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BankTalk 2023

Accounting Update: Interest Rate Risk, Liquidity and CECL

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Discussion Topics

- Current Banking Environment
- Current trends and topics – Interest Rate Risk
 - Net interest margin
 - Unrealized losses on AFS Securities
- Current trends and topics – Liquidity
 - Impact of market interest rates volatility
 - Increasing competition for deposits
 - Impact of recent bank failures from liquidity related issues
- Current trends and topics – Implementation of CECL
 - Looking back on implementation issues
 - Current issues on quarterly adjustments
 - Auditor and regulatory concerns over CECL practices

Current Banking Environment

- Banking is doing very well while uncertainty in the outlook for the US and global Economy remains.
- Lending demand remains strong, we continue to see loan growth.
- The industry has experienced a long “bull” credit market, with much lower charge-offs and problem loans; most analysts and regulators expect that the “credit cycle” has already turned (worse), we just haven’t seen it in the metrics yet
- Loan rates and asset yields rose rapidly in 2022, and may continue to rise somewhat but quite a bit of uncertainty about rates as we move through the remainder of 2023 and 2024
- Competition for deposits is getting tough, with a lot of the liquidity from COVID working out and nonbank competition for funding accelerating significantly; cost of funds was slow to match Fed action in early 2022, but has moved up dramatically starting in the fourth quarter of 2022 and generally expected to continue to move up over the remainder of 2023
- Net margin is under significant pressure; possibly the most significant issue for most banks over the next 12-24 months

Industry Metrics

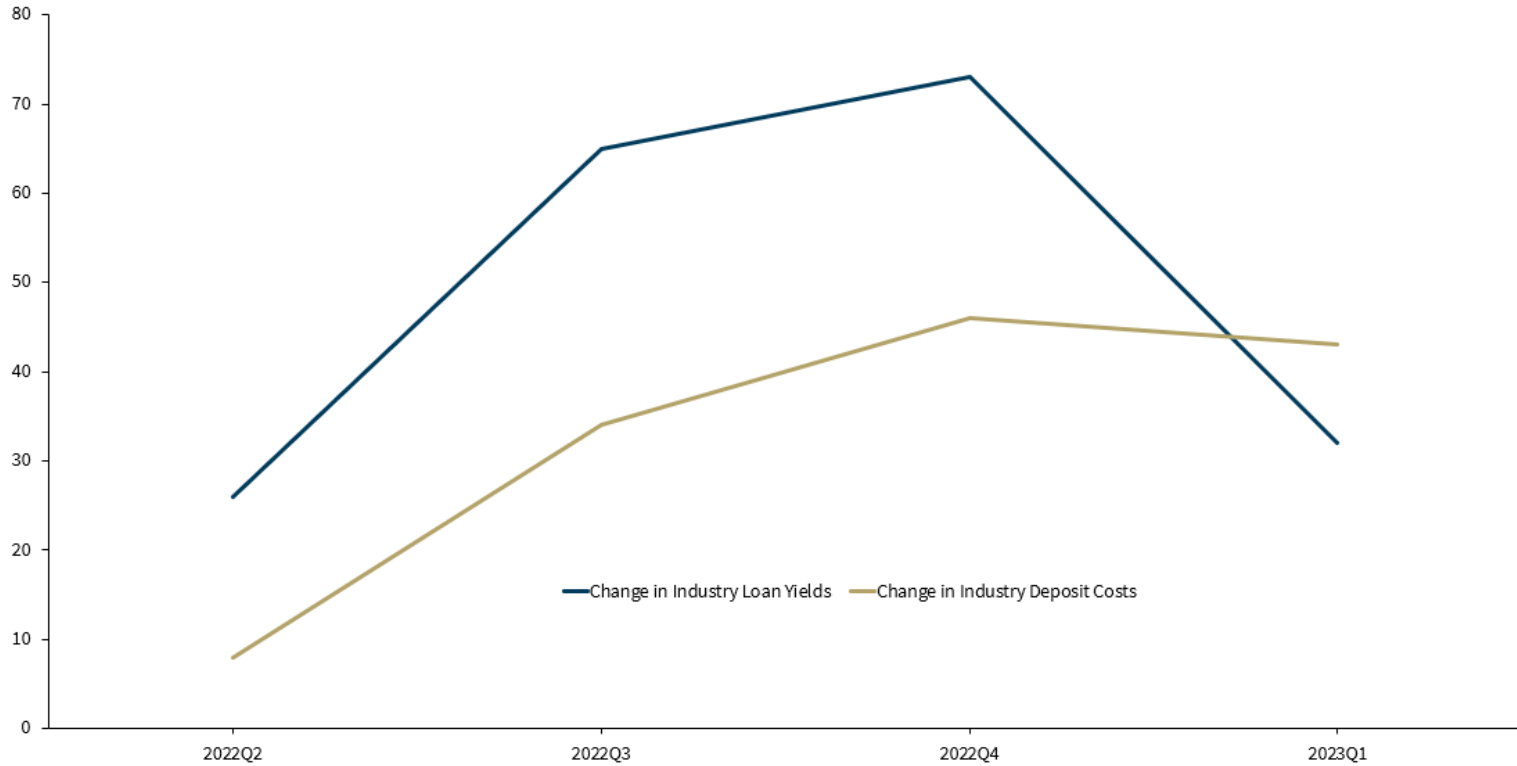
Historical Industry Results-Selected Metrics - FDIC	2022	2021	2020	2019	2010	2009	2008
Number of institutions	4,706	4,839	5,001	5,177	7,658	8,012	8,305
Number -New Reporters (denovo)	15	9	6	13	11	31	98
Number Mergers	134	164	168	228	197	179	293
Failures	0	0	4	4	157	140	25
Industry Profit(Loss)	263B	279B	148B	233B	85.5B	(9.9B)	4.5B
ROA	1.11	1.23	.72	1.29	.65	(.08)	.03
ROE	11.82	12.21	6.88	11.38	5.85	(.73)	.35
Net Interest Margin	2.95	2.54	2.82	3.36	3.76	3.49	3.16
Efficiency Ratio	57.74	61.15	59.78	56.67	57.17	55.53	59.35

Note: Number of institutions 1984=17,901

Historical Industry Results-Selected Metrics - FDIC	2022	2021	2020	2019	2010	2009	2008
Earning assets to total assets	90.68	91.77	91.02	90.48	86.76	86.1	84.87
Loans to Deposits	62.62	56.18	59.62	71.51	75.8	76.4	85.2
Yield on earning assets	3.5	2.71	3.24	4.43	4.70	4.75	5.33
Cost of funding earning assets	.17	.17	.41	.97	.94	1.26	2.17
Net Charge-offs to Loans	.55	.25	.50	.52	2.55	2.52	1.29
ALLL to loans	1.60	1.58	2.18	1.18	3.14	3.14	2.21
Loan Provision (Dollars in millions)	5,192	(31,007)	132,260	55,101	157,989	249,695	174,123
Loan Loss Provision to Assets	.22	(.13)	.60	.30	1.19	1.91	1.26
Noninterest Income to Assets	1.23	1.32	1.36	1.47	1.78	1.96	1.56
Equity to Assets ratio	9.34	9.95	10.07	11.32	11.15	10.88	9.33
Leverage ratio	8.98	8.74	8.81	9.66	8.89	8.60	7.47

Quarterly Change in Loan Yields and Deposit Costs

Basis Points



Source: FDIC.
Note: Ratios are annualized.

Chart 1
Quarterly Net Income

All FDIC-Insured Institutions

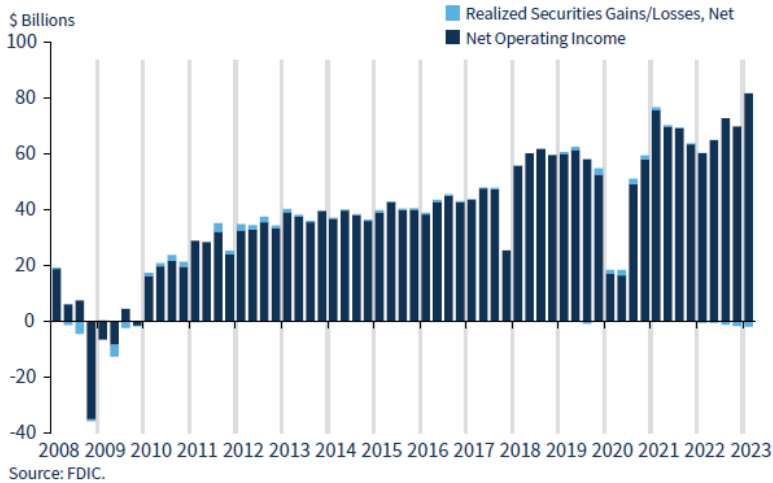


Chart 2
Quarterly Net Interest Margin

All FDIC-Insured Institutions

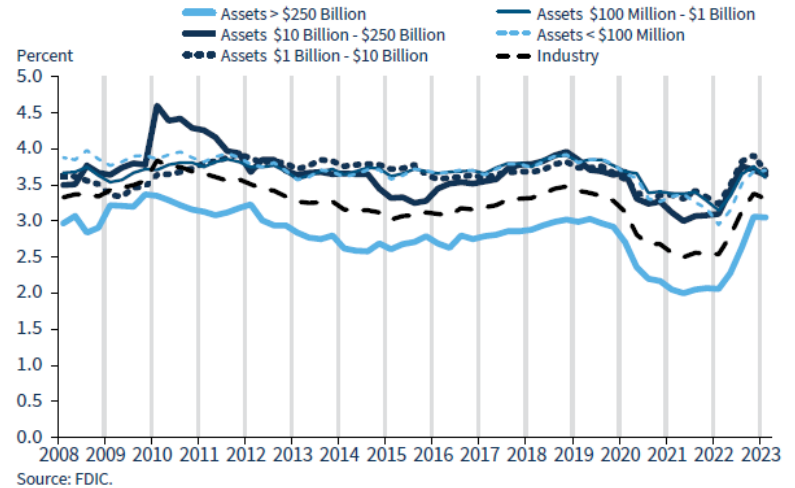
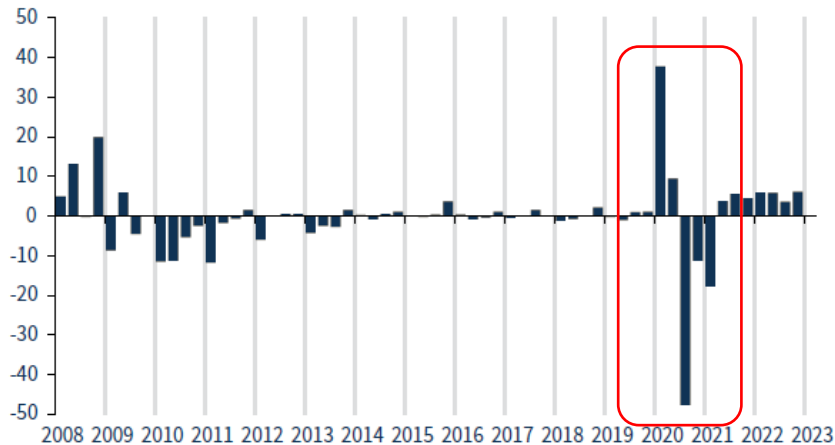


Chart 3

Change in Quarterly Credit Loss Provisions

All FDIC-Insured Institutions

Quarter-Over-Quarter Change
(\$ Billions)



Source: FDIC.

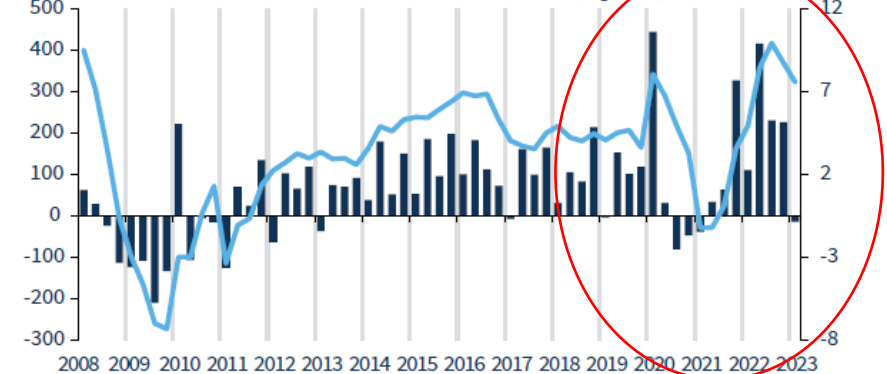
¹The “pre-pandemic average” refers to the period first quarter 2015 through fourth quarter 2019 and is used consistently throughout this report.

Chart 4

Quarterly Change in Loan Balances

All FDIC-Insured Institutions

\$ Billions
Quarterly Change (Left Axis)
12-Month Growth Rate (Right Axis)



Source: FDIC.

Note: ASC Topics 810 and 860 resulted in the consolidation of large amounts of securitized loan balances back onto banks' balance sheets in the first quarter of 2010. Although the amount consolidated cannot be precisely quantified, the industry would have reported a decline in loan balances for the quarter absent this change in accounting standards.

Chart 5
Quarterly Change in Deposits

All FDIC-Insured Institutions

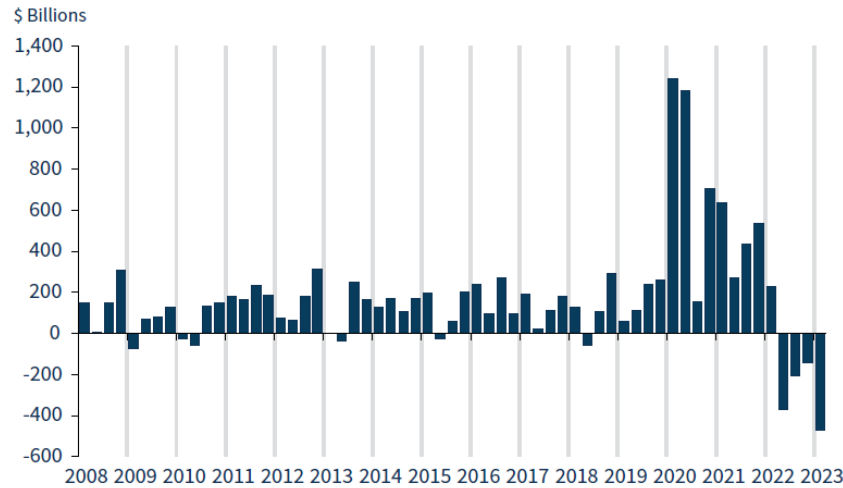


Chart 6
Noncurrent Loan Rate and Quarterly Net Charge-Off Rate

All FDIC-Insured Institutions

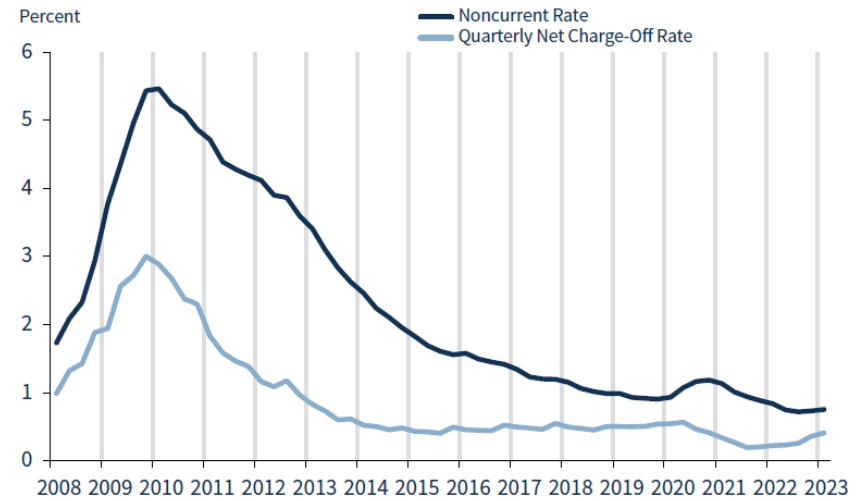
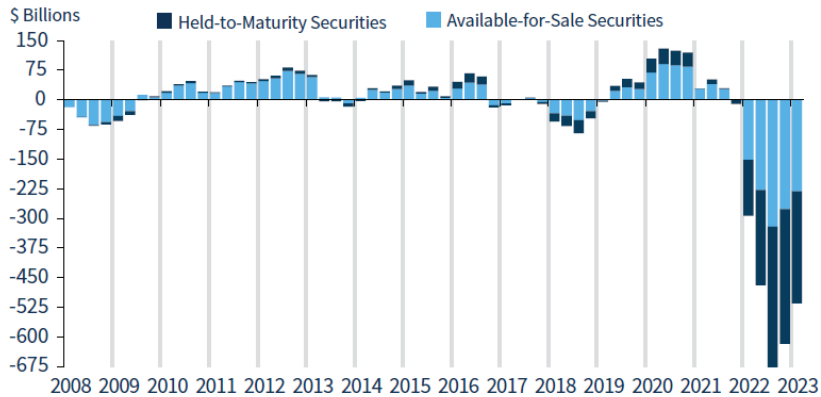


Chart 7

Unrealized Gains (Losses) on Investment Securities

All FDIC-Insured Institutions

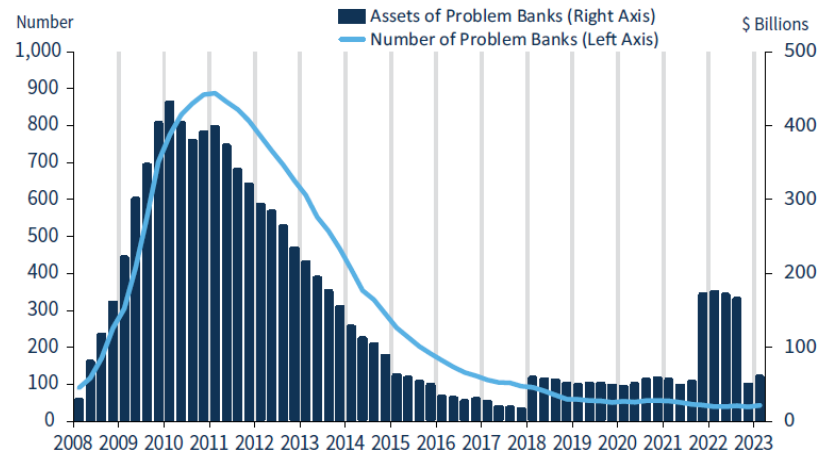


Source: FDIC.
 Note: Insured Call Report filers only. Unrealized losses on securities reflects the difference between the market value as of quarter end and the book value of non-equity securities. This calculation does not account for any unrealized gains or losses in "accumulated other comprehensive income" because they cannot be derived from Call Reports for the industry.

Chart 8

Number and Assets of Banks on the "Problem Bank List"

All FDIC-Insured Institutions



Source: FDIC.
 Note: The asset values of insured financial institutions on the problem bank list are what were on record as of the last day of the quarter.

How does IRR and Liquidity “Fit into” CAMELS Risk?

- IRR – if the Bank does not effectively match the earning assets with the underlying funding, the Bank would be exposed to earnings pressure by a deteriorating NIM and therefore pressure on capital; NIM pressure may drive poor decision making in response (chasing asset yield, lowering credit standards, use of higher cost funding sources)
- Liquidity – ever seen a run on a bank?
 - Discussion of recent bank failures and liquidity issues in 2023

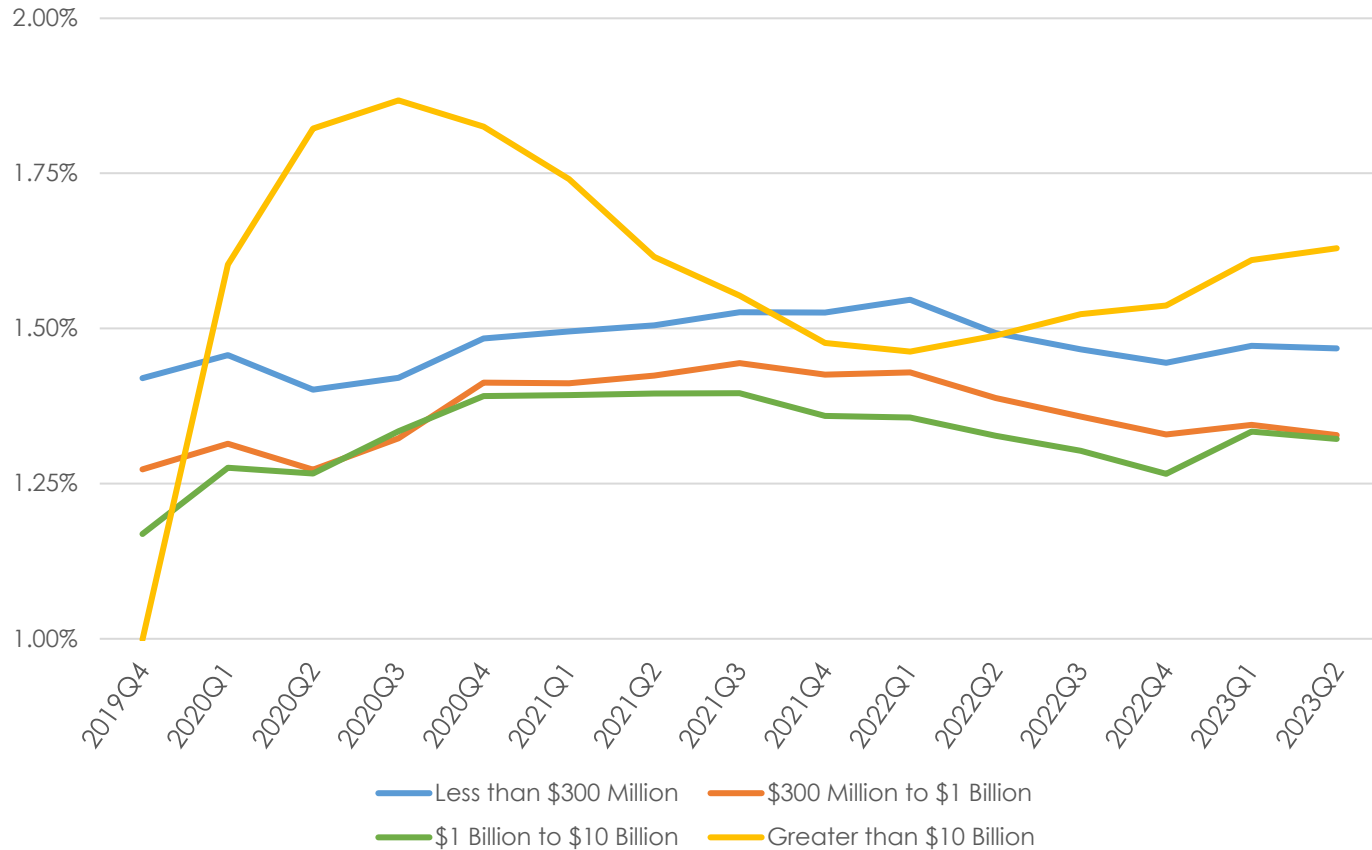
Regulatory Concerns-Liquidity

- What is your reliance on noncore funding?
- What are your liquid assets?
- What is your borrowing capacity?
- How stable are your large deposits?
- Do you have a written Contingency Funding Plan (“CFP”)?
Have you testing it, and your access to funding sources?
- Are you performing dynamic cash flow analysis?
- “New” regulatory focus – Funding Concentrations (it was always there, but with recent failures, much higher priority and focus)

CECL Implementation

- Overall Level of Allowance for Credit Losses
- Common methodologies used in Community Banks
 - FRB Scale Method
 - WARM Method
- Qualitative Factor Documentation
- Economic Factors
- Reserve on Unfunded Commitments
 - Average Reserve as a percentage of unfunded commitments
 - Banks less than \$1 Billion - .17%
 - Banks \$1 to \$10 Billion - .19%
- Allowance for Credit Losses on HTM Securities

Loan Loss Reserves: % of Total Loans



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