

# ***Banking Conditions & Dodd-Frank Progress***

Prepared for:

**L.A. Chapter**

**National Association of Business Economists**

**Los Angeles, CA**

June 9, 2011

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*Disclaimer: Views expressed are those of the presenter and are not necessarily those of the Federal Reserve Bank of San Francisco or the Board of Governors.*

## ▶ **Banking Conditions**

[www.frbsf.org/publications/banking/index.html](http://www.frbsf.org/publications/banking/index.html)

## ▶ **Dodd-Frank Act Implementation**

- **A Progress Report**

**Earnings**

**Asset Quality**

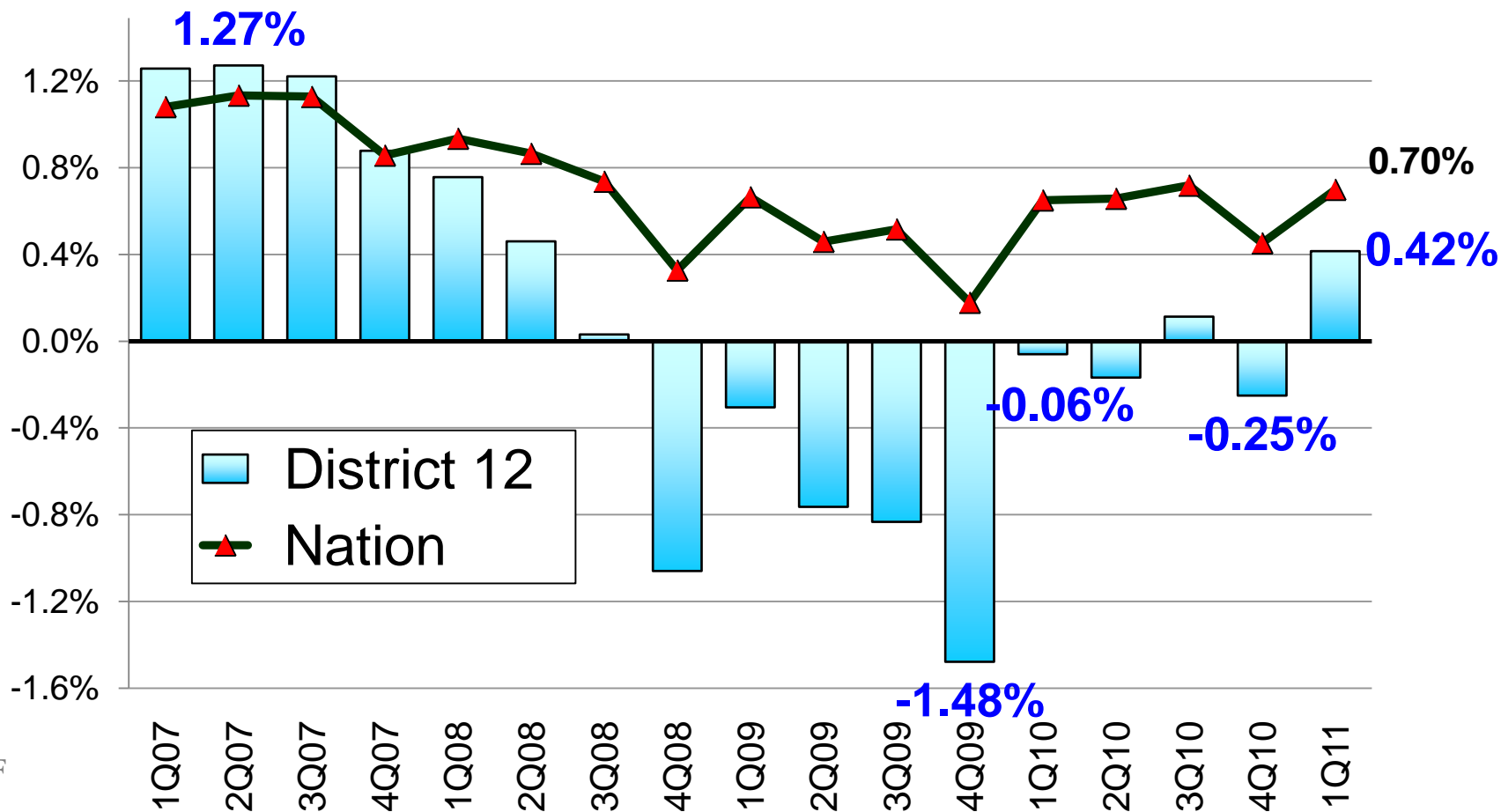
**Liquidity**

**Capital**

**CAMELS Ratings**

# 1Q11 Results: Best District Bank Profitability Since 2Q08

Average Return on Average Assets - quarterly, annualized (%)

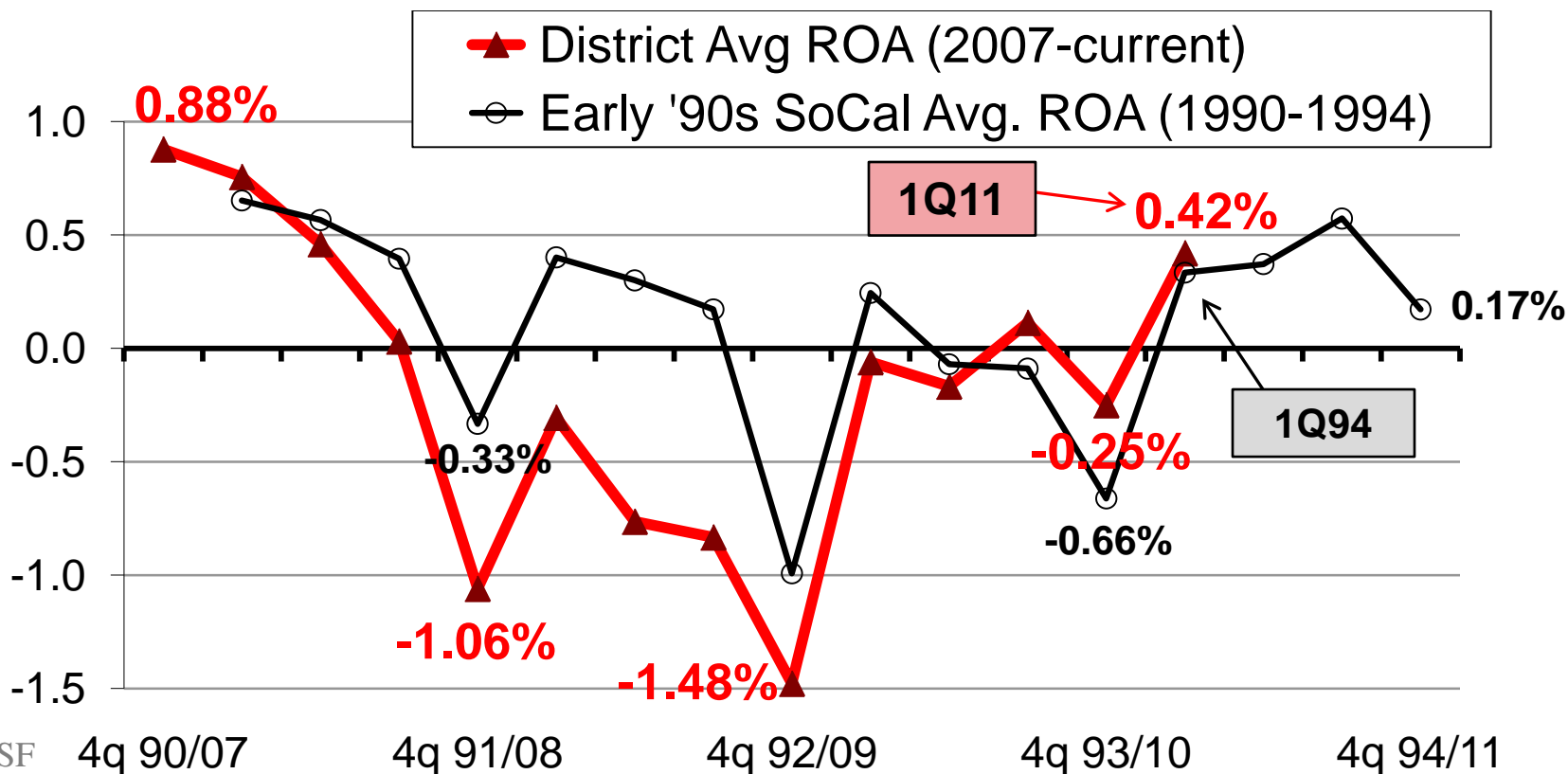


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Source: Regulatory Call & Income Reports; all banks excluding De Novos; trimmed means; quarterly ratios are annualized; prelim 1Q11 data

# District Avg. ROA Continued 4-Year Cyclical Pattern Similar to Early '90s SoCal; Relatively Strong Results in 1Q11

1-Qtr Average ROA (%) – Mapping SoCal '91 to District '08, etc.



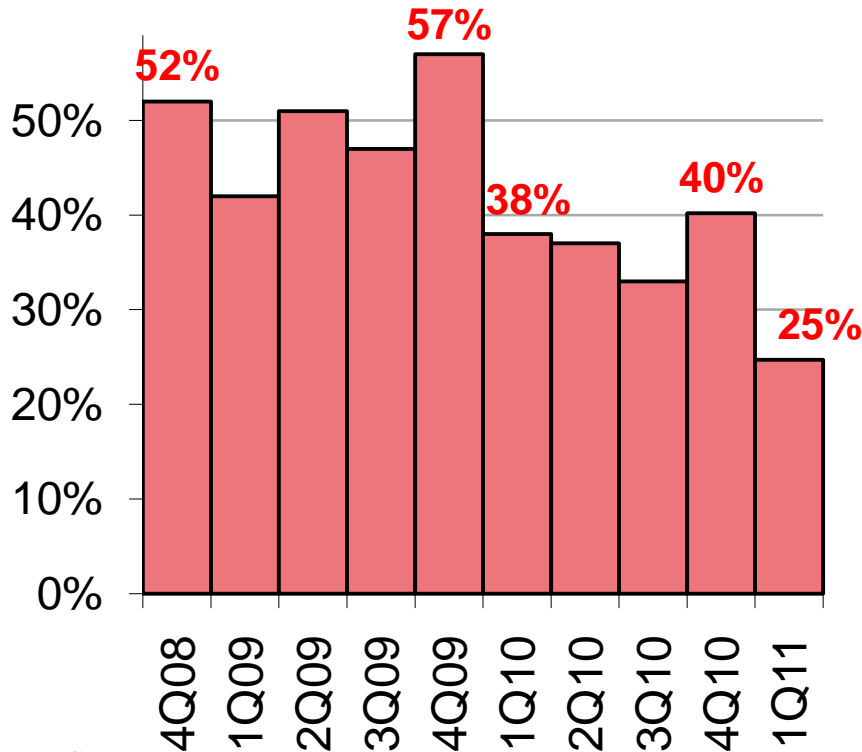
The SoCal bank avg. ROA from 4q1991 is mapped against the District bank avg. ROA of 4Q2008; 1Q1992 is mapped against 1Q2009, etc. During down cycles, ROA tends to be cyclical, with the strongest performance in 1<sup>st</sup> quarters and weakest in 4th quarters.

Source: Regulatory Call & Income Reports; all banks excluding De Novos; trimmed means; quarterly ratios are annualized; 1990s data exclude industrial & savings banks

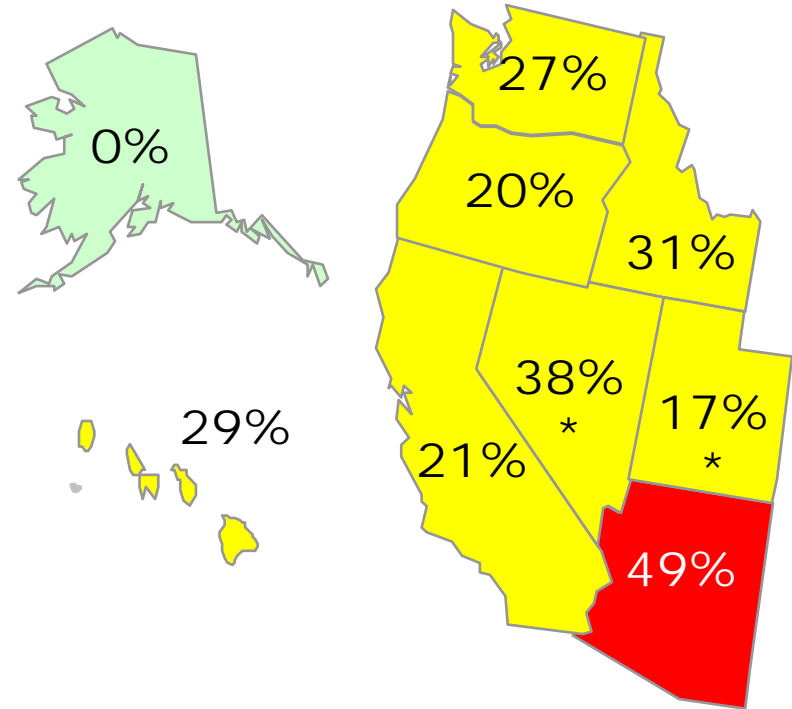
# Just 25% of District Banks Lost Money in 1Q11, the Best Quarter in 3 Years

*Percentages in AZ, ID, NV and WA Still High*

Percentage of Banks Reporting Net Losses by Quarter



Percentage of Banks Reporting Net Losses in 1Q2011



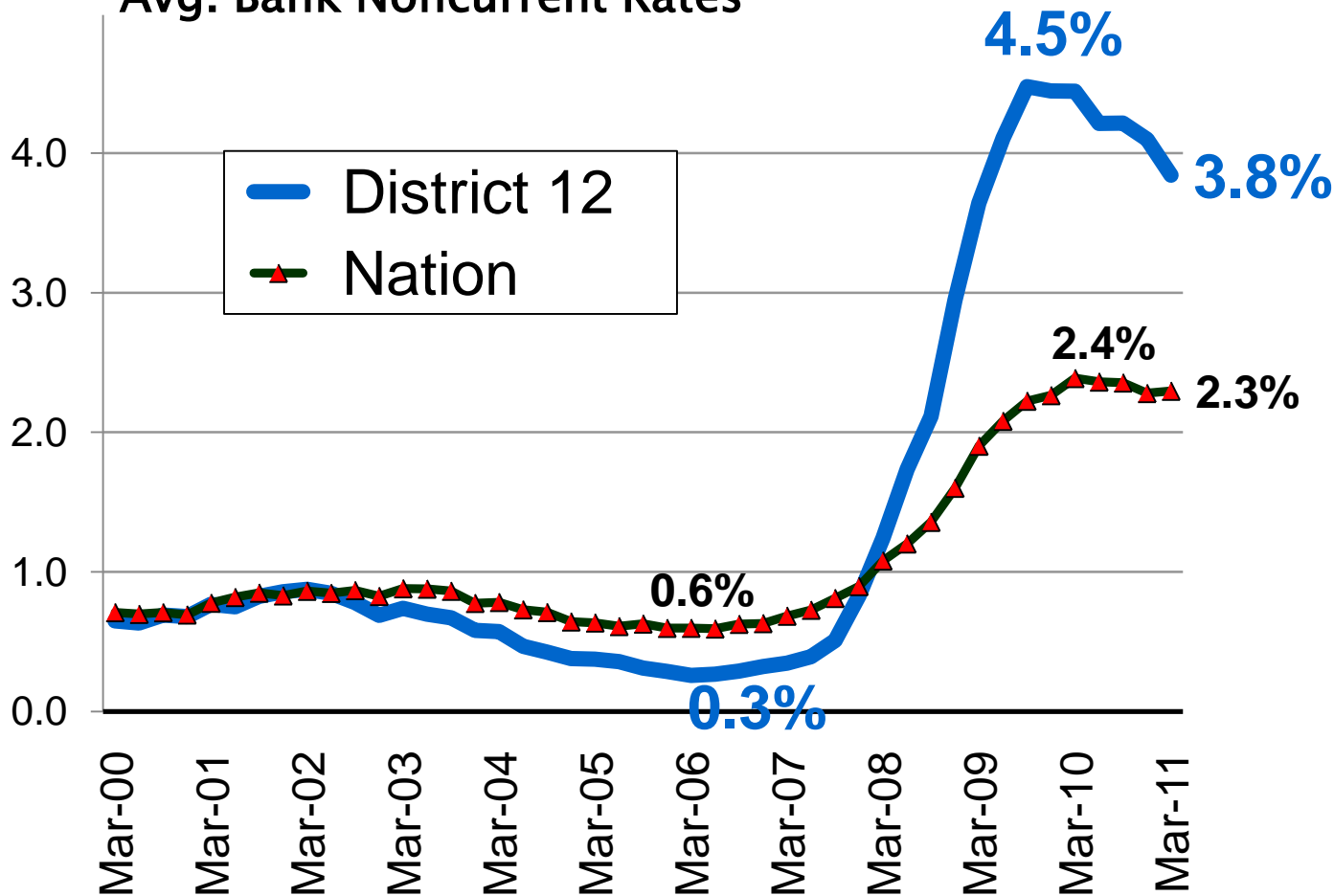
Source: Regulatory Call & Income Reports; banks excluding De Novos; preliminary 1Q11 data

Red: >40%; Yellow: 15%–40%; Green < 15%

\* Excl. Industrial banks, 27% of UT banks and 45% of NV banks lost money in 1Q2011

# 12<sup>th</sup> District Banks' Avg. Noncurrent Rate has Reduced at a Faster Pace than the Nation

Avg. Bank Noncurrent Rates



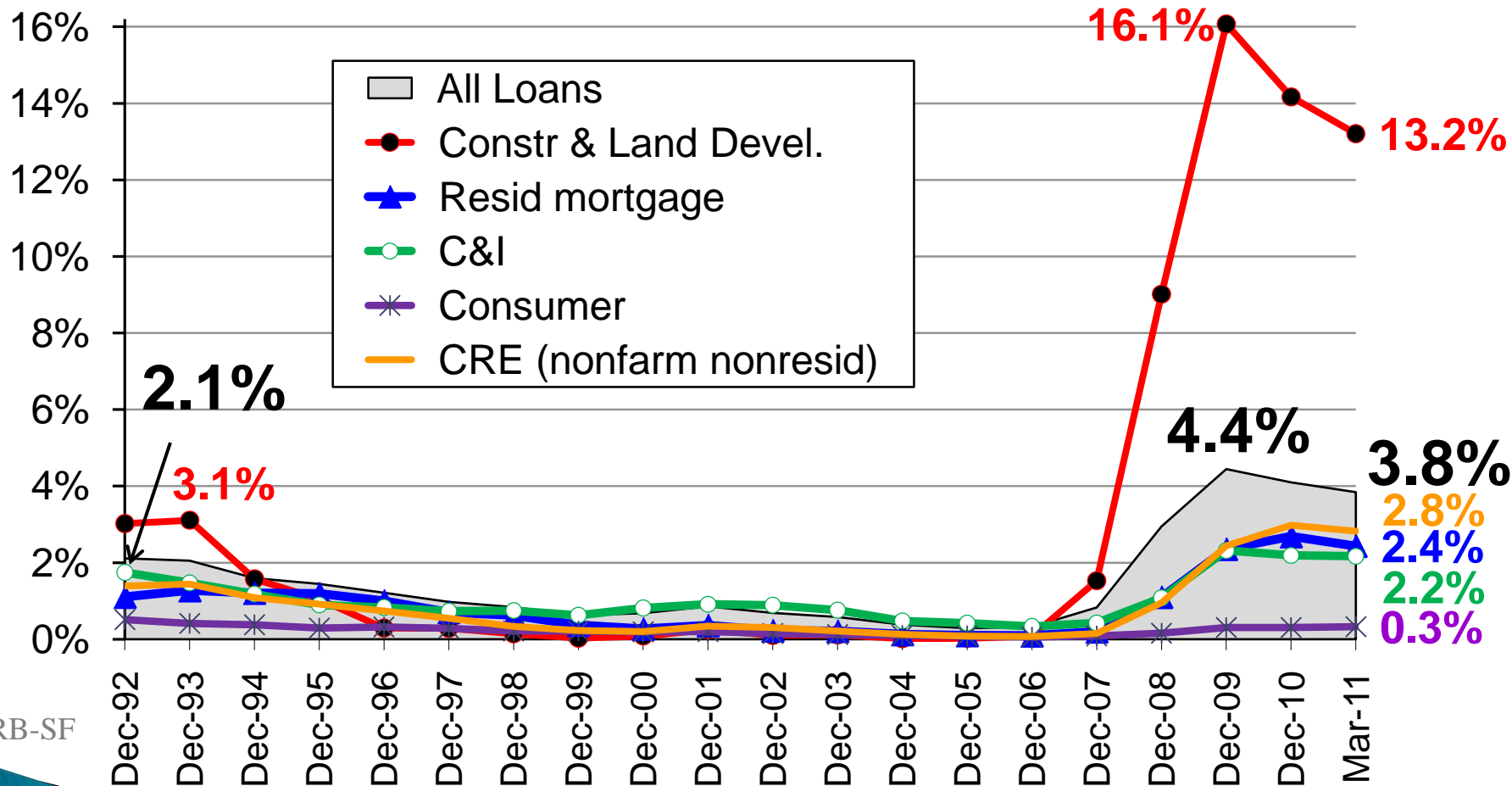
Avg. Noncurrent Rate by Fed District 3/31/11		
1	6-Atlanta	4.2%
2	12-San Fran	3.8%
3	5-Richmond	3.4%
4	2-New York	2.6%
5	7-Chicago	2.3%
6	9-Minneapolis	2.2%
7	3-Philadelphia	2.1%
8	4-Cleveland	2.1%
9	8-St. Louis	1.8%
10	1-Boston	1.8%
11	10-Kansas City	1.6%
12	11-Dallas	1.2%

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Source: Regulatory Call & Income Reports; banks excluding De Novos; trimmed means; preliminary 1Q11 data

# Noncurrent Rates in Key Loan Categories are Edging Downward

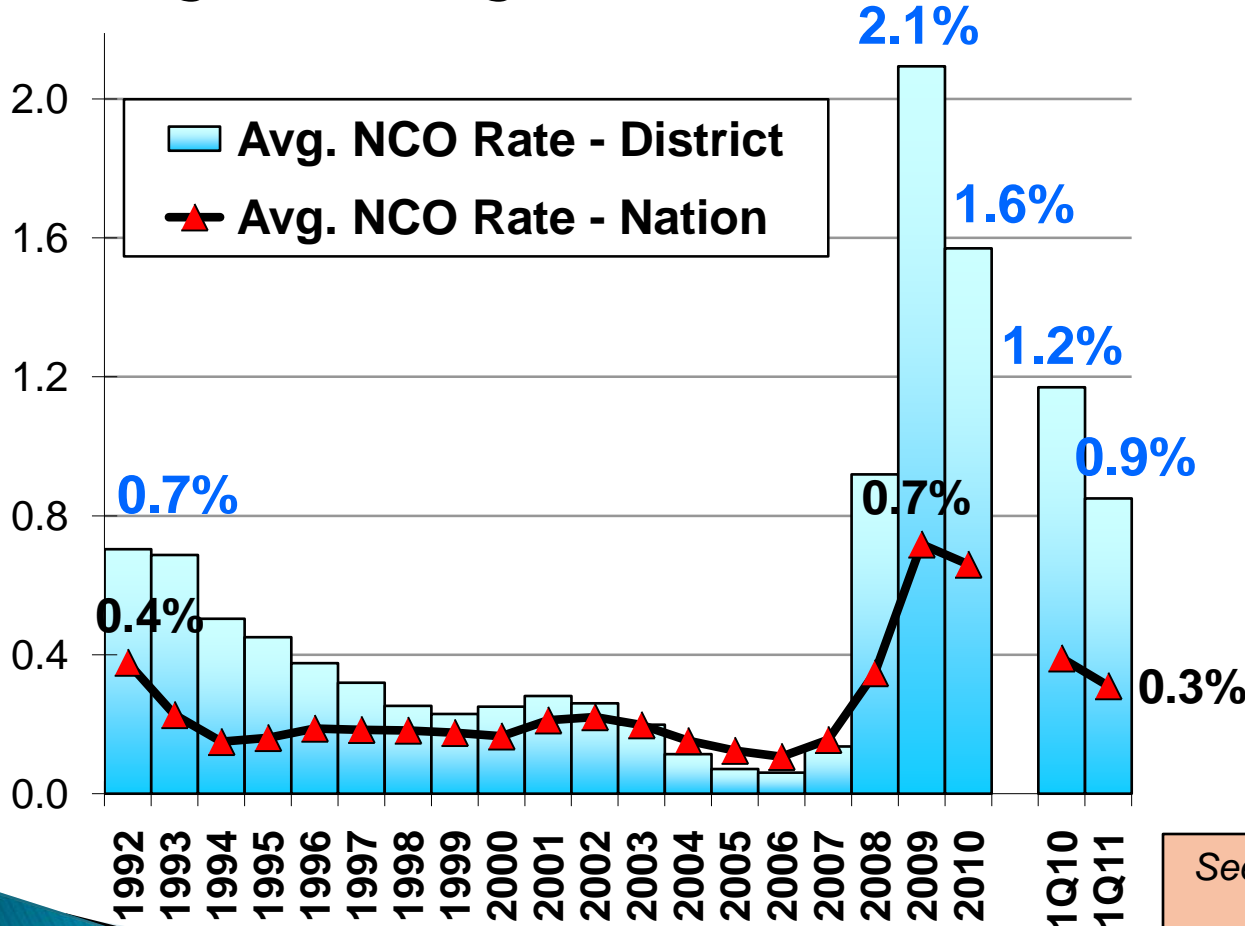
12<sup>th</sup> District Bank Noncurrent Loan Rates (Pctg. of loans 90+ days past due or on nonaccrual)



Source: Regulatory Call & Income Reports; all banks excluding De Novos; trimmed means, preliminary 3/2011 data

# Net Charge-Off Rates Remained High, but Down Considerably from Prior Year

Average Net Charge-Off Rates (%)



Avg. NCO rates		
rank	state	1Q11
2	NV	1.93%
3	UT	1.21%
4	AZ	1.15%
7	WA	1.10%
9	ID	0.99%
11	OR	0.85%
14	CA	0.63%
25	HI	0.29%
39	AK	0.14%
	Dist	0.85%
	Nat	0.31%

Red: > 2%; Yellow: 1% to 2%

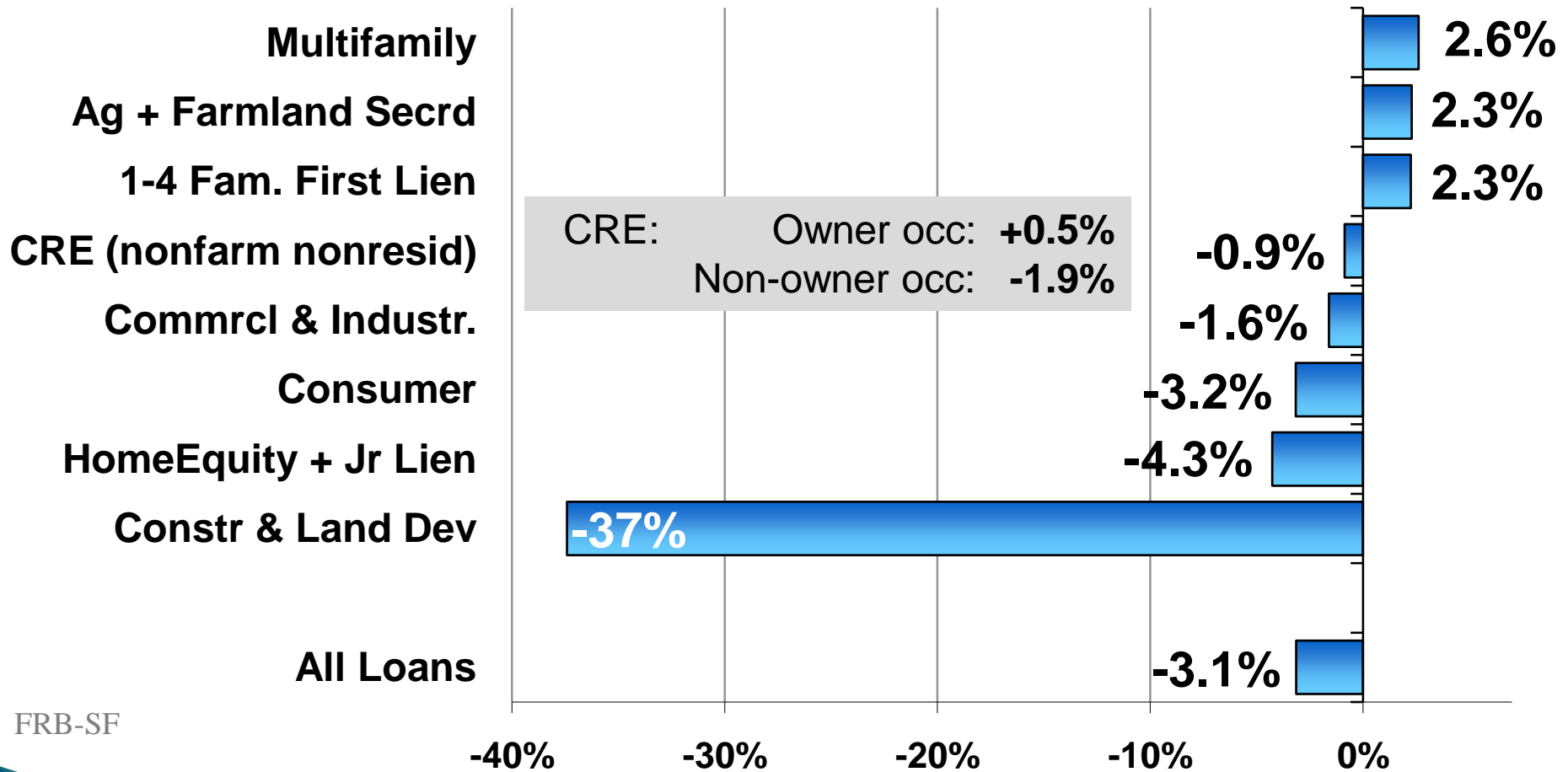
See Appendix 2 for Detailed Aggregate District Net Charge-Off Rates

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Source: Regulatory Call & Income Reports; all banks excluding De Novos; trimmed means; 1Q11 data are preliminary and annualized

# Annual Loan Growth Positive only for Ag and Residential Loan Categories

12<sup>th</sup> District Bank Aggregate Loan Growth Rates – 12 months ending 3/31/11



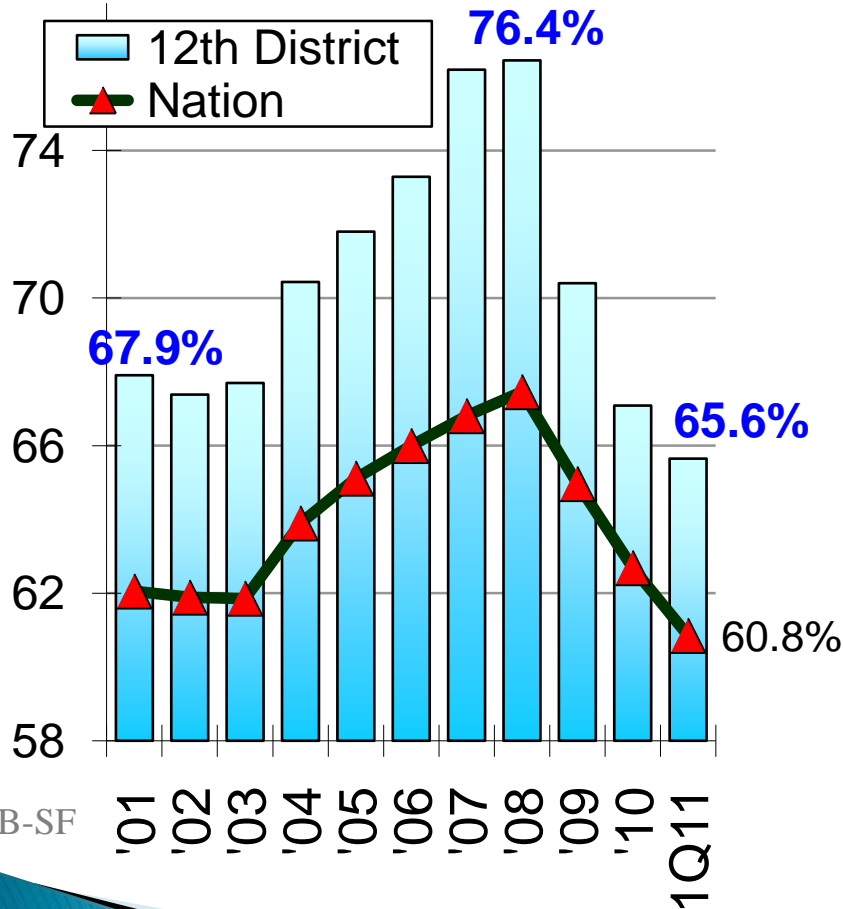
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Based on a panel of District commercial banks with assets < \$100B; excludes banks with significant mergers, loan sales or loan purchases over the period

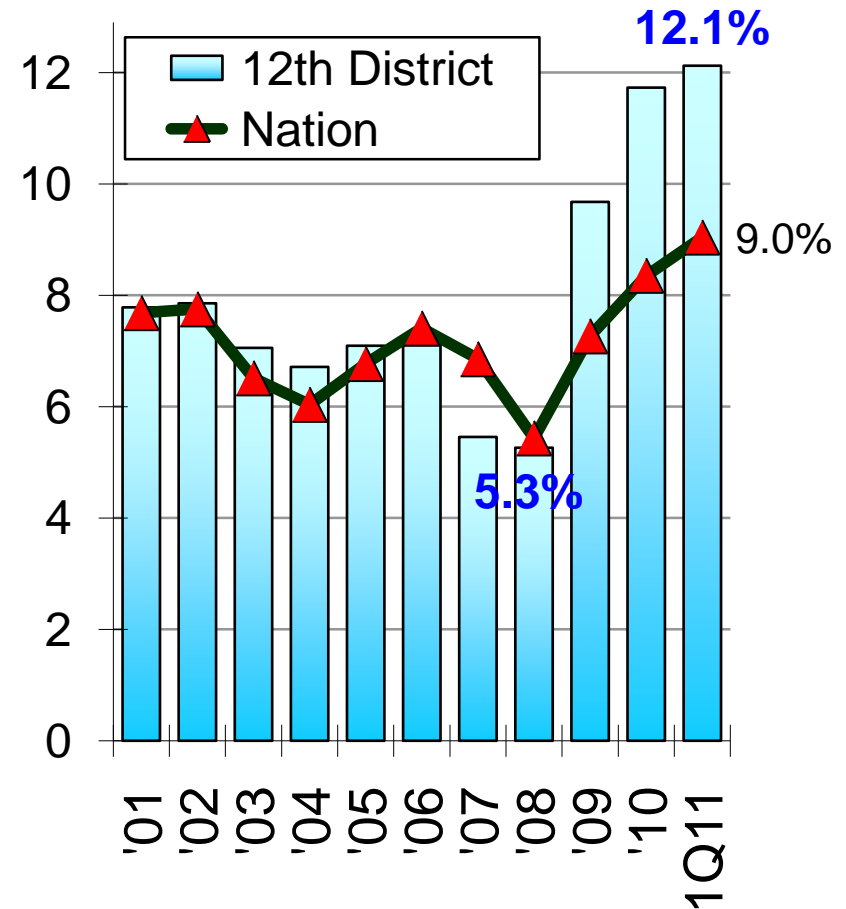
# Balance Sheet Liquidity Ratios Continued to Improve

## *Due to Declines in Total Loans*

Loans/Assets (adj. average %)



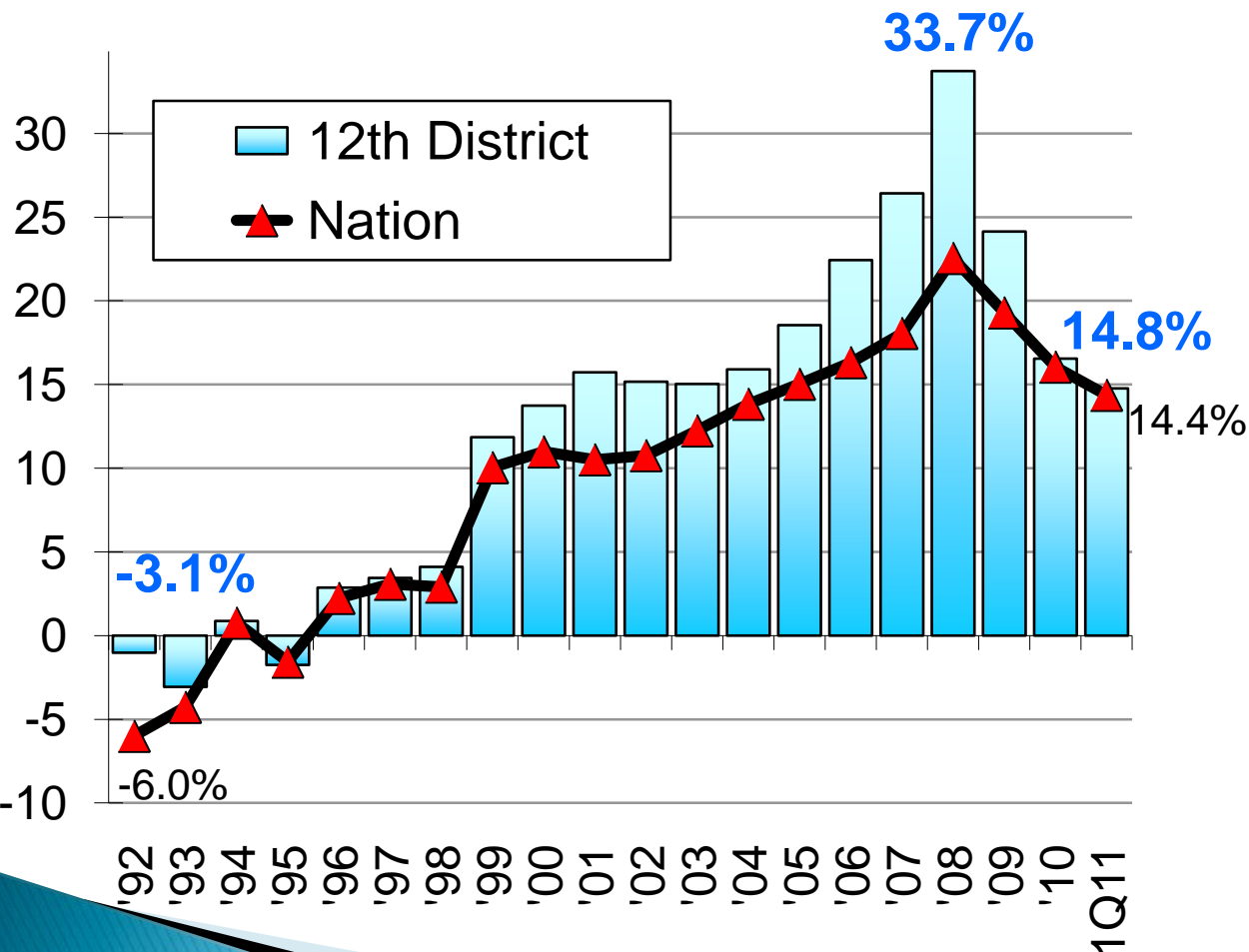
Short Term Investments/Assets (adj. avg. %)



Source: Regulatory Call & Income Reports; all banks excl. De Novos; trimmed means, prelim 1Q11 data

# Average Reliance on Noncore Funding Sources at Lowest Level in 10 Years

Net Noncore Funding Dependence (Adjusted Average %)



## Net Noncore Funding Dependence

*The degree to which banks fund longer-term assets with noncore funding*

### Definition:

Noncore funding (e.g., brokered deposits, large CDs, borrowed money) minus short-term investments (e.g., fed funds sold, securities with one year or less remaining maturity, interest bearing bank balances)

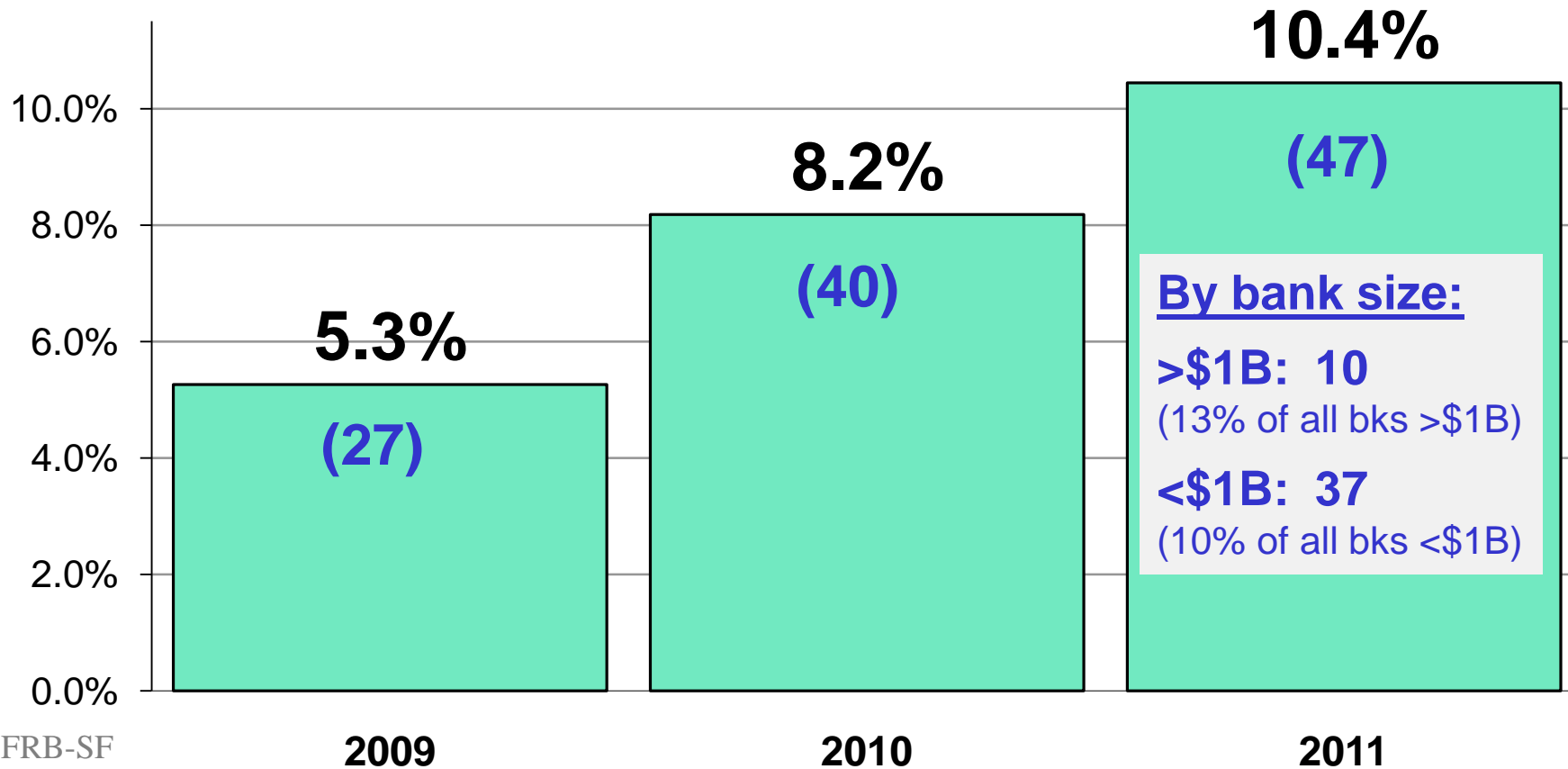
Divided by: Longer-term assets (net loans and securities with remaining maturities over one year and non-investment other real estate owned)

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Source: Regulatory Call & Income Reports; all banks excl. De Novos; trimmed means, prelim 1Q11 data

# Common Equity Raising / Injections from Parent Company Up Significantly

Pct (and number) of District Commercial Banks Obtaining Significant Volumes of Capital in Preceding 12 Months (>3% of Bank's Avg. Assets)



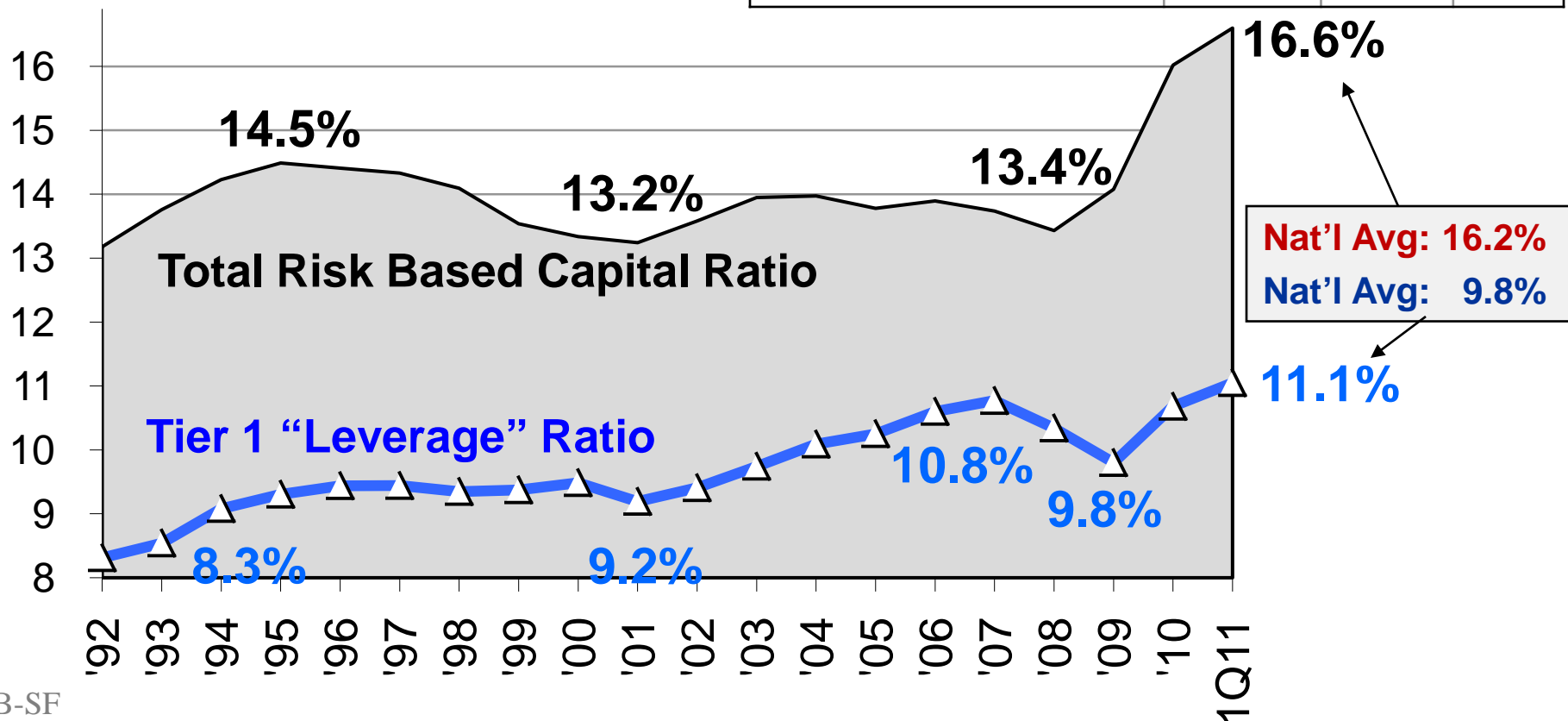
Source: Regulatory Call & Income Reports; capital raises at District commercial banks that occurred in 12-months ending 3/31 of each year, excludes preferred stock increases; preliminary 3/11 data

# Loan Reductions & New Capital Boosted Capital Ratios

*These Two Factors Contributed Equally to Improved Ratios Over the Past Year*

12<sup>th</sup> District bank average capital ratios (%)

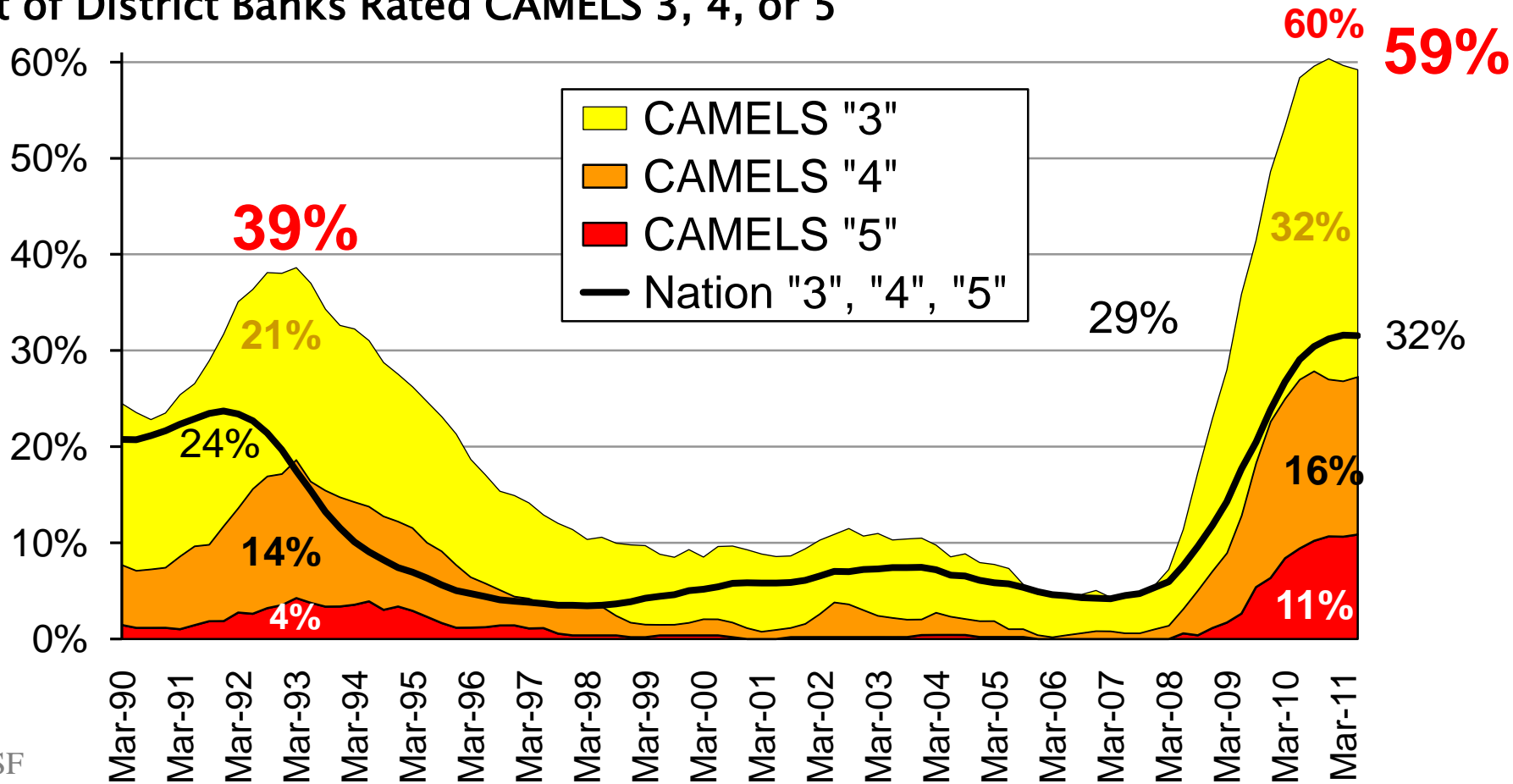
Pct. of District Banks	12/09	12/10	3/11
Less than Well Capitalized*	13.0%	7.7%	7.2%
Below Minimum Standards*	7.7%	4.7%	4.1%



Source: Regulatory Call & Income Reports; chart: trimmed means for all banks excluding De Novos; preliminary 1Q11 data. \*Capital categories based on Prompt Corrective Action framework, using Call report data (not examination adjusted)

# Percentage of 12<sup>th</sup> District Banks Rated CAMELS 3, 4 or 5 Edged Lower to 59%

Pct of District Banks Rated CAMELS 3, 4, or 5



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Trends for all banks based on examination completion dates (mail dates); the latest totals should be considered preliminary, subject to change; updated 05/12/11

# DFA Implementation

## Progress Report

# Comments/Opinions on Specific Dodd-Frank Matters.....

The Federal Reserve Board is charged with significant rule-writing responsibilities. To help ensure that the rule-writing process is conducted in a fair, open and transparent manner that is consistent with federal law, Federal Reserve policy requires documentation of communications between the public and the Federal Reserve on matters related to a Federal Reserve rulemaking under Dodd-Frank.

**Any comments on specific matters related to Dodd-Frank must be summarized in a memo and posted to the Federal Reserve Board's public web site**

To submit formal written comments on any Federal Reserve rule pertaining to Dodd-Frank, see:

[http://www.federalreserve.gov/newsevents/reform\\_proposals.htm](http://www.federalreserve.gov/newsevents/reform_proposals.htm)



## Dodd-Frank Act – Progress?

“ I see a whole lot of choppin, but I don’t see too many chips”.



Quote from Foghorn J.  
Leghorn

# Dodd-Frank Act – Federal Reserve Progress

- ▶ Federal Reserve is making substantial progress on 255 work-streams related to rulemaking, consultations, studies/reports, process and organizational changes.
  - ▶ Work streams incorporate Board only requirements, and includes coordination with the FSOC, FDIC, OCC, SEC, CFTC, GAO, and the new Consumer Bureau.

Area	Rules	Consult	Studies/ Reports	Process	Total
Financial Stability & Systemic Risk	34	5	8	20	67
Governance	3	4	4	7	18
Banking Supervision	23	7	8	21	59
Derivatives	7	7	0	3	17
Payments, Clearing & Settlements	12	1	3	13	29
Consumer Protection	24	7	1	33*	65

\* Includes 20 work-streams related to CFPB Transition

# Dodd-Frank Act – Completed Initiatives

- ▶ **Issued four (4) final rules:**
  - ▶ Truth in Lending Act: Exemption Threshold Increase;
  - ▶ Volcker Rule Conformance Period;
  - ▶ Truth in Lending Act Escrow Requirements; and
  - ▶ Appraisal Independence Rule.
- ▶ **Completed five (5) process and organizational changes;** including the establishment of an Office of Financial Stability Policy and Research, and the establishment of the Office of Minority Women & Inclusion (OMWI).
- ▶ **Issued seventeen (17) proposals** covering key issues such as Resolution Plan (Living Will) requirements, Residential Mortgage Requirements, Credit Risk Retention, Incentive Compensation, Debit Interchange, Risk Management Standards for Financial Market Utilities (FMU), etc.
- ▶ **Issued nine (9) studies and reports;** including Volcker Rule Activity Restrictions, Bankruptcy-Related Studies, Study of Macroeconomic Effects of Risk Retention, etc.
- ▶ **Acted as Adviser on three (3) FSOC studies** related to the establishment of the FSOC office, Volcker Rule, and Designation of NonBank Financial Companies for Enhanced Consolidated Supervision.

# Dodd-Frank Act Pipeline Activity

- ▶ **Several final rules are expected in the coming months – Through July**
  - ▶ Debit Interchange
  - ▶ Incentive Compensation
  - ▶ Significant BHC and Nonbank Financial Company Rules (criteria that will be considered for possible FSOC SIFI Designation)
  - ▶ FSOC is expected to issue final rules regarding their authority to designate certain nonbank financial companies for enhanced consolidated supervision by the Federal Reserve, and designate FMU's as systemically important.
- ▶ **Several key proposals are also expected in the coming months**
  - ▶ Enhanced Prudential Standards for Large BHCs and Nonbank Financial Companies Designated for Consolidated Supervision
  - ▶ Section 13(3) Policies and Procedures
  - ▶ Volcker Rule (Activity Restrictions, Concentration Limits)

# Dodd-Frank Act Pipeline – After July

- ▶ **Expect to finalize rules on:**
  - ▶ Risk Management Standards for Financial Market Utilities (FMUs)
  - ▶ Credit Risk Retention on Asset-Backed Securities
  - ▶ Swap Margin Requirements (Swap Dealers, Security Based Swap Dealers, Major Swap Participants, and Major Security Based Swap Participants)
  - ▶ Criteria for requiring the formation of an Intermediate Holding Company for a Grandfathered Unitary Savings & Loan Holding Company
  
- ▶ **Expect to issue key proposals on:**
  - ▶ Minimum Leverage and Risk Based Capital Requirements (Collins Amendment)
  - ▶ Credit Rating Alternatives

# Dodd-Frank Act – Industry Questions

- ▶ Will the Title I and II framework pro-actively identify and develop appropriate mechanisms to withstand and mitigate another systemic shock to the U.S. Economy?
- ▶ Will the business models for very large and systemic organizations attract the requisite capital and management talent to meet evolving supervisory expectations (e.g., Enhanced Prudential Supervision, Basel 3), or will significant changes need to be made?
- ▶ What is the future of the community bank as the direct and indirect costs of DFA materialize?
- ▶ Will the new Consumer Protection Bureau policies result in credit rationing?
- ▶ Why is the Federal Reserve regulating commerce? (Debit Interchange)

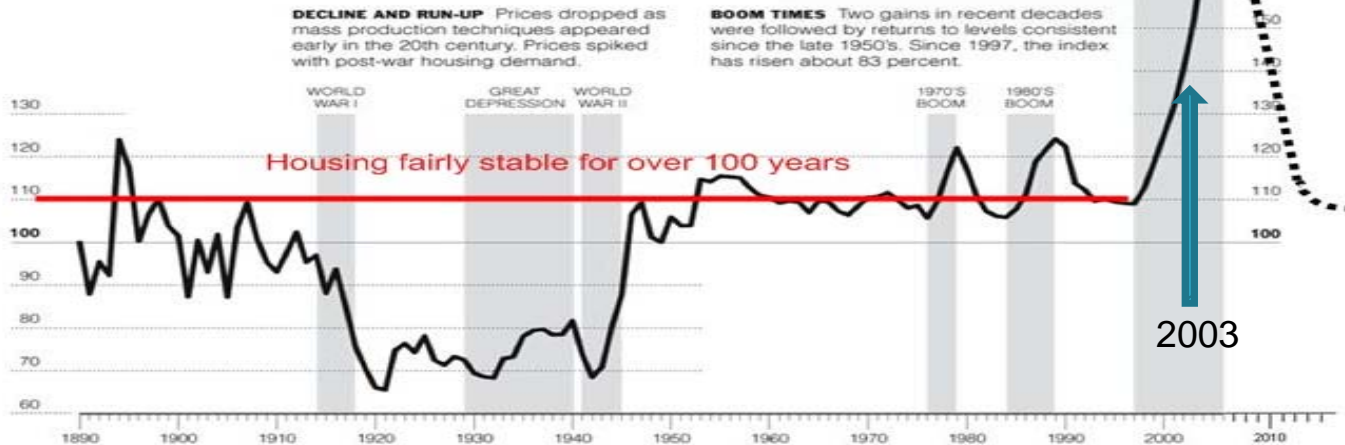
# Systemic Risk – When to Act?

## A History of Home Values

The Yale economist Robert J. Shiller created an index of American housing prices going back to 1890. It is based on sale prices of standard existing houses, not new construction, to track the value of housing as an investment over time. It presents housing values in consistent terms over 116 years, factoring out the effects of inflation.

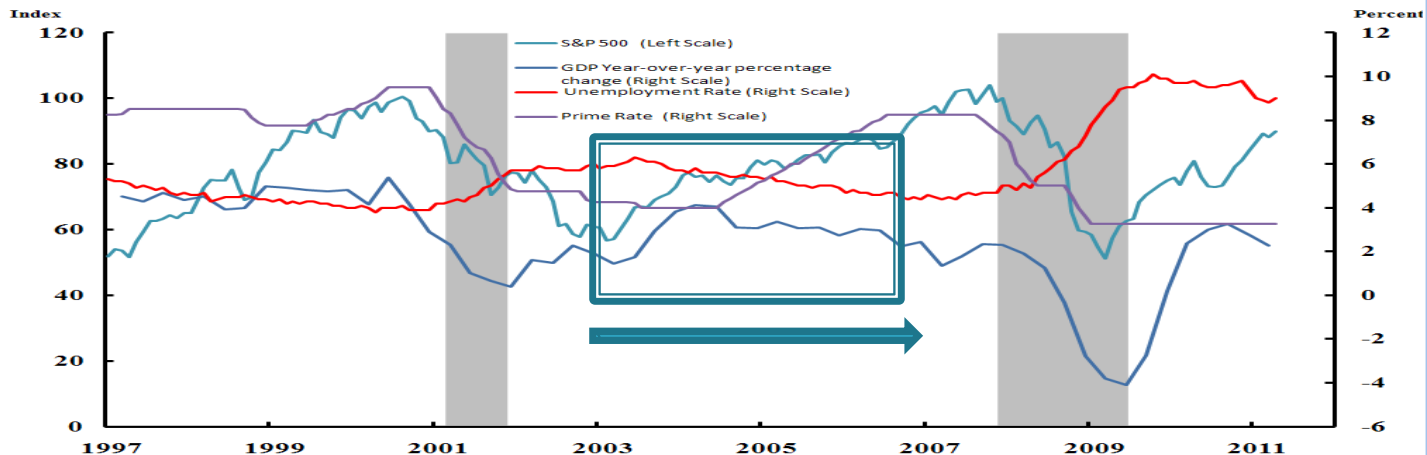
The 1890 benchmark is 100 on the chart. If a standard house sold in 1890 for \$100,000 (inflation-adjusted to today's dollars), an equivalent standard house would have sold for \$66,000 in 1920 (66 on the index scale) and \$199,000 in 2006 (199 on the index scale, or 99 percent higher than 1890).

What happened here?



## S&P 500, GDP, Unemployment, and Prime Interest Rate

Indexed to 2007Q4=100



# In Conclusion....

*(Banking Conditions & Dodd-Frank Update)*

- ▶ Housing bust led to three tumultuous years for western banks *(13% failure rate for District banks/thrifts)*
- ▶ Assuming the economy stays on course, 2011 should be a year of incremental banking recovery
- ▶ **Caution:** we probably haven't seen the full extent of CRE income property loan problems
- ▶ **Dodd-Frank Act** has many good & well-intentioned components; overall it should result in an improved U.S. financial sector with a more level playing field between banks and nonbanks.
- ▶ However, it will add costs and uncertainty to an industry already under significant strain.

# Questions / Discussion

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# Overview of Rulemaking Process

## Typical U.S. federal rulemaking under the Administrative Procedure Act:

- **Advance Notice of Proposed Rulemaking (ANPR) (optional)**
  - Sets forth the Agency's initial analysis of the subject matter
  - Provides opportunity for early public comment
- **Notice of Proposed Rulemaking (NPR)**
  - Agency publishes actual proposed regulatory language in Federal Register
  - Includes discussion of justification and response to early public comments
- **Request for Public Comment**
  - Publication triggers a formal public comment period (30 to 180 days)
  - Agency is required to consider issues and concerns raised in comments
- **Final Rule**
  - Proposed rule often becomes the final rule with modifications
  - Final rule accompanied by updated justification and response to comments
  - If modifications are substantial, the agency may publish a second proposed rule