OCC Northeastern District Performance and Condition of Community National Banks and Federal Savings Associations (FSAs)

The condition of community national banks and federal savings associations (collectively banks) continues to improve in the OCC's Northeastern District.

- At the end of June 2014, 85 percent of the banks in the 16 states and the District of Columbia of the district are rated 1 or 2 on the five-point scale with 1 being the best rating. This compares favorably to 80 percent at the end of 2013 and 78 percent at the end of 2012.
- At 78 percent rated 1 or 2, ratings for banks in New York, New Jersey, and Connecticut lag slightly behind the remainder of the district.
- The number of problem banks in the district fell to 57 as of June 30, 2014, down from 70 institutions at the end 2013, 89 at the end of 2012, and 101 at the end of 2011.
    - Almost 40 percent of the problem banks are in New York, New Jersey, and Connecticut.

Asset quality is improving, but earnings performance is deteriorating as non-interest income remains low.

- Allowance for loan and lease losses (ALLL) is decreasing, a reflection of improved asset quality and fewer losses on loans.
- Median return on average assets remains near a cyclical low because of dropping non-interest income, despite an improving net interest margin (NIM) and lower provision expenses.

Loan growth for OCC-supervised community national banks and FSAs in the Northeastern District increased to 4.4 percent from 2 percent a year ago, but remains below pre-financial crisis levels.

- One-to-four family first lien loans comprise 36 percent of $138 billion of the portfolio of the district's banks and commercial real estate loans comprise 35 percent of their portfolios.
- Loan growth at banks in New York, New Jersey, and Connecticut is outpacing the remainder of the district at 7 percent. Loan growth in the tri-state region centers on multifamily, commercial and industrial, and auto lending.
- Loan growth among banks in Massachusetts, Maine, New Hampshire, Rhode Island and Vermont was 6 percent at the end of June 2014, up from 4.6 percent a year earlier.
- Loan growth in Pennsylvania, at 4.6 percent at the end of June, is outpacing the district average.

The most significant risks facing banks in the district are strategic, asset and liability management, credit, operational, and compliance risks.

- Strategic vulnerabilities exist as banks focus on loan growth, higher profit margin products and services, and cost cutting.
- Approximately 12 percent of district banks have high strategic risk with increasing strategic risk at 43 percent of the district's banks. The OCC is focusing on:
  - Execution of bank strategic plans and management of strategic risk;
  - Effectiveness of profit plans and growth projections; and
  - Board risk parameters, adequacy of staffing, succession planning, and audit.
- Asset and liability risk management is a concern as continued low interest rates and pressure on traditional earnings sources cause many banks to increase long-term asset holdings. The OCC is focusing on:
  - Identification, measurement, monitoring, and control of interest rate risk;
  - Reasonable interest rate risk limits;
  - Ongoing validation and updating of key assumptions used in modeling; and
  - Liquidity risk management and adequacy of contingency funding plans.
- While credit quality improves, the low interest rate environment, modest loan demand, and lower fee income results in changing business models and increasing risk tolerances. Eleven percent of the district's institutions have high credit risk, down from 14 percent in the first quarter of 2014. The OCC is focusing on:
  - Risk management for new and high growth loan products; and
  - Changes in underwriting.
- Banks are striving to reduce operating costs through increasing use of new technology and outsourcing arrangements, staffing reductions, changes to compensation plans, and changes in workflow processes.
- Operational risk is increasing at 43 percent of the district's banks. The OCC is focusing on:
  - Significant growth areas, new products, new or expanded services, and changes in strategic direction;
  - Vendor and third-party management processes;
  - Security measures to deter and detect cyber attacks; and
  - Traditional control processes (audit, loan review, internal controls, due diligence).
- Compliance and Bank Secrecy Act (BSA) risks continue. High-risk BSA institutions in the district represent one-third of the national high-risk BSA population. Forty-eight percent of the district's banks have increasing compliance risk. The OCC is focusing on:
  - Change management process for new and amended regulations;
  - Compliance including BSA risks; and
  - National Flood Insurance Program and Servicemembers Civil Relief Act compliance.

New York, New Jersey and Connecticut (tri-state region). The OCC supervises 112 community institutions in the tri-state region, with total assets of $97 billion; about half of the institutions are community national banks and the remainder are FSAs.

- While faced with strong competition from large institutions, many smaller banks in the region have been established for decades. As a result, they have a loyal customer base, serve niche customer markets including minority or ethnically based communities that rely on these institutions, and offer specialized products and services. Good customer service and community involvement also contribute to the success of smaller banks in the tri-state region.
- The condition of tri-state region banks is improving and the level of problem institutions has declined. At the end of June 2014, 78 percent of the institutions are 1 or 2 rated, a modest improvement from 75 percent in 2013; of these 14 percent are top-rated 1, compared with 13 percent in 2013.
- Asset quality is improving for most banks in the tri-state region:
    - Classified assets declined to 16 percent from 20 percent in 2013. Credit risk has decreased. Approximately 53 percent of these institutions have high or moderate and increasing credit risk, compared with 59 percent in 2013.
    - Loan growth in the region was 7 percent at the end of June 2014 compared to 4 percent at the end of June 2013; and this seems to be on a path to a pre-recession level.
- Loan growth in the tri-state region is centered in multifamily, commercial and industrial, and auto lending, at 34 percent, 19 percent and 14 percent, respectively.
- The region has a strong multifamily housing market. Given the population density, limited availability of land, and elevated home prices, apartment buildings are an accessible housing option for many people who choose to rent instead of purchasing.
- Commercial and industrial lending is via predominantly traditional commercial business loans.
- Auto lending has been a main stay for community banks located in the upstate New York region.
- Strategic risk is the most prominent risk for banks in the tri-state region, a change from previous years when credit risk predominated. About 54 percent, up from 49 percent last year, of OCC supervised banks have high or moderate, and increasing strategic risk. Banks are focused on improving income and NIM through loan growth, expanded products and services, and cost cutting measures and initiatives.
- Earnings pressures continue. Return on average assets is 0.51 percent, a decline from 0.54 percent in 2013. NIM was 3.33 percent at the end of June 2014, slightly up from 3.25 percent a year earlier. Community banks in the region are challenged with improving earnings performance despite increasing compliance costs, and modest loan growth.
- The OCC has four offices in the tri-state region: Syracuse, N.Y., New York City, Edison, N.J. and Jersey City, N.J.

Pennsylvania. The OCC supervises 50 community banks in the state with total assets of $55 billion; 25 percent of the institutions are mutual FSAs. The OCC has field offices in Pittsburgh, Trevose, and Wilkes-Barre, PA.

The condition of Pennsylvania banks is improving and the level of problem institutions has declined. The percentage of 1 or 2 top-rated banks and FSAs in the state rose to 92 percent at the end of June 2014 up, from 81 percent a year ago. Pennsylvania community banks continue to struggle to improve earnings performance, despite increasing compliance costs.

- Key asset quality indicators are improving. Classified, special mention and net loss levels declined year-over-year. ALLL fell in 2014. Despite the improvement, credit risk remains a supervisory concern.
- BSA and Anti-Money Laundering compliance, consumer compliance, and information technology are other areas that receive supervisory attention.
- Loan growth has been better for community banks in PA in 2014, but a return to pre-recession levels will take time. Loan growth is up, at 4.6 percent, compared with 1.2 percent in 2013, and has been centered in consumer and commercial lending.

North Carolina and South Carolina. The OCC's field office in Charlotte supervises 29 banks and FSAs in these two states with total assets of approximately $13 billion.

- The condition of community banks has improved and the level of problem institutions has significantly declined. Capital levels are increasing, but earnings performance lags. Loan demand in the Carolinas has trended slightly upward.
- North Carolina and South Carolina economies continue to recover following the economic downturn that began in the fourth quarter 2008. While many traditional industries like textiles, tobacco, and furniture manufacturing continue to struggle, new growth in energy, biotechnology, healthcare and financial services are driving economic recovery, and providing community banks with new loan opportunities.
- After substantial deterioration in real estate markets, real estate has stabilized and values are beginning to increase. There are isolated pockets of new residential construction in Charlotte and Raleigh but smaller markets remain flat. The commercial real estate market remains weak.

New England. The OCC's Boston field office supervises 42 institutions with approximately $17 billion in assets. FSAs represent 62 percent of the institutions.

- The condition of community banks in New England is improving with the level of problem institutions falling to under 10 percent. The quality of bank loan portfolios also is improving and banks are eager to lend to increase profit margins. More than a third, 36 percent, of the banks are experiencing double-digit loan growth.
- Since most of New England experienced a more modest commercial real estate and housing boom, the subsequent bust was not as severe. In many parts of New England, housing prices and employment are near pre-recession levels.

Washington D.C. and Maryland. The OCC's field office in Washington supervises 31 banks in Washington, D.C. and Maryland, with total assets of approximately $11 billion. Approximately 76 percent of these institutions are FSAs located in Maryland.

The economy in Washington D.C. and Baltimore is recovering. The condition of community banks is improving and the level of problem institutions has declined. Earnings performance is still marginal. Multifamily and commercial real estate lending is increasing.

Virginia. The OCC's field offices in Roanoke, Virginia and Charleston, West Virginia supervise 32 institutions, in central and southwest Virginia, West Virginia, and eastern Kentucky, with total assets of approximately $12.7 billion.

The condition of community national banks is improving. Earnings performance remains relatively stable. Loan growth centered in multifamily and commercial real estate lending is increasing slightly, but remains low, as banks continue to seek opportunities to grow.

About the OCC's Northeastern District

The OCC's Northeastern District, headquartered in New York, N.Y. supervises 339 banks in Connecticut, Delaware, the District of Columbia, eastern Kentucky, Maine, Maryland, Massachusetts, New Hampshire, New Jersey, New York, North Carolina, Pennsylvania, Rhode Island, South Carolina, Vermont, Virginia, and West Virginia. The Northeastern District also supervises trust companies in California, Georgia, Michigan, Missouri, and Wisconsin. The District supervises $216 billion in assets out of its 11 field offices and two satellite offices managed by Assistant Deputy Comptrollers who make decisions locally. Examination personnel reside near these field and satellite offices so that examiners may live and work near the institutions they supervise.

About the Office of the Comptroller of the Currency

The OCC charters, regulates, and supervises national banks and FSAs and also supervises the federal branches and agencies of foreign banks. Nationwide, the OCC regulates and supervises nearly 1,637 national banks and FSAs with approximately $10.4 trillion in total assets, about 69 percent of total U.S. commercial banking assets, as of June 30, 2014. The OCC also supervises 48 federal branches of foreign banks, which hold $334 billion in assets.

Headquartered in Washington, D.C., the OCC has four district offices, which oversee 92 field and satellite offices. In addition, the OCC maintains a London office to supervise the international activities of national banks.