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

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.

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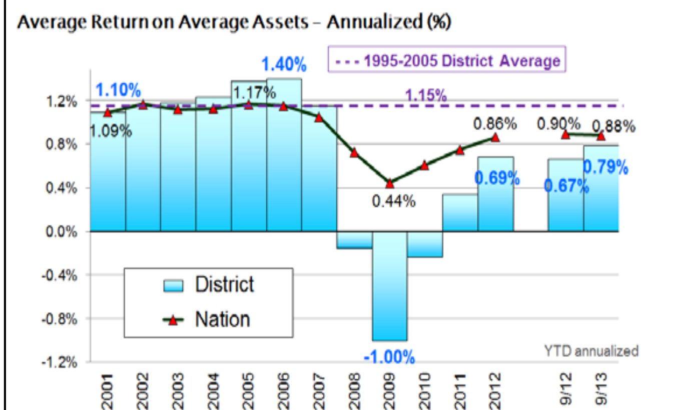
- <u>Profitability—Slow Improvement:</u> District earnings have yet to recover to the pre-crisis levels, though year-to-date average ROAA was slightly improved from a year ago (Slide 11; right). Earnings in most District states showed an improvement year-over-year as well (Slide 12). Record low loss 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).

- <u>Credit Quality—Steady Recovery:</u> 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).

- <u>Capital & Liquidity—Peaking:</u> 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).

- <u>Loan Growth—Accelerating:</u> 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).

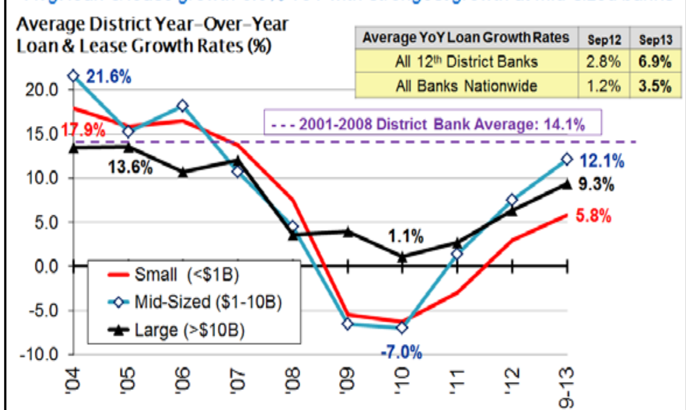
<u>Earnings:</u> District Profitability Improving Slowly; Still Well Below Pre-Crisis Averages



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

<u>Loan Growth</u>: Turnaround Accelerated

Avg. loan & lease growth 6.9% YoY with strongest growth at mid-sized banks



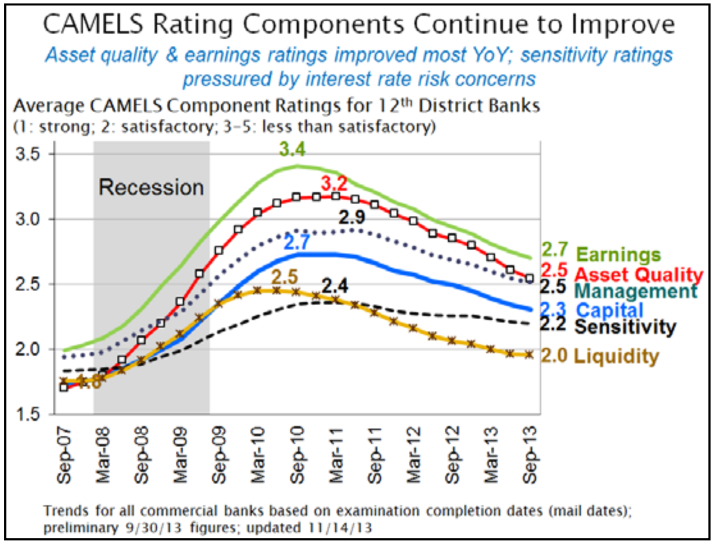
Average YoY Loan Growth Rates	Sep12	Sep13
All 12th District Banks	2.8%	6.9%
All Banks Nationwide	1.2%	3.5%

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 9/30/13 data

First Glance 12L – Third Quarter 2013

- **<u>CAMELS* Ratings—Rating Components Reflect Steady Recovery:</u>** 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).

- **<u>Overall—Slow and Steady Recovery:</u>** 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).



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

Bank Supervisors' Hot Topics

- **<u>Hot Topics:</u>** 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
  6. Capital Planning / Stress Testing Expectations
  7. Model Risk Management
  8. Maintaining Compliance with Laws and Regulations

Section 1
Economic Highlights

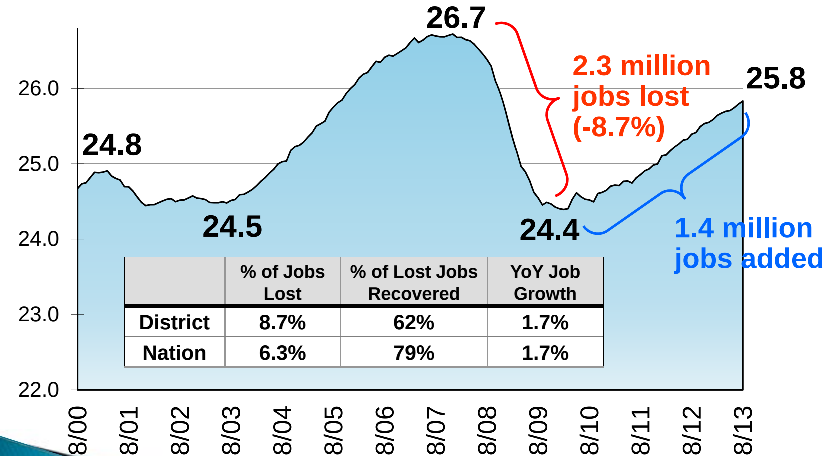
This section provides a high-level look at economic conditions focusing on degree of recovery from the recession. It covers state-by-state job growth and home price changes, two key metrics that are closely related with banking conditions.

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

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)



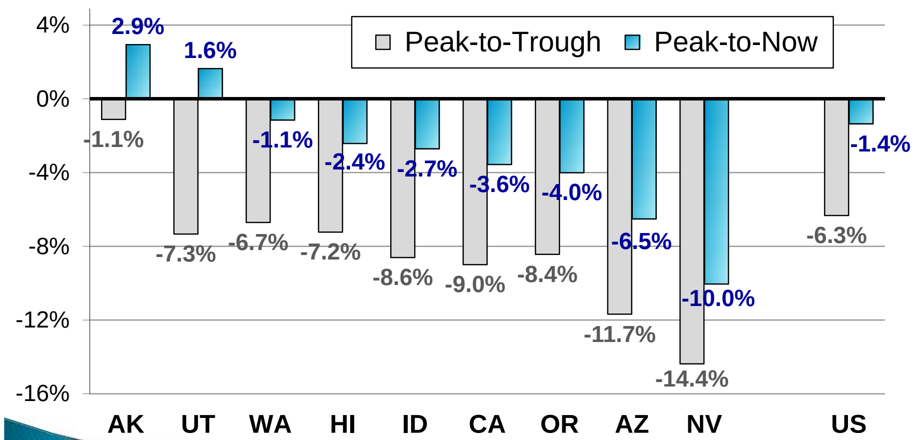
	% of Jobs Lost	% of Lost Jobs Recovered	YoY Job Growth
District	8.7%	62%	1.7%
Nation	6.3%	79%	1.7%

Source: Bureau of Labor Statistics, Haver Analytics

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.

Nonfarm Jobs – % Change from Pre-Recession Peaks through August 2013

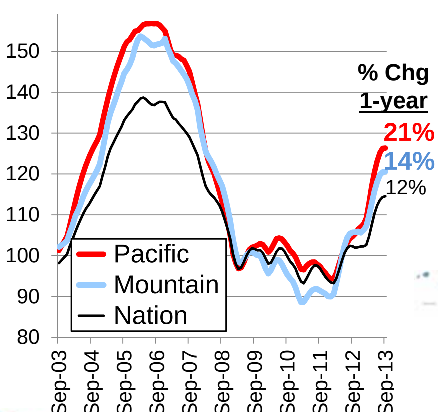


The pre-recession peak and trough dates are unique for each state based on monthly nonfarm jobs data. Sources: Bureau of Labor Statistics, Haver Analytics; data through August 2013

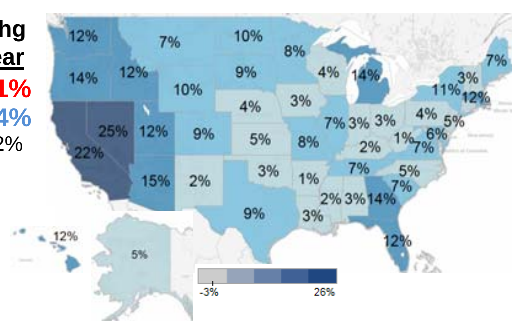
Housing Recovery: Tailwind for District Banks

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)

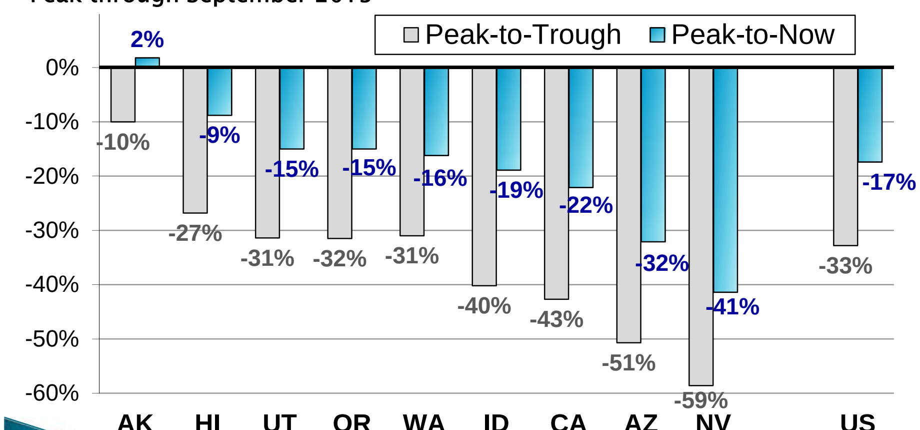


Source: CoreLogic Home Price Indices, indexed to 100 at 6/09; Mountain: AZ, ID, MT, NM, NV, UT, WY; Pacific: AK, CA, HI, OR, WA

Housing Situation in the 12th District

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



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

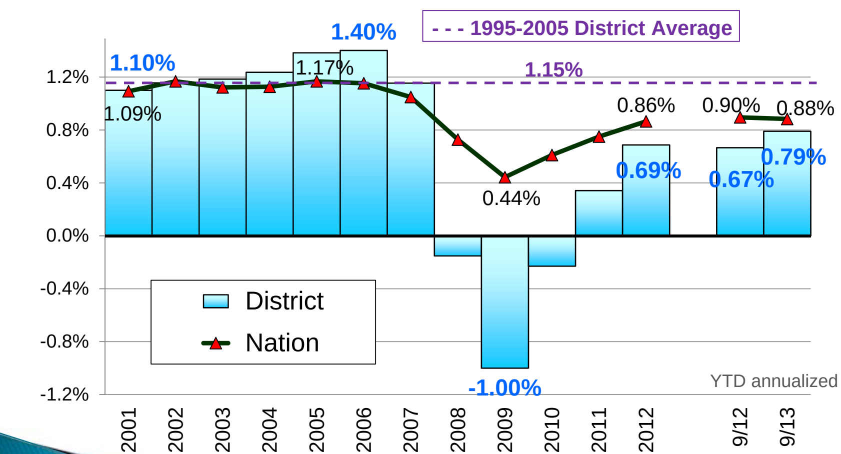
Section 2
Commercial Bank Performance

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 (%)



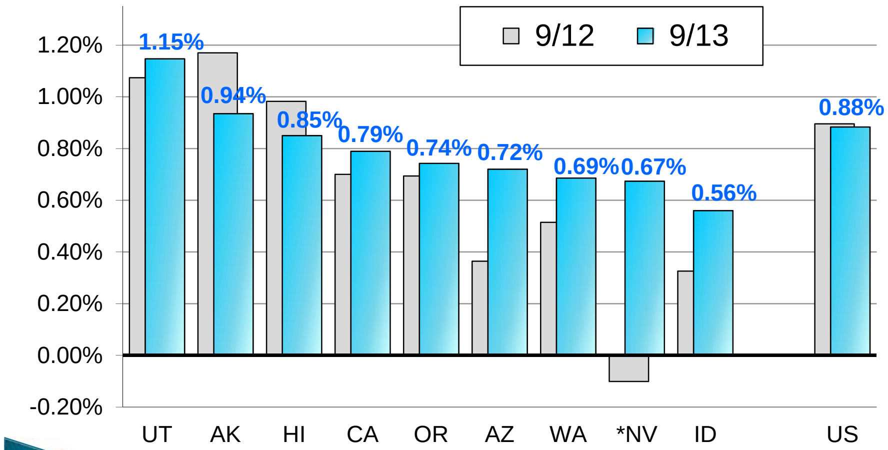
FRB-SF

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

Average ROAAs Improved in 7 of 9 States

NV and AZ banks had the strongest turnaround.

Average Return on Average Assets YTD Annualized (%)



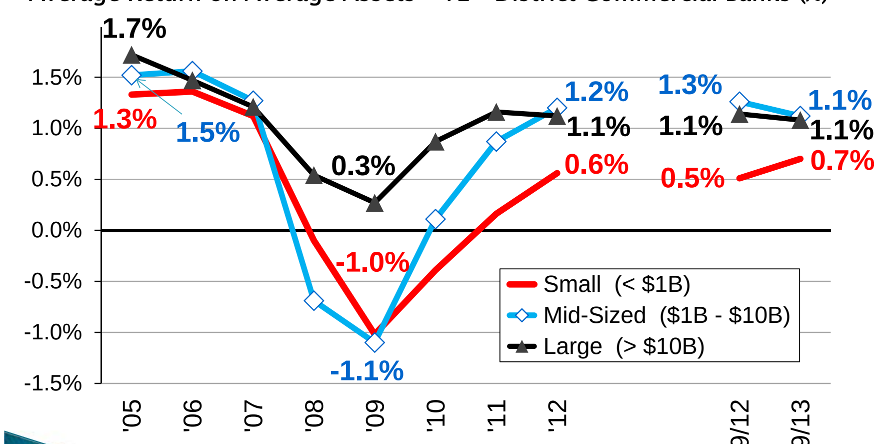
FRB-SF

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 (%)



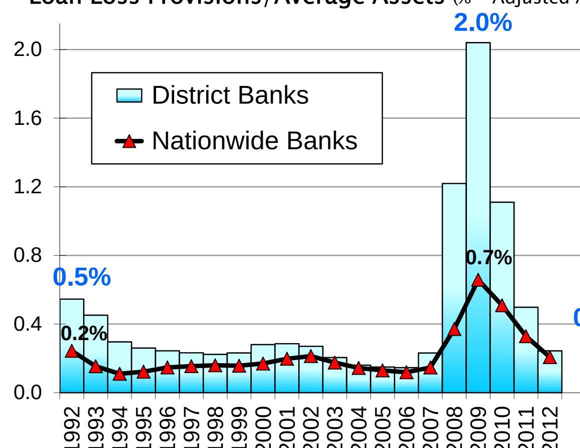
FRB-SF

Based on commercial banks, excluding De Novos; trimmed means; Sept. 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)



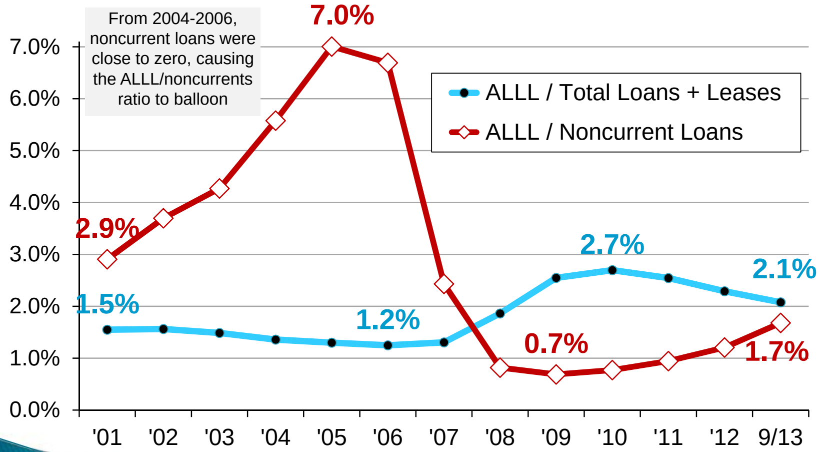
Through 9/2013 YTD, Percent of Commercial Banks with:	Dist.	U.S.
Negative loss provisions	14%	6%
Zero loss provisions	35%	23%
Lowered ALLL / Loan Ratios	66%	56%

FRB-SF

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

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

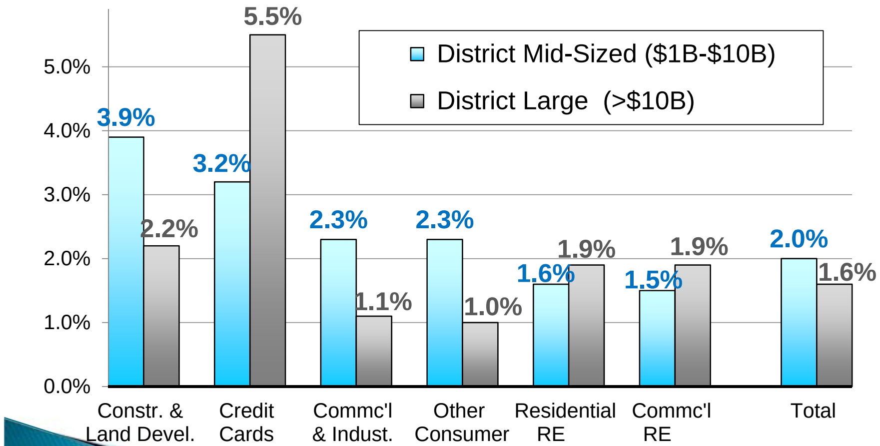


Based on commercial banks, excluding De Novos; trimmed means; noncurrent = 90+ days past due or on nonaccrual; preliminary 9/30/13

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

Reserving is Considerably Higher at Mid-Sized Banks for C&I, Other Consumer, and C&LD

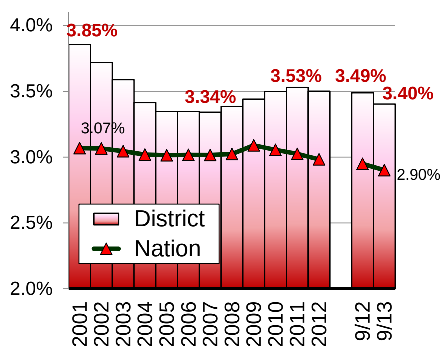
Aggregate Allowance for Loan & Lease Losses / Loans & Leases (%) 9/30/13



Based on aggregate data for commercial banks, preliminary 9/30/13 data. Note: banks with assets <$1B do not report this information

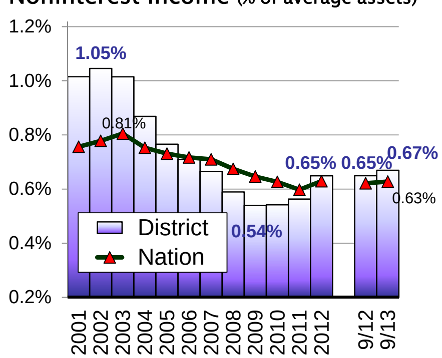
Noninterest Expense Ratios Dropped Slightly (for small & mid-sized banks) While Noninterest Income Ratios Grew Slightly (including at small banks)

Noninterest Expense (% of average assets)



Average Noninterest Expense YTD Annualized		
District Group	9/12	9/13
Small (<$1B)	3.64%	3.56%
Mid-Sized ($1B-$10B)	3.13%	2.96%
Large (>$10B)	2.25%	2.37%

Noninterest Income (% of average assets)



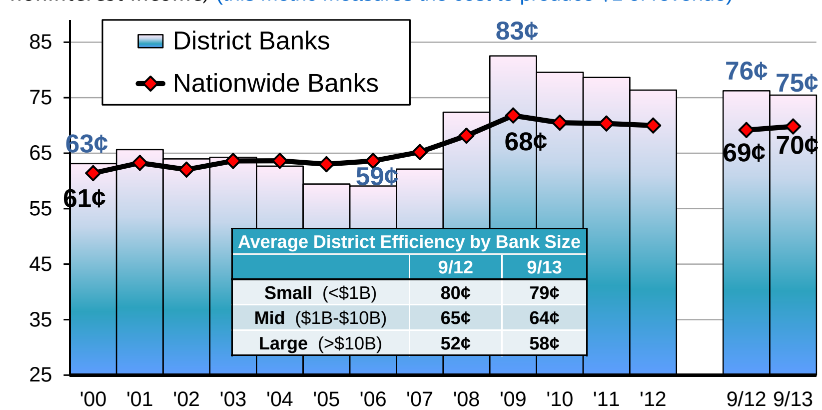
Average Noninterest Income YTD Annualized		
District Group	9/12	9/13
Small (<$1B)	0.61%	0.64%
Mid-Sized ($1B-$10B)	0.81%	0.78%
Large (>$10B)	0.82%	0.83%

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

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

Large bank ratios remain lower (i.e., better), but they're moving in the wrong direction.

District Banks' Efficiency Measures – overhead / (net interest income + noninterest income) (this metric measures the cost to produce $1 of revenue)

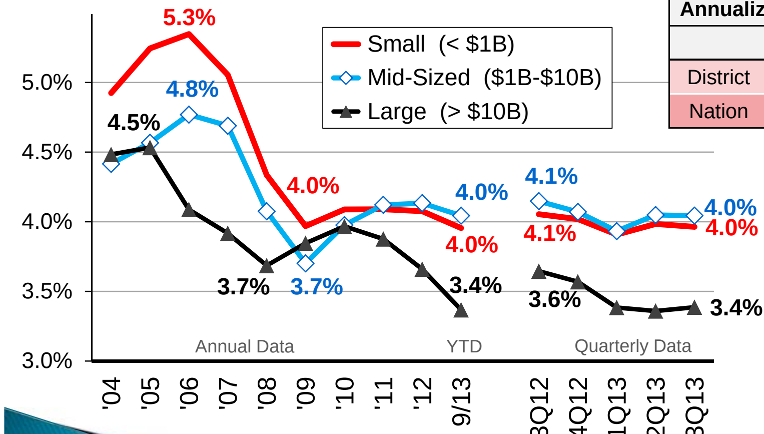


Average District Efficiency by Bank Size		
	9/12	9/13
Small (<$1B)	**80¢**	**79¢**
Mid ($1B-$10B)	**65¢**	**64¢**
Large (>$10B)	**52¢**	**58¢**

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

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**



Average NIM YTD Annualized – All Banks	9/12	9/13
District	4.1%	3.9%
Nation	3.9%	3.7%

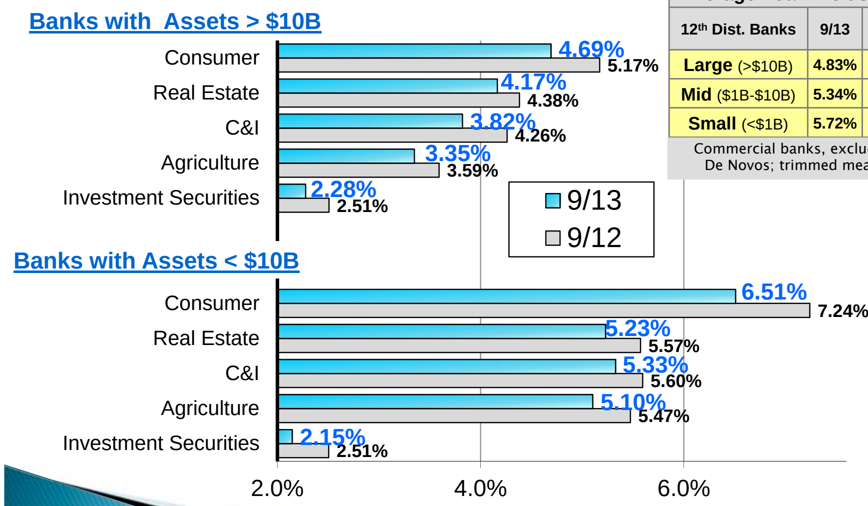
FRB-SF

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

Loan & Investment Securities Yields Continued to Fall

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

Yields – Nationwide Banks (%)



Average Loan Yields YTD		
12th Dist. Banks	9/13	YoY Chg
Large (>$10B)	4.83%	-31bp
Mid ($1B-$10B)	5.34%	-45bp
Small (<$1B)	5.72%	-25bp

Commercial banks, excluding De Novos; trimmed means

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

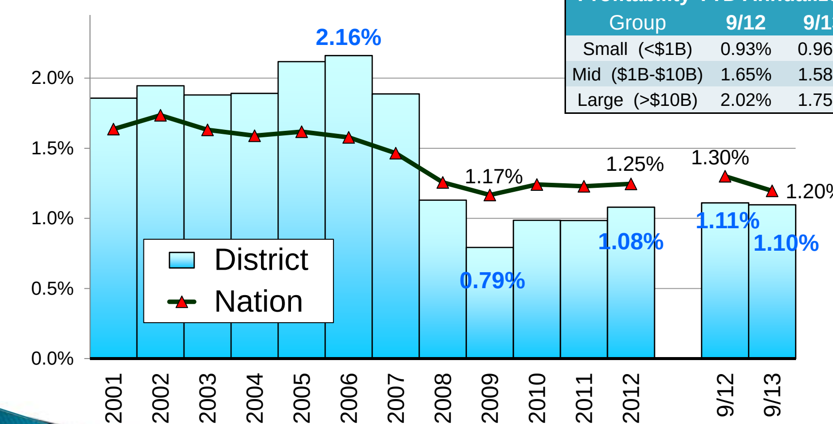
Core Profitability Flat in 2013 on Average

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		
Group	9/12	9/13
Small (<$1B)	0.93%	0.96%
Mid ($1B-$10B)	1.65%	1.58%
Large (>$10B)	2.02%	1.75%



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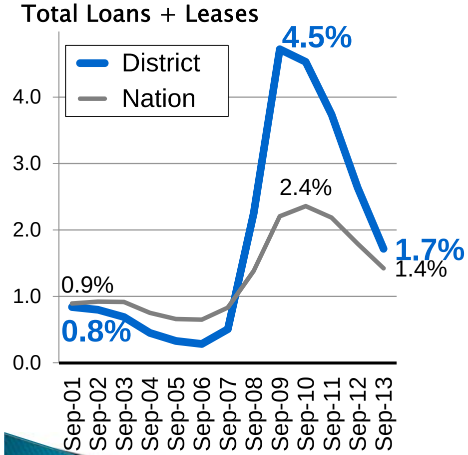
Based on commercial banks, excluding De Novos; trimmed means; September ratios are YTD annualized; preliminary 9/30/13 data

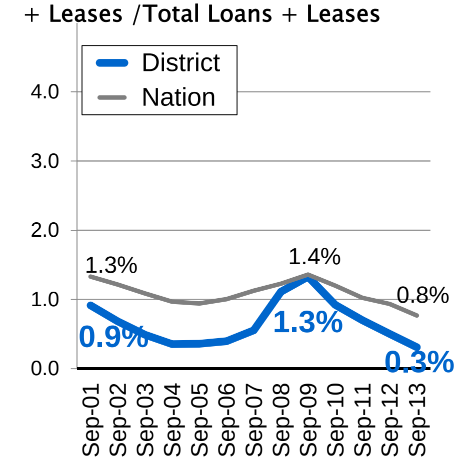
Credit Quality: Average 12th District Bank Noncurrent Rate Close to the Nationwide Rate

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

Average Noncurrent Loans + Leases / Total Loans + Leases



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



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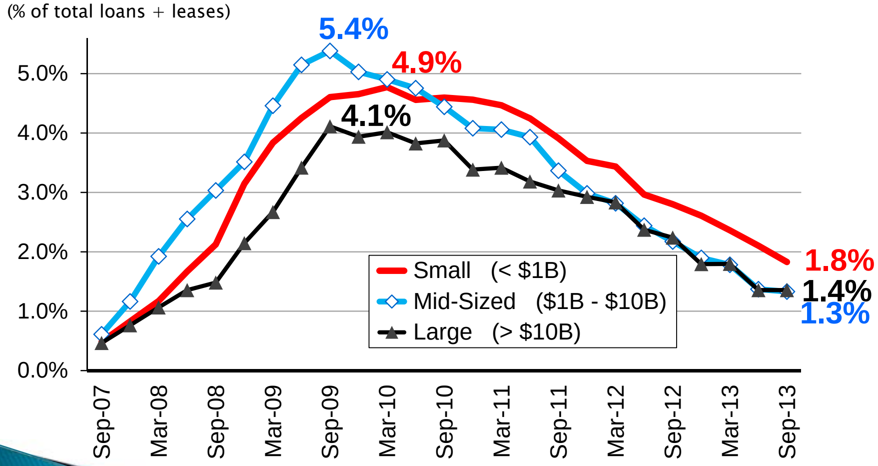
Based on commercial banks, excluding De Novos; trimmed means; Noncurrent = 90 Days past due or on nonaccrual; preliminary 9/30/13 data

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)

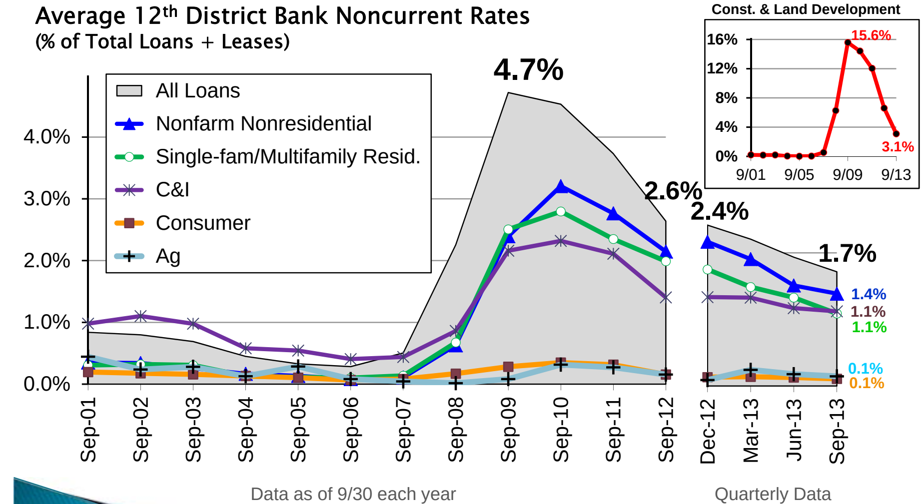


FRB-SF

Based on commercial banks, excluding De Novos; trimmed means; Noncurrent = 90+ Days past due or on nonaccrual; preliminary 9/30/13 data

Average Noncurrent Rates Improving Across All Major Loan Types *Note: C&LD rates are shown in inset chart*

Average 12th District Bank Noncurrent Rates
(% of Total Loans + Leases)

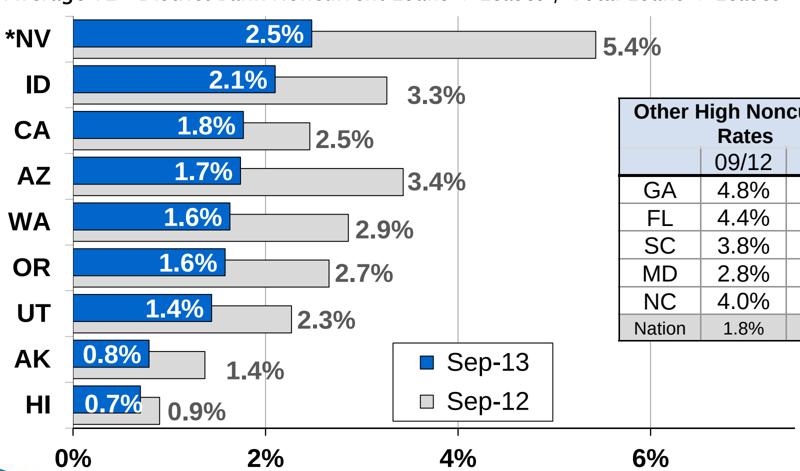


FRB-SF

Based on commercial banks excluding De Novos; trimmed means; Noncurrent = 90+ days past due or on nonaccrual; preliminary 9/30/13 data

By State: Noncurrent Rates Dropped Most in Nevada and Arizona

Average 12th District Bank Noncurrent Loans + Leases / Total Loans + Leases



Other High Noncurrent Rates

	09/12	09/13
GA	4.8%	3.3%
FL	4.4%	2.8%
SC	3.8%	2.5%
MD	2.8%	2.3%
NC	4.0%	2.2%
Nation	1.8%	1.4%

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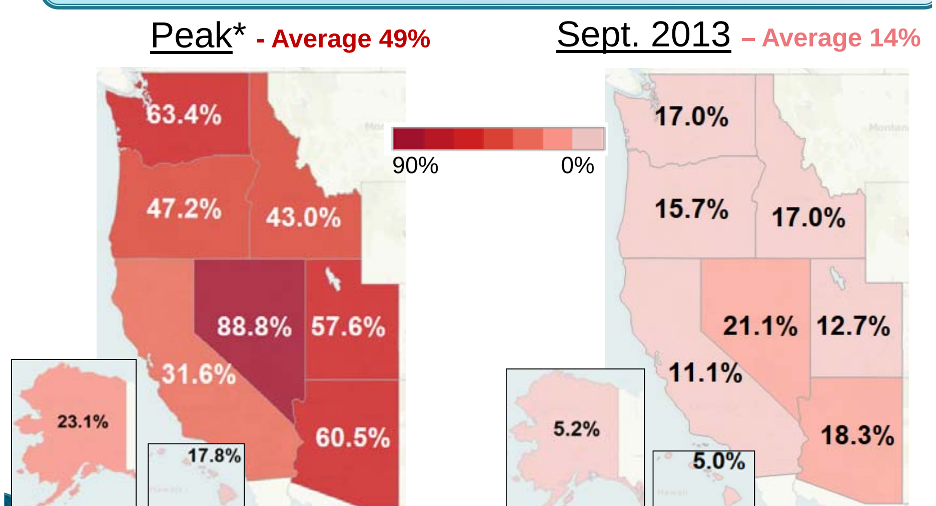
Based on commercial banks, excl. De Novos; trimmed means; Noncurrent = 90+ days past due or on nonaccrual; preliminary 9/30/13 data.
*NV: excludes credit card and zero-loan banks

Average "Texas Ratios" Each State's Recession Peak vs. Now

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



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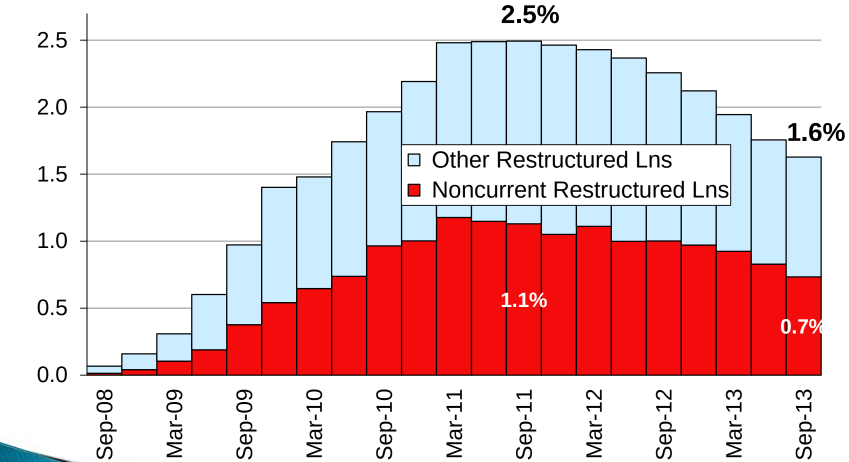
Texas Ratio: noncurrent loans + foreclosed real estate / equity + allowance for loan and lease losses; *Peak ratios occurred at different times for each state (between 9/09 and 3/11); commercial bank trimmed means, excluding De Novos

Troubled Debt Restructurings Continue Steady Decline

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



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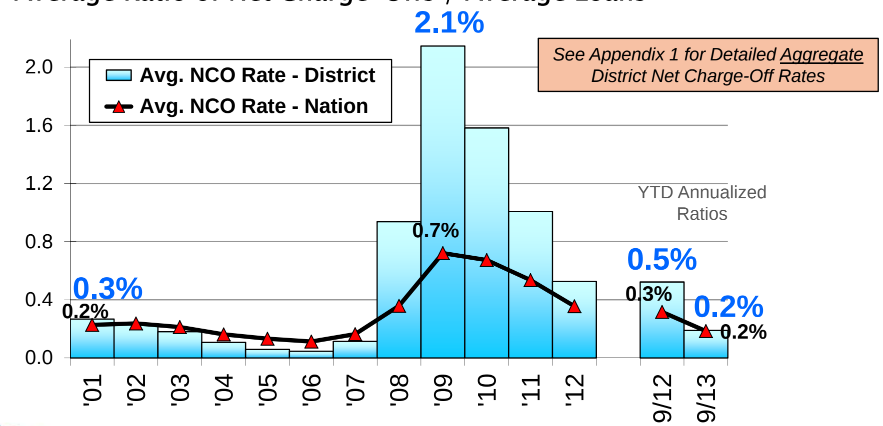
Based on commercial banks, excluding De Novos; trimmed means; Noncurrent = 90+ Days past due or on nonaccrual; preliminary 09/30/13 data

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

Average Ratio of Net Charge-Offs / Average Loans



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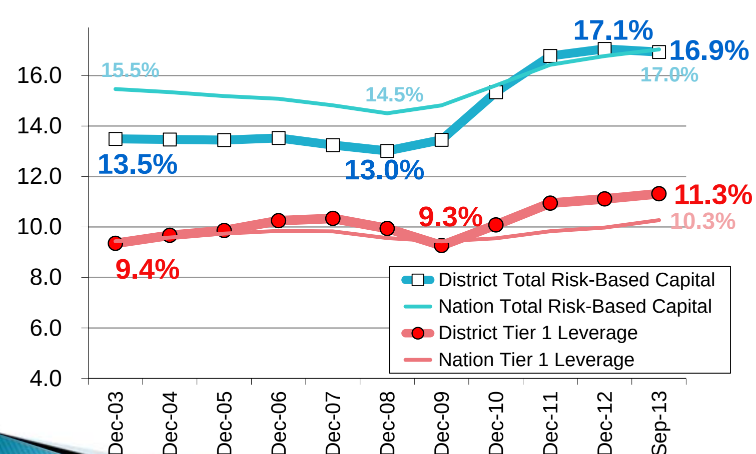
Based on commercial banks excluding De Novos; trimmed means; preliminary 9/30/13 data; September NCO Rates are year-to-date annualized

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

12th District Bank Average Capital Ratios (%)



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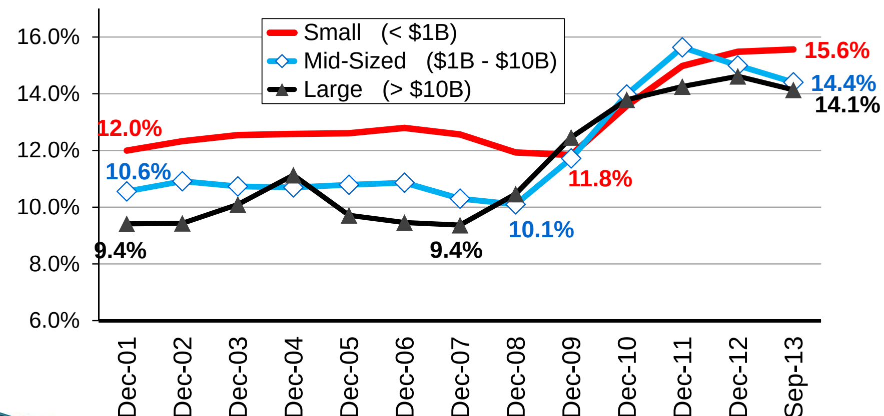
Based on commercial banks, excluding De Novos; trimmed means; preliminary 9/30/13 data

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



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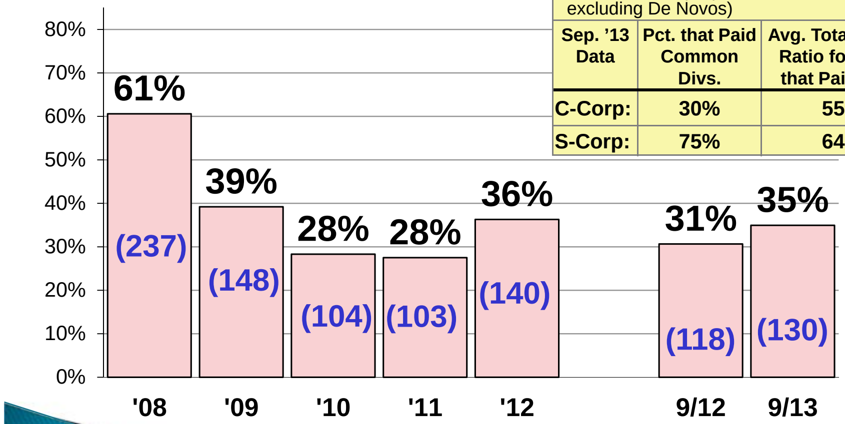
Based on commercial banks, excluding De Novos; trimmed means; preliminary 9/30/13 data

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

Sep. '13 Data	Pct. that Paid Common Divs.	Avg. Total Payout Ratio for those that Paid Divs.
C-Corp:	30%	55%
S-Corp:	75%	64%

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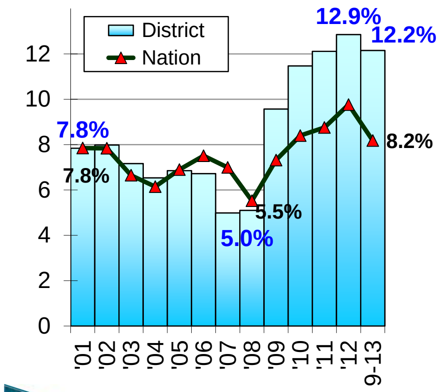
Based on commercial banks, excluding De Novos; averages are trimmed means; preliminary 9/30/13 data

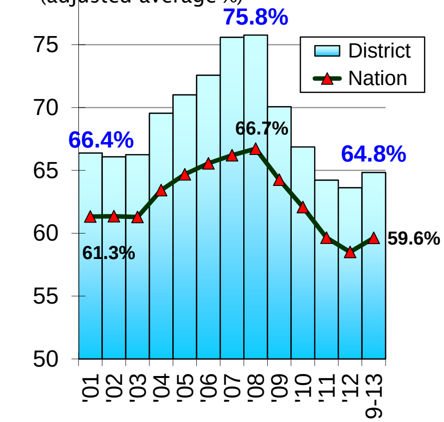
Liquidity: Traditional Balance Sheet Liquidity Ratios Remain Strong

Loan growth has outpaced other earning asset growth thus far in 2013

Short-Term Investments/Assets
(adjusted average %)



Loans & Leases/Assets
(adjusted average %)

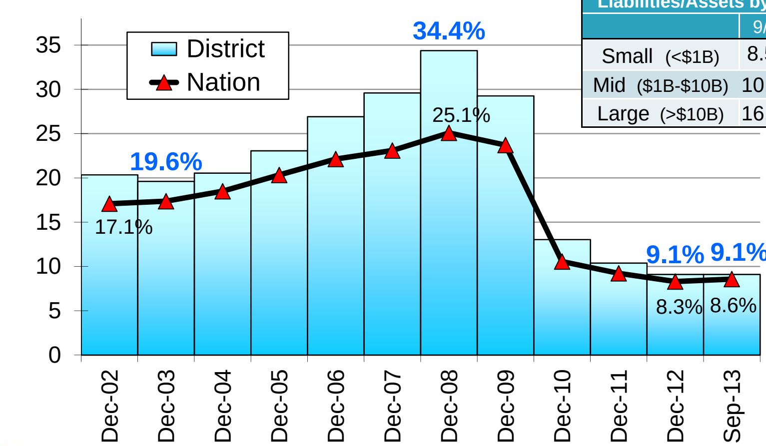


FRB-SF

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

Average Bank Reliance on Noncore Funding Remains Low, But Rising at Large Banks

Noncore Liabilities / Assets (Adjusted Average %)



Average District Noncore Liabilities/Assets by Bank Size	9/12	9/13
Small (<$1B)	8.5%	8.5%
Mid ($1B-$10B)	10.3%	10.2%
Large (>$10B)	16.9%	17.5%

FRB-SF

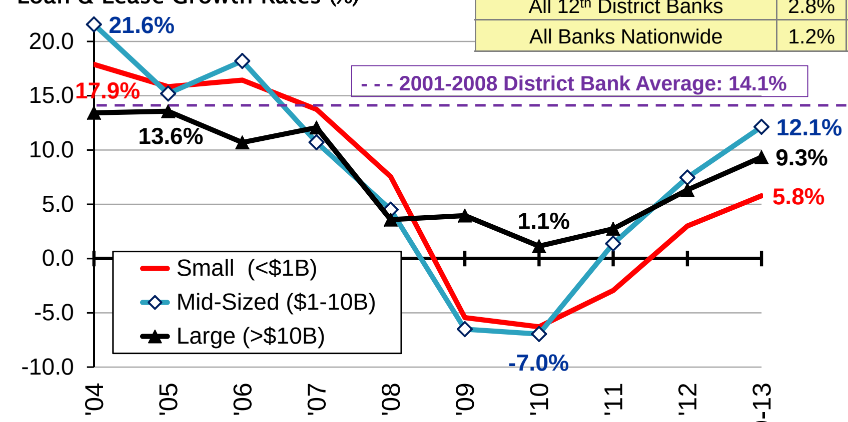
Noncore includes borrowed funds, brokered deposits and CDs>250K; Based on commercial banks, excluding De Novos; trimmed means; preliminary 9/30/13 data

Loan Growth: Turnaround Accelerated

Avg. loan & lease growth 6.9% YoY with strongest growth at mid-sized banks

Average District Year-Over-Year Loan & Lease Growth Rates (%)

Average YoY Loan Growth Rates	9/12	9/13
All 12th District Banks	2.8%	**6.9%**
All Banks Nationwide	1.2%	**3.5%**



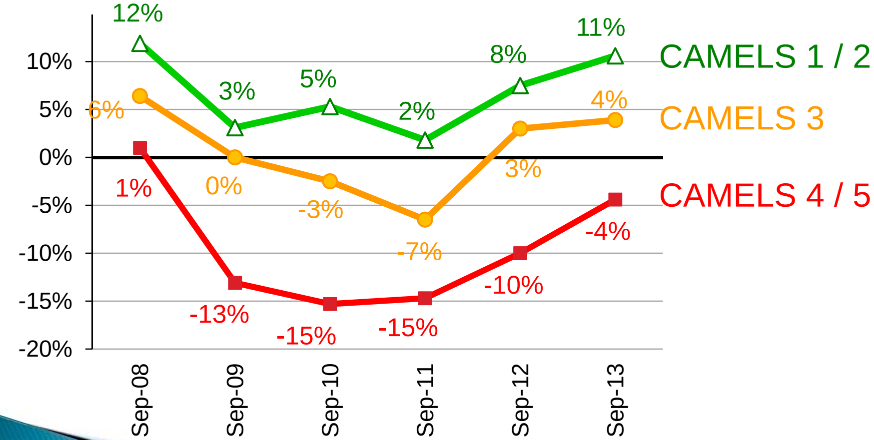
FRB-SF

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 9/30/13 data

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



FRB-SF

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

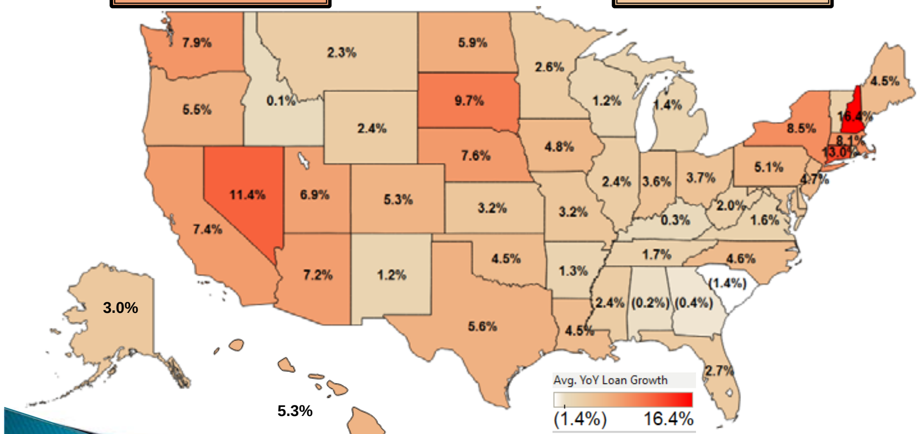
Loan Growth Rates Picked Up Across the West

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

District: 6.9%

Nation: 3.5%



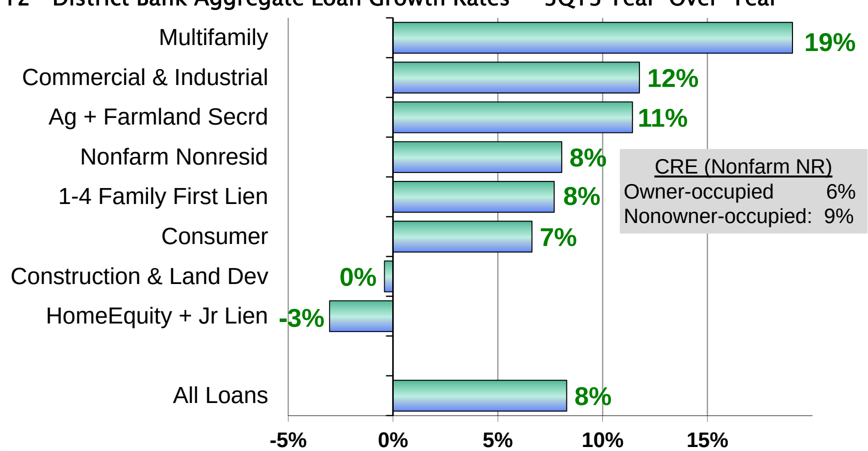
FRB-SF

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

Switching to Loan Growth Aggregates for Bank <$200B:

Multifamily and C&I Strongest YoY Growth; C&LD and HELOC Weakest

12th District Bank Aggregate Loan Growth Rates – 3Q13 Year-Over-Year



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; preliminary 9/30/13 data

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

12th District Bank Aggregate Loan Growth

Loan Growth 9/12–9/13	Small Banks (<$1B)		Mid-Sized Banks ($1B - $10B)		Large Banks ($10B-$200B)	
	YoY Growth Rate	Pct. of Total Ln Growth	YoY Growth Rate	Pct. of Total Ln Growth	YoY Growth Rate	Pct. of Total Ln Growth
Nonfarm Nonresidential Secured	8%	**66%**	8%	**54%**	8%	**30%**
Multifamily	17%	15%	34%	**29%**	19%	12%
Commercial & Industrial	3%	10%	8%	20%	12%	**26%**
Ag & Farmland Secured	13%	9%	7%	6%	11%	6%
Consumer	3%	2%	-1%	n/a	7%	5%
1-4 Family First Liens	-1%	n/a	-1%	n/a	8%	19%

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

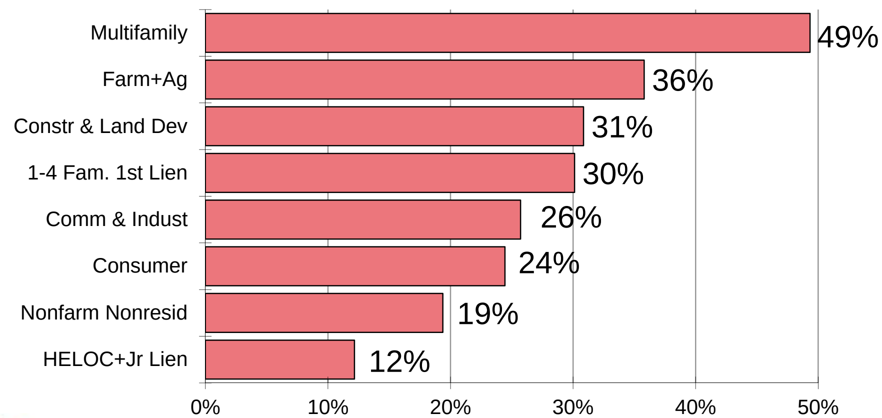
FRB-SF

Based on a panel of District commercial banks with assets <$200B; excludes banks with significant mergers, loan sales, or loan purchases over the period; preliminary 9/30/13 data

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%+

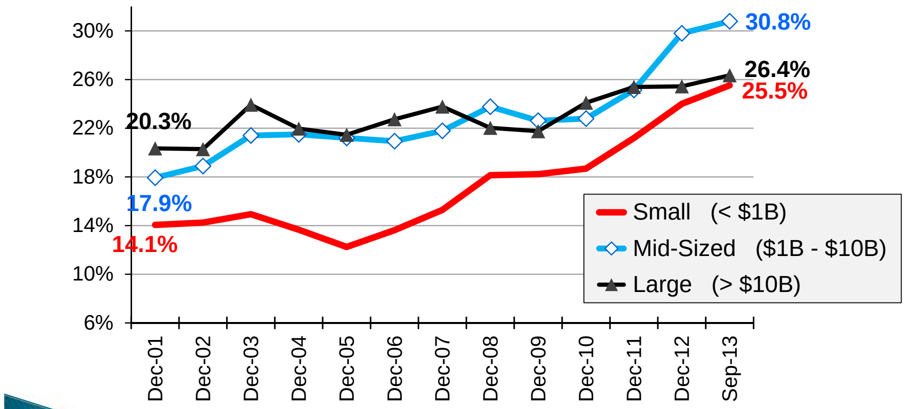
% of District Banks* With >20% YoY Growth by Loan Type – 9/30/13



* 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

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

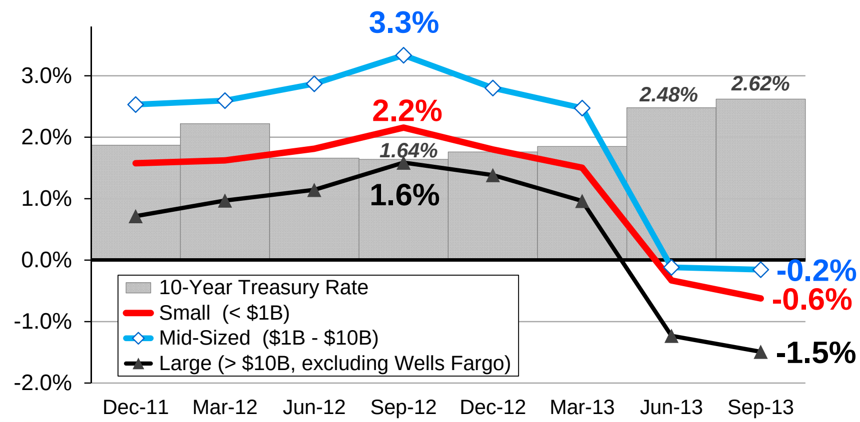
12th District Banks: Loans & Securities Maturing or Repricing > 5 Years / Assets



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

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

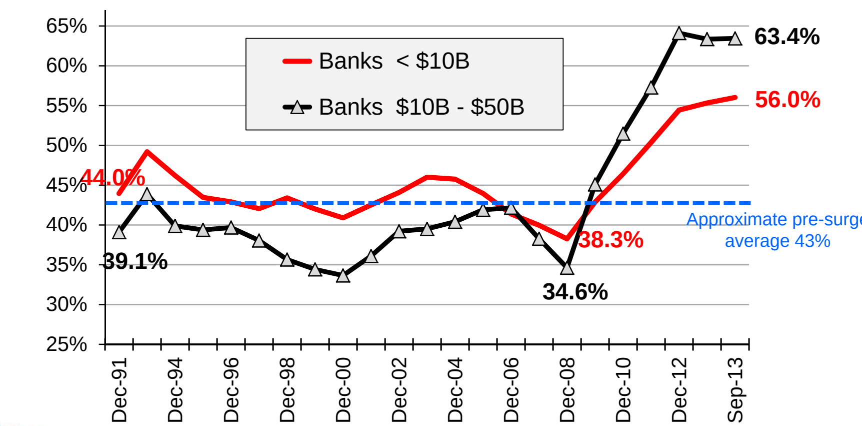
Unrealized Gains (Losses) on all Securities / Equity – District Banks in Aggregate



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.

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

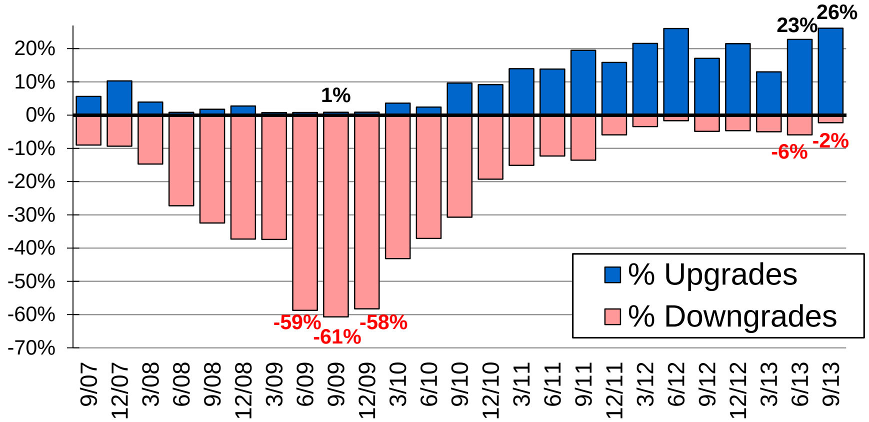
Non-Maturity Deposits / Total Assets – Nationwide Bank Aggregates



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

Regulatory Ratings: CAMELS Upgrades Outpaced Downgrades for the Past 10 Quarters

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

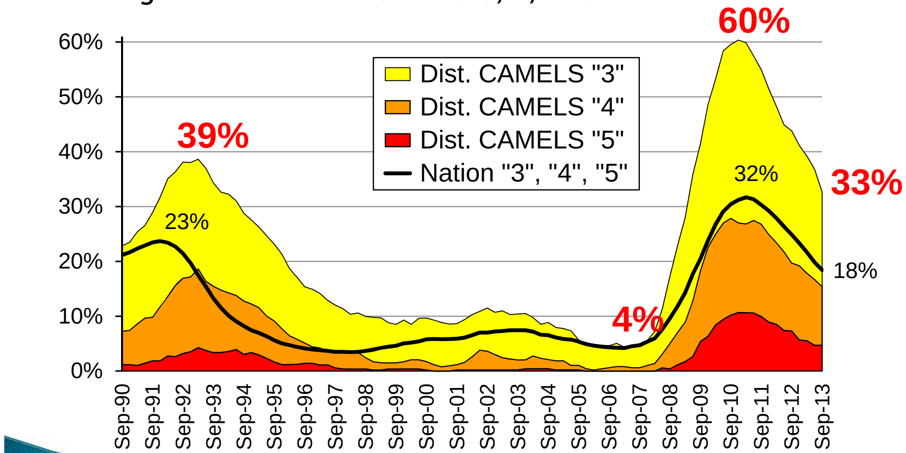


FRB-SF

Includes any change in composite CAMELS rating for commercial banks; quarterly trends based on examination completion dates (mail dates); preliminary 9/30/13 figures; updated 11/14/13

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

Percentage of Banks Rated CAMELS 3, 4, or 5



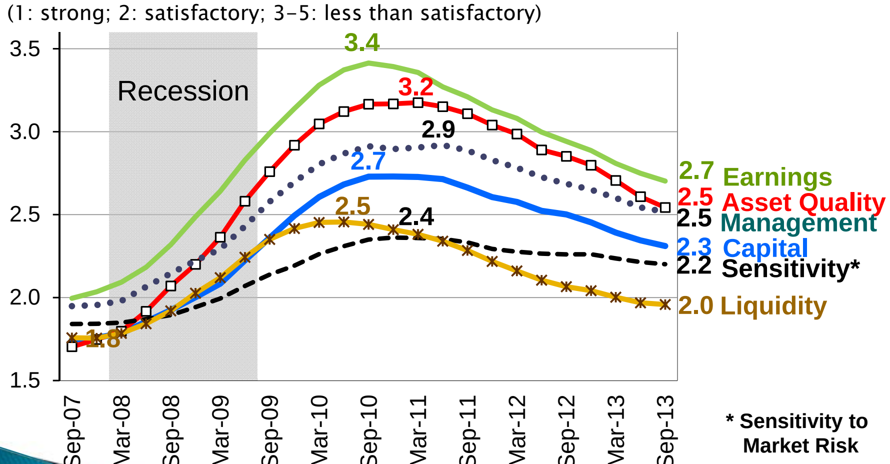
FRB-SF

Trends for all commercial banks based on examination completion dates (mail dates); preliminary 9/30/13 figures; updated 11/14/13

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)



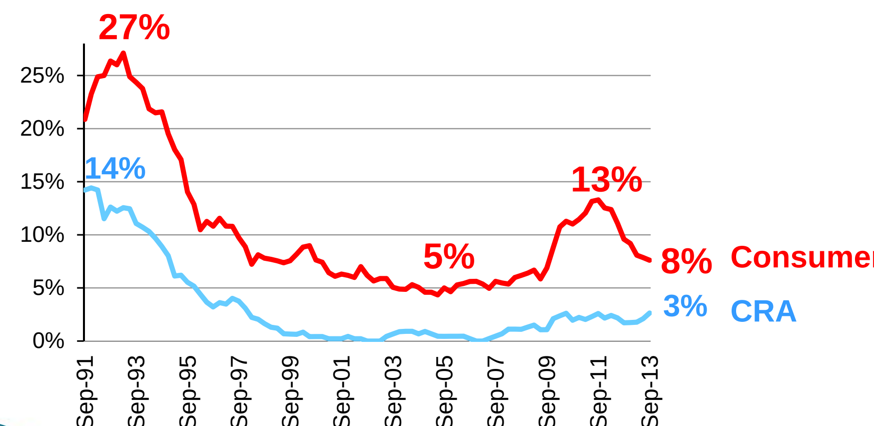
*** Sensitivity to Market Risk**

FRB-SF

Trends for all commercial banks based on examination completion dates (mail dates); preliminary 9/30/13 figures; updated 11/14/13

District Bank Consumer Ratings Improving with CRA Ratings Holding Steady

Percentage of District Banks with Less-than-Satisfactory Ratings



FRB-SF

Trends for all commercial banks based on examination completion dates (mail dates); CRA = Community Reinvestment Act; prelim. 9/30/13 figures; updated 11/14/13

Section 3 – Savings Institution and Industrial Bank Performance

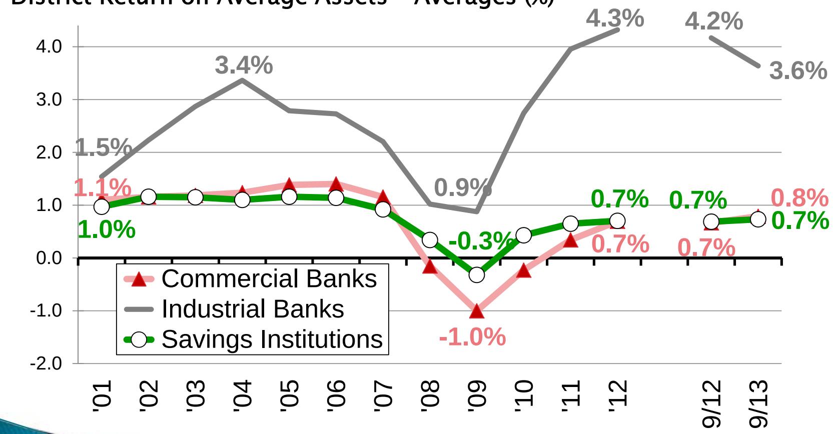
Slides in this section focus on trends among the 46 savings institutions and 30 industrial banks headquartered within the 12th Federal Reserve District.

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)

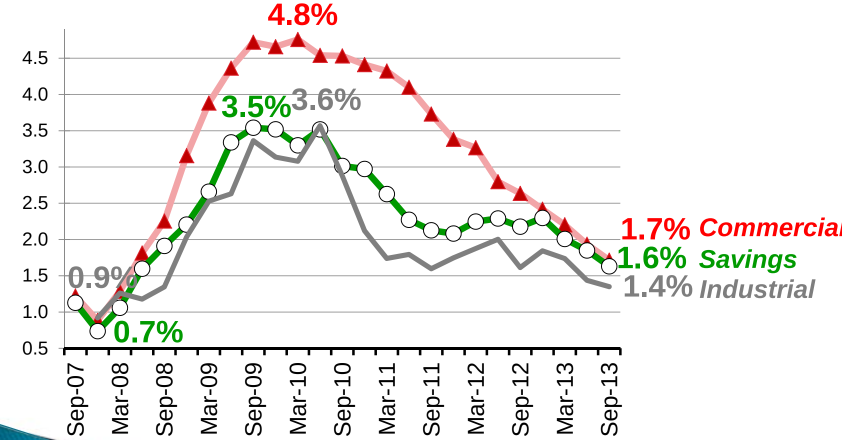
District Return on Average Assets – Averages (%)



Based on District commercial banks, savings institutions, and industrial banks; excluding De Novos; trimmed means; 3Q ratios YTD annualized; preliminary 9/30/13 data

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

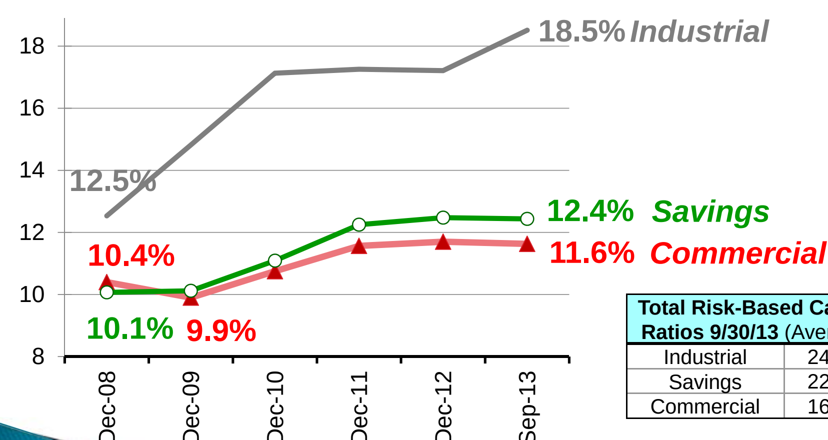
Average 12th District Noncurrent Loans and Leases /Total Loans and Leases – quarterly (%)



Based on District commercial banks, savings institutions, and industrial banks; excluding De Novos; trimmed means; Noncurrent = 90+ days past due or on nonaccrual; preliminary 9/30/13 data

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

Average 12th District Institution Equity/Assets Ratios

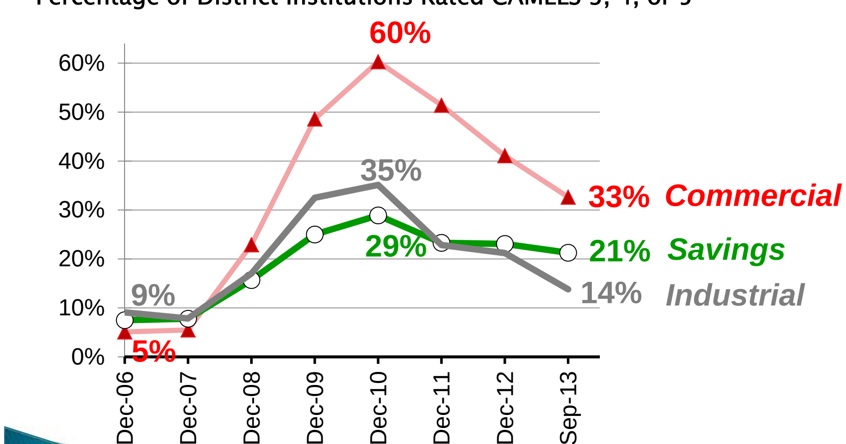


Total Risk-Based Capital Ratios 9/30/13 (Average)	
Industrial	24.4%
Savings	22.0%
Commercial	16.9%

Based on District commercial banks, savings institutions, and industrial banks; excluding De Novos; trimmed means; preliminary 9/30/13 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



Trends for all institutions based on examination completion dates (mail dates); preliminary 9/30/13 figures; updated 11/14/13

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.

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.

Bank Supervisors' Hot Topics

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/bankinforeg/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.

Bank Supervisors' Hot Topics

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

New capital rules implementing Basel III will be phased-in starting January 1, 2014, for advanced approaches firms. Former Capital Plan Review (CapPR) firms are transitioning to Comprehensive Capital Analysis & Review (CCAR), with their first supervisory stress test to be conducted in 2014. Other over-$10B institutions are preparing for their first submission under Dodd-Frank Act Stress Testing (DFAST) in March 2014.

Large and regional banks are expected to conduct regular stress tests to support their risk identification and capital and liquidity management. For more information on the Basel regulatory framework and U.S. banks, see: http://www.federalreserve.gov/bankinforeg/basel/USImplementation.htm.

Community banks become subject to Basel III on January 1, 2015. In November, the agencies released a regulatory capital estimation tool for community banks – see http://www.federalreserve.gov/newsevents/press/bcreg/20131119a.htm.

Bank Supervisors' Hot Topics

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. Erroneous 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

Aggregate District Commercial Bank Net Charge-Off Rates (%)	All Banks			Small Bks (<$1 Billion)	
	09/12	09/13		09/12	09/13
Construction & Land Development	1.02	(0.55)		1.81	0.29
Residential Construction	0.44	(0.45)		1.41	(0.09)
Other C&LD	1.17	(0.57)		1.94	0.42
CRE - Nonfarm Nonresidential Loans	0.33	0.08		0.50	0.15
Owner-Occupied	0.37	0.10		0.39	0.15
Nonowner-Occupied	0.30	0.07		0.59	0.16
Residential Closed-End Loans	0.97	0.40		0.90	0.25
Home Equity Loans	2.42	1.17		0.66	0.18
Multifamily Loans	0.03	(0.02)		0.19	0.00
Commercial & Industrial Loans	0.44	0.17		0.65	0.37
Agricultural Loans	0.80	(0.26)		(0.05)	0.12
Farmland Secured	0.64	(0.26)		0.81	(0.01)
Credit Card Loans	4.08	3.64		2.09	1.72
Installment Loans	0.82	0.78		0.87	0.52
Total Loans	0.86	0.40		0.65	0.22

NCO rates for all District commercial banks, annualized;
Red: >= 2%; Yellow: 0.75% to 2%; Green: net recovery. This data soon will be available at http://www.frbsf.org/banking-supervision/banking-economic-data/aggregate-data/ - see 12th District Net Charge-Off Rates

Appendix 2 – Banks Covered in this Report

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

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.