rates
- While non-maturity deposit balances are strong at most banks, a material portion of these deposits may flow out as rates rise; banks need to account for this as they conduct interest rate sensitivity analyses (see Slide 24)
- Many loans have adjustable rates, and can help keep a bank's duration gap narrow; however, rising interest rates could raise debt service burdens on borrowers and increase credit risk

2 - Cyber-Security

- Cyber-Security has become a top concern for all banks
- Concerns include distributed denial of service attacks, evolution of malicious software, including software targeting mobile devices, account takeovers/fraudulent funds transfers, vendor security, targeted attacks against bank employees to steal or destroy data, or disable systems, and increased costs for mitigating security threats

Bank Supervisors' Hot Topics

3 - Operational or Compliance Issues

This can cover many potential issues, such as:

- Challenges with adjusting to new rules and regulations (e.g., new Consumer Financial Protection Bureau "Ability to Repay Rule" for mortgage lending)
- Model risk management – high reliance on complex models to manage risks and operations – significant risk of erroneous or misused model results with potential for adverse consequences and/or financial loss
- Vendor Management – Institutions need to have risk assessment processes for outsourced activities and appropriate monitoring procedures
- Capital planning and stress testing expectations

4 – Another Economic Shock

- It is difficult to predict issues that could impact the economy and banks
- They could be geopolitical; they could be precipitated by the Sequestration's impact or Congress's failure to deal with the U.S. debt ceiling; they could result from unexpected inflation and rising rates caused by stimulative monetary policy. Whatever the cause, history has shown that economic shocks can have an enormous impact on banking conditions

Bank Supervisors' Hot Topics

5 - Credit Losses in Areas of Rapid Loan Growth

While overall loan growth is not fully recovered from recession, banks are experiencing fairly rapid loan growth in certain lending areas like C&I, 1-4 family residential, and multifamily (see Slides 18-19)

Concerns include:

- Competition/pricing pressures leading to easing of underwriting criteria and terms (we often hear that "the bank down the street" is being very aggressive)
- Banks with rapid loan growth often have relatively high credit loss rates in future periods
- 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

Other Issues – Junior Lien Mortgages / CRE Loans

- With 15% of homeowners underwater on their mortgages (per Lending Processing Services, 7/2013), residential loans and junior lien loans in particular, remain a concern
- CRE income property loans originated near market peaks (2005-2008) remain a concern as property values and market fundamentals are still recovering and 12th District banks have sizable CRE loan exposures

Appendices

Appendix 1
12th District Bank Aggregate Net Charge-Off Rates

NCO rates declined significantly year-over-year

Aggregate District Commercial Bank Net Charge-Off Rates (%)

	All Banks			Small Bks (<$1 Billion)	
	1H12	1H13		1H12	1H13
Construction & Land Development	1.27	(0.60)		1.80	0.52
Residential Construction	1.42	(0.57)		1.85	0.62
Other C&LD	0.66	(0.68)		1.60	0.24
CRE - Nonfarm Nonresidential Loans	0.35	0.09		0.51	0.13
Owner-Occupied	0.42	0.12		0.43	0.13
Nonowner-Occupied	0.30	0.07		0.59	0.13
Residential Closed-End Loans	1.01	0.48		0.97	0.26
Home Equity Loans	2.12	1.28		0.61	0.12
Multifamily Loans	0.12	0.03		0.32	(0.00)
Commercial & Industrial Loans	0.49	0.19		0.76	0.50
Agricultural Loans	0.79	(0.21)		(0.07)	0.16
Credit Card Loans	4.38	3.90		1.92	1.47
Installment Loans	0.81	0.76		0.70	0.50
Total Loans	0.87	0.44		0.70	0.24

NCO rates for all District commercial banks; Red: >= 2%; Yellow: 0.75% to 2%; Green: net recovery

This data soon will be available at http://www.frbsf.org/banking/data/index.html - see Charge-Off Rates: 12th District (FRB SF)

Appendix 2 – Banks Covered in this Report

Geography	Commercial Banks (De Novos)		Industrial Banks (De Novos)		Savings Institutions (De Novos)	
	06-12	06-13	06-12	06-13	06-12	06-13
Alaska	4 (0)	4 (0)	-	-	2 (0)	2 (0)
Arizona	27 (0)	24 (0)	-	-	1 (0)	1 (0)
California	212 (6)	207 (5)	7 (1)	6 (1)	18 (1)	18 (1)
Guam	2 (0)	2 (0)	-	-	1 (0)	1 (0)
Hawaii	6 (0)	6 (0)	1 (0)	1 (0)	2 (0)	2 (0)
Idaho	15 (0)	15 (0)	-	-	1 (0)	1 (0)
Nevada	17 (1)	15 (0)	4 (0)	4 (0)	2 (0)	2 (0)
Oregon	28 (1)	25 (0)	-	-	3 (0)	3 (0)
Utah	32 0)	32 (0)	19 (0)	19 (0)	4 (0)	4 (0)
Washington	55 (1)	53 (1)	-		13 (0)	13 (0)
12th District	398 (9)	383 (6)	31 (1)	30 (1)	47 (1)	47 (1)
Nation	5,984 (77)	5,913 (56)	33 (1)	32 (1)	1,000 (6)	998 (4)

Based on preliminary 6/30/13 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.