Overview

- Banking system structure
  - What does the industry look like?
  - Regulatory burden

- Overall conditions solid and improving

- Our biggest concerns
  - Energy prices
  - Commercial real estate concentrations
  - Cyber security
What is the structure of the U.S. banking system?
Banks by Asset Size

September 30, 2015

Percent of Total

Nationwide

- >$10 Billion
- $1-10 Billion
- $500 Million-$1 Billion
- $100-500 Million
- <$100 Million
Banks by Asset Size

September 30, 2015

Percent of Total

Nationwide       11th District

- Banks
- Bank Assets

- >$10 Billion
- $1-10 Billion
- $500 Million-$1 Billion
- $100-500 Million
- <$100 Million
Growth and Consolidation

U.S. Banks and Savings Associations

*As of September 30th.*
Who Supervises What?

- Office of the Comptroller of the Currency
  - National banks

- Federal Reserve System
  - State “member” banks
  - Bank holding companies

- FDIC
  - State “nonmember” banks
Regulatory Burden Rising
Financial reporting items:

1960: 241
2014: 1,955

Banking Laws:

Glass-Steagall (1933): 37 pages
Dodd-Frank (2010): more than 800
Expansive Rules

- Template-driven, formulaic regulation befitting transaction-oriented big banks
- Creates mismatch when applied to relationship-based, individualized approach of community banks
Cost Imbalance

- Increased regulation for community banks may do more harm than good
- They were not central to the crisis
- Their smaller scale increases the difficulty of absorbing regulatory costs
- This could drive further consolidation
A Simplified Regulatory Map

Source: The Economist; February 18, 2012
What are the conditions and performance of the banking industry?
Eleventh District Banks More Profitable than U.S. Banks

*Through September 30th, annualized.
District Loan Growth Slowing

Year-over-Year Growth, Percent

-10 -5 0 5 10 15 20


11th District 6.6%
U.S. 6.0%
Overall Asset Quality Improving

Percent of Loans Noncurrent

- U.S.
- 11th District

*As of September 30th*
One potential concern: Falling oil prices
Texas Bank Troubles Lag Oil Price Declines

- Oil Price per Barrel (WTI Spot Price, 2015 $)
- Texas Bank & Thrift Failures
- Percent of TX Banks with Texas Ratio > 100% (right axis)
From June 1980 to September 1986, oil prices declined 74%. By year-end 1988, 20% of all Texas banks had a Texas ratio greater than 100%. From September 1986 to year-end 1990, a total of 706 Texas banks and thrifts failed.
From 6/30/08 to 3/31/09, oil prices declined 65%. In 2008 and 2009, there were only seven Texas failures. In 2008 and 2009, less than 1% of Texas banks had a Texas ratio greater than 100%.
From September 2013 to December 2015, oil prices declined over 60%. Since September 2013, only one Texas bank has failed.
Oil and Gas Update

- Continuing Risk
  - Price of oil affects collateral valuations and borrower income
  - Low prices for extended durations will cause some loss
  - Do not expect large and wide-ranging losses across the industry

- Supervision activities continue
  - Recent exams for all large and regional banks, and most small banks
    - High sampling rates of O&G loans (80% or more)
    - Underwriting and credit administration still appropriate
    - Collateral valuation is conservative; amortizations are short
  - Monthly contact with banks to discuss O&G portfolio
Oil and Gas Update

- State Member Banks in good condition
  - 49 of 53 banks (92%) have energy loan concentrations of less than 25% of capital
    - One bank has a concentration of capital over 100%
    - Two banks are in “oil field” regions
  - Asset quality is good and banks are well-capitalized
  - Banks addressing decreasing collateral valuations
    - Borrowers asked to pledge additional collateral or pay down note
  - Loan committees meeting more frequently to review loans
  - Risks appear well managed to date
CRE Booming
(but for how long?)
CRE Prices Have Reached New Highs

Index, Dec. 2000=100

Source: CoStar Property Price Index (value-weighted).
CRE Credit Quality Nearing Pre-Crisis Levels

CRE Loans (% Noncurrent)

*As of September 30th.*
CRE Loan Concentration Rising

*As of September 30th.*
Regulatory guidance issued January 2007 suggests potentially significant CRE concentration if:

1) Construction and land development (CLD) loans equal 100 percent or more of risk-based capital, or
2) Total non-owner occupied CRE loans equal 300 percent or more of risk-based capital and CRE loan growth of 50 percent or more over the last three years.

Used to identify institutions for further supervisory analysis of the level and nature of their CRE concentration risk.

Percent of Institutions Exceeding CRE Guidance Thresholds Growing, Especially in the 11th District

Percent

Regulatory Guidance Issued Jan. 2007

11th District

U.S.

*As of September 30th.
(Yet) another concern: Cyber Security
Cyber Security Incidents Take Off

- Over 117,000 detected incidents per day in 2014
- 66% compound annual growth since 2009.

69% of victims were notified by an external party

78% of observed phishing emails were IT related, often attempting to impersonate the targeted company’s IT department

205 Days median number of days that threat groups were present on a victim’s network before detection

Cyber Security – Key Steps for Banks

- Conduct a self-assessment
  - Internal Audit or FFIEC self-assessment tool

- Get up-to-date intelligence
  - FS-ISAC alerts

- Assess third-party vendors
  - Review contract terms and assess performance regularly

- Have an incident response plan
Eleventh District IT Examinations

- Customized assessment based on size and complexity
- Focus on preparedness
  - Insider threats
  - Social engineering
  - Compensating controls (policy, procedure, and technology)
- Exam approach evolves as threats evolve
- Federal Reserve System committee studies threat landscape and recommends actions
Conclusion

- Banking structured evolved in ad hoc manner
- Regulatory burden a major complaint
- Banking conditions generally improving
- Impact from oil price decline
- Commercial real estate concentrations bear watching
- Cyber security a growing risk
Questions?
One potential concern: Interest rate risk
Long-term Assets

*As of September 30th.
Note: Long-term assets are loans and securities that mature or reprice in 5 years or more.
Nonmaturity Deposits

*As of September 30th.

Note: Non-maturity deposits are demand deposits, other transaction accounts, MMDAs and other savings deposits.
*2015 data are as of June 30th.

Note: Municipal securities are securities issued by U.S. states and political subdivisions.
Banks May Have More Exposure to Rising Interest Rates

Net Over Three-Year Asset/Liability Gap, Percent of Assets (Median Value)

*As of September 30th.*
Growth and Consolidation

11th District Banks and Savings Associations

*As of September 30th.*
Profitability by Federal Reserve District

Return on Assets, Percent

*Through September 30th, annualized.
Top Cyber Security Concerns

Source: Cyber Security for Financial Services Exchange
Does Your Bank Have a Website?

*As of September 30th.*
Banks and Cyber Security

- FFIEC self-assessment tool
- Middle market and smaller also vulnerable
- Third parties
  - Vendors
  - Commercial customers
- Importance of incident response
Eleventh District Customized Assessment

- Developed beginning in 2014
- Didn’t wait for rest of System
- Based on institution size and complexity
- Focus on preparedness
- Much is left to examiner discretion