Office of the
Comptroller of the Currency

MDIAC Meeting

April 25, 2023

State of MDIs

Financial Information as of December 31, 2022

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Agenda

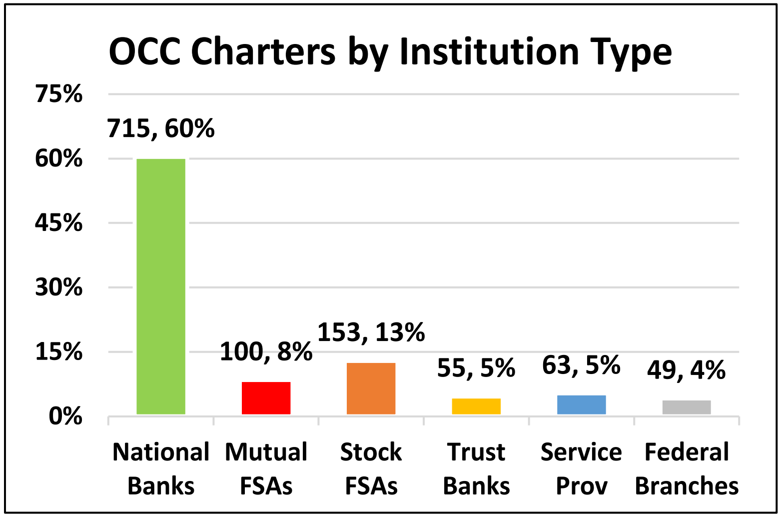
This presentation will focus on:

- **Portfolio Demographics**
- **Supervisory Information**
- **Financial Performance**
- **Economic Challenges**

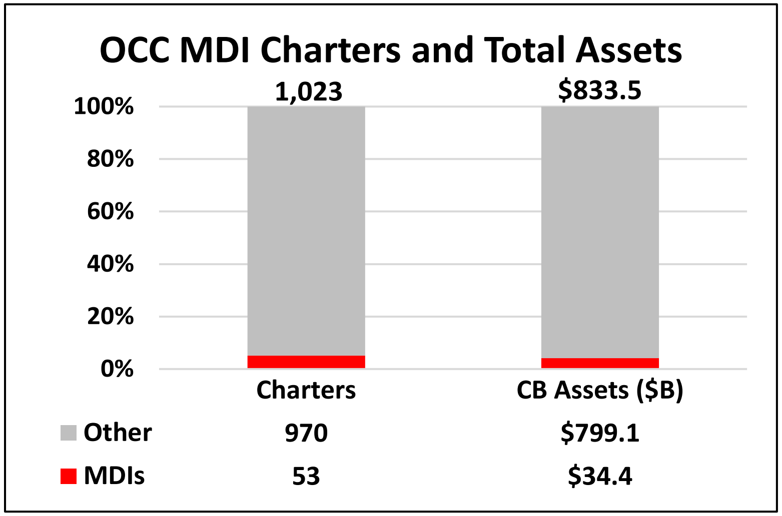
Preface: The current bank population as of December 31, 2022, is "held constant" for financial analysis. Financial trend charts start in 2008. All federal savings associations (FSAs) have filed the commercial bank call report since 2012. Some charts use the median; others use weighted averages.

MDI Charters and Total Assets

- OCC supervised 1,135 total institutions or 1,023 bank charters (first 4 columns) as of December 31, 2022.

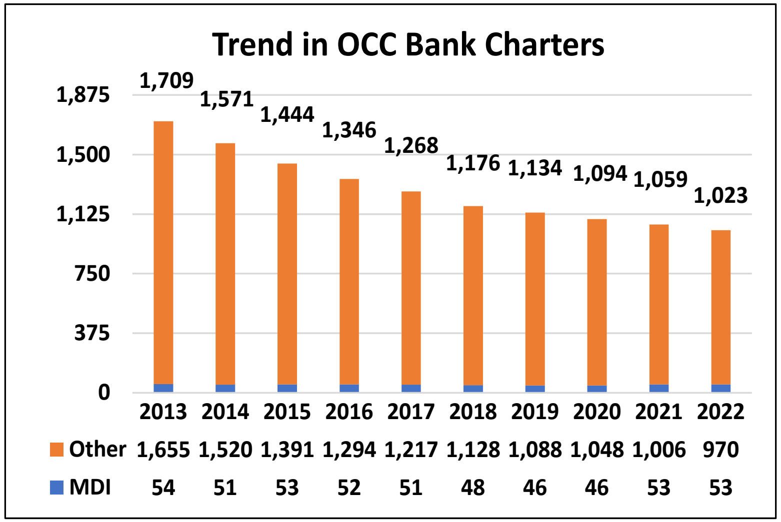


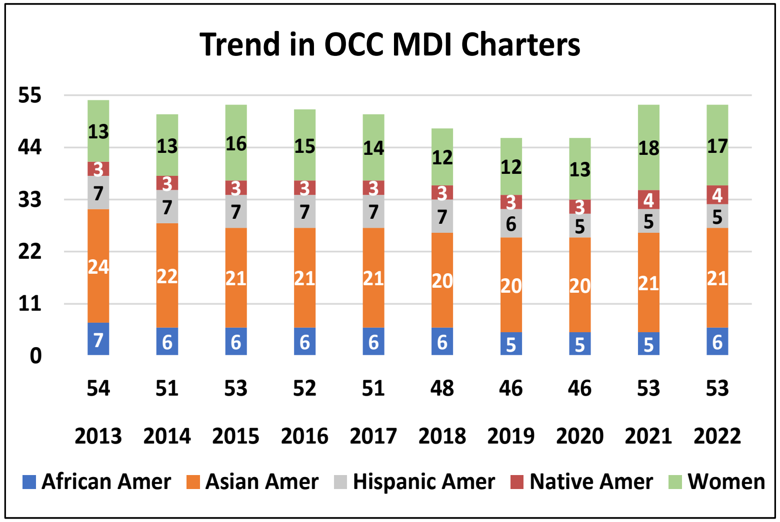
- Minority Depository Institutions (MDIs) represent 53 or 5.2 percent of OCC-supervised bank charters and $34.4 billion or 4.1 percent of OCC-supervised community bank assets as of December 31, 2022.



Trends in OCC and MDI Charters

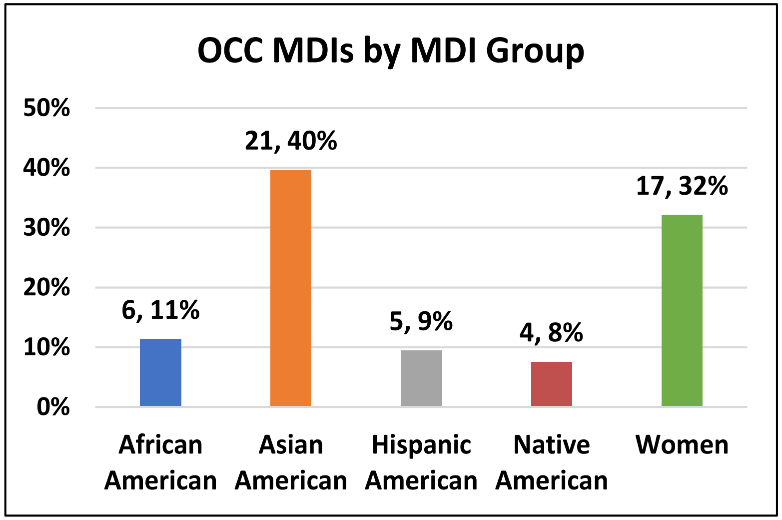
- The banking system continues to consolidate. MDIs are increasing as a share of total OCC charters. The number of MDIs decreased by one since 2013 but the net number of total OCC charters decreased by 686 or 40 percent due primarily to mergers and acquisitions.



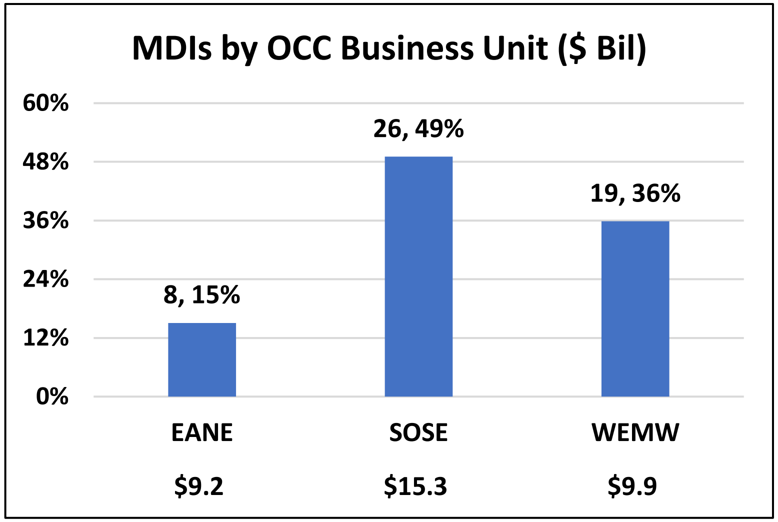


MDIs by Group and OCC Business Unit

- Most OCC-supervised MDIs or 40 percent are Asian or Pacific Islander American as of December 31, 2022.

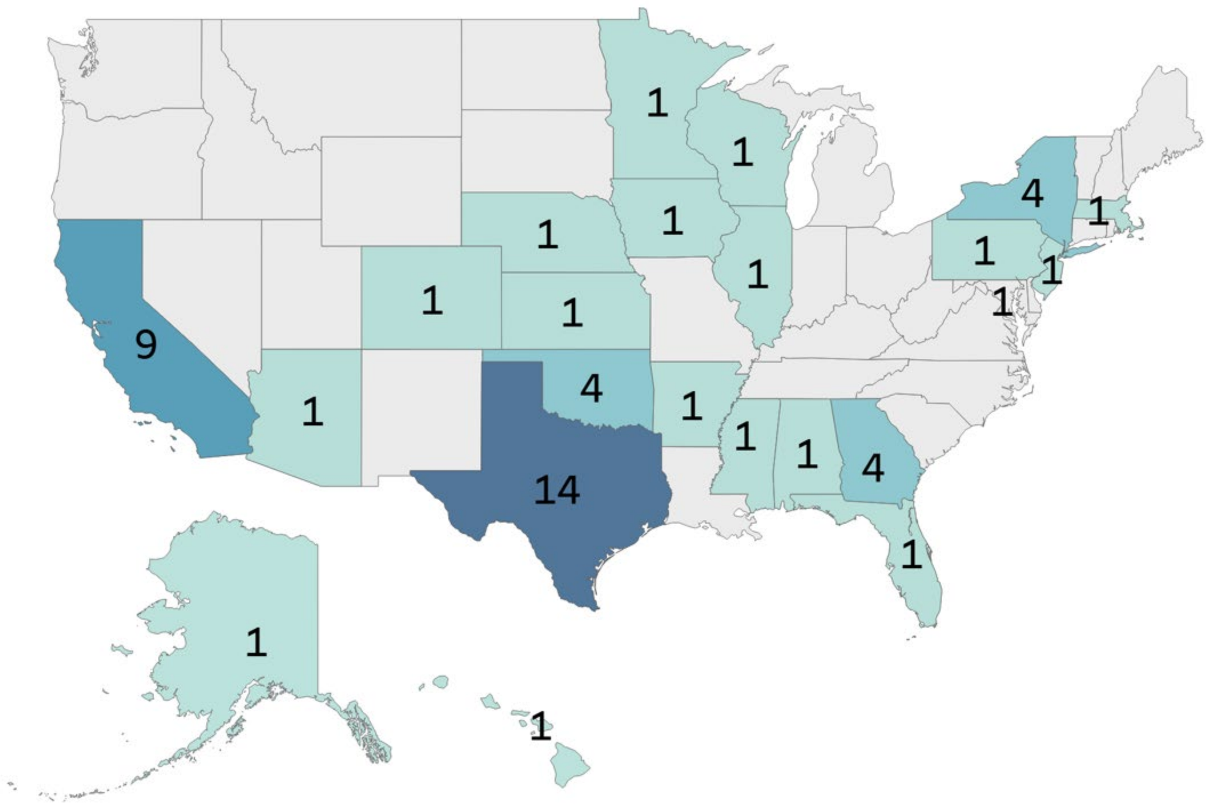


- Most OCC-supervised MDIs or 49 percent are in the South/Southeast community bank portfolio.



MDIs by State

OCC supervised 53 MDIs in 23 states as of December 31, 2022. MDIs are concentrated in Texas (14) and California (9). Three other states have multiple MDIs: Georgia (4), New York (4), and Oklahoma (4).

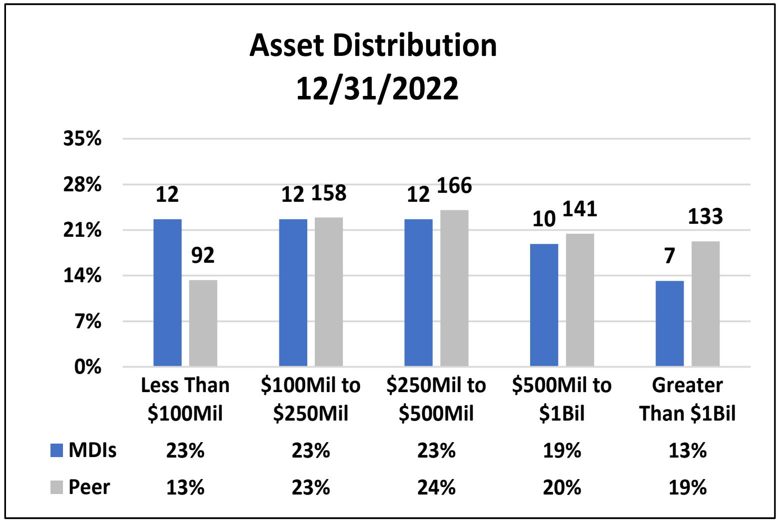


MDI Peer Groups

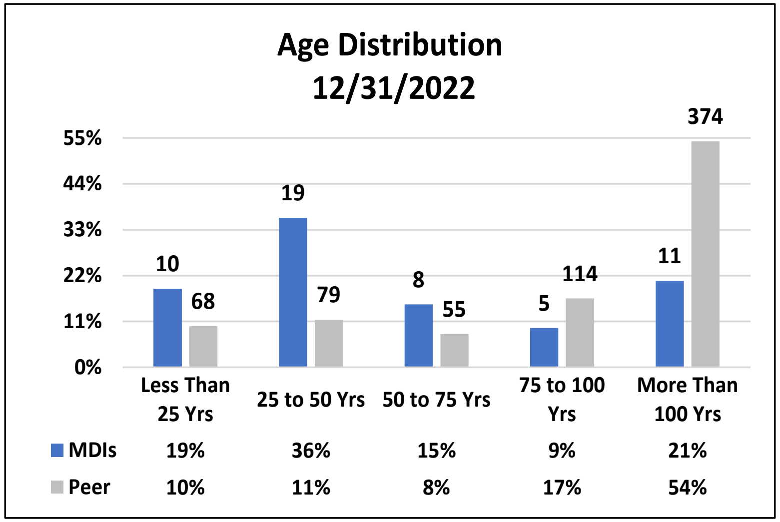
- As of December 31, 2022, the smallest MDI had $29.8 million in total assets and the largest MDI had $5.3 billion.
- MDIs fall into two institution type categories – national banks or stock FSAs. There are no mutual FSA MDIs or trust company MDIs.
- No MDI is supervised by Midsize or Large Bank Supervision.
- As such, the MDI peer group referenced throughout this presentation is community banks with total assets less than $5.5 billion and not mutually-owned (CB Peer).
- We will also compare OCC-supervised MDIs to MDIs supervised by the FDIC and Federal Reserve.

MDIs by Asset Size and Age

- MDIs are generally smaller in size than the community bank peer group. Forty-six percent of MDIs have total assets less than $250 million versus 36 percent of the community bank peer.

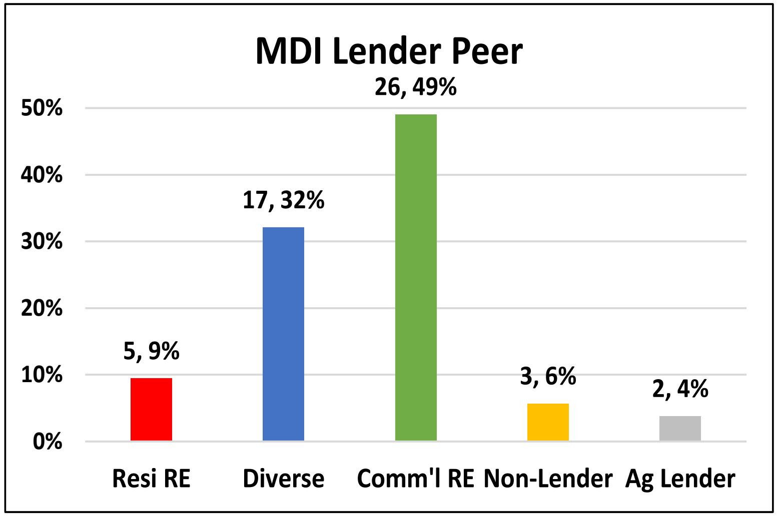


- MDIs have been operating for fewer years than other community banks. Fifty-five percent of MDIs have operated for less than 50 years compared to 21 percent for the community bank peer. Only 21 percent of MDIs were formed more than 100 years ago.

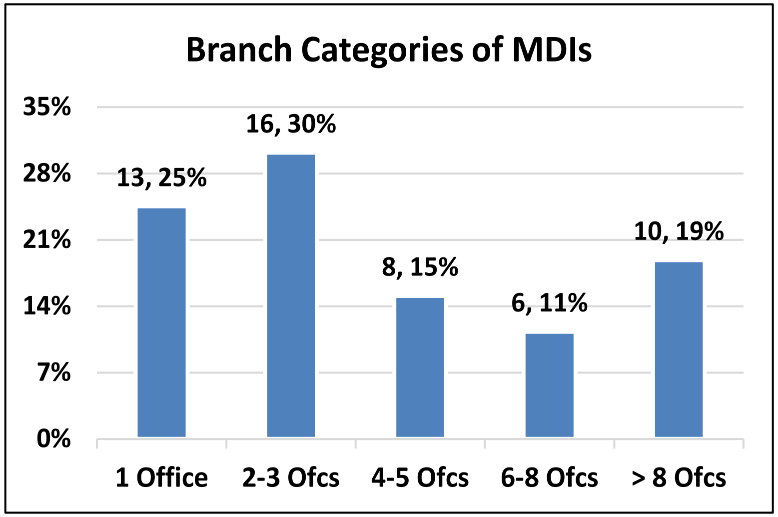


MDIs by Lender Peer and Branch Network

- The majority or 81 percent of MDIs are either commercial real estate lenders or diversified lenders.

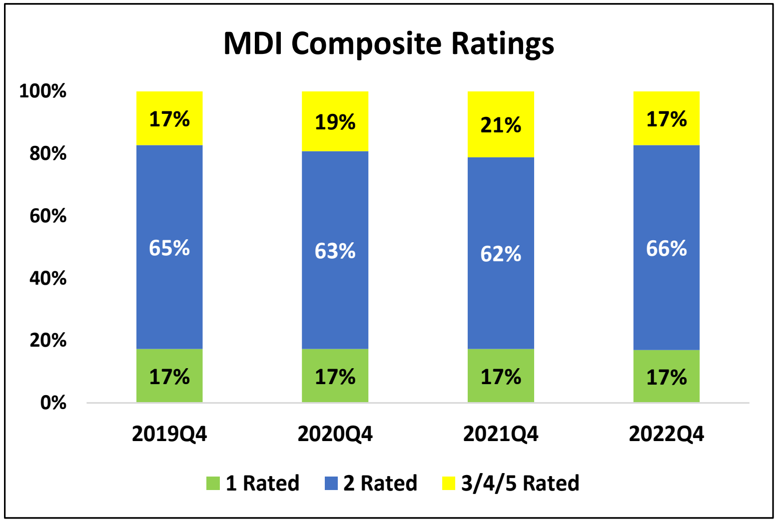


- Twenty-five percent of MDIs operate from one location. Twenty-three MDIs or 43 percent have changed their branch configuration since 2014. Sixteen MDIs increased their branch network. Seven MDIs reduced their branch network.

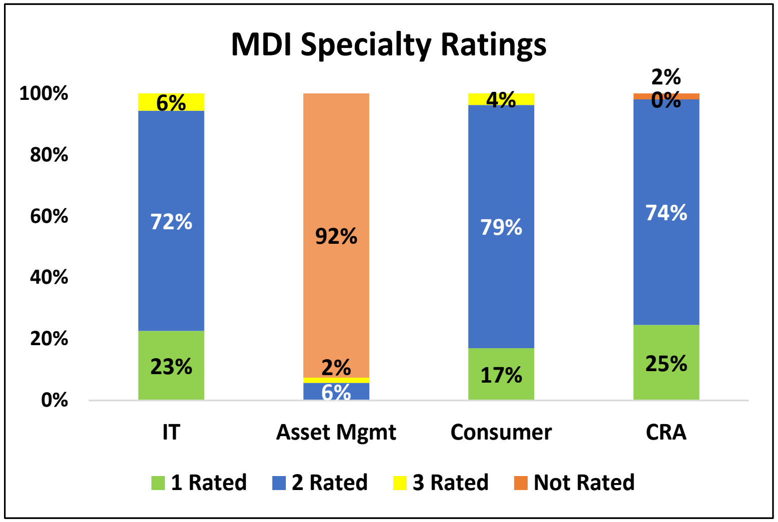


Composite and Specialty Ratings

- The overall condition of MDIs is satisfactory and improving. The share of MDIs rated composite 1 or 2 increased to 83 percent this year.

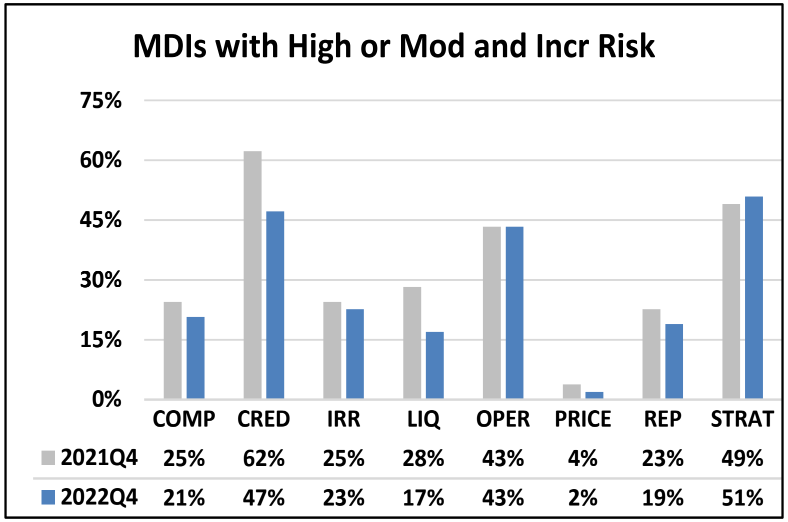


- Specialty ratings are satisfactory. Three MDIs are rated 3 for IT. Four MDIs have trust powers. One is rated 3. Two MDIs are rated 3 for consumer compliance. No MDI is rated less than satisfactory for CRA.

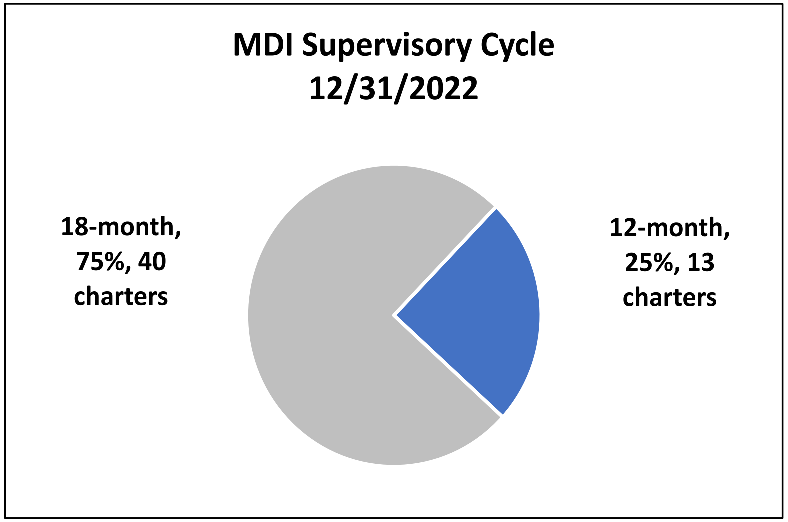


Risk Assessments and Supervisory Cycle

- The top three risks for MDIs are strategic (increasing), credit (decreasing), and operational (stable).

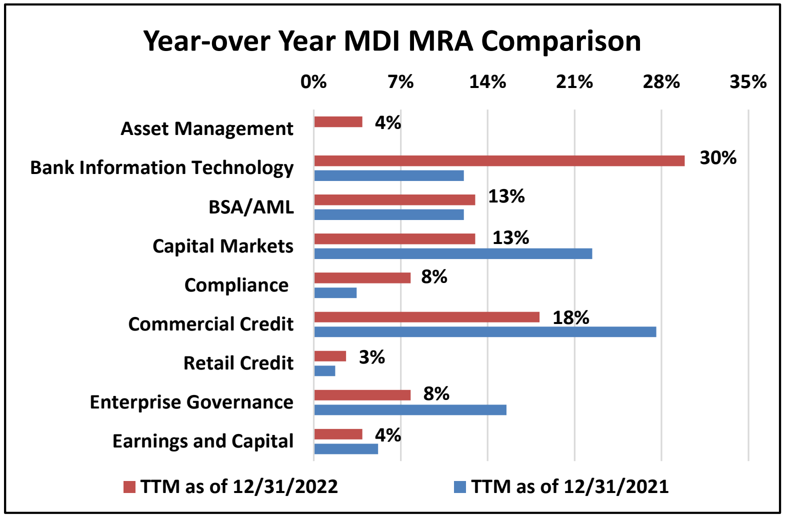


- Qualifying banks with less than $3 billion in total assets are eligible for an 18-month examination cycle. Seventy-five percent of MDIs are on the 18-month cycle.

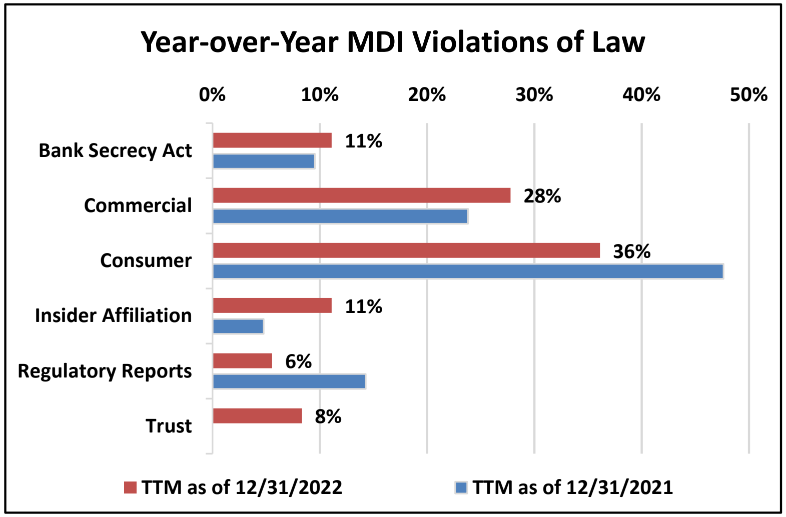


MRAs and VOLs

- MRA volume is up 33 percent for the trailing 12 months ending December 31, 2022. MRAs increased the most for Bank Information Technology and decreased the most for Enterprise Governance and Capital Markets.

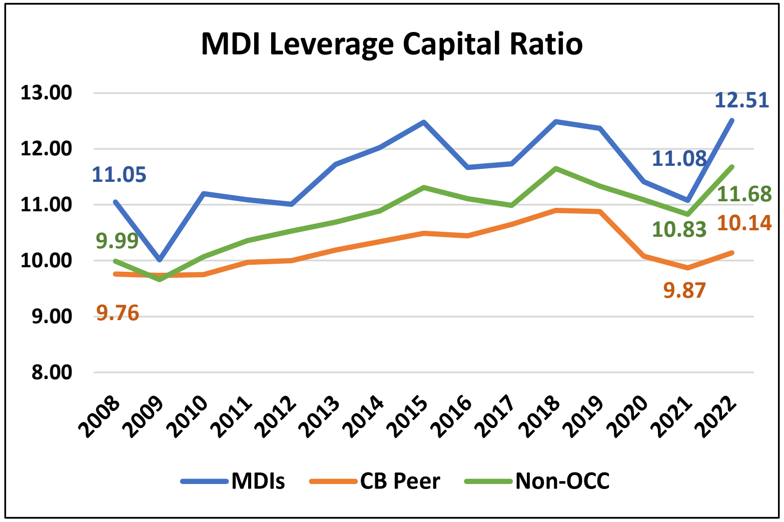


- VOL volume is down 14 percent for the trailing 12 months ending December 31, 2022. The top three VOLs are Loans in Areas Having Special Flood Hazards (12 CFR 22), Real Estate Lending and Appraisals (12 CFR 34), and Loans to Executive Officers (12 CFR 215).

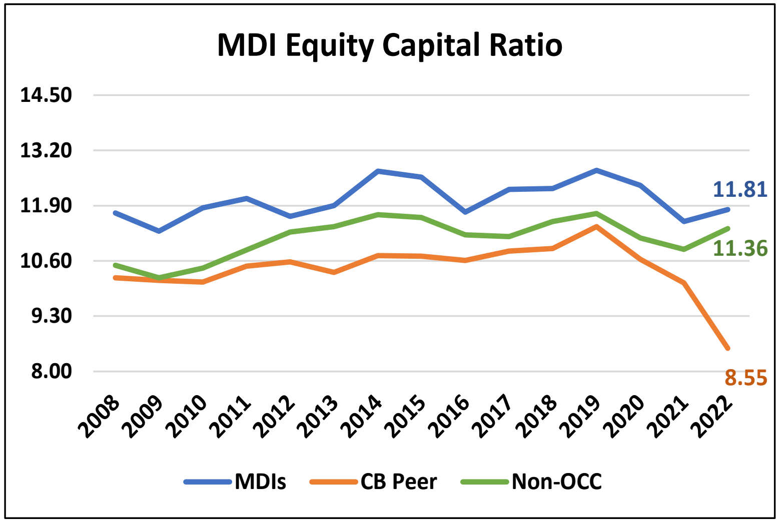


Capital Levels are Strong

- The median MDI leverage ratio jumped 143 basis points this year and remains well above peer.

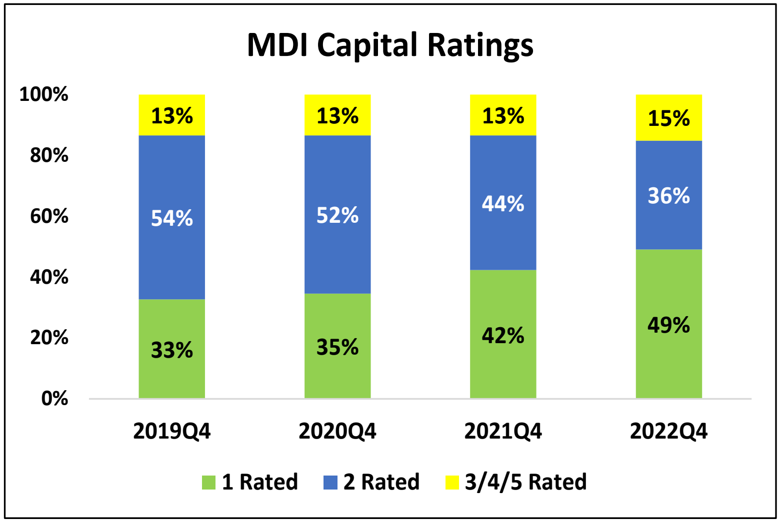


- MDIs increased equity capital ratios in 2022. Equity capital to total asset ratios declined in 2020 and 2021 due to pandemic-related asset growth and fell more sharply in 2022 for the community bank peer due to AOCI-related adjustments.

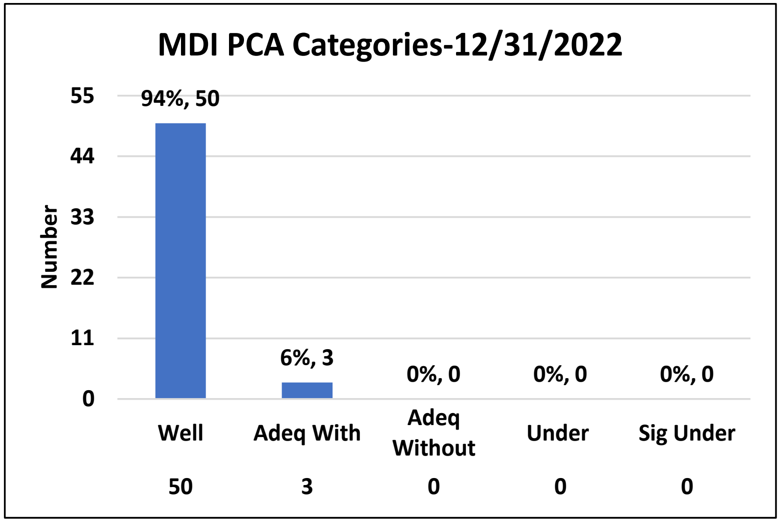


MDIs are Well Capitalized

- Capital ratings saw some slippage this year. Eighty-five percent of MDIs are rated 1 or 2 for capital but more MDIs are rated 1.

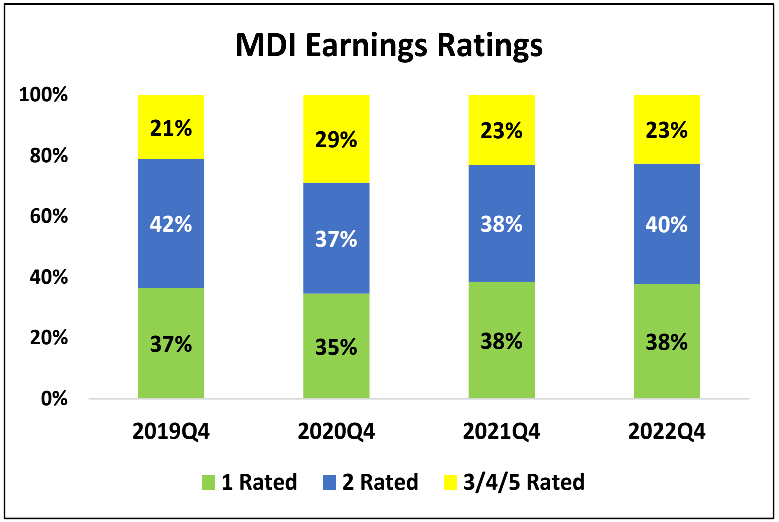


- Ninety-four percent of MDIs met the well-capitalized definition contained in Prompt Corrective Action as of December 31, 2022. Three MDIs – with formal actions requiring higher minimums – are adequately capitalized.

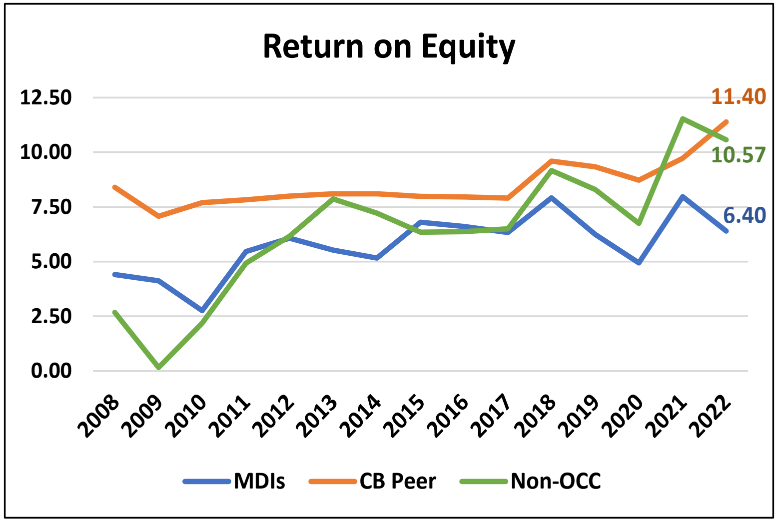


Earnings Ratings Stable in 2022

- Earnings ratings are stable but lag ratings in other safety and soundness areas. Seventy-eight percent of MDIs are rated 1 or 2 for earnings.

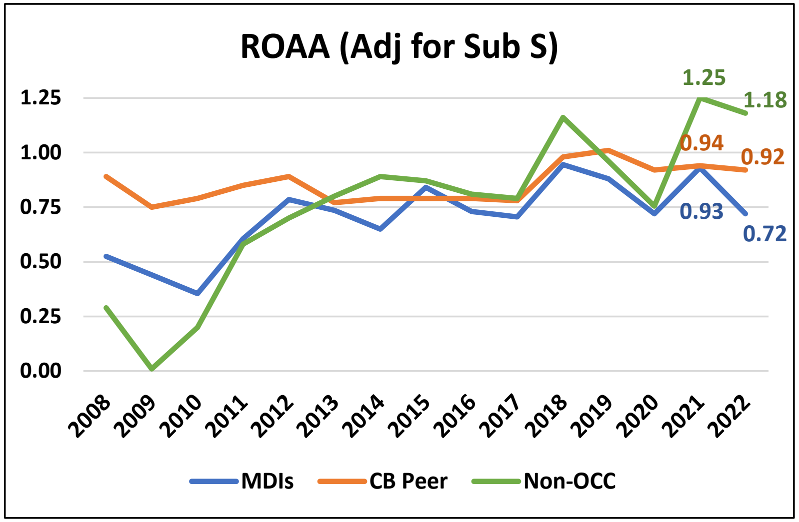


- Return on equity is lower this year for MDIs and Non-OCC MDIs.



ROAA Lower This Year

- MDI ROAA decreased 21 basis points to 0.72 percent and remains below peer banks.



- If you stratify ROAA by asset size, you will generally find the larger the bank, the better the ROAA.

Return on Assets - December 31, 2022

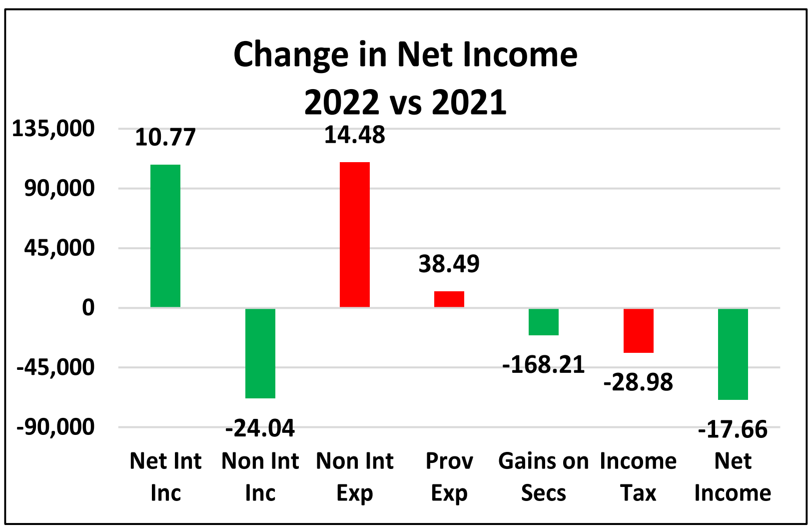
Asset Category	Peer	MDIs
Under $50MM	0.44	0.28
$50MM - $100MM	0.71	0.51
$100MM - $250MM	0.81	0.62
$250MM - $500MM	0.93	0.76
$500MM - $1B	0.94	1.37
Greater than $1B	1.13	1.04
Median	**0.92**	**0.72**

Net Income Down 18 Percent in 2022

ROAA fell due to a contraction in fee income and much higher overhead.

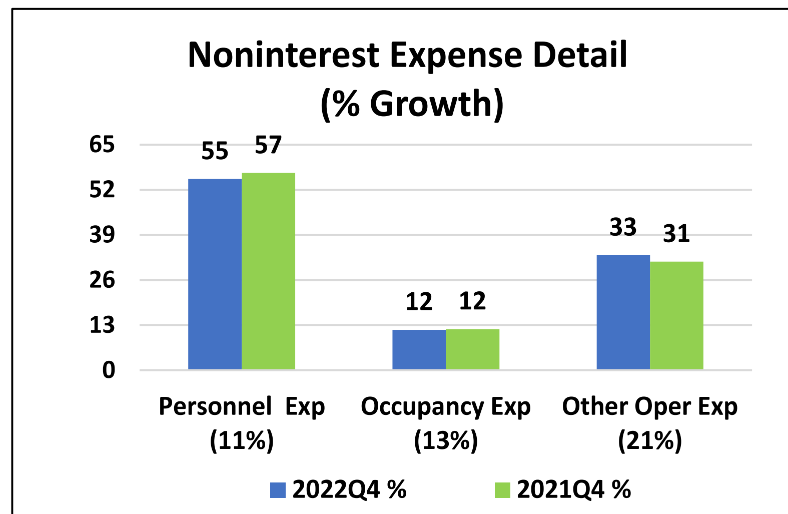
MDI Income Stmt ($000's) - as of Dec 31st

	2022	2021	Δ 1 Yr $	Δ 1 Yr %
Int Income	1,275,764	1,095,802	179,962	16.42
Int Expense	166,161	94,080	72,081	76.62
Net Int Inc	1,109,603	1,001,722	107,881	10.77
Non Int Inc	216,115	284,494	-68,379	-24.04
Non Int Exp	867,481	757,756	109,725	14.48
Prov Exp	44,417	32,072	12,345	38.49
Gains on Secs	-8,280	12,139	-20,419	-168.21
Income Tax	82,615	116,333	-33,718	-28.98
Net Income	322,854	392,093	-69,269	-17.66



MDI ROAA Decomposition - as of Dec 31st

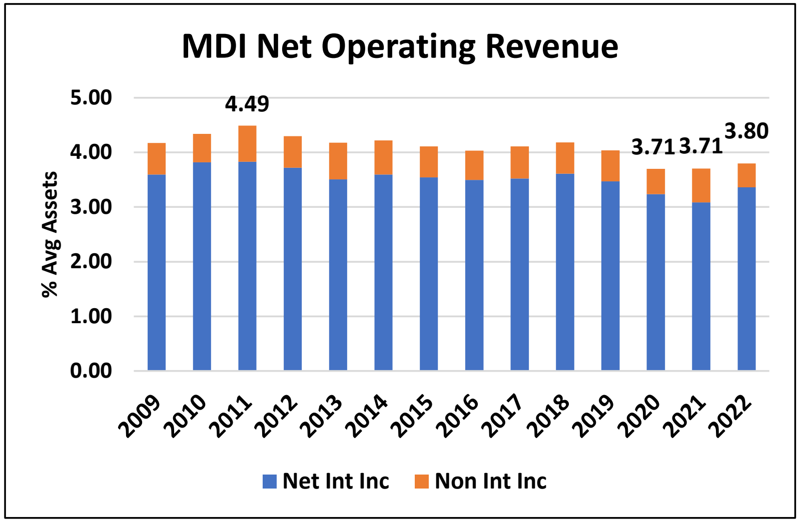
	2022	2021	Δ 1 Yr
Int Income	3.79	3.60	
Int Expense	0.49	0.31	
Net Int Inc	3.30	3.29	0.01
Non Int Inc	0.64	0.93	-0.29
Non Int Exp	2.58	2.49	0.09
Prov Exp	0.13	0.11	0.03
Gns on Secs	-0.02	0.04	-0.06
Income Tax	0.25	0.38	0.13
ROAA	0.96	1.29	-0.33

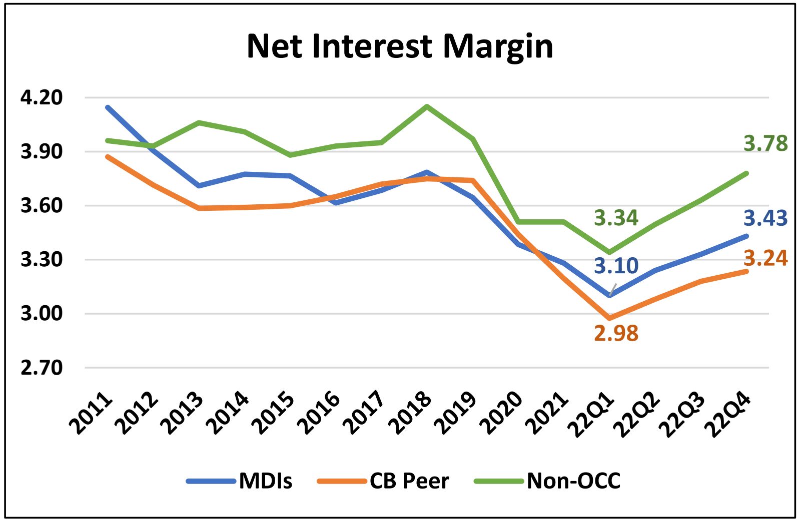


Net Interest Margin Rebounds

- MDI net operating revenue rose nine basis points since 2021. Net interest income rose 27 basis points to 3.36 percent. Fee income fell 18 basis points to 0.44 percent. Higher fee income remains a key distinction between smaller and larger banks.

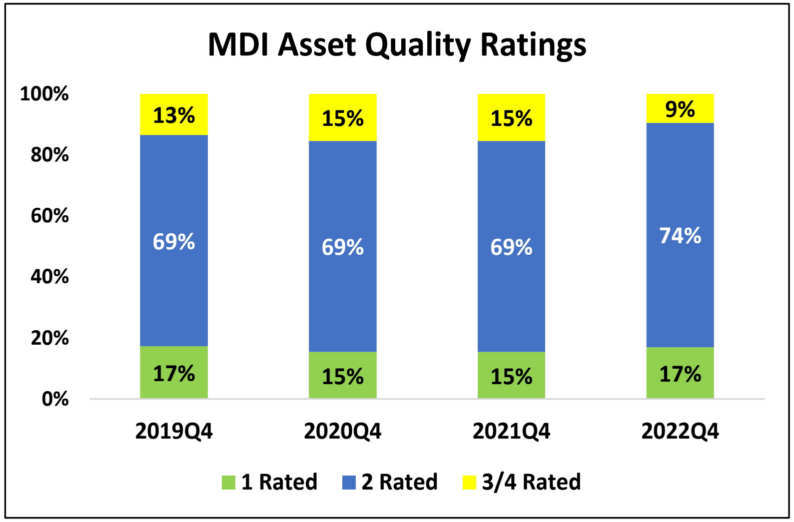
- NIM compression bottomed in the first quarter of 2022. Margins continued to improve this quarter due to the rise in the federal funds target rate.



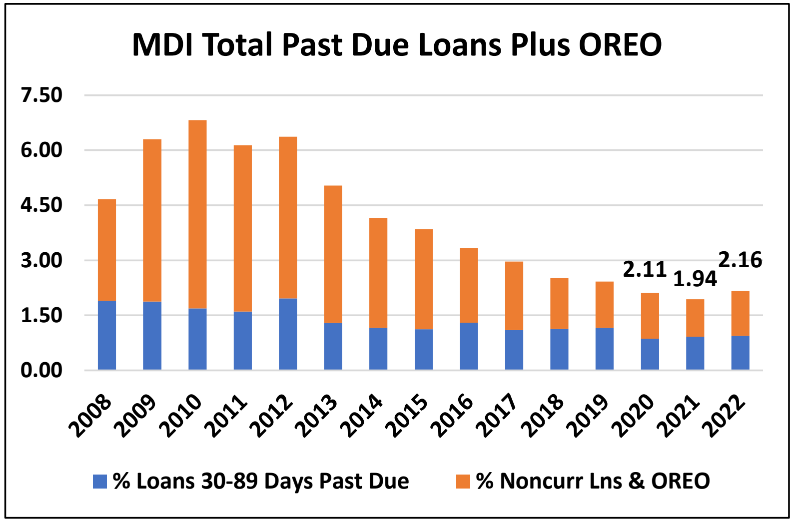


Asset Quality Ratings Better

- Asset quality ratings improved in 2022. Ninety-one percent of MDIs are rated 1 or 2 for asset quality.

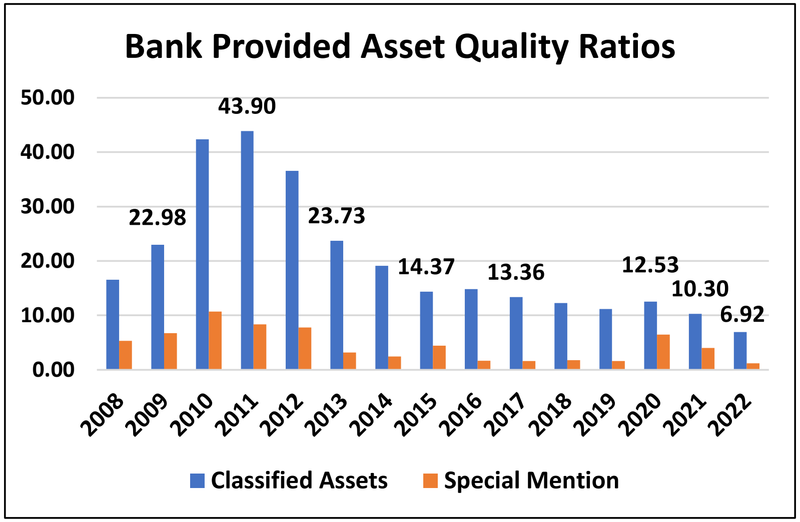


- Past due loans plus OREO remain low but increased 22 basis points in 2022. Noncurrent loans and OREO rose 20 basis points and loans 30-89 days past due rose 2 basis points. CARES Act modification loans continue to decline and only six MDIs report values.

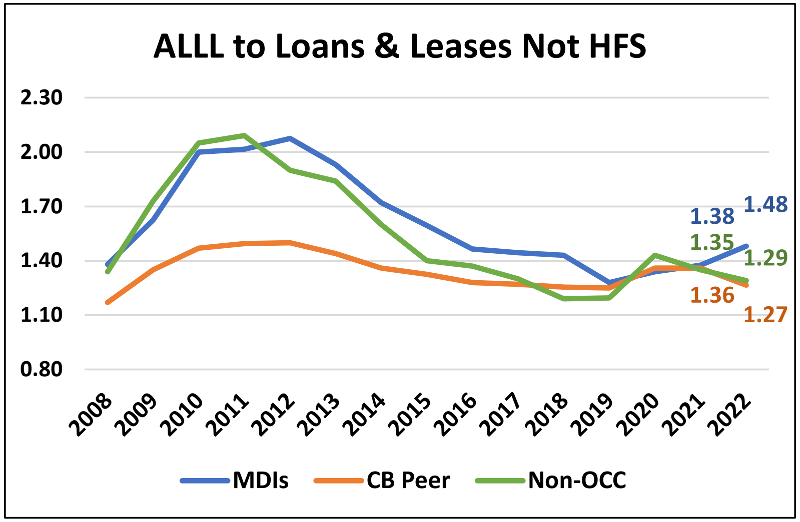


MDI ALLL Higher

- MDI bank provided classified assets to tier 1 capital plus the ALLL ratios continue to decline.

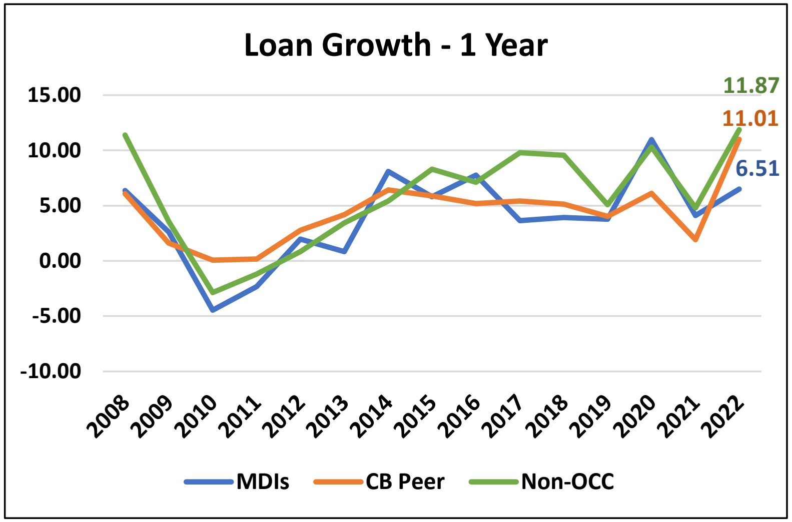


- The MDI ALLL is directionally consistent with the increasing level of noncurrent loans plus OREO.

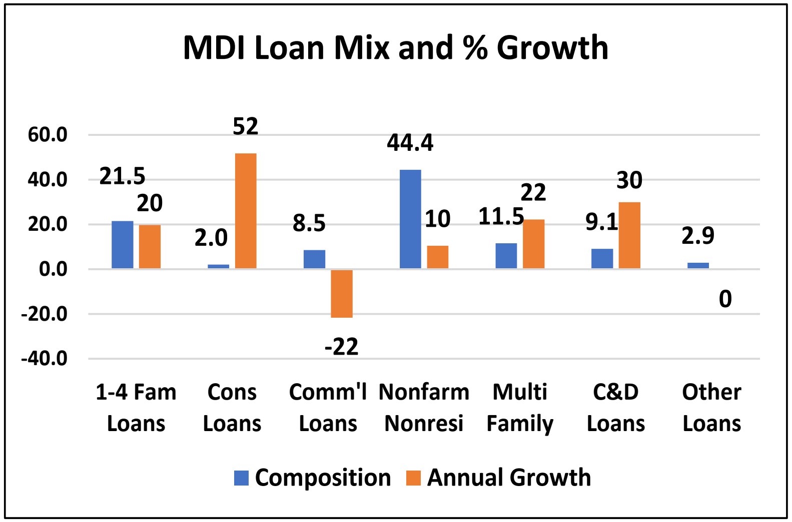


Loan Growth Improved

- After removing PPP loans, the adjusted MDI loan growth rate improved to 9.55 percent in 2022.

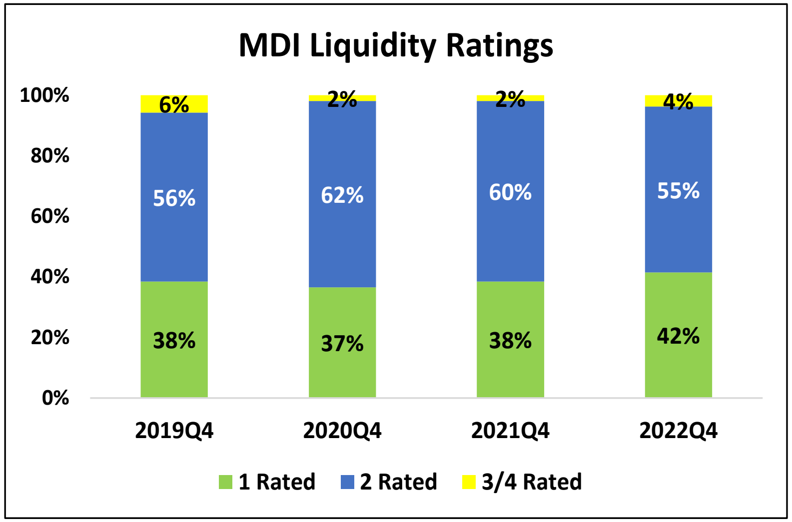


- CRE at 65.0 percent is the largest MDI loan category. MDI loan growth was highest for consumer, C&D, and multifamily loans. Loan balances increased for all categories except commercial loans.

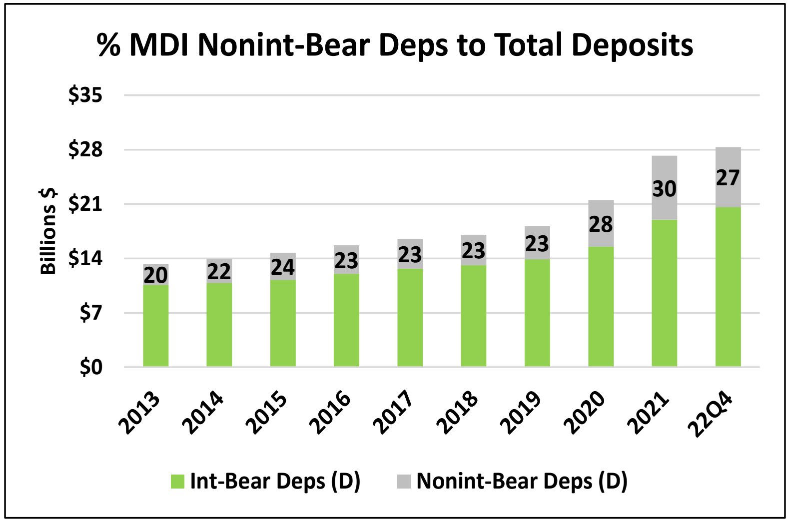


Liquidity is Sufficient

- Liquidity ratings remain strong. Ninety-seven percent of MDIs are rated 1 or 2.

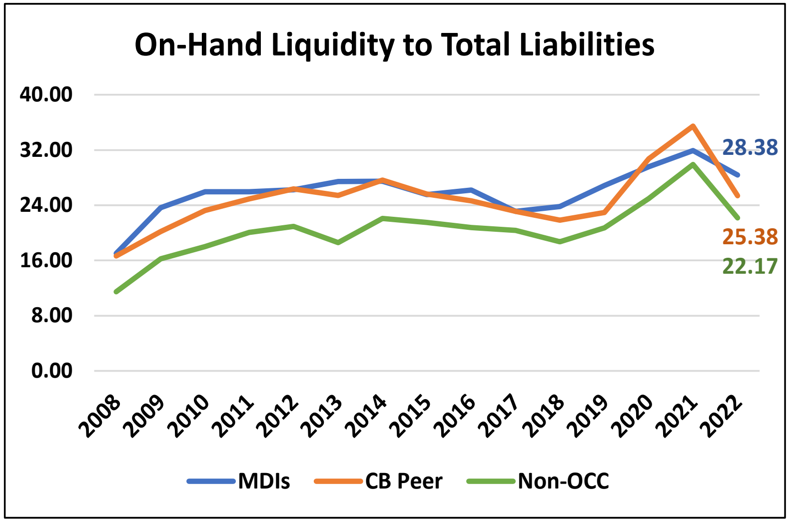


- MDI deposits grew 4.1 this year, down from the 9.1 percent rate reported last quarter. Consumers are saving less this year. The US personal savings rate for February 2023 fell to 4.6 percent compared to 13.4 percent two years ago.

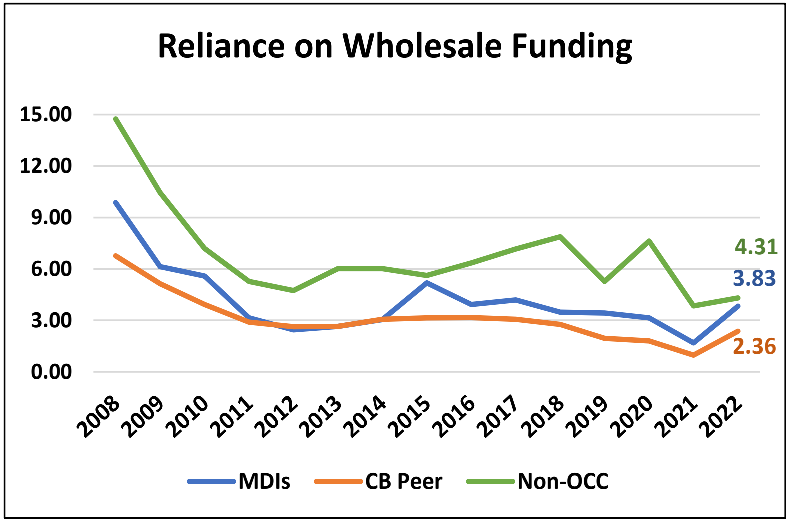


On-Hand Liquidity Declined

- MDI on-hand liquidity ratios declined this year but remain above pre-pandemic levels.

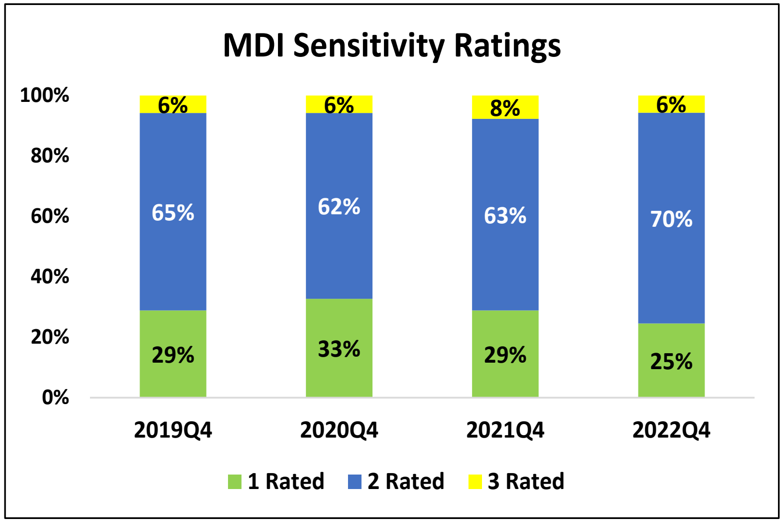


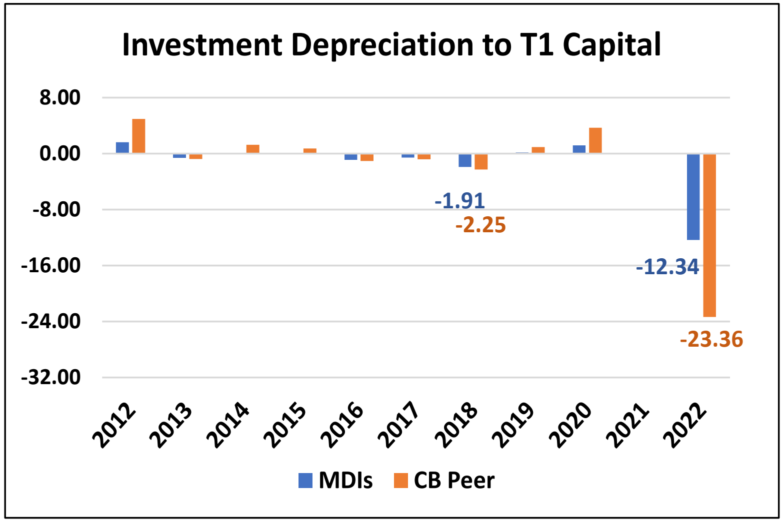
- Because of declining on-balance sheet liquidity, MDIs are relying more on wholesale funding sources.

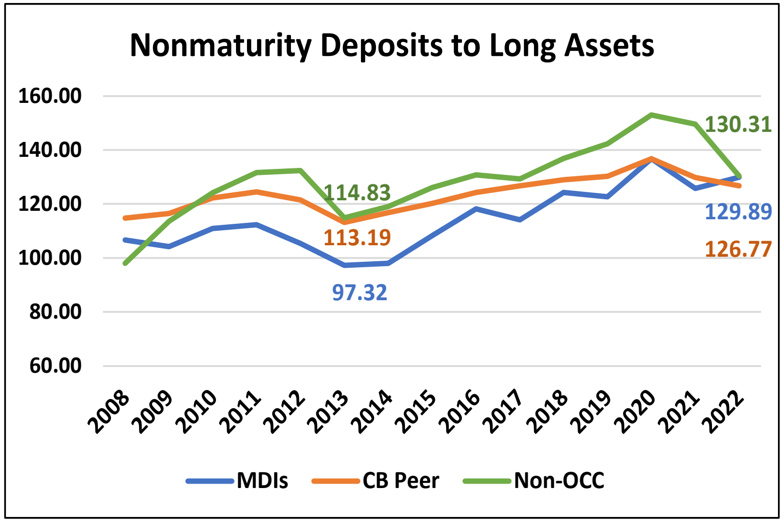


Sensitivity is Adequately Controlled

- Sensitivity to market risk ratings remain satisfactory. Nonmaturity deposits to long-term assets are up for MDIs in 2022. Investment portfolio depreciation has increased significantly this year due to the Fed raising interest rates and Quantitative Tightening.







Key Observations – December 31, 2022

- MDIs are increasing as a share of total OCC charters. MDIs represent 53 or 5.2 percent of OCC bank charters and $34.4 billion or 4.1 percent of community bank assets.
- MDI composite ratings improved this year; 83 percent of MDIs are rated composite 1 or 2.
- **Capital levels are strong.** MDI capital levels are sharply higher this year and remain above peer. The MDI leverage ratio increased to 12.51 percent and more MDIs are rated 1 for capital this year.
- **Asset quality is satisfactory**. Total past due loans plus OREO remain low but increased this year to 2.16 percent. Loan growth has rebounded this year and is much higher especially when adjusting for PPP loans. The ALLL is adequate and directionally consistent with the uptick in past due loans.
- **Earnings are adequate**. ROAA decreased in 2022 due to a contraction in noninterest income and much higher noninterest expense.
- **Liquidity is adequate**. While MDIs have adequate levels of liquidity, the growth rate in deposits continues to slow. Ninety-seven percent of MDIs are rated 1 or 2 for liquidity.
- **Sensitivity to market risk remains adequately controlled**. MDIs are holding sufficient levels of nonmaturity deposits relative to long-term assets making them less vulnerable to rising interest rates. Investment portfolio depreciation increased significantly this year.

Outlook and Challenges in 2023

- **Employment**
- **Inflation**
- **Consumer**

Rate Hikes

The Fed raised the federal funds target rate 25 basis points to 4.75-5.00 percent at its Mar 21-22 meeting and the latest dot plot forecasts a 5.1 percent federal funds rate by year-end 2023. **Rates will be higher for longer.**

FOMC Meetings 2022	Rate Decision
Jan 25-26	0
Mar 15-16	+25 bps
May 3-4	+50 bps
Jun 14-15	+75 bps
Jul 26-27	+75 bps
Sep 20-21	+75 bps
Nov 1-2	+75 bps
Dec 13-14	+50 bps

FOMC Meetings 2023	Rate Decision
Jan/Feb 31-1	+25 bps
Mar 21-22	+25 bps
May 2-3	**+25 bps**
Jun 13-14	**+25 bps**
Jul 25-26	**0**
Sep 19-20	**0**
Oct/Nov 31-1	**0**
Dec 12-13	**0**

Summary of Economic Projections

In conjunction with the FOMC meeting held on Mar 21–22, 2023, meeting participants submitted their projections of the most likely outcomes for real gross domestic product (GDP) growth, the unemployment rate, and inflation for each year from 2023 to 2025 and over the longer run.

Percent

Variable	Median			
	2023	2024	2025	Longer run
Change in real GDP	0.4	1.2	1.9	1.8
December projection	0.5	1.6	1.8	1.8
Unemployment rate	4.5	4.6	4.6	4.0
December projection	4.6	4.6	4.5	4.0
PCE inflation	3.3	2.5	2.1	2.0
December projection	3.1	2.5	2.1	2.0
Core PCE inflation	3.6	2.6	2.1	
December projection	3.5	2.5	2.1	
Memo: Projected appropriate policy path				
Federal funds rate	5.1	4.3	3.1	2.5
December projection	5.1	4.1	3.1	2.5

Fed's Dual Mandate

The Fed's priority continues to be inflation over job creation. They are trying to engineer that proverbial soft landing – which will take some skill and some luck.

Employment	Mar-2023
Payroll change	+236,000
Unemployment rate	3.5%

Inflation	Feb-2023
Core PCE (x-food/energy)	4.6%Y/Y
PCE Price Index	5.0%Y/Y

Consumer	Mar/Apr-2023
Retail sales	-1.0% M/M
Michigan Sentiment	63.5

Economic Challenges

- The Fed will not pause rate hikes until they see clear and convincing evidence inflation is cooling. Powell, "Recession may be the price to pay for reducing inflation." Many economists believe it will be difficult to avoid recession to achieve 2 percent inflation.

- The disinflationary process has begun. The process will be bumpy. The Fed will maintain rates at a level that is sufficiently restrictive for a significant amount of time. Powell is seeing less progress in the non-housing services elements of the PCE basket, which are closely tied to wages. Getting disinflation in services may take some softening of consumer demand and labor market conditions.

- If the Fed keeps raising rates, there is more probability of overshooting and causing a financial accident. Monetary policy affects economic conditions only after a long and variable lag. Inflation and employment reports are moving targets.

- Supply constraints that initially led to inflationary issues are not fully resolved. The Ukraine war continues to cause global supply chain disruptions. Prices of essential commodities such as fuel and food are significantly higher versus pre-pandemic.

Questions