

Minority Depository Institutions

First Quarter 2020



Ernie Knott, OCC Financial Analyst
June 17, 2020

MDI Agenda

This presentation will provide key metrics, trends, and conclusions for the following:

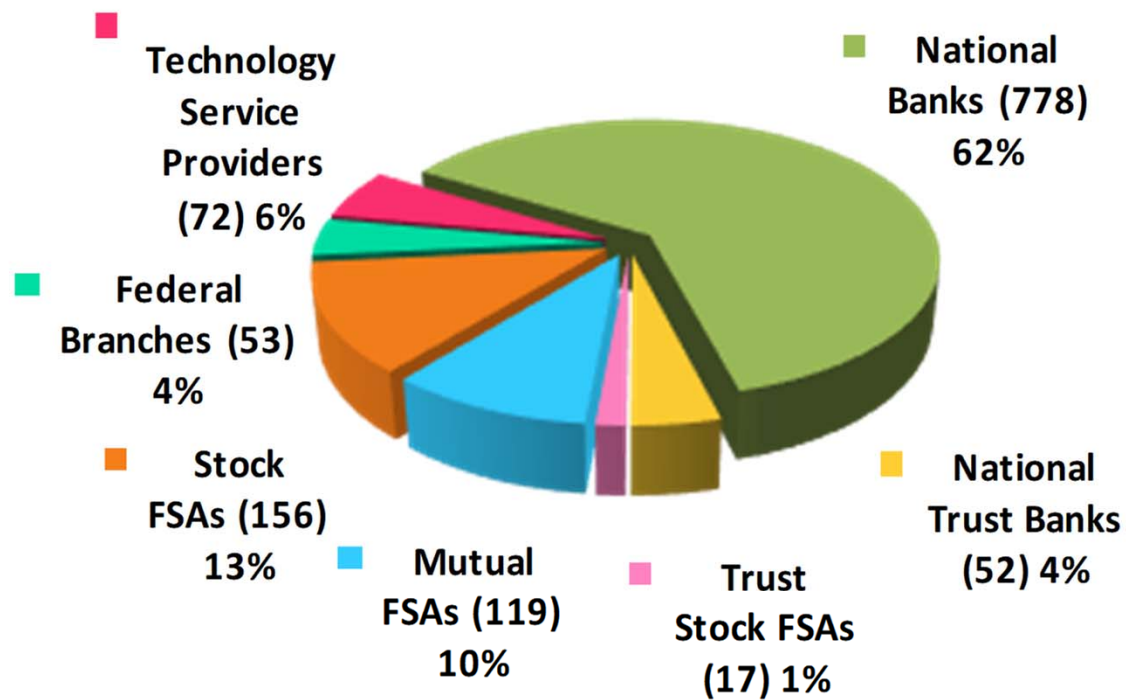
- **Portfolio Demographics**
- **Financial Ratios & Ratings**
- **Supervisory Information**

Caveats about the Data. Financial trend charts start in 2002. The current bank population as of March 31, 2020 is “held constant.” All federal savings associations (FSAs) have filed the commercial bank call reports since March 31, 2012. Some charts use the median; others use weighted averages.



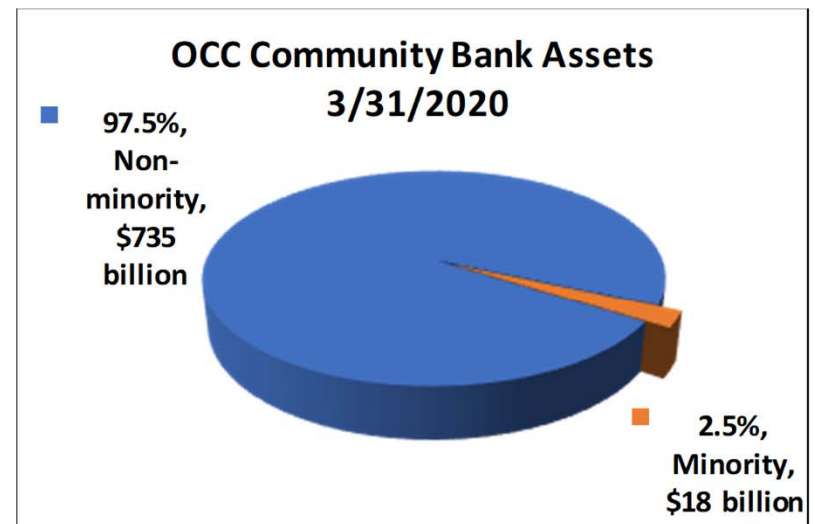
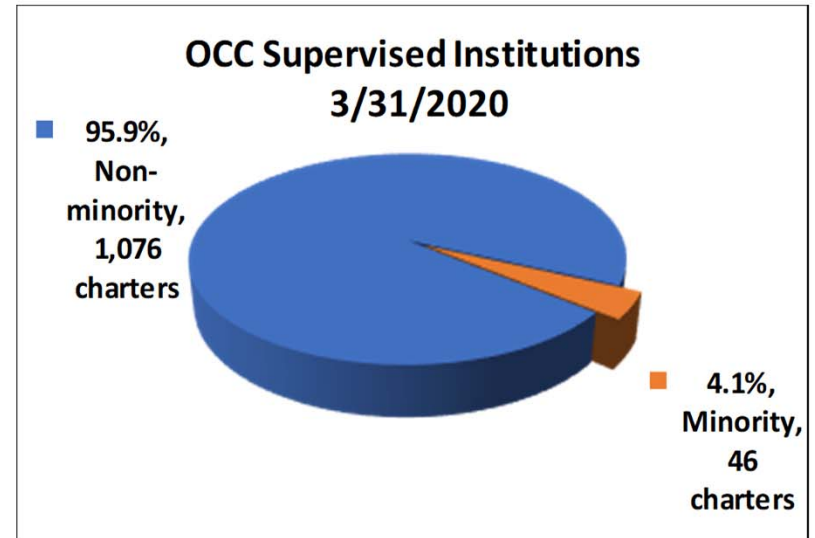
OCC Supervised Institutions by Type

OCC supervised 1,247 institutions as of March 31, 2020.



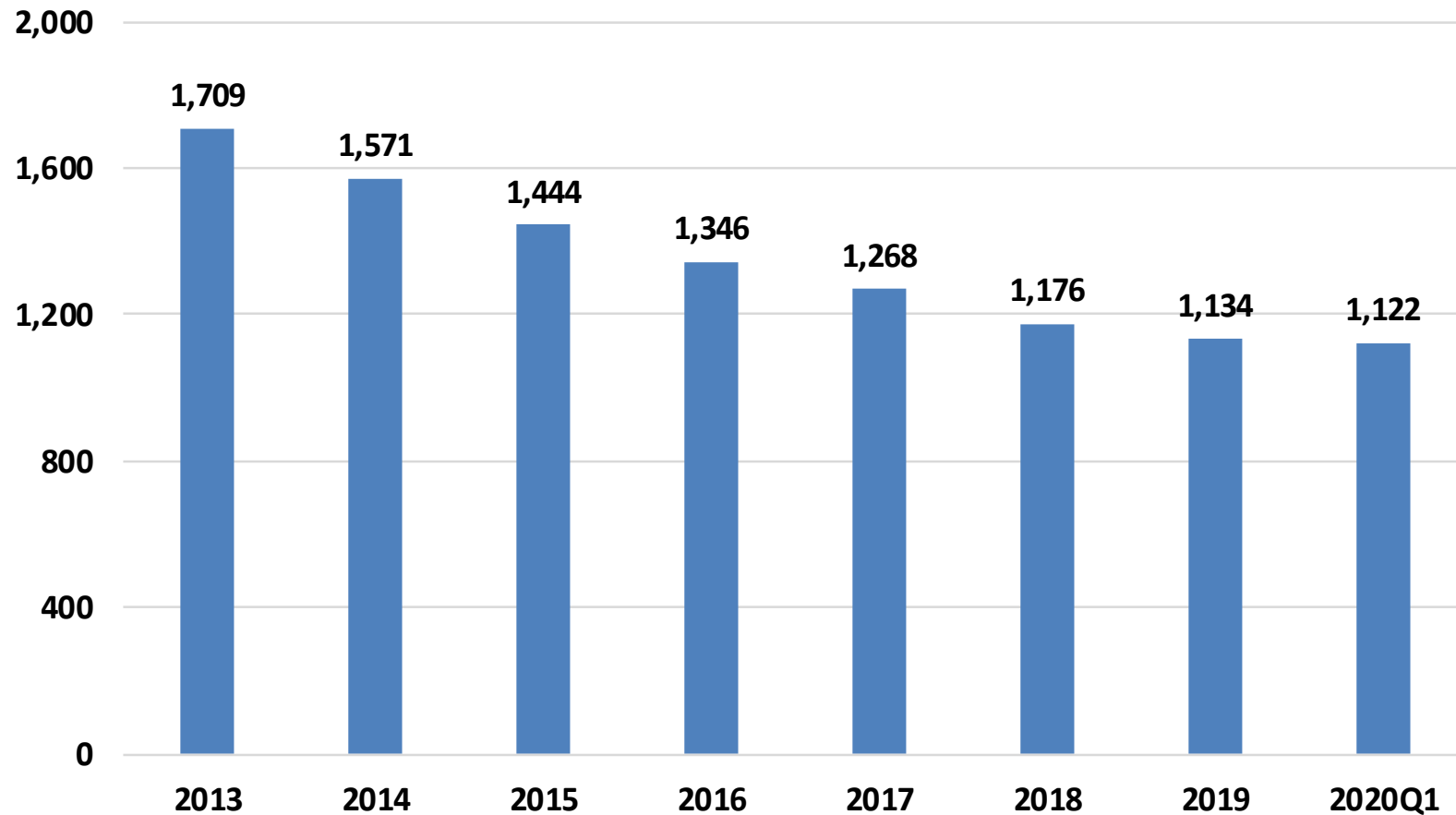
Minority Charters and Total Assets

- Minority Depository Institutions (MDIs) represent 46 or about 4.1 percent of total OCC financial institution charters as of March 31, 2020.
- Minority Depository Institutions represent \$18 billion or 2.5 percent of total OCC supervised community bank assets as of March 31, 2020. (This chart does not include Midsize and Large Bank charters.)



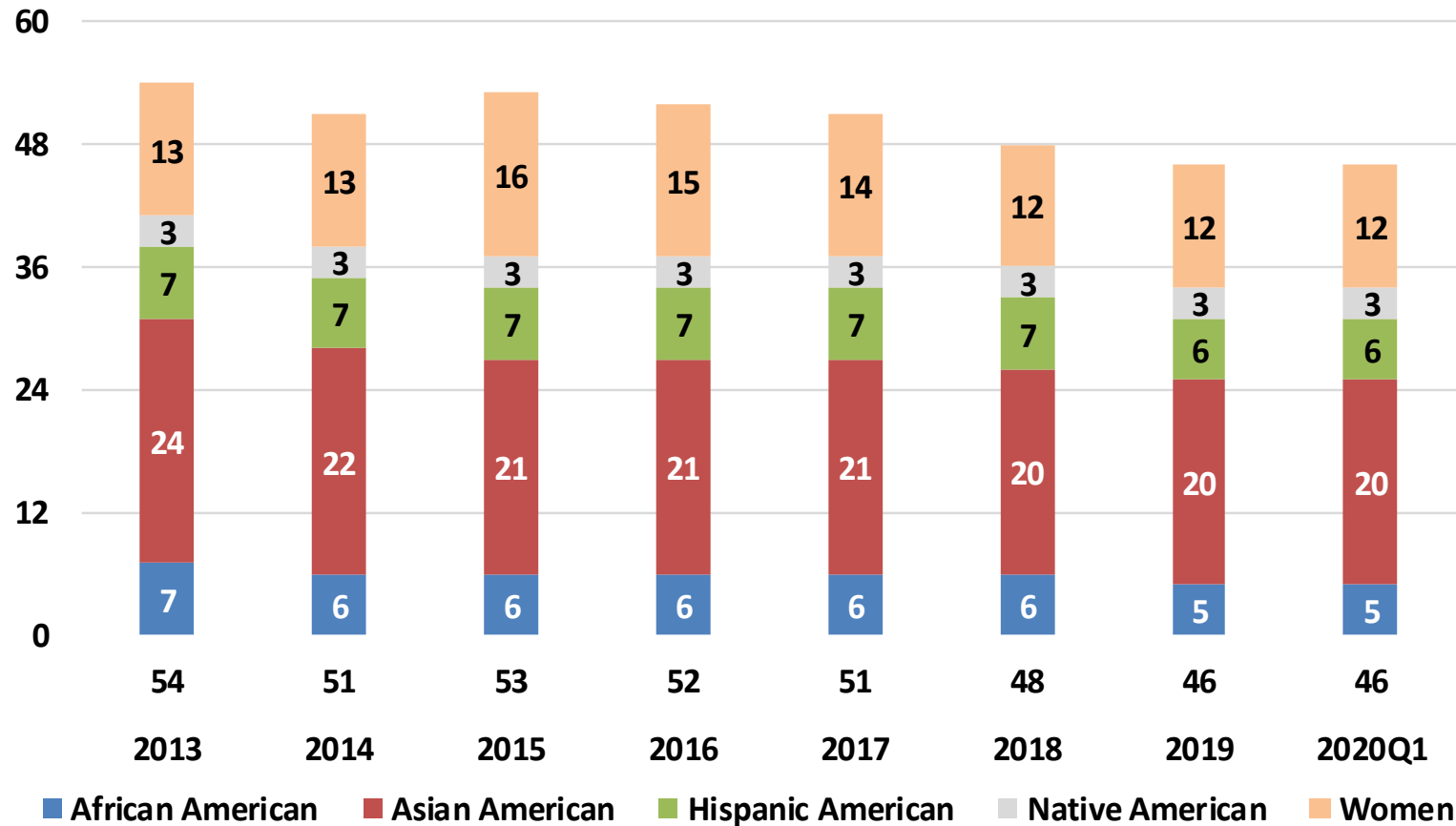
Trends in OCC Charters

The net number of OCC charters decreased by 587 or 34 percent since 2013 due primarily to mergers and acquisitions.



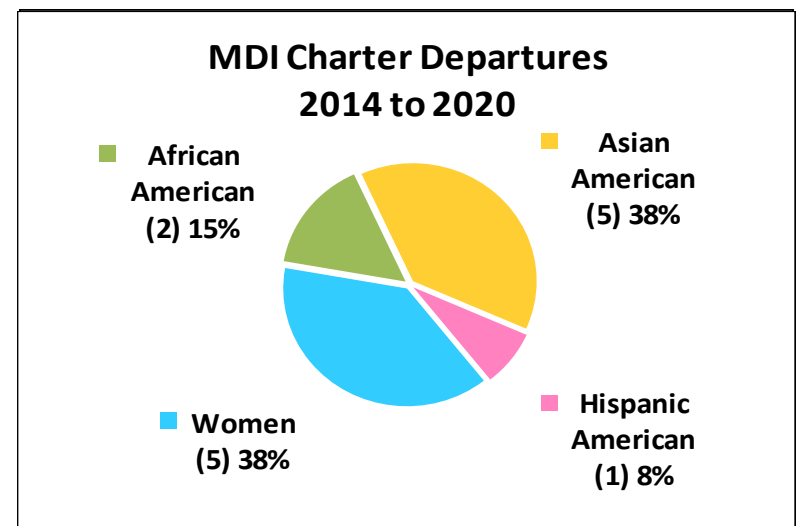
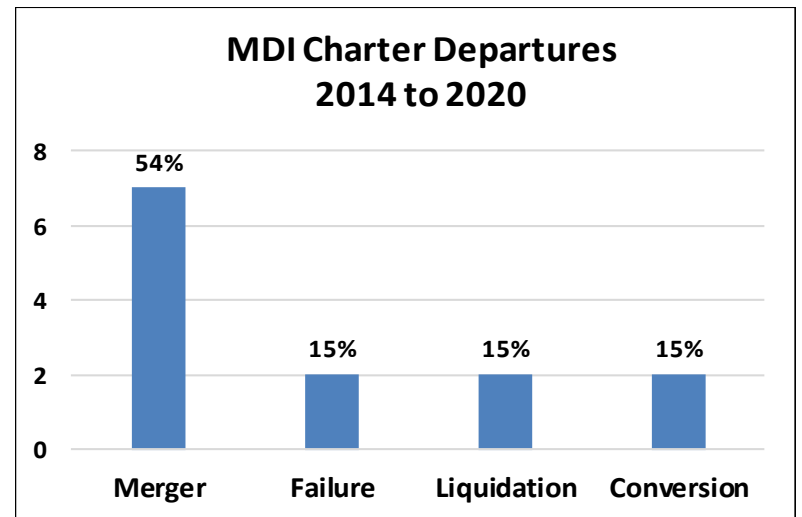
Trends in MDI Charters by Group

The net number of MDI charters decreased by eight or 15 percent since 2013 due primarily to mergers and acquisitions.



Disposition of Inactive MDI Charters

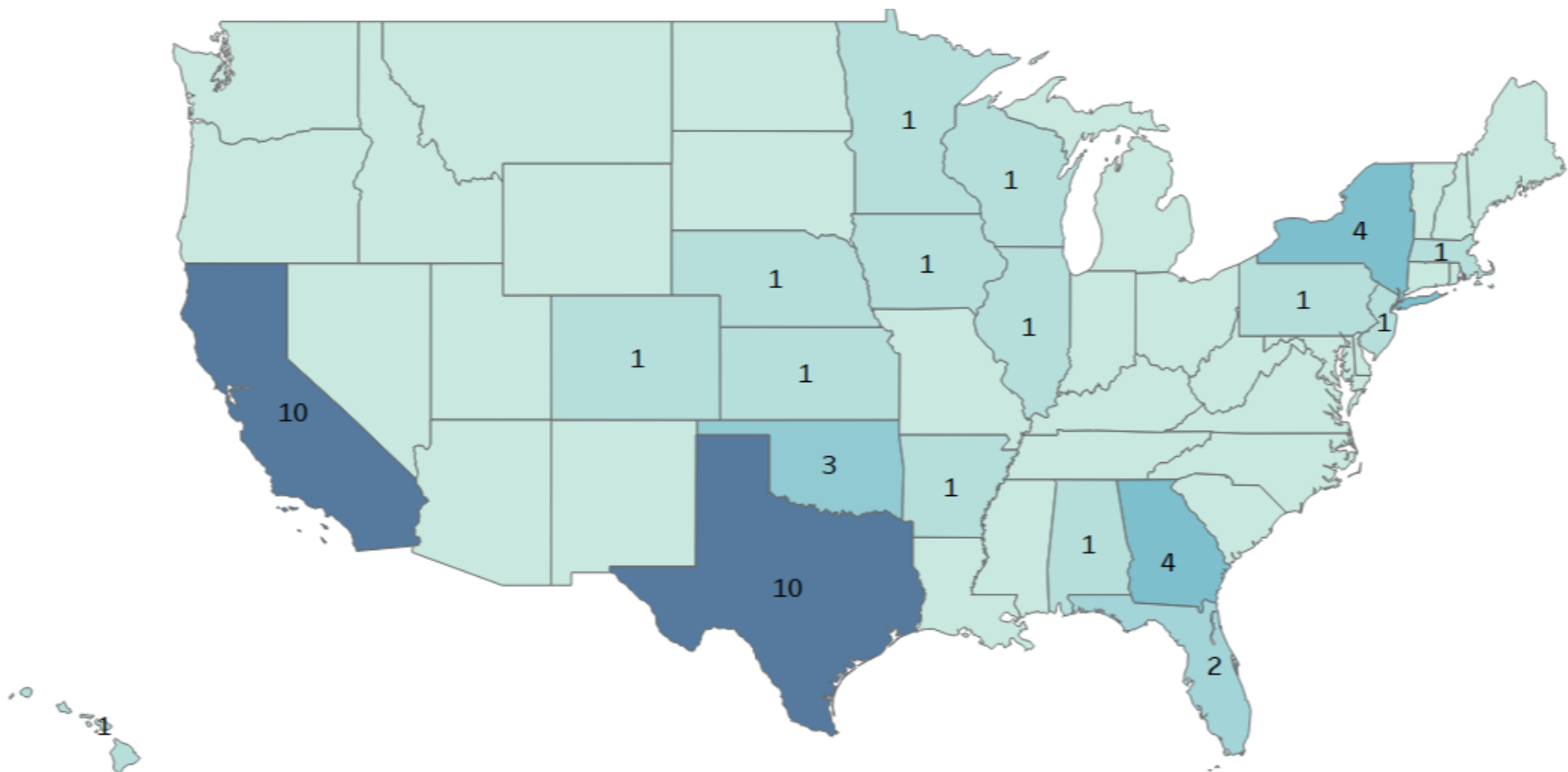
- Thirteen or 21 percent of MDIs have gone inactive since 2014. This compares favorably with the OCC departure rate of 34 percent for the same period.
- Mergers and acquisitions was the primary reason for departure.
- Most MDI departures were from the Asian American and Women groups.



Minority Institutions by State

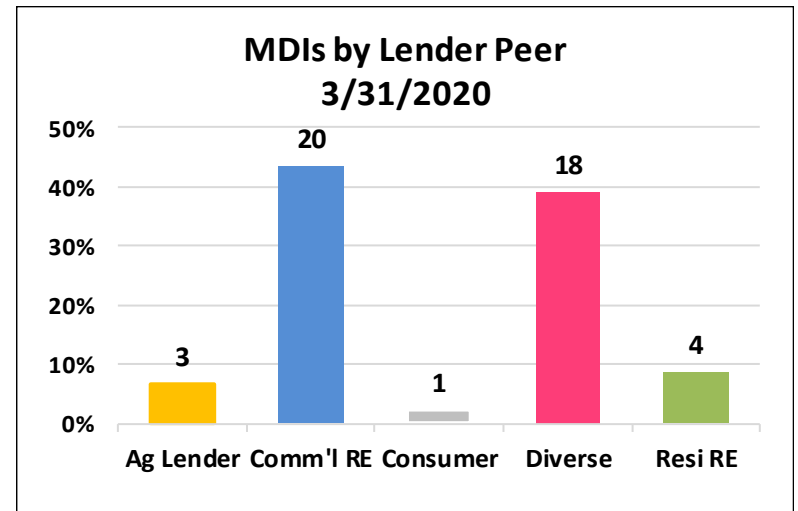
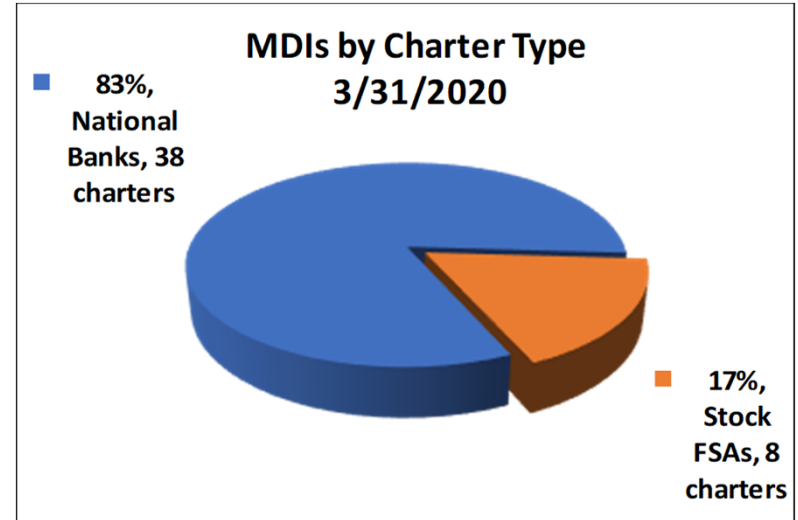
MDIs are located in 19 states and concentrated in California and Texas.

Both of these states have ten MDIs. There are four other states with multiple MDIs: Georgia (4), New York (4), Oklahoma (3), and Florida (2).



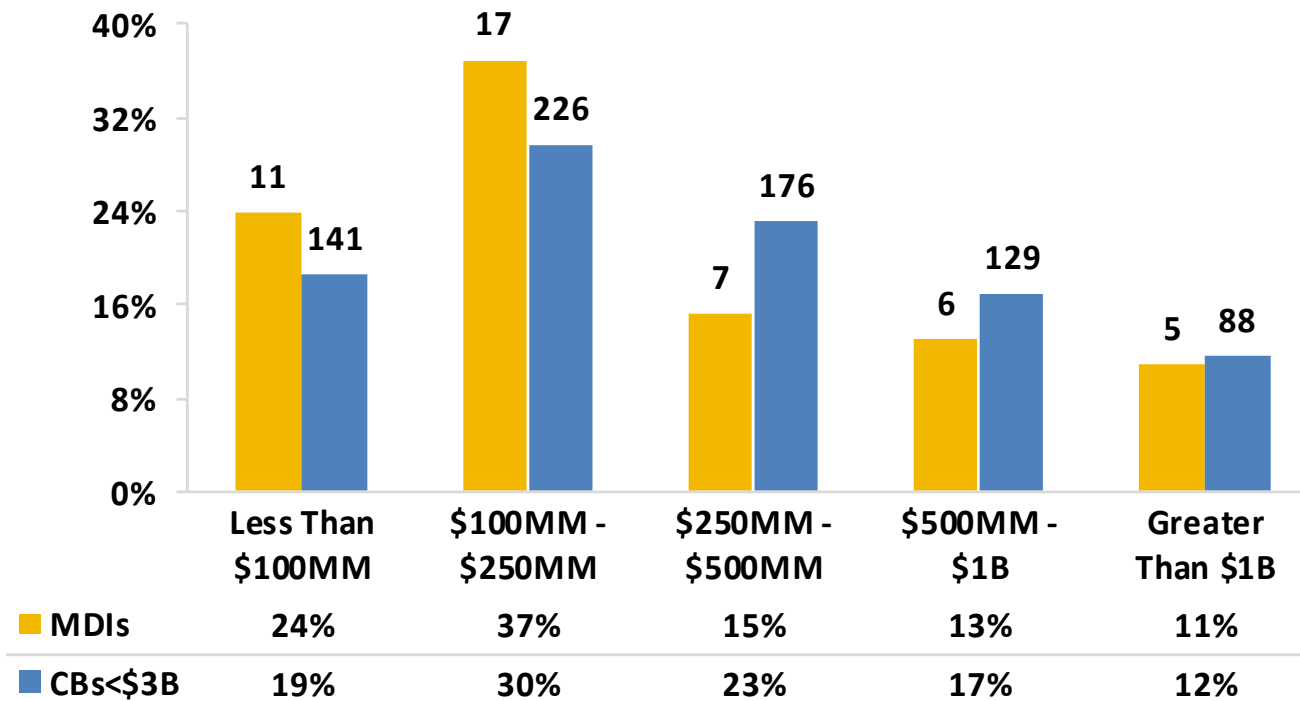
MDIs by Type and Lender Peer

- The majority or 83 percent of MDIs are national banks.
- The MDI peer group referenced throughout this presentation are community banks with total assets less than \$3 billion and not mutually-owned (CBs<\$3B).
- The majority or 83 percent of MDIs are classified as commercial real estate lenders and diversified lenders.



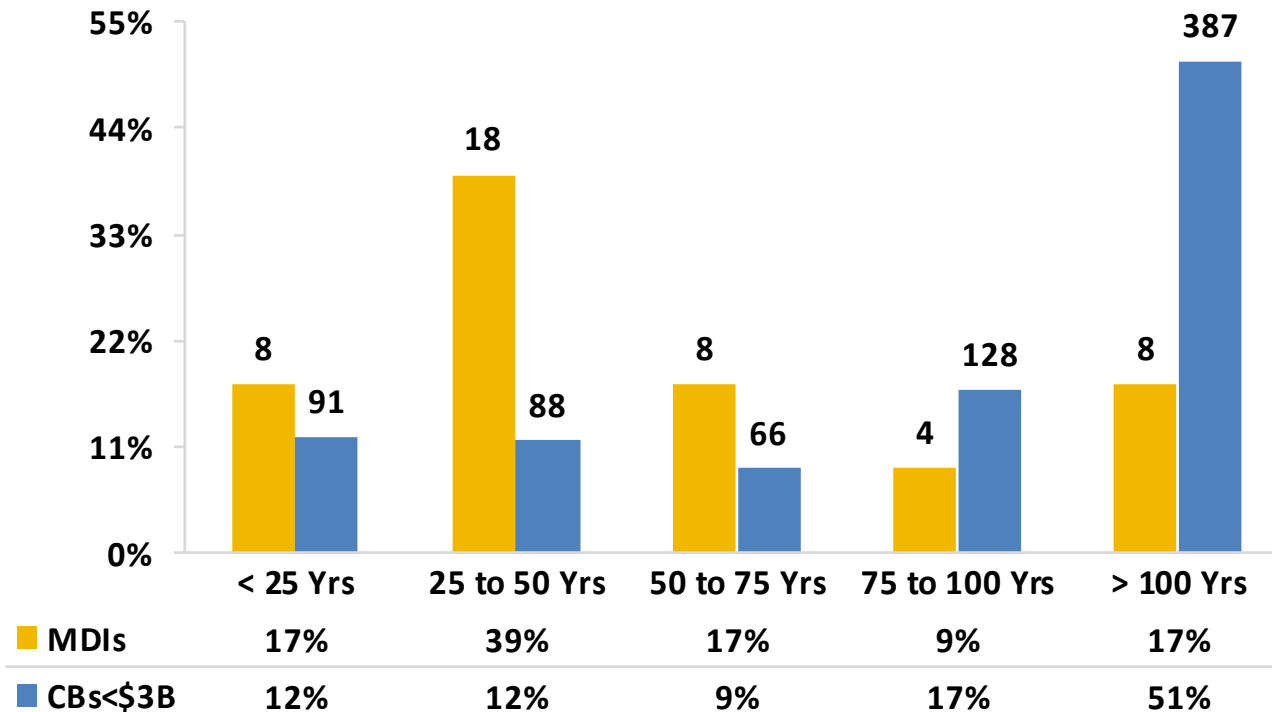
MDIs by Asset Size

MDIs are generally smaller in size than the community bank peer group. Sixty-one percent of MDIs have total assets less than \$250 million versus 49 percent of CBs<\$3B.



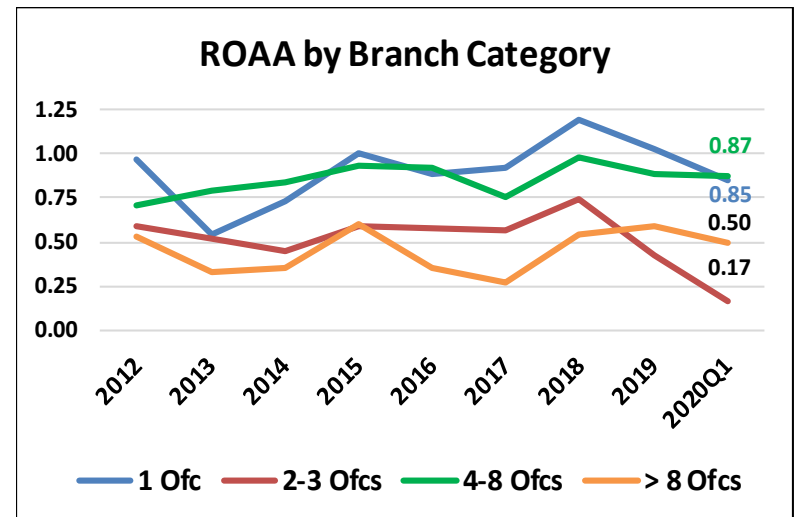
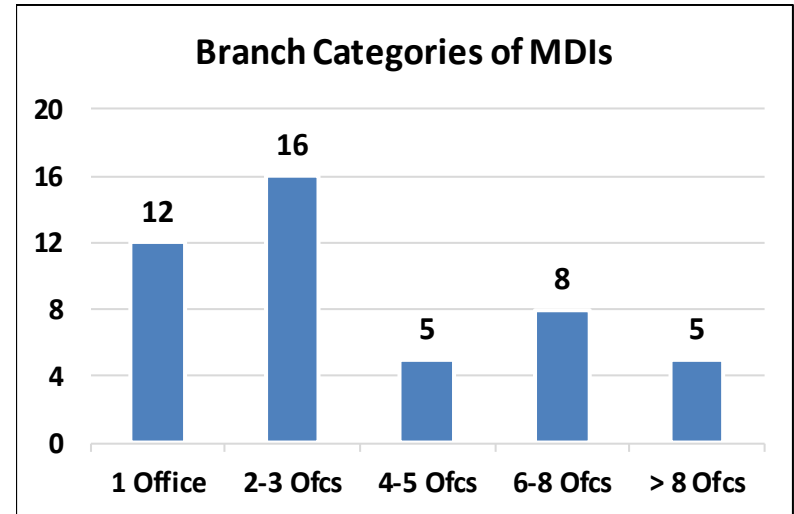
MDI Age Distribution

MDIs have been operating for fewer years than other community banks. Fifty-six percent of MDIs have operated for less than 50 years compared to 24 percent for the community bank peer group. Only 17 percent of MDIs were formed more than 100 years ago.



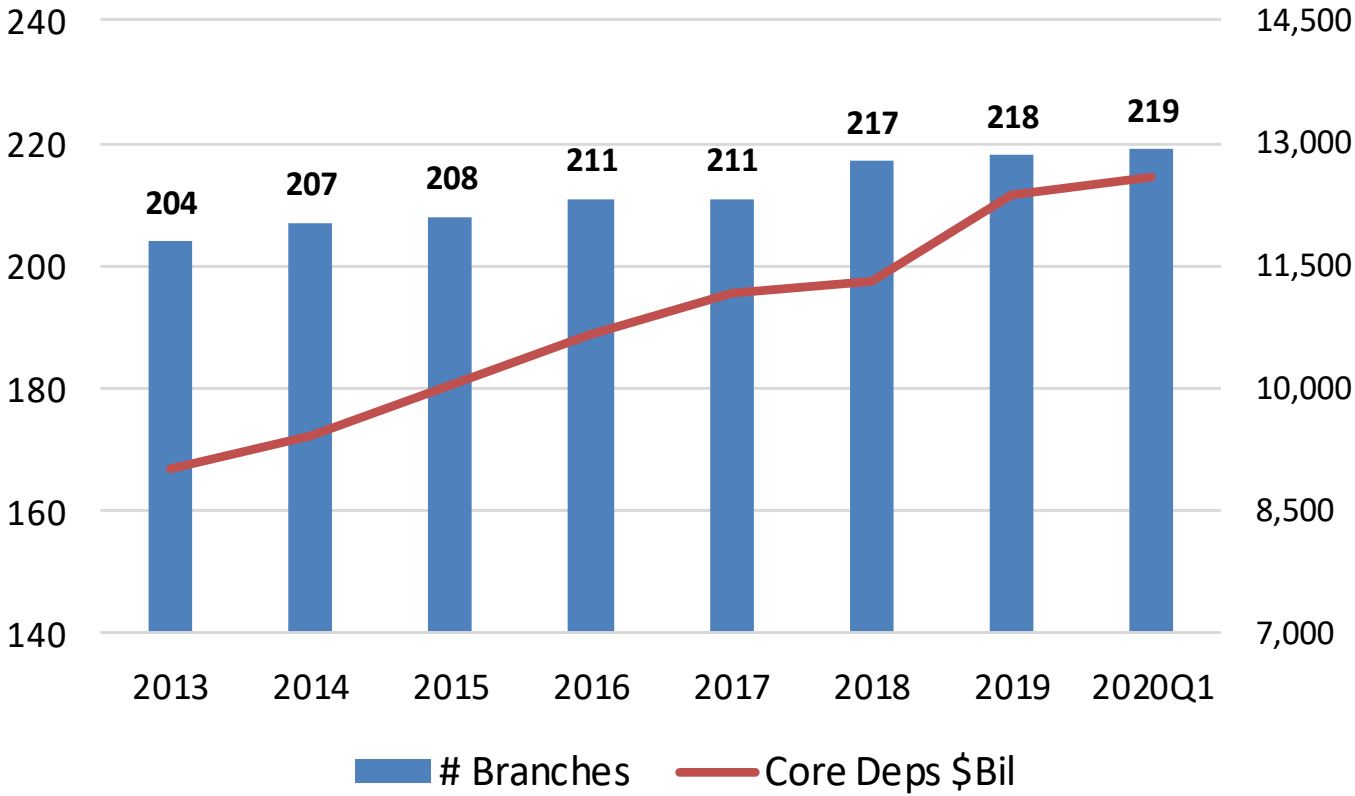
MDI Branches

- Twenty-six percent of MDIs operate from one location, and 61 percent have three locations or less.
- Eighteen MDIs or 39 percent have changed their branch configuration since 2012.
- Twelve MDIs increased their branch network and six MDIs reduced their branch network since 2012.
- MDIs with “4-8 Ofcs” reported the highest earnings in 2020, while MDIs with “2-3 Ofcs” reported the largest drop in earnings from 2012 to 2020.



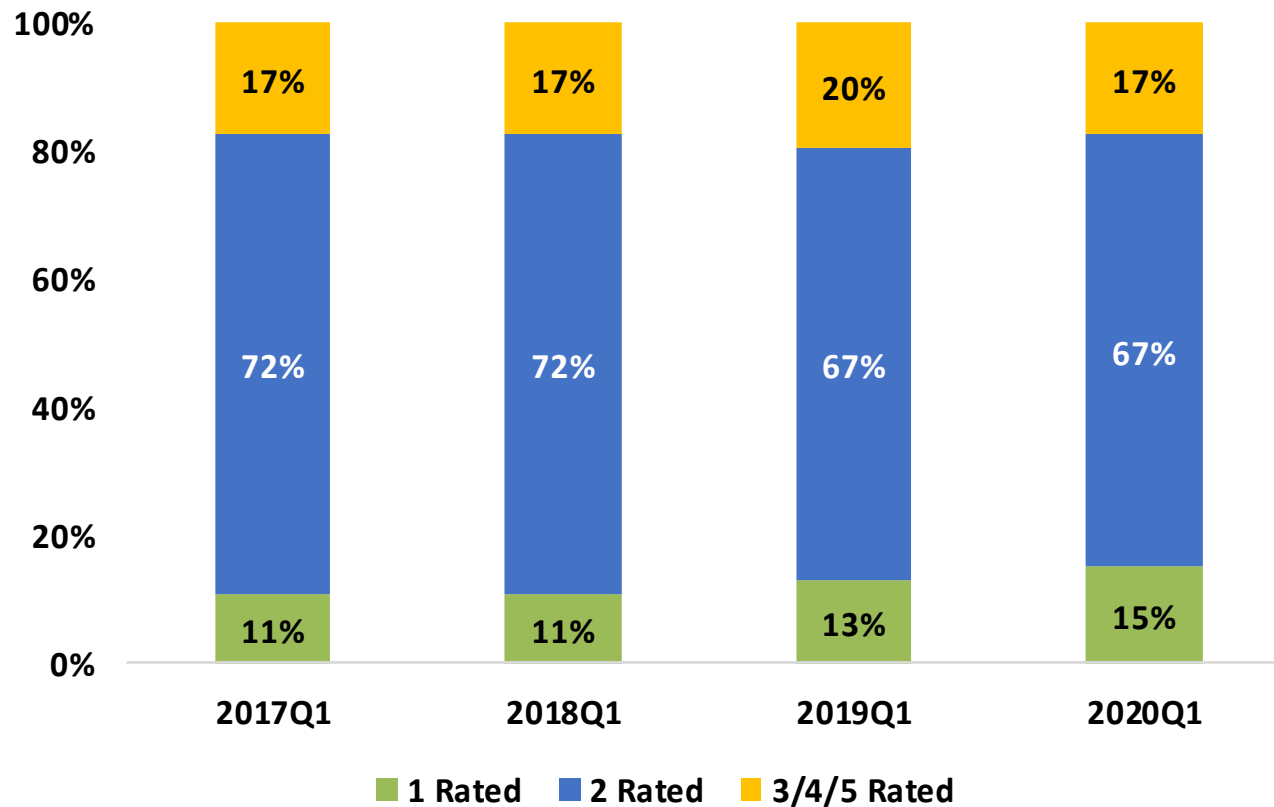
MDI Branch and Deposit Trends

Since 2013, the number of MDI office locations has grown 7 percent but core deposits have grown 39 percent.



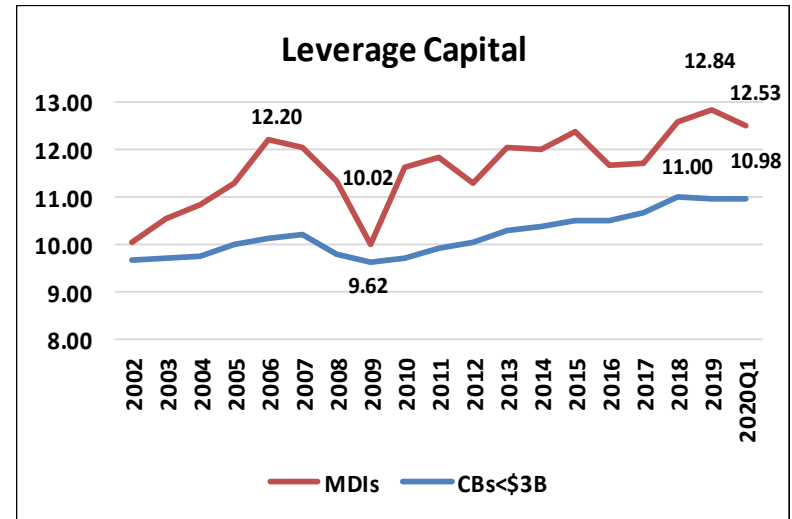
MDI Composite Ratings

Composite ratings for MDIs have improved this year. Eighty-two percent of MDIs have a composite rating of 1 or 2. The number of 1-rated charters also increased.



Capital Levels Remain Solid

- The median MDI leverage ratio fell 31 basis points this year.
- The gap between MDI and community bank charters narrowed to 155 basis points.
- MDI charters are better capitalized today versus pre-crisis.
- In general, the smaller banks hold higher levels of capital.



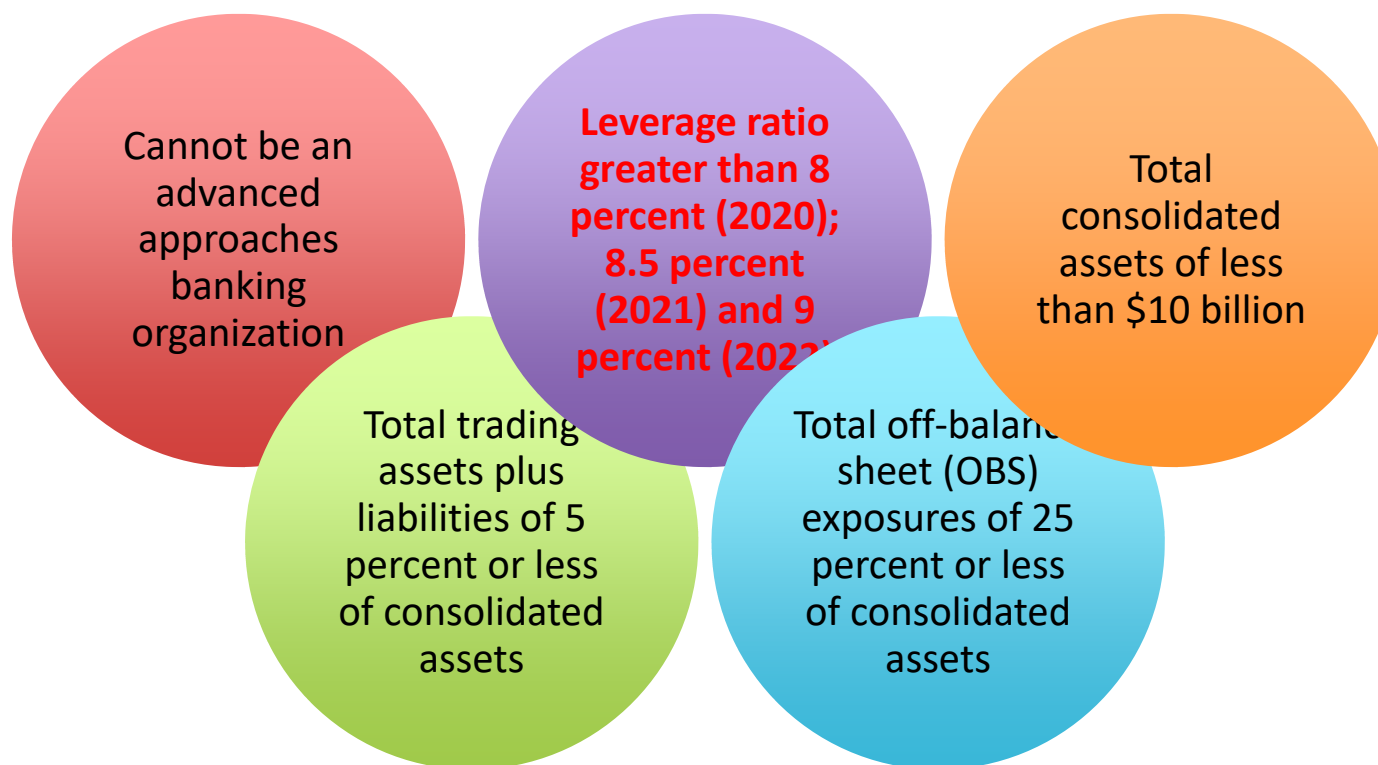
Leverage Ratio - March 31, 2020

| Asset Category | MDIs | CBs <\$3B |
|-------------------|--------------|--------------|
| Under \$50MM | 12.23 | 12.82 |
| \$50MM - \$100MM | 17.14 | 11.75 |
| \$100MM - \$250MM | 13.48 | 11.47 |
| \$250MM - \$500MM | 11.71 | 10.93 |
| \$500MM - \$1B | 11.28 | 10.42 |
| Greater than \$1B | 11.88 | 10.43 |
| Median | 12.53 | 10.98 |



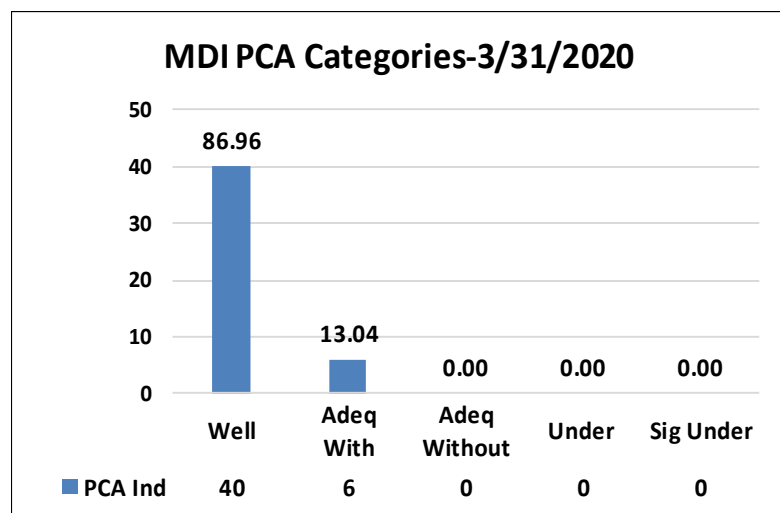
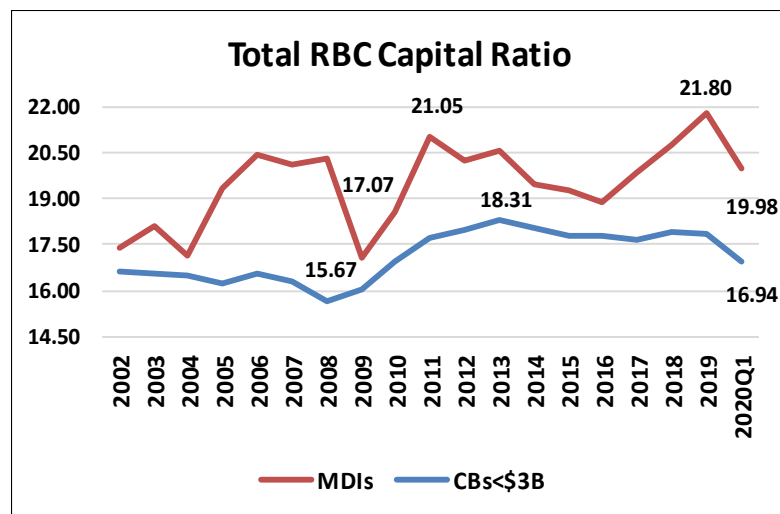
CBLR Framework – Now Being Phased In

The Community Bank Leverage Ratio (CBLR) is an optional simple leverage capital measure that became effective January 1, 2020. Institutions using the CBLR would be subject to a simplified reporting requirement.



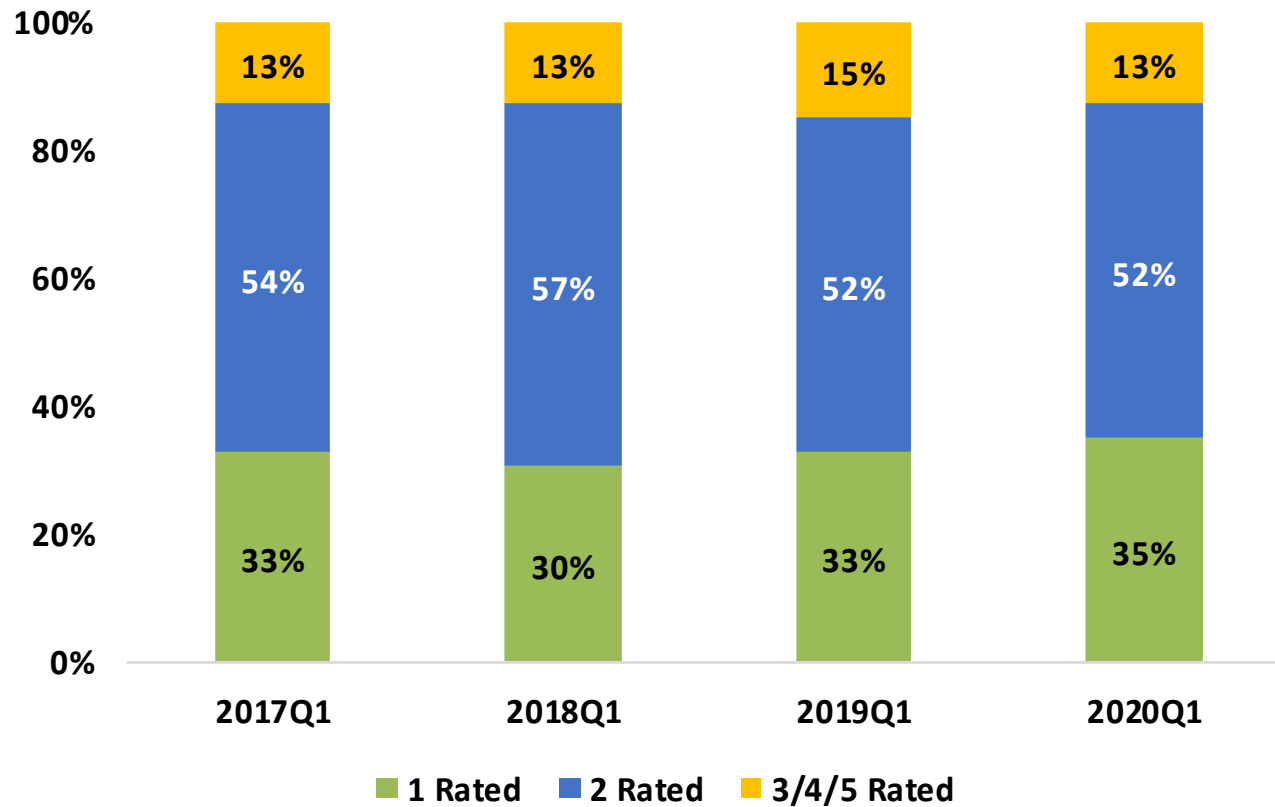
MDIs Are “Well-Capitalized”

- MDI total risk-based capital levels fell to 19.98 percent this year.
- The gap between MDIs and CBs<\$3B has narrowed to 304 basis points this year.
- Seventeen or 37 percent of MDIs have opted into the new CBLR framework.
- Eighty-seven percent of MDIs met the “well-capitalized” definition contained in Prompt Corrective Action as of March 31, 2020.
- Six MDIs – with formal actions requiring higher minimums – are “adequately-capitalized.”



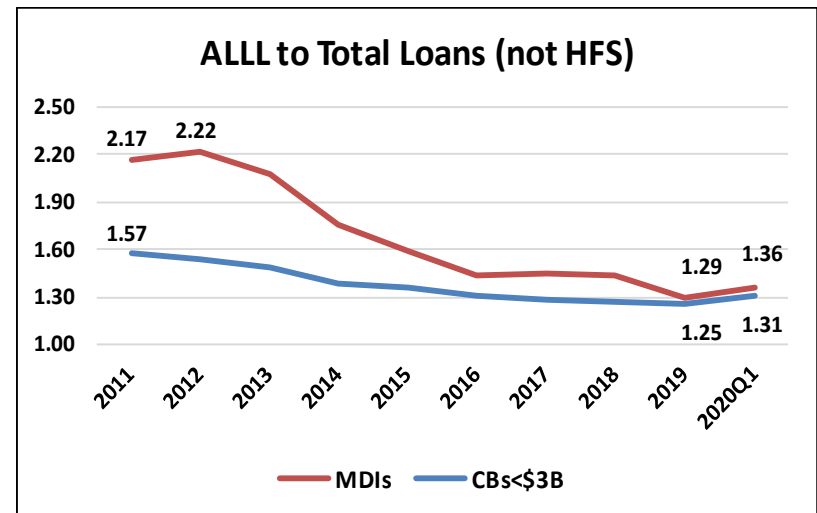
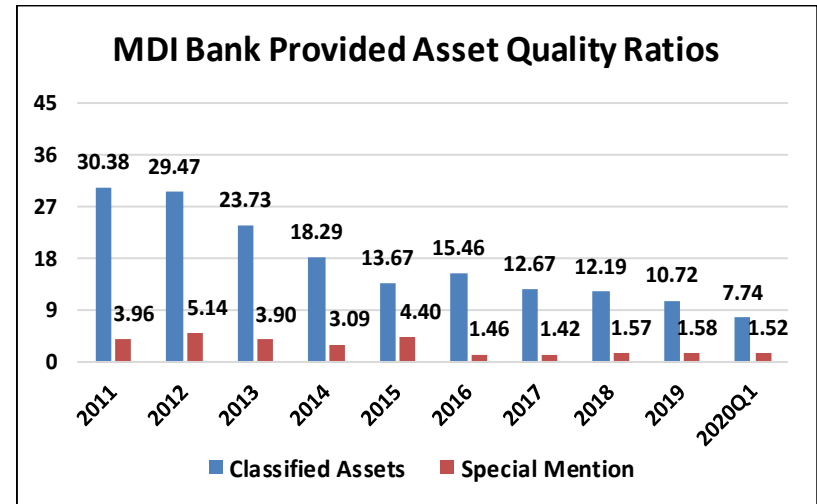
MDI Capital Ratings

MDI capital ratings improved this year. Eighty-seven percent of MDIs are rated 1 or 2 for capital.



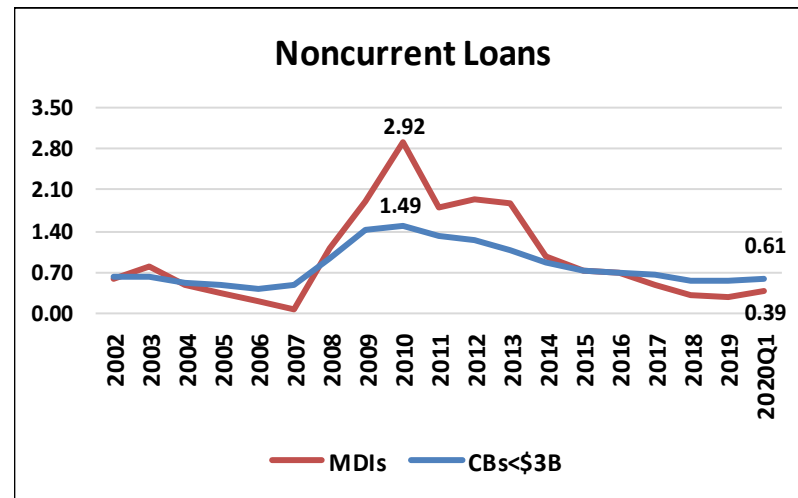
Classified Levels Near a Cyclical Trough

- MDI bank provided classified assets to tier 1 capital plus the ALLL ratios peaked in 2010 and continue to decline.
- MDI bank provided special mention assets to tier 1 capital plus the ALLL ratios remain at low levels since 2016.
- MDI ALLL to total loans increased in 2020. This is directionally consistent with the economic concerns related to COVID-19, which might lead to higher classified levels.



Noncurrent Loans Remain at Low Levels

- MDI noncurrent loans were on a downward trajectory before the COVID-19 disruption. Noncurrent levels increased 12 basis points for MDIs and three basis points for CBs<\$3B to 0.39 percent and 0.61 percent, respectively in 2020.
- The most recent trough for MDI noncurrent levels was 0.07 percent in 2007 (start of Great Recession).
- 30-89 day past due levels remain manageable but some banks saw a spike in past dues for certain loan categories.



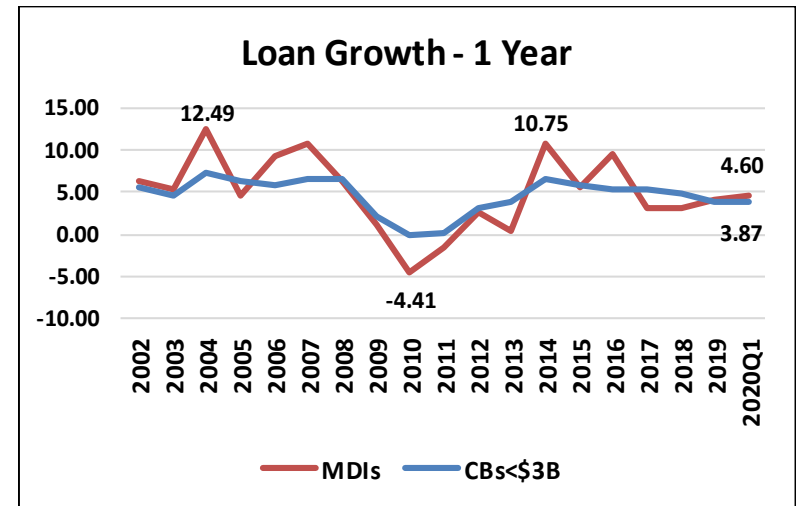
MDI 30-89 Days Past Due - March 31, 2020

| <u>Loan Category</u> | <u>Median</u> | <u>Maximum</u> |
|----------------------|---------------|----------------|
| 1-4 Fam 1st Liens | 0.10 | 6.42 |
| Home Equity | 0.00 | 1.18 |
| C&D Loans | 0.00 | 20.78 |
| Multifamily | 0.00 | 12.22 |
| NonFarm NonResi | 0.00 | 10.49 |
| Consumer | 0.16 | 3.31 |
| C&I Loans | 0.19 | 4.26 |
| Gross Loans | 0.55 | 6.65 |



Loan Growth Remains Satisfactory

- MDI loan growth rose to 4.60 percent compared to 4.04 percent for the prior quarter.
- MDI loan growth exceeded the CBs<\$3B median of 3.87 percent in 2020.
- Loan growth was highest for banks with total assets over \$1 billion and lowest for banks with total assets under \$50 million.



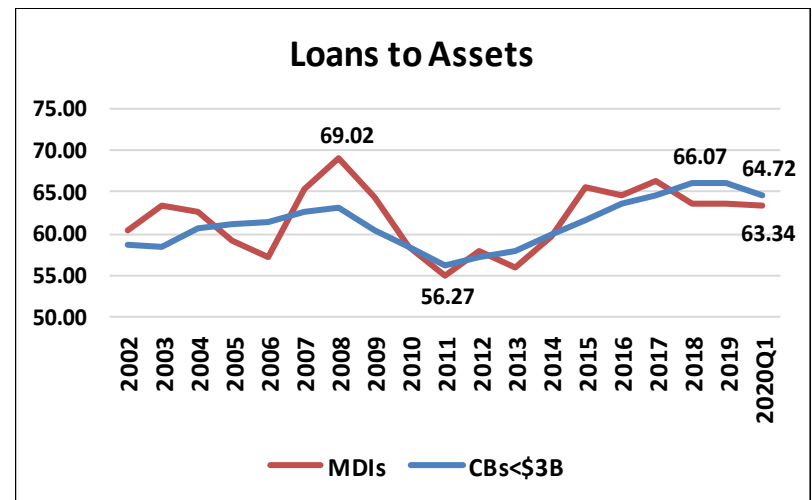
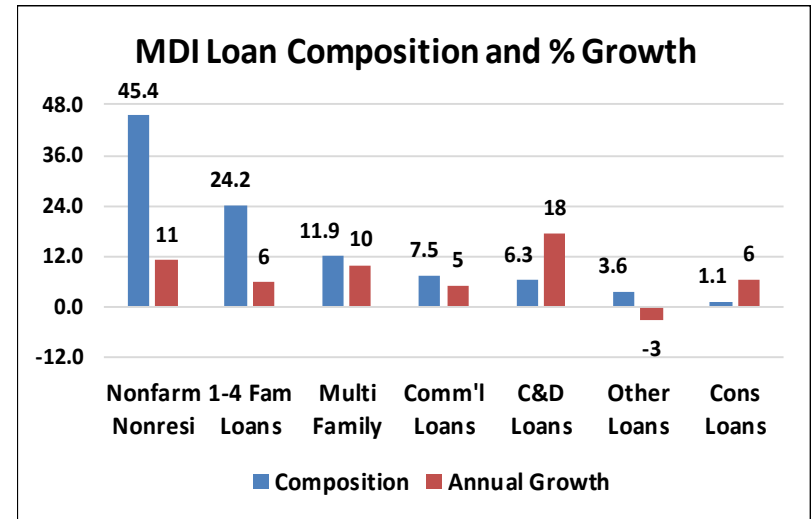
Loan Growth Ratio - March 31, 2020

| <u>Asset Category</u> | <u>MDIs</u> | <u>CBs<\$3B</u> |
|-----------------------|-------------|--------------------|
| Under \$50MM | -7.43 | -0.51 |
| \$50MM - \$100MM | 3.70 | 1.95 |
| \$100MM - \$250MM | 4.99 | 2.91 |
| \$250MM - \$500MM | 4.82 | 3.41 |
| \$500MM - \$1B | 3.38 | 4.94 |
| Greater than \$1B | 11.39 | 5.41 |
| Median | 4.60 | 3.87 |



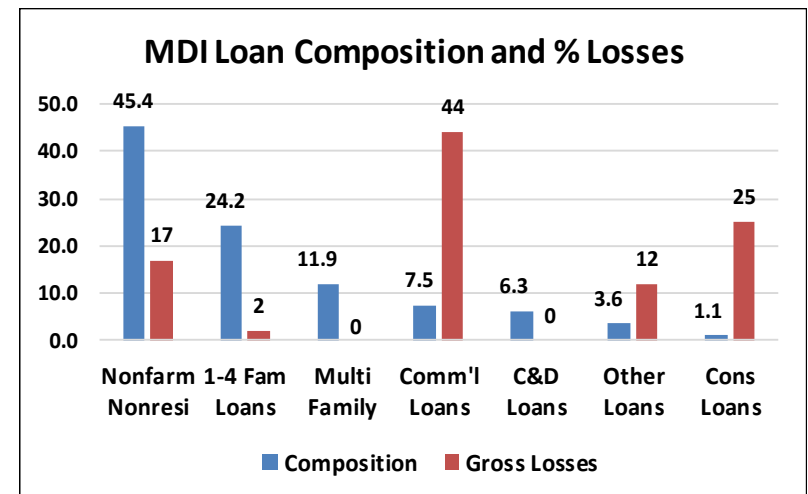
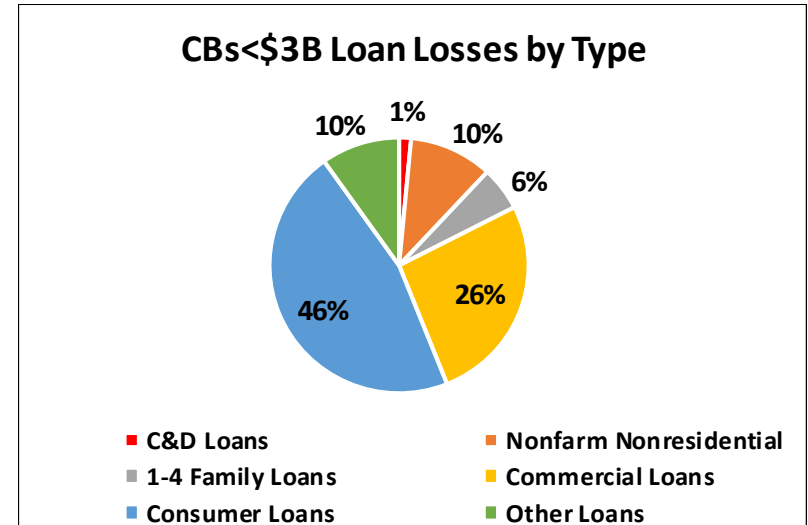
MDI Loan Composition

- MDI banks added \$1.1 billion or 9 percent to loan and lease balances in 2020.
- Loan balances for all categories increased from the prior year except Other Loans.
- Loan growth was highest for C&D Loans and Nonfarm Nonresi at 18 and 11 percent, respectively.
- Loans to assets for MDIs are up since 2013 but declined to 63.34 percent in 2020.



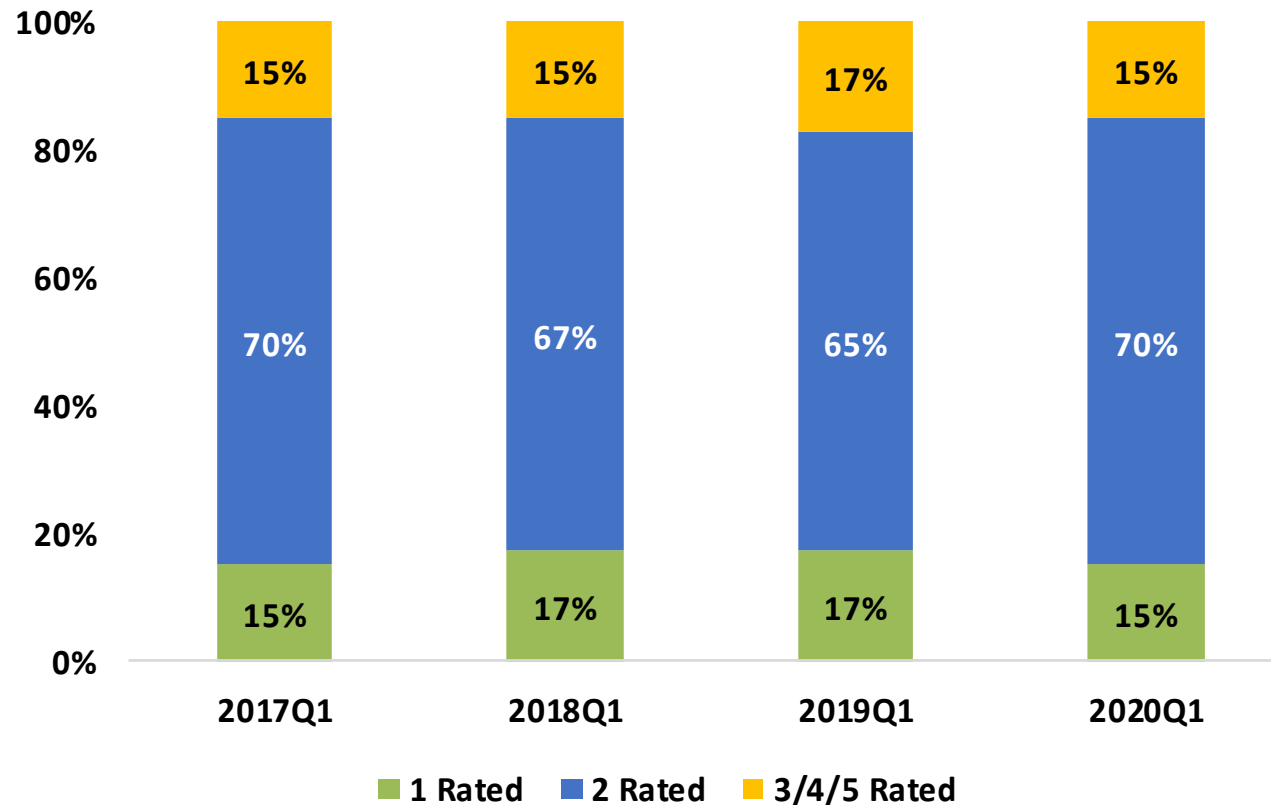
MDI Loan Losses Are Low

- Gross loan losses as of first quarter 2020 remain low for CBs<\$3B at 0.05 percent and even lower for the MDIs at 0.02 percent.
- Most losses for CBs<\$3B emanate from consumer loans (46 percent) and commercial loans (26 percent).
- Consumer loans account for 1 percent of MDI loan volume but 25 percent (auto-9%) of charge-offs.
- Commercial loans account for 8 percent of loans but 44 percent of gross charge-offs.
- On the other hand, multifamily loans account for 12 percent of loan outstandings with nominal losses.



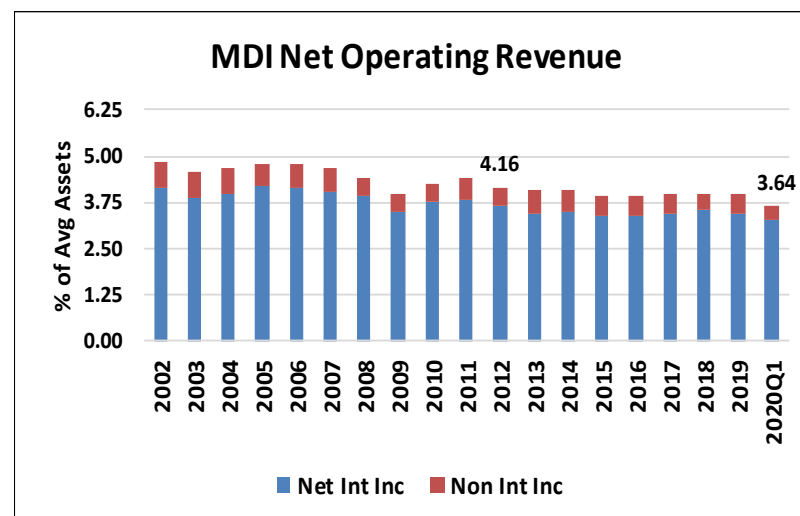
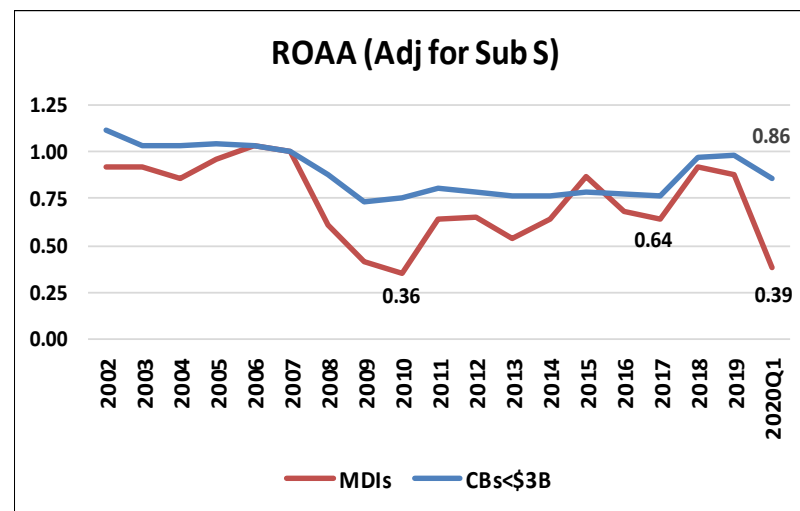
MDI Asset Quality Ratings

Asset quality ratings remain satisfactory for MDIs. Eighty-five percent are rated 1 or 2 for asset quality.



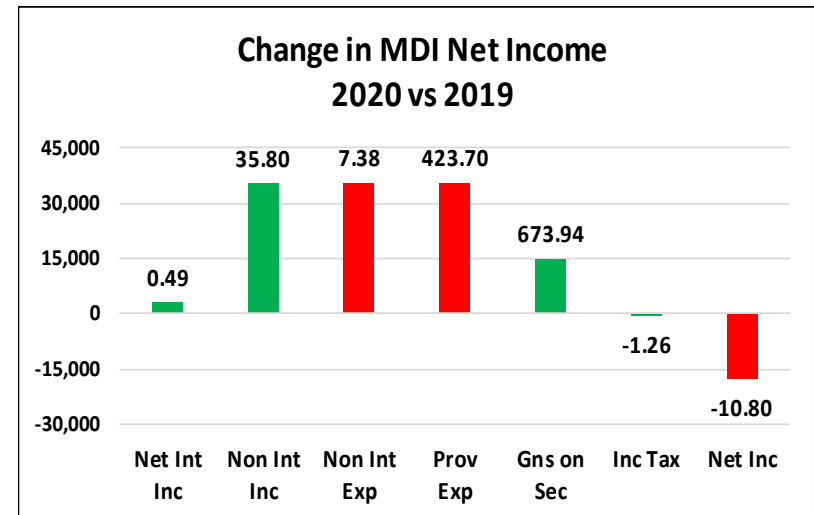
Earnings Down From 2019 and 2012

- MDI ROAA fell 49 basis points to 0.39 percent as of March 31, 2020 and lags the CBs<\$3B ROAA of 0.86 percent.
- MDI net operating revenue fell 32 basis points over the last year but fell 52 basis points from 2012.
- Since 2012, net interest income fell 38 basis points to 3.26 and noninterest income fell 14 basis points to 0.38 percent.

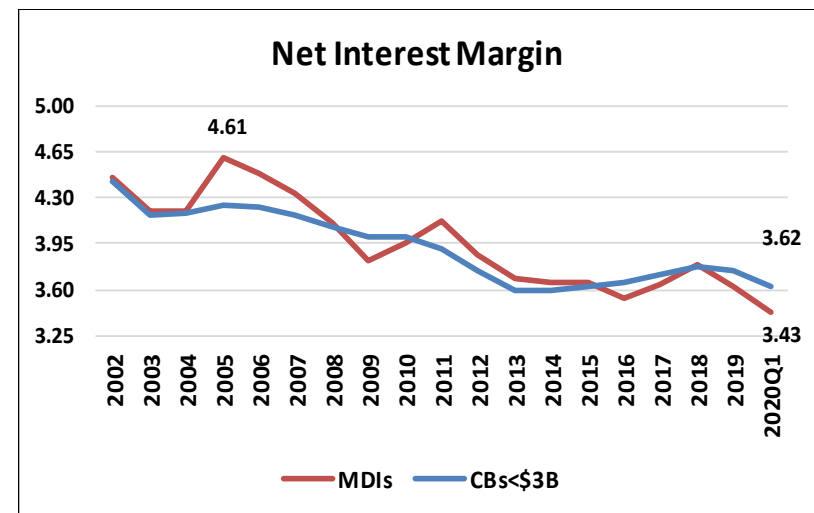


MDI Net Income Down 11 Percent

- MDIs beat on the top but not the bottom line versus last year.
 - Net inc of \$144 mil, down 10.80%
 - Net int inc of \$594 mil, up 0.49%
 - Nonint inc of \$134 mil, up 35.80%
 - Nonint exp of \$514 mil, up 7.38%

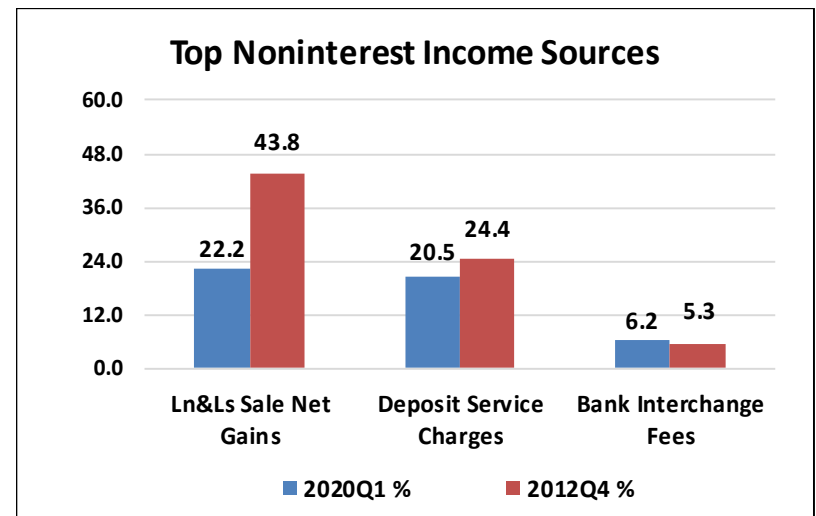
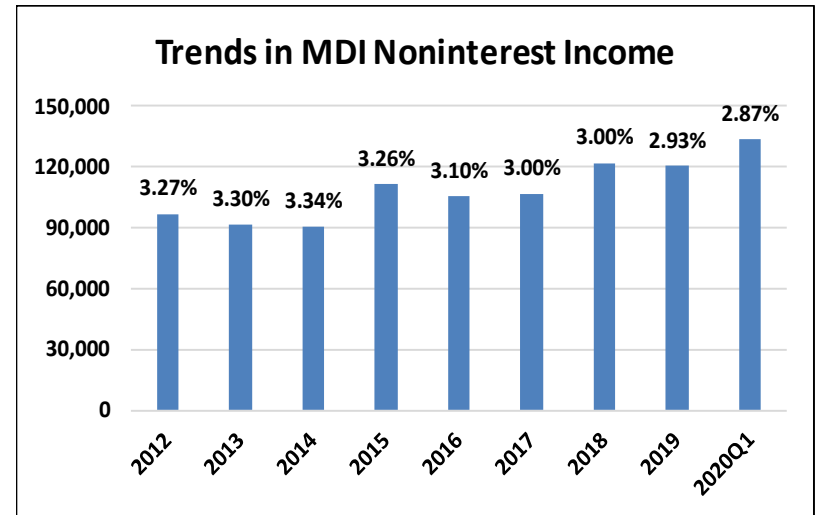


- MDI net interest margin (NIM) of 3.43 percent is down 19 basis points from last quarter and lags CBs<\$3B.
- NIMs have compressed considerably since 2002. This underscores the importance of fee income. NIM compression may also lead to more industry consolidation.



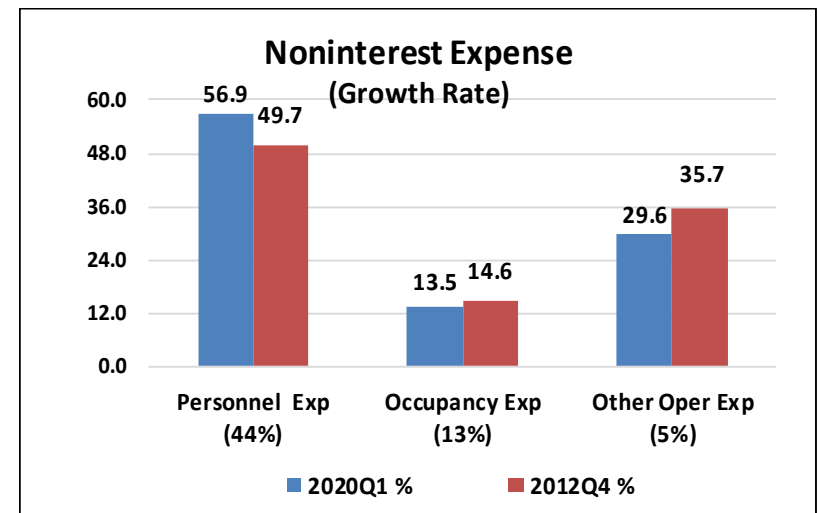
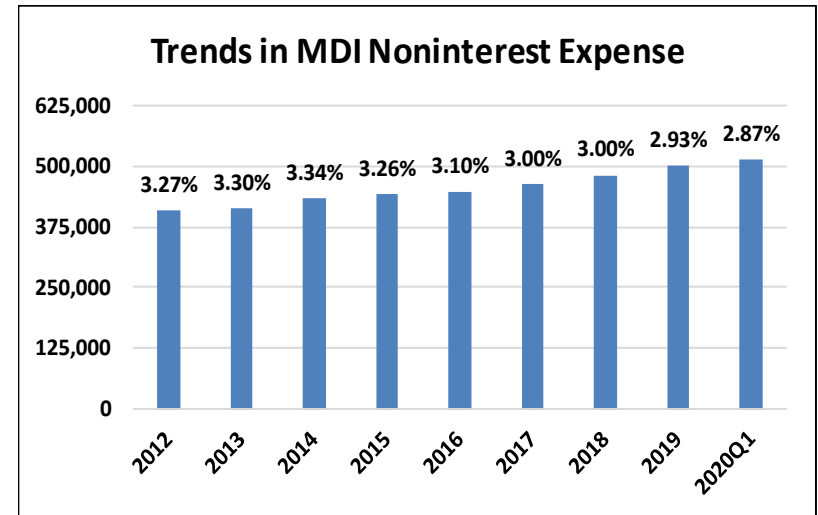
Noninterest Income Slowing

- MDI noninterest income of just under \$134 million is up \$35 million or 36 percent compared to last year.
 - MDI noninterest income to average assets has declined since 2012 (4 MDI charters reported 0.10 percent of average assets or less this quarter).
 - Lack of fee income diversity has hurt the smaller charters.
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- At 22.2 percent loan and lease sales is the top other noninterest income category in 2020. Deposit service charges is in second place. It has grown 16 percent since 2012.



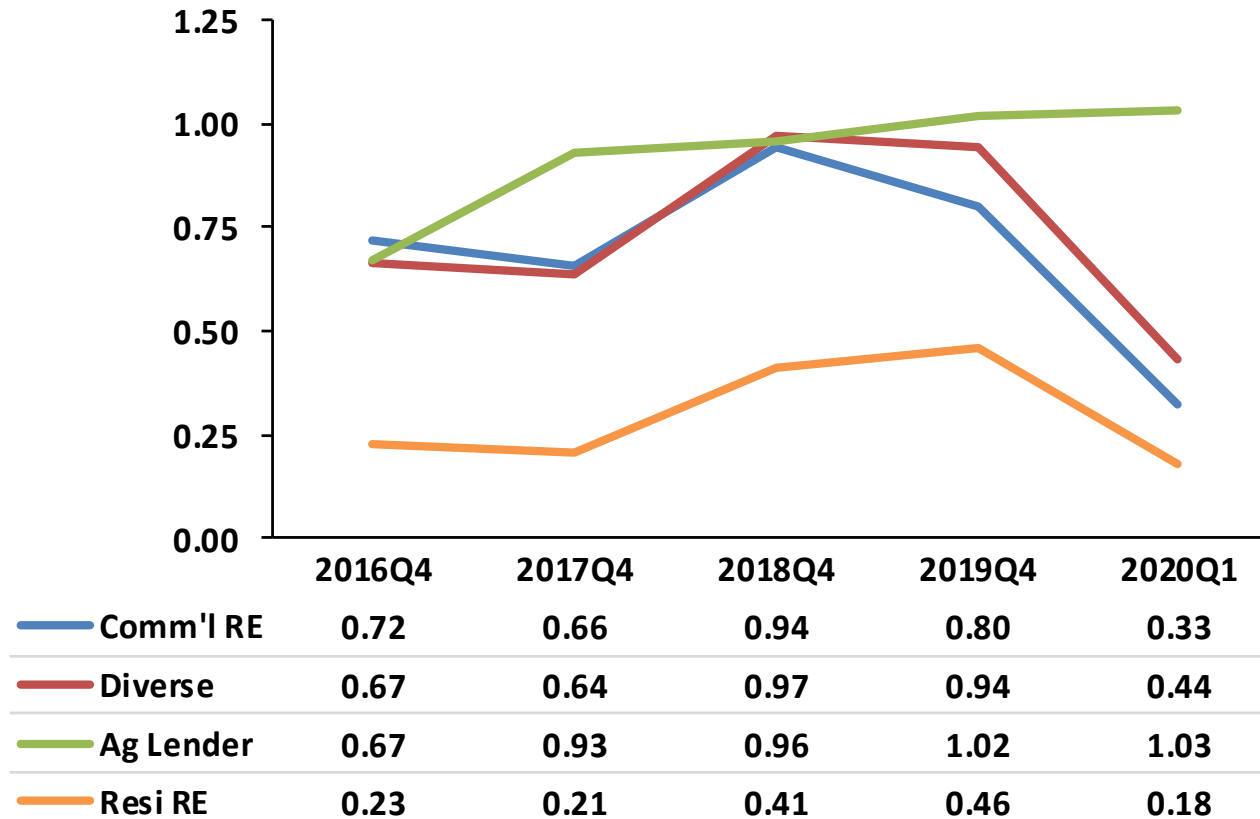
Noninterest Expense Improving

- MDI noninterest expense of \$514 million is up \$35 million or 7 percent compared to last year.
- Noninterest expense to average assets has decreased steadily since 2014.
- Eleven MDIs or 24 percent reported noninterest expense greater than 4 percent of average assets.
- At 57 percent, personnel expense is the top noninterest expense category. It has grown 44 percent since 2012.
- Occupancy expense is much lower at 14 percent of noninterest expense and growing slower at 13 percent.



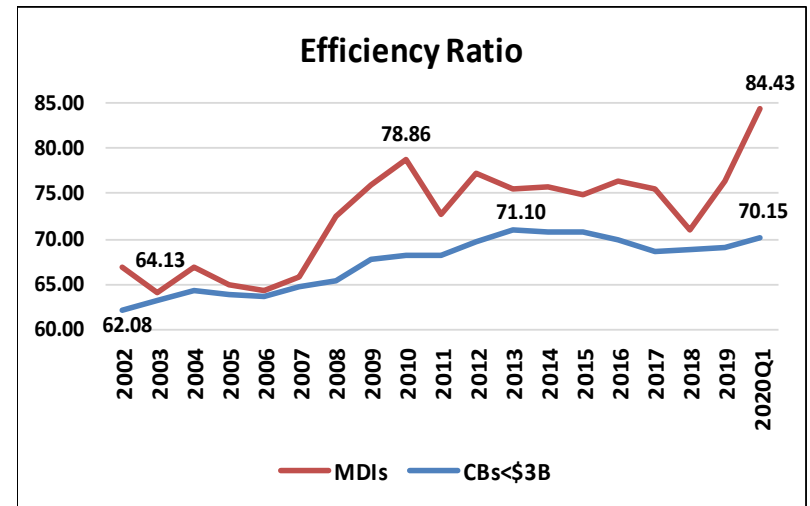
MDI Return on Assets by Lender Peer

Except for Ag Lenders, ROAAs have declined in 2020.



Efficiency Ratio Still High

- The MDI efficiency ratio peaked in first quarter 2020.



- If you stratify the efficiency ratio by asset size, you will find the larger the bank, the lower the efficiency ratio.
- Thirty-four of 46 MDIs or 74 percent reported higher efficiency ratios for first quarter 2020 versus the same period last year.

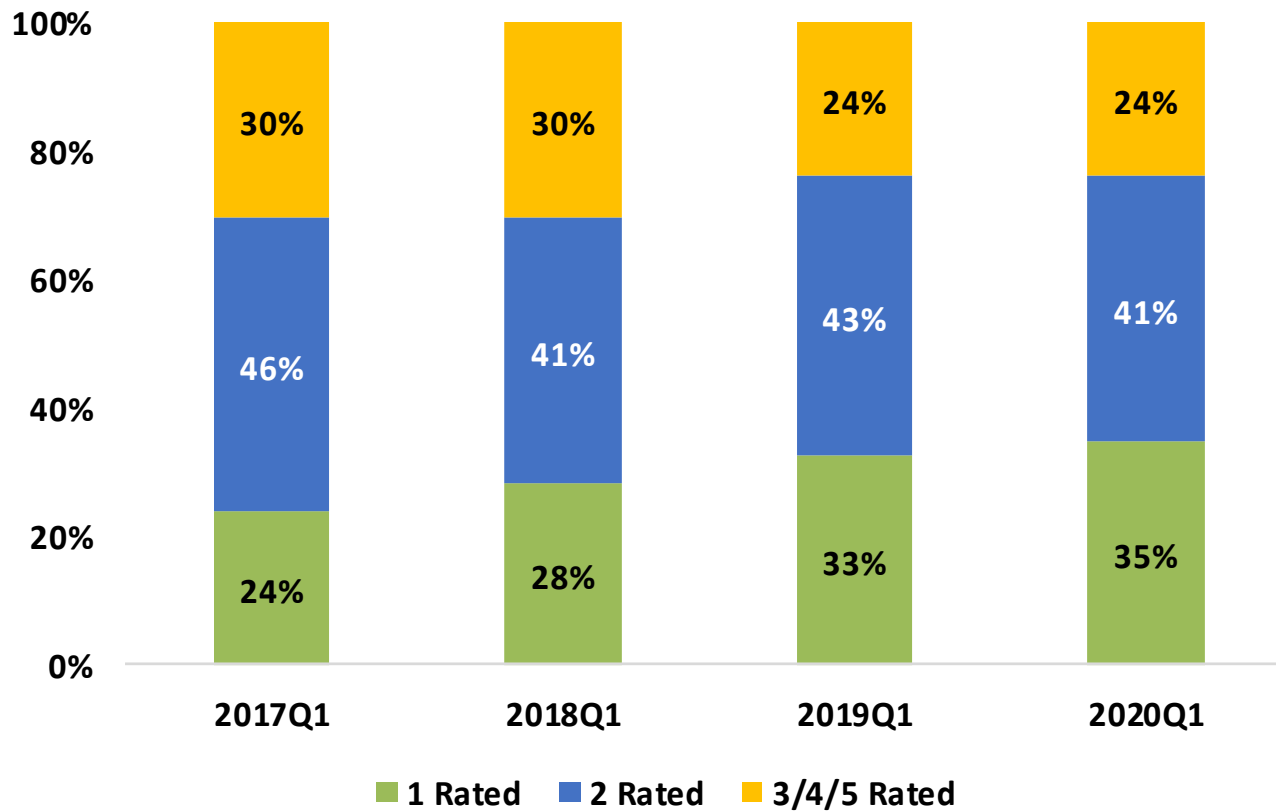
Efficiency Ratio - March 31, 2020

| <u>Asset Category</u> | <u>MDIs</u> | <u>CBs < \$3B</u> |
|-----------------------|--------------|----------------------|
| Under \$50MM | 125.00 | 82.87 |
| \$50MM - \$100MM | 65.76 | 75.22 |
| \$100MM - \$250MM | 92.35 | 70.30 |
| \$250MM - \$500MM | 80.25 | 69.18 |
| \$500MM - \$1B | 74.91 | 67.01 |
| Greater than \$1B | 55.83 | 64.57 |
| Median | 84.43 | 70.15 |



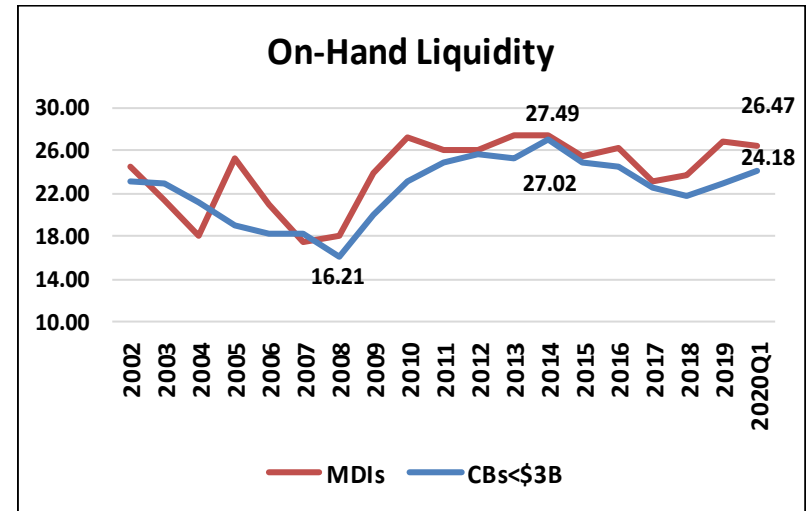
MDI Earnings Ratings

Earnings ratings are stable but lag behind ratings in other safety and soundness areas. Only 76 percent of MDIs are rated 1 or 2 for earnings.



On-Hand Liquidity Higher

- MDI liquidity levels remain strong as of first quarter 2020 and well above pre-crisis levels.



- If you stratify the on-hand liquidity ratio by asset size, you will generally find the larger the bank, the lower the on-hand liquidity ratio.

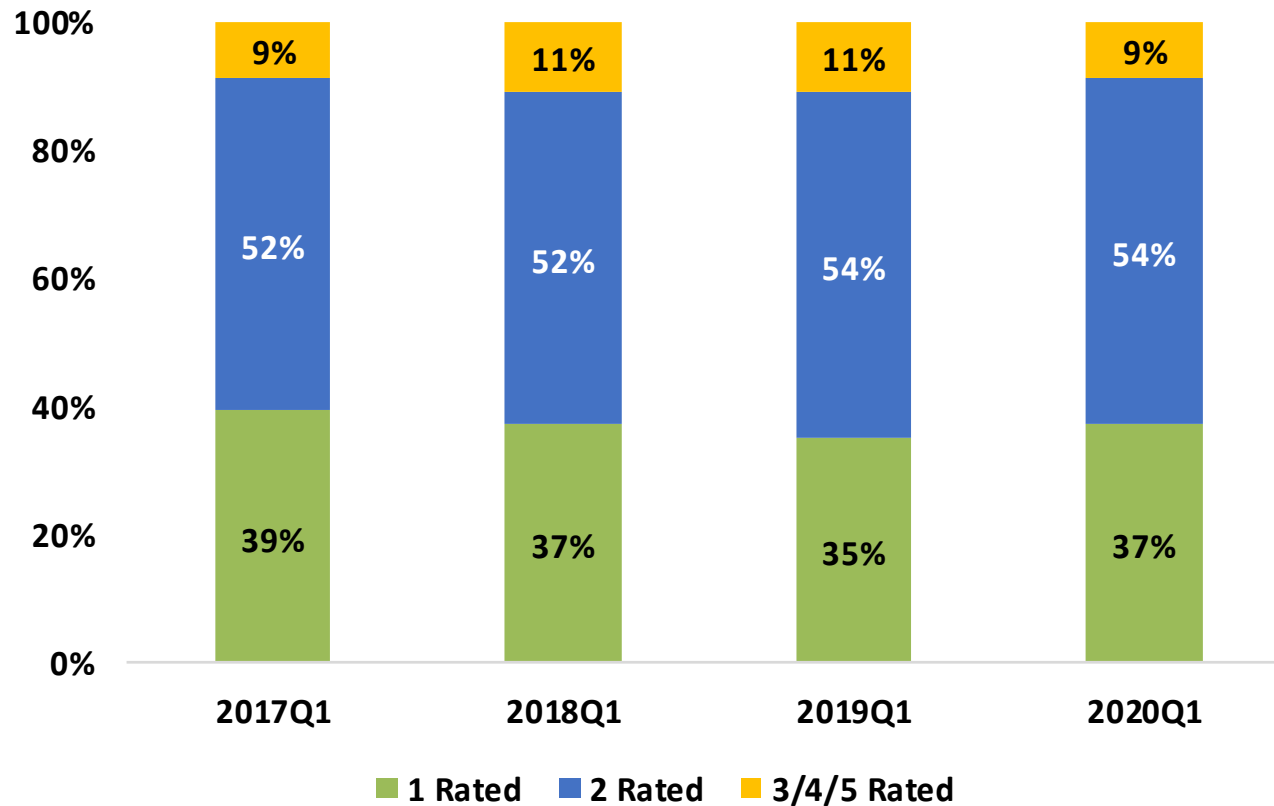
On-Hand Liquidity - March 31, 2020

| Asset Category | MDIs | CBs < \$3B |
|-------------------|--------------|--------------|
| Under \$50MM | 40.87 | 44.85 |
| \$50MM - \$100MM | 44.73 | 31.59 |
| \$100MM - \$250MM | 36.66 | 25.98 |
| \$250MM - \$500MM | 16.87 | 24.38 |
| \$500MM - \$1B | 15.44 | 19.46 |
| Greater than \$1B | 18.57 | 16.93 |
| Median | 26.47 | 24.18 |



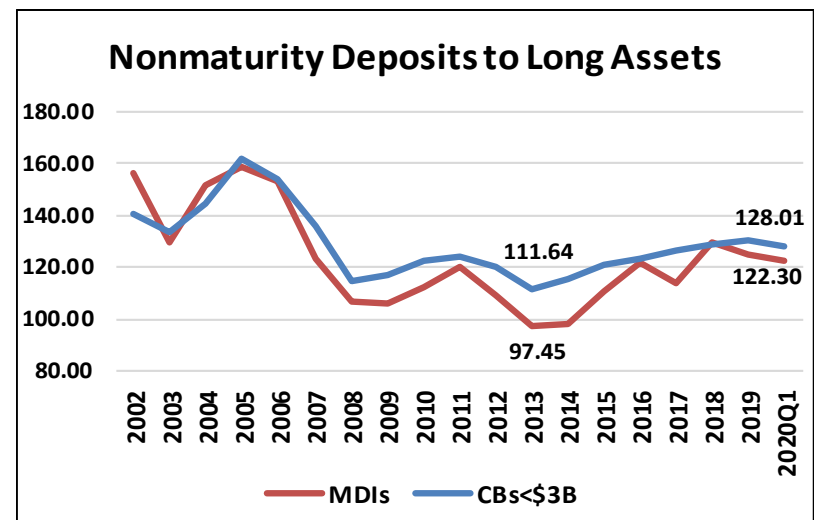
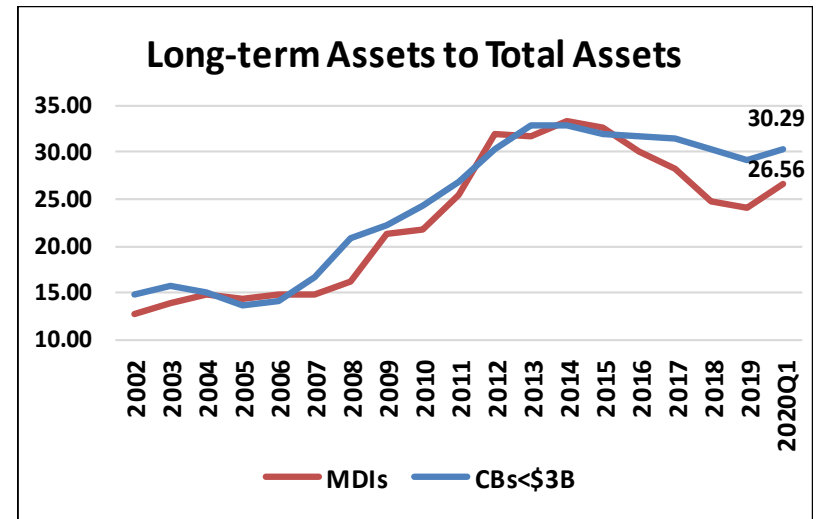
MDI Liquidity Ratings

Liquidity ratings for MDIs remain strong and improving. Ninety-one percent are rated 1 or 2.



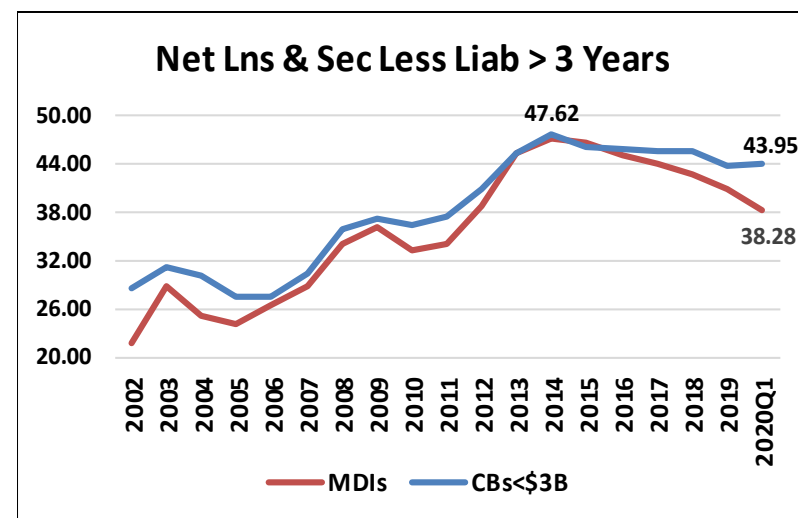
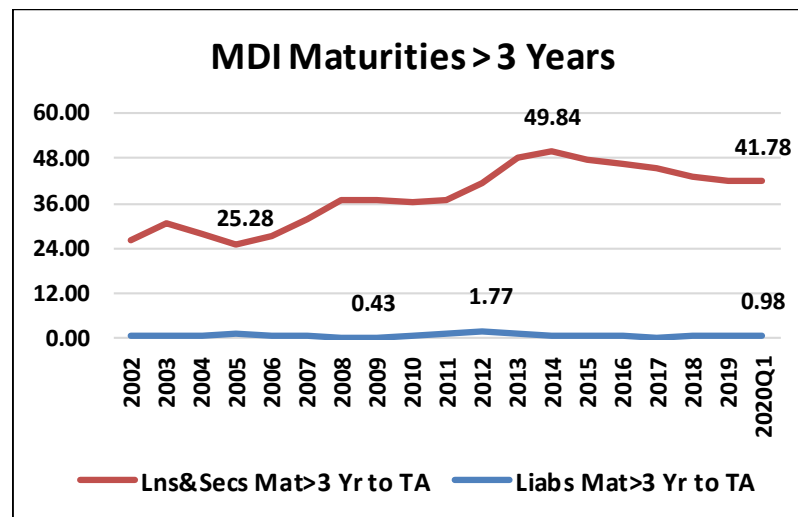
Nonmaturity Deposits Up Since 2012

- Long-term assets to total assets of 26.56 percent are down from their peak in 2014.
- Nonmaturity deposits to long-term assets have decreased for MDIs in 2020 but are up from their lows of 2013.



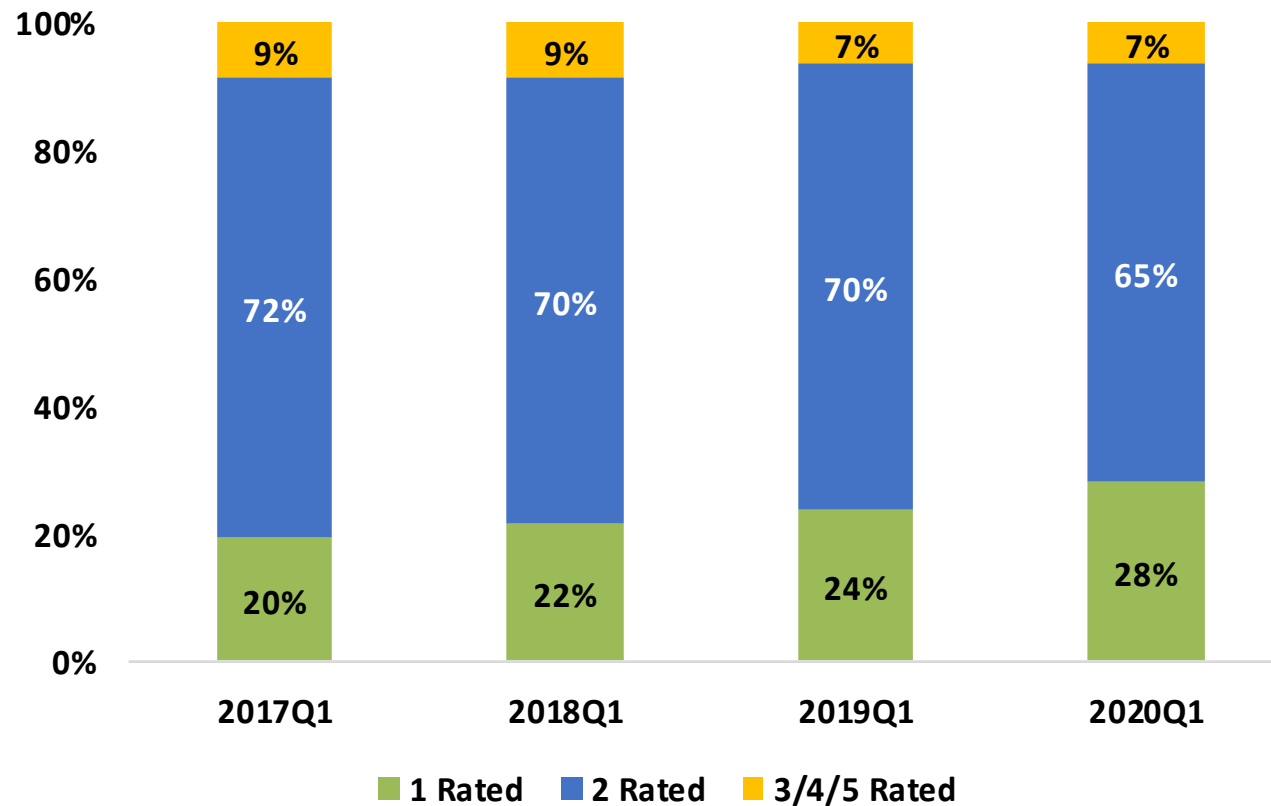
MDI Funding Gap Narrowing

- MDI loans and securities over three years fell for the sixth consecutive year to 41.78 percent.
- Only 0.98 percent of MDI liabilities mature or reprice in more than three years.
- The gap between loans and securities and liabilities has greatly widened since 2005.
- The high level of longer-term assets compared with the low level of longer-term liabilities represents a significant funding gap.
- The funding gap is more pronounced for CBs > \$3B compared to MDIs.



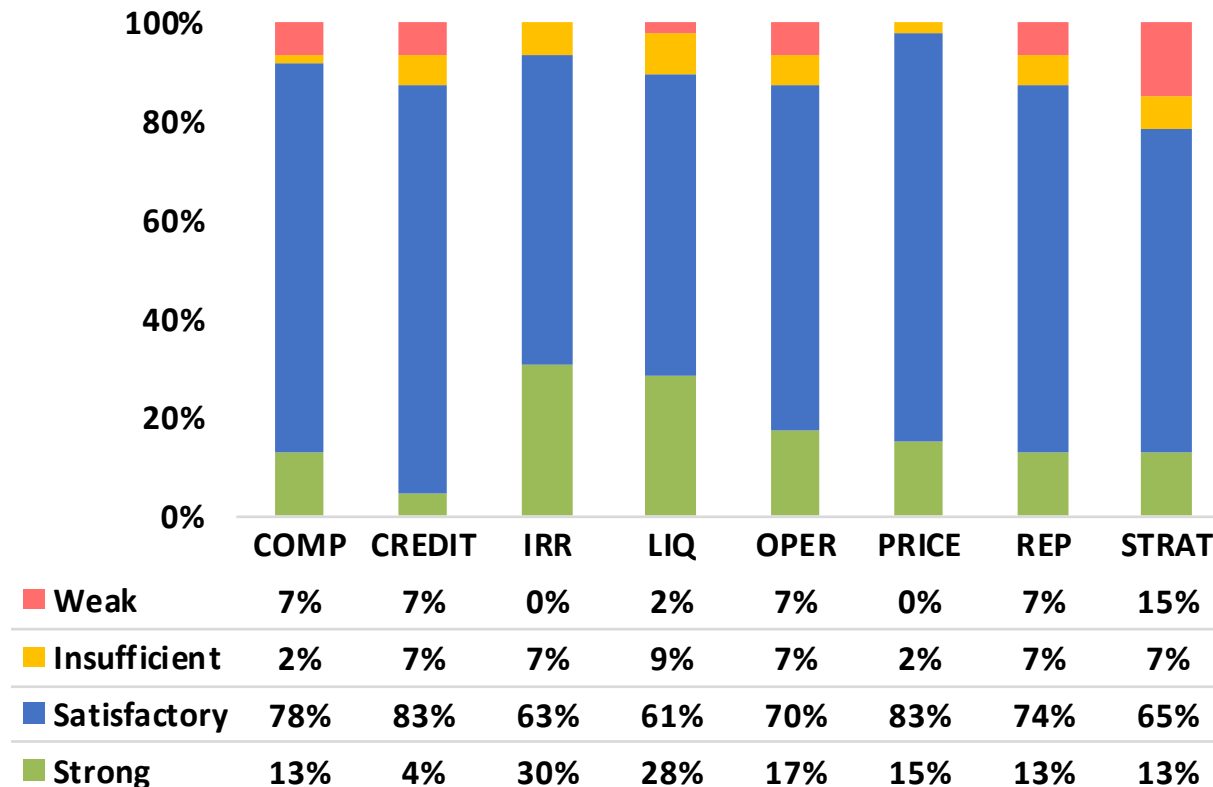
MDI Sensitivity to Market Risk Ratings

Sensitivity to market risk ratings for MDIs remain satisfactory. Ninety-three percent are rated 1 or 2.



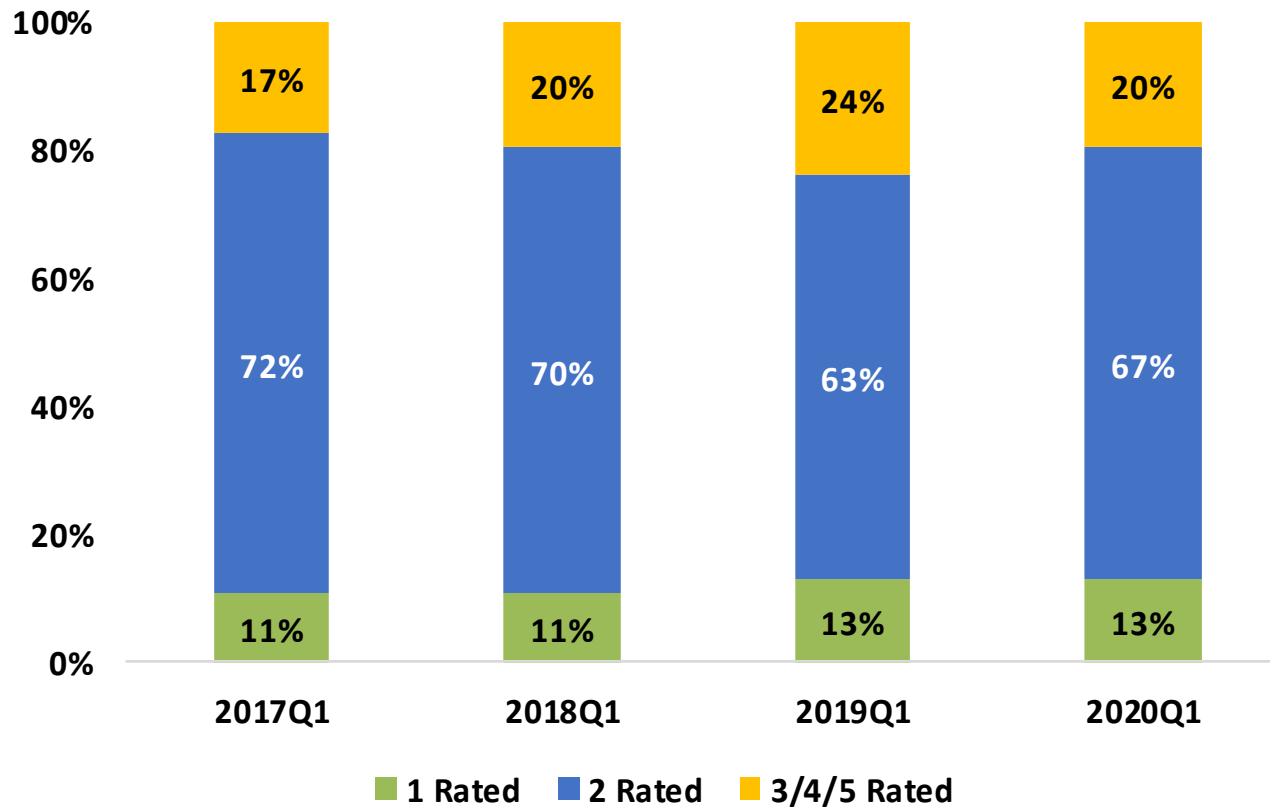
MDIs Quality of Risk Management

Interest rate risk and liquidity risk have the most strong ratings at 30 percent and 28 percent, respectively. Strategic has the most insufficient/weak ratings at 22 percent.



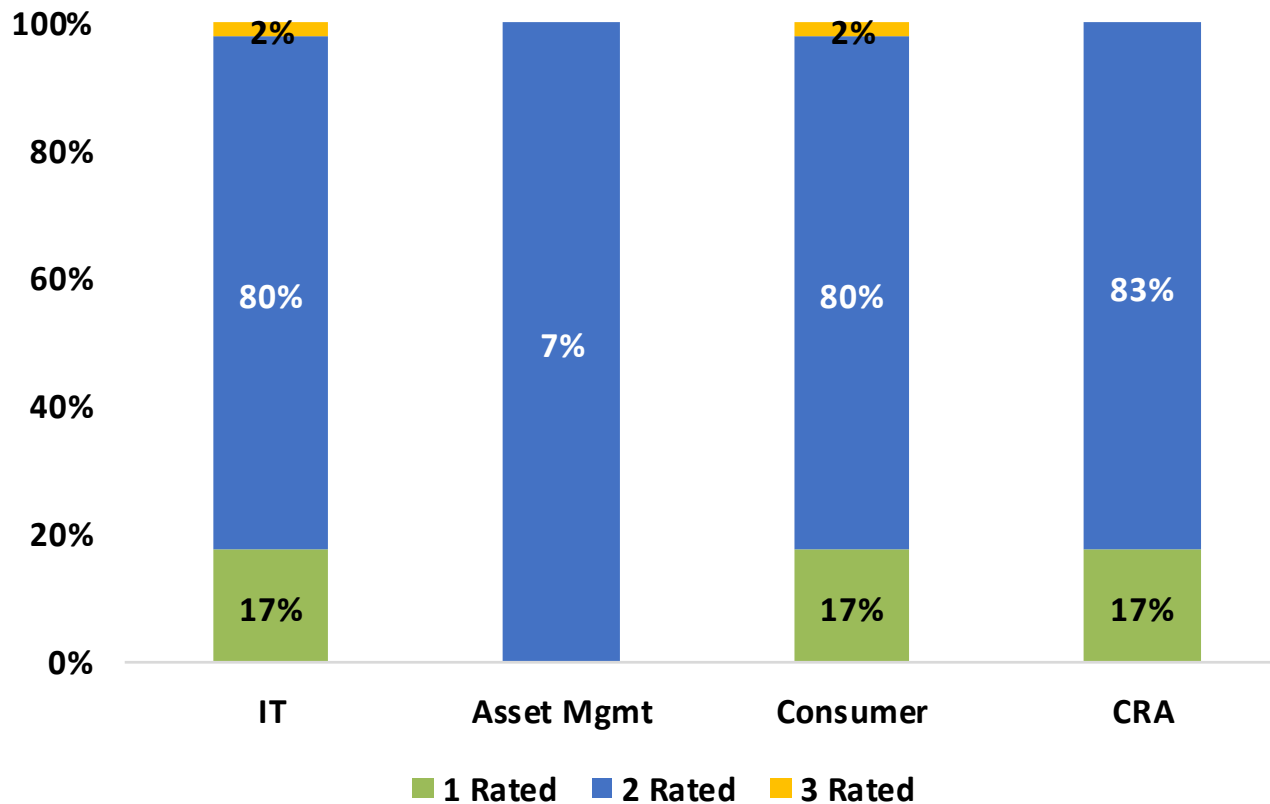
MDI Management Ratings

Management ratings are satisfactory and improving. Eighty percent of MDIs are rated 1 or 2 for management.



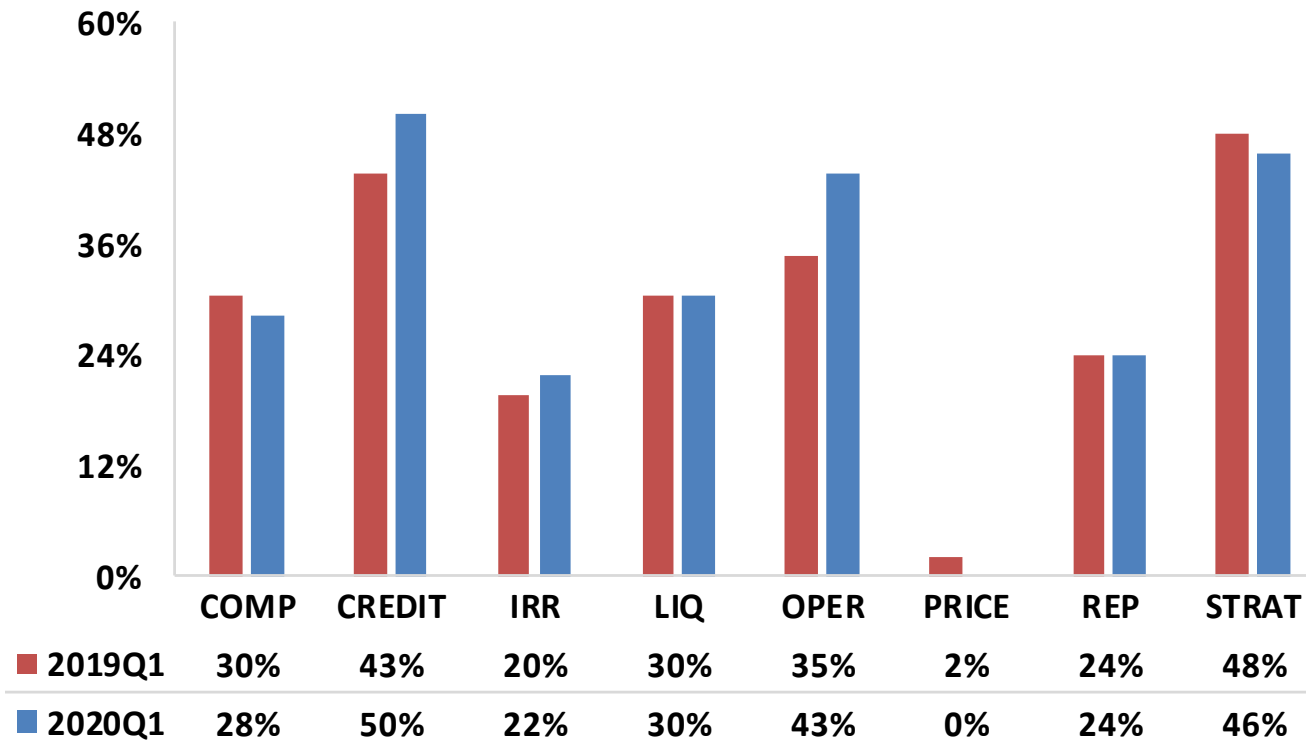
MDI Specialty Ratings

Specialty ratings are satisfactory. Only three MDIs have trust powers.
For purposes of this chart, a CRA rating of outstanding is 1 and
satisfactory is 2.



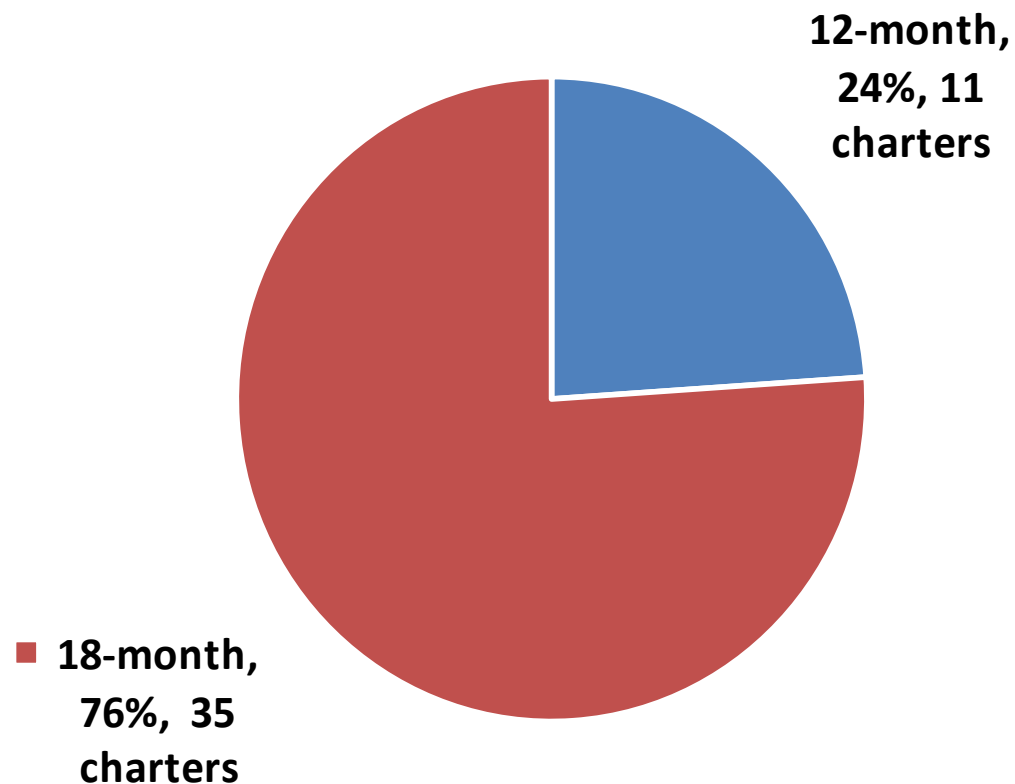
High or Moderate/Increasing Risk Ratings

Below are the percentages of MDIs designated with either high or moderate and increasing risk. The top three risks are credit, strategic, and operational.



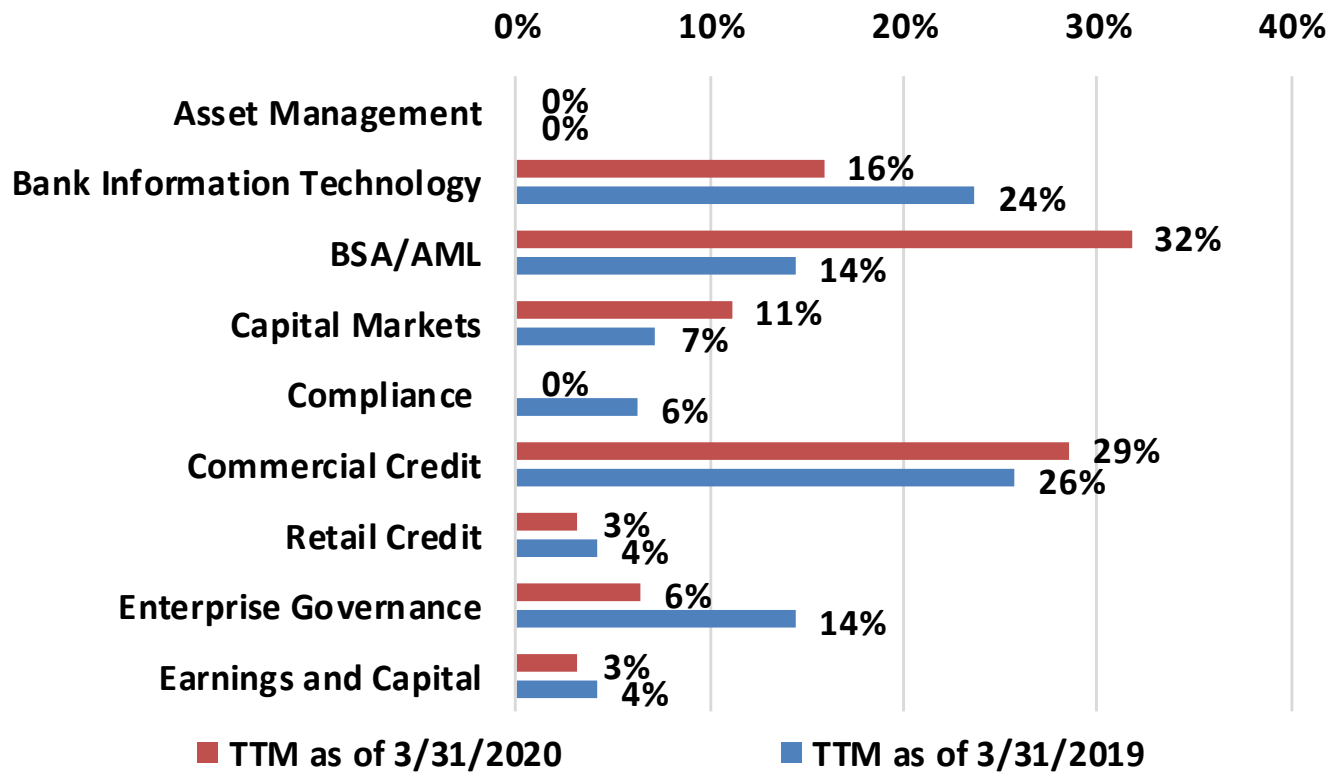
MDI Supervisory Cycles

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



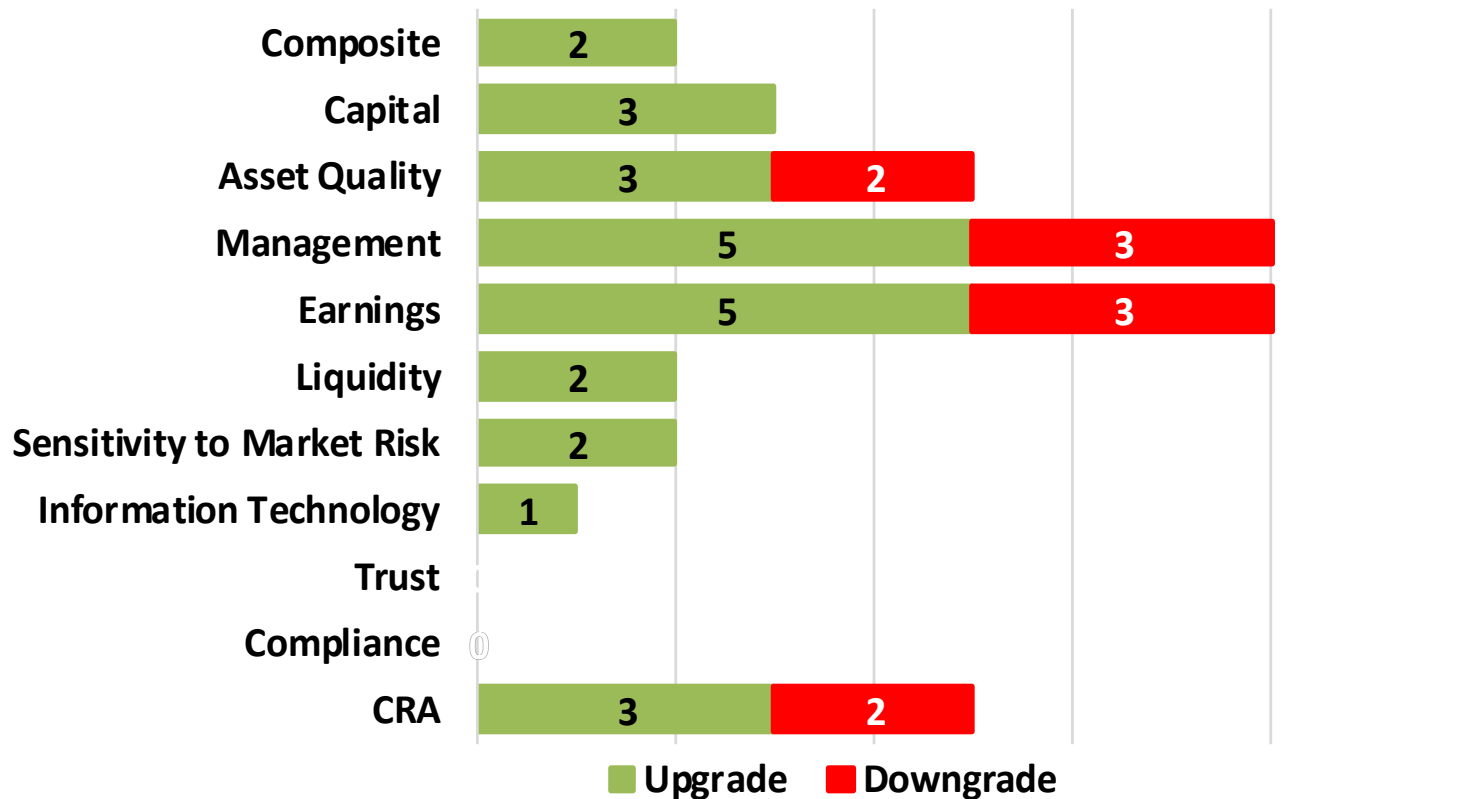
MDI MRAs by Examination Area

MRA concerns cited in the trailing twelve-month period ending March 31, 2020 were centered in BSA/AML, Commercial Credit, and Bank Information Technology. MRA volume is down by 35 percent in 2020. BSA/AML is the only category with a year-over-year increase in MRAs.



MDI Rating Changes

Over the last 4 quarters, rating upgrades exceeded downgrades. There were 26 upgrades and 10 downgrades, which translates to a net upgrade of 16. While most of the downgrades were in management and earnings, most of the upgrades were also in these rating categories.



Key Observations – March 31, 2020

- The number of MDIs continues to decline but not as rapidly as the community bank population.
- Composite ratings for MDIs are satisfactory and improved this year.
- Capital is strong. MDI charters are better capitalized today versus pre-crisis.
- Asset quality is satisfactory. Noncurrent loans remain at low levels. Loan growth is satisfactory. ALLL levels have increased.
- Earnings are satisfactory but ROAA dropped sharply this year. More banks are adversely rated for earnings than any other rating category.
- Liquidity is sound. On-hand liquidity levels are sufficient.
- Sensitivity to market risk remains adequately controlled. Since 2013, the relative level of long-term assets declined and nonmaturity deposits to long-term assets improved.



Questions

