Office of the Comptroller of the Currency

FACT SHEETS

OCC Southern District
Community National Banks and Federal Savings Associations in the South Show Improving Financial Performance and Accelerated Loan Growth

The condition of Southern District institutions continues to improve and return to pre-crisis levels.

- Ninety-one percent of national banks and federal savings associations (FSA) in the nine states in the Office of the Comptroller of the Currency's (OCC) Southern District are rated 1 or 2 on the five-point CAMELS scale.
- The number of problem institutions in the district has decreased to 43 at the end of 2014, compared with 71 at the end of 2013, 133 at the end of 2012, and 148 at the end of 2011.

Loan growth accelerated in 2014 in all states across the district.

- During 2014, the loan growth rate doubled among community national banks and FSAs located in the district's nine states from 4 percent in December 2013 to 8 percent in December 2014.
- Pronounced loan growth occurred in Texas (10.9 percent), Louisiana (9.3 percent), and Florida (8.4 percent) in 2014.
- Loan growth accelerated significantly in Texas, Louisiana, Florida, Arkansas, and Georgia. Loan growth increased from 3 to 6 percentage points in these states during 2014.
- For the first time in several years, loan growth occurred in the community national banks and FSAs in Mississippi, Alabama, and Tennessee.

Return on average assets in the district improved slightly from 0.76 percent at the end of 2013 to 0.81 percent at the end of 2014.

- Net interest margin (NIM) improved slightly despite loan yields falling by 19 basis points from the prior year. The slight improvement in NIM resulted from increased yields on investment securities (9 basis points) and declines in the cost of interest bearing deposits (6 basis points).
- Non-interest income and expense remained relatively stable year to year.
- Provision expense declined from 0.11 percent to 0.09 percent of average assets.
- The eastern region of the district (Florida, Georgia, and Alabama) experienced the most improvement in earnings as institutions in that region have addressed problem assets and reduced their need for additional loan loss provisions.
- Generating future earnings growth remains difficult.
    - The cost of funds and provision for loan losses have limited room for further declines.

  - Competitive pressures and the low interest rate environment make it difficult to obtain yields to cover overhead costs without assuming significant interest rate or credit risk.
  - Declining oil prices may affect economic growth in Texas, Oklahoma, and Louisiana.

Credit risk is increasing within district institutions.

- Despite the loan growth, strong competition for good quality loans in most markets within the district is affecting prices and putting pressure on underwriting.
  - In some instances, underwriting standards show signs of liberal concessions including extensions in repayment terms, fewer and less restrictive loan covenants, and releasing borrowers from personal liability on business and real estate development lending.
  - The 19 basis point decline in loan yields in 2014 points to a highly competitive market with interest rate concessions possibly offered to achieve loan growth while resulting in potentially improper pricing for risk.
- While economies in the western part of the district are more diverse than in the mid-1980s, commodity prices (e.g., oil) remain a significant economic force. Nearly 300 of the district's 455 community national banks and FSAs are located in Texas, Oklahoma, and Louisiana. Developing economic concerns related to oil and gas lending could raise asset quality and liquidity concerns in institutions dependent on oil and gas as a primary economic driver.
  - Fewer than 25 community national banks and FSAs reported credit concentrations in direct lending to oil and gas exploration/production of more than 25 percent of capital.
  - Significant ***indirect exposure*** exists for the community national banks and FSAs located in areas where economic activity is heavily dependent on oil production and exploration. Numerous community national banks and FSAs are located in areas where the Bureau of Labor Statistics shows heavy reliance on the oil industry such as Midland/Odessa, Victoria, Longview/Tyler, and Abilene/San Angelo. Localized economic softness can contribute to indirect risks, including stress on employment levels, tax revenues, and local businesses. Layoffs have occurred, and drilling has declined. Several municipalities in energy-centric locales have indicated expectations for substantially lower revenues in 2015.
  - Many community national banks and FSAs located in oil-producing states experienced significant deposit growth during the run up in oil prices. These banks should prepare for potential drops in these "surge deposits" as the business environment weakens. Community national banks and FSAs that are not making direct loans to oil companies may support service industries that have indirect exposures to employment, tax revenues, etc.
  - One significant area of indirect exposure to risks associated with the decline in oil processing is the increasing level of concentrations in commercial real estate (CRE).

  - As of the end of 2014, 42 district institutions exceeded the CRE guidelines outlined in federal banking guidance. Most of these institutions are located in Texas and Oklahoma.
  - While the decline in oil prices is recent, community national banks and FSAs in markets dependent upon oil activity and employment should consider these changing economic factors in their analysis of the allowance for loan and lease losses. Increasing or restarting their provisions for future loan losses in the coming quarters may be necessary.
- In early 2014, the OCC published an oil and gas production-lending handbook with critical industry information and exam guidance to evaluate bank oil-and-gas-related portfolios. Since oil prices began falling in mid-2014, OCC examiners have discussed the impact of the decline with bank management and reviewed 2015 examination strategies to see if changes are required. Examiners will:
  - Closely monitor market conditions and financial results, including liquidity, operating cash flow projections, and capital expenditure forecasts.
  - Reassess borrowing base "price decks" more frequently, perform periodic stress testing at various price floors, and perfect collateral liens. In the oil and gas lending business price deck refers to the current and future price estimates a lender and its engineering function will use to calculate a borrower's borrowing base and collateral value.
  - Evaluate concentrations in service companies viewed as most at risk in the short-term.
  - Reassess growth strategies, maintain discipline around prudent underwriting and administration practices, and ensure the allowance for loan and lease loss are adjusted for the increased risk.
- OCC examiners in the district will pay close attention to new credit underwriting to ensure that banks have considered the potential effects of a potential contraction in economic activity from falling energy prices and sufficiently addressed these concerns in their strategic, capital, and liquidity planning.

Strategic risk, interest rate risk, and operational risk remain significant concerns.

- One third of district institutions show a high or a moderate-but-increasing level of strategic risk.
  - Protracted low interest rates, declining loan yields from competition, and limited non-interest income opportunities continue to pressure earnings.
  - Mergers and acquisition activity remains at a historically high level as many smaller institutions see limited profitability and growth opportunity.
- Interest rate risk remains a concern as the Federal Reserve considers increases in interest rates and the lack of yield in short-term rates continues to entice banks to increase their exposure to longer term assets.

  - The ratio of long-term assets to total assets continues to increase. Long-term assets are defined as total loans and investment securities where contractual maturity or repricing is greater than five years—plus collateralized mortgage obligations with a contractual maturity greater than three years.
  - Banks continue to report an increasing trend in holding long-term assets while locking in rates that are close to all-time lows.
- Operational risk is also increasing.
  - Cost-cutting measures to control overhead have in some instances affected risk management systems and internal controls in some institutions. Cybersecurity remains a significant area of focus for the OCC and a potential concern at institutions within the district.
  - Banks continue to outsource critical functions to third parties, increasing the need for effective vendor management programs.

About the OCC and the Southern District

The OCC's Southern District, headquartered in Dallas, supervises 385 community national banks and 70 federal savings associations through a network of 24 field and satellite offices located throughout the district's nine states. Each of the offices is headed by an Assistant Deputy Comptroller, who is empowered to make supervisory decisions locally. Examiners in the Southern District are based in those offices, so they live and work near the institutions they supervise.

The institutions hold a total of $216 billion in assets, ranging in size from less than $1 billion up to $11 billion in assets. The district also supervises nine community trust companies and 31 technology service providers.

The OCC has three other district offices – in New York, Denver and Chicago – as well as an office in London which is tasked with supervision of international activities of national banks.

OCC Southern District Loan Growth by State 2010-2014