Office of the Comptroller of the Currency

Economics

# Long-term asset strategy performance in a rising rate climate

Mutual Advisory Committee meeting

April 28, 2015

# Overview

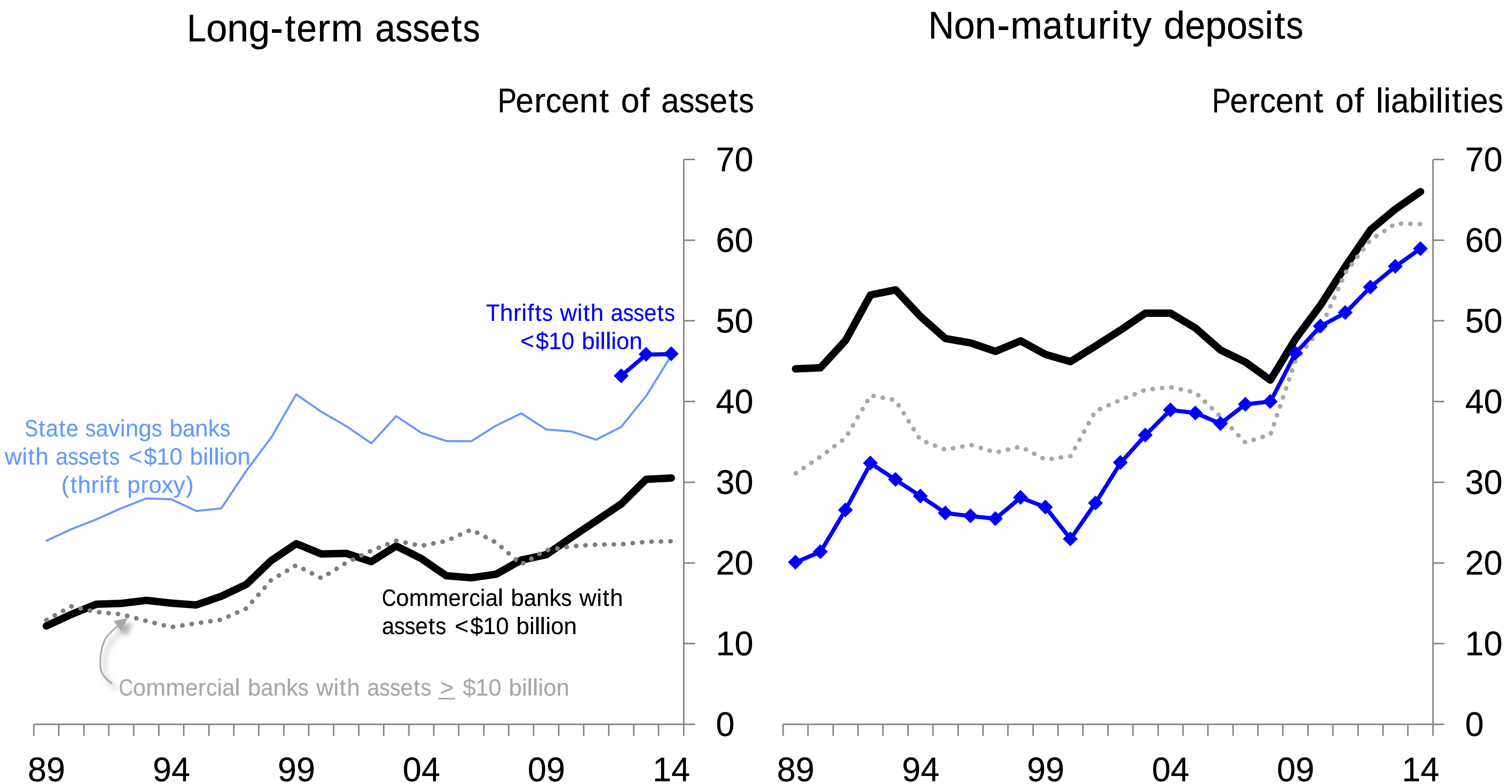
- Our concern: first rate increase cycle in almost ten years—how will OCC-supervised institutions perform?
  - Current state of balance sheets (long-term assets and non-maturity deposits)
  - Are some institutions likely to face performance headwinds as rates rise?

- Although this rate increase cycle likely to be unique, can look to historical rate cycles for some insights
  - 1994 rate “shock” and well-telegraphed, steady cycle in 2004-06

- For banks with a long-term asset strategy, how did they perform versus peers in these two cycles?

# Community institutions seem more exposed to rising interest rates than in the past

FDIC-insured institutions

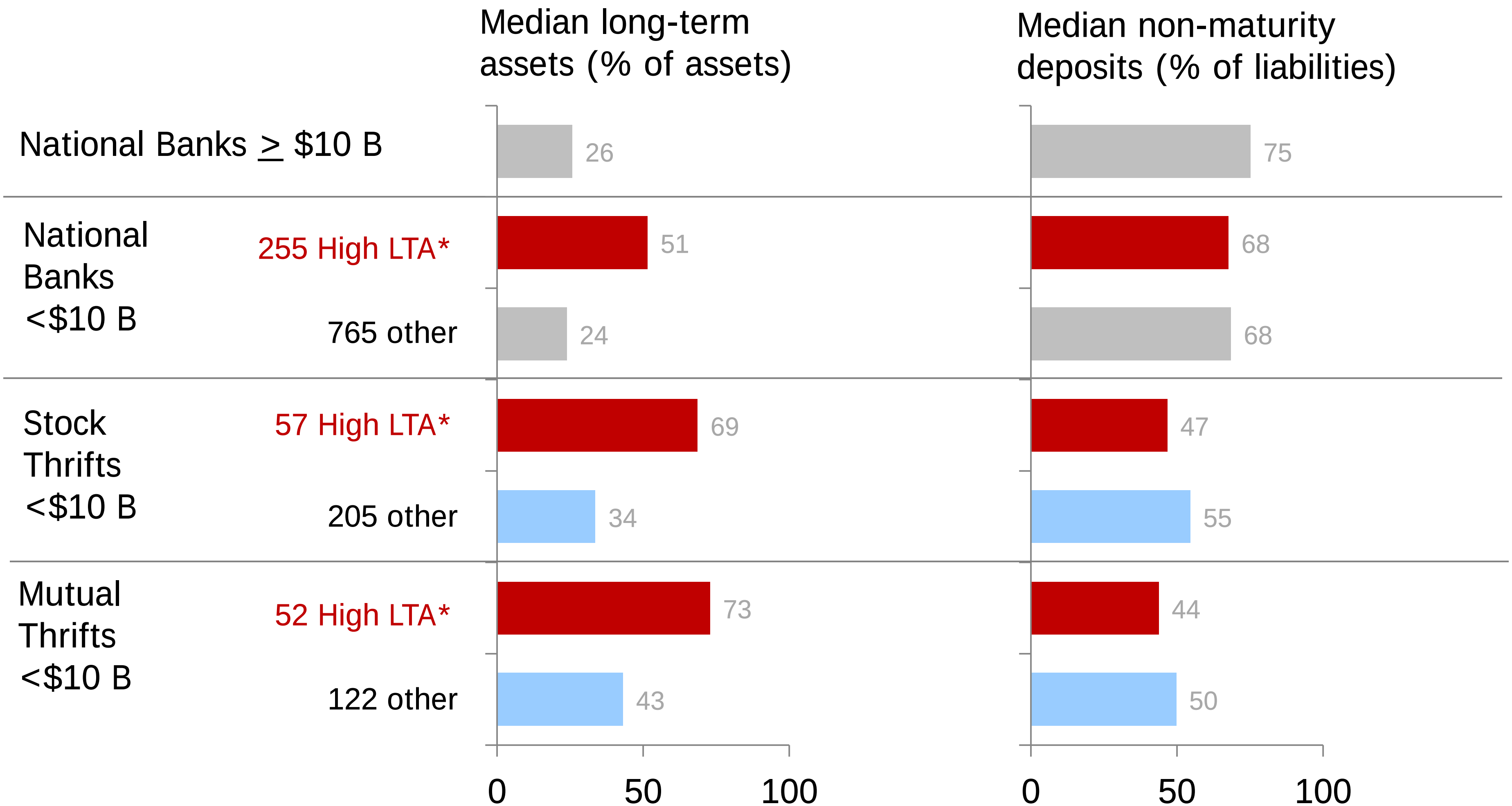



Source: Integrated Banking Information System (OCC)

Annual data as of December 31. Long-term assets are securities and loans with remaining maturity or next repricing interval of five years or more (data not reported by TFR filers). Non-maturity deposits include transaction, MMDA, and other savings accounts.

# Some OCC-supervised community institutions have strategy emphasizing long-term assets

## National banks and federal thrifts

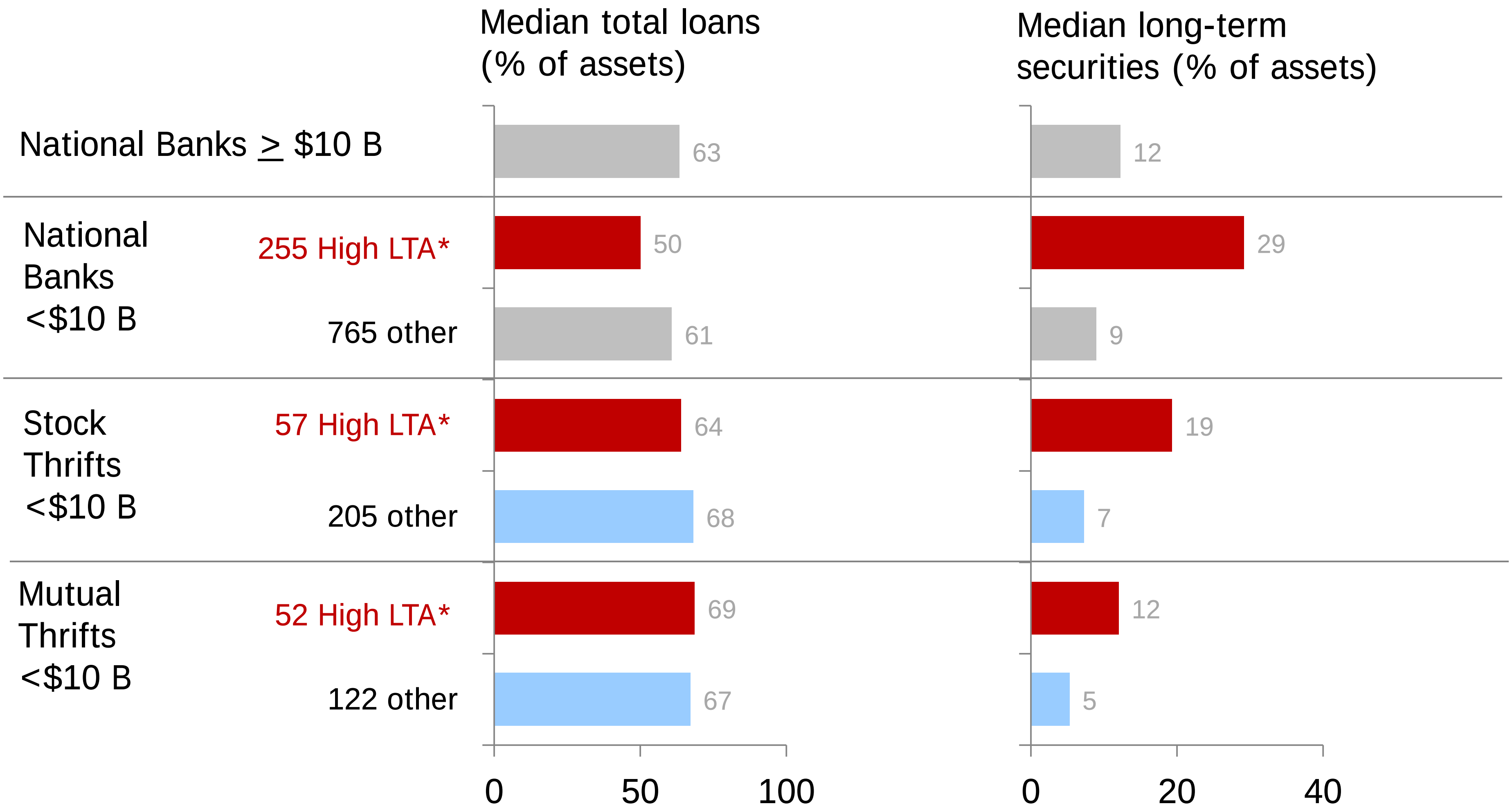



Source: Integrated Banking Information System (OCC)

* High LTA (long-term asset) = institutions in top quartile of long-term assets as % of total assets (banks ≥ 42% of assets; thrifts ≥ 59%). Long-term assets are securities and loans with remaining maturity or next repricing interval of five years or more. Non-maturity deposits include transaction, MMDA, and other savings accounts. Data as of December 31, 2014.

# Small bank long-term asset strategy emphasizes long duration securities

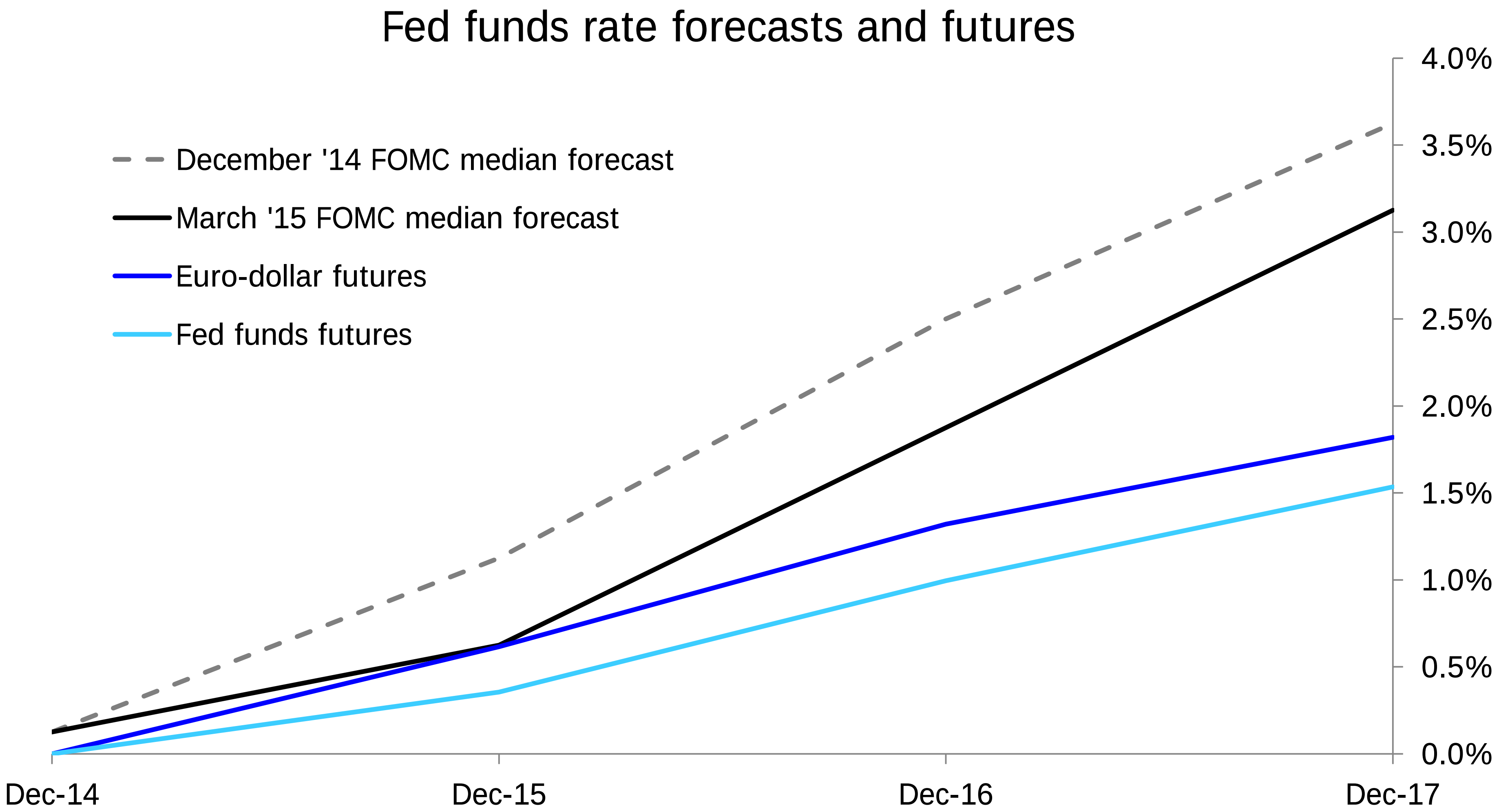
## National banks and federal thrifts




Source: Integrated Banking Information System (OCC)

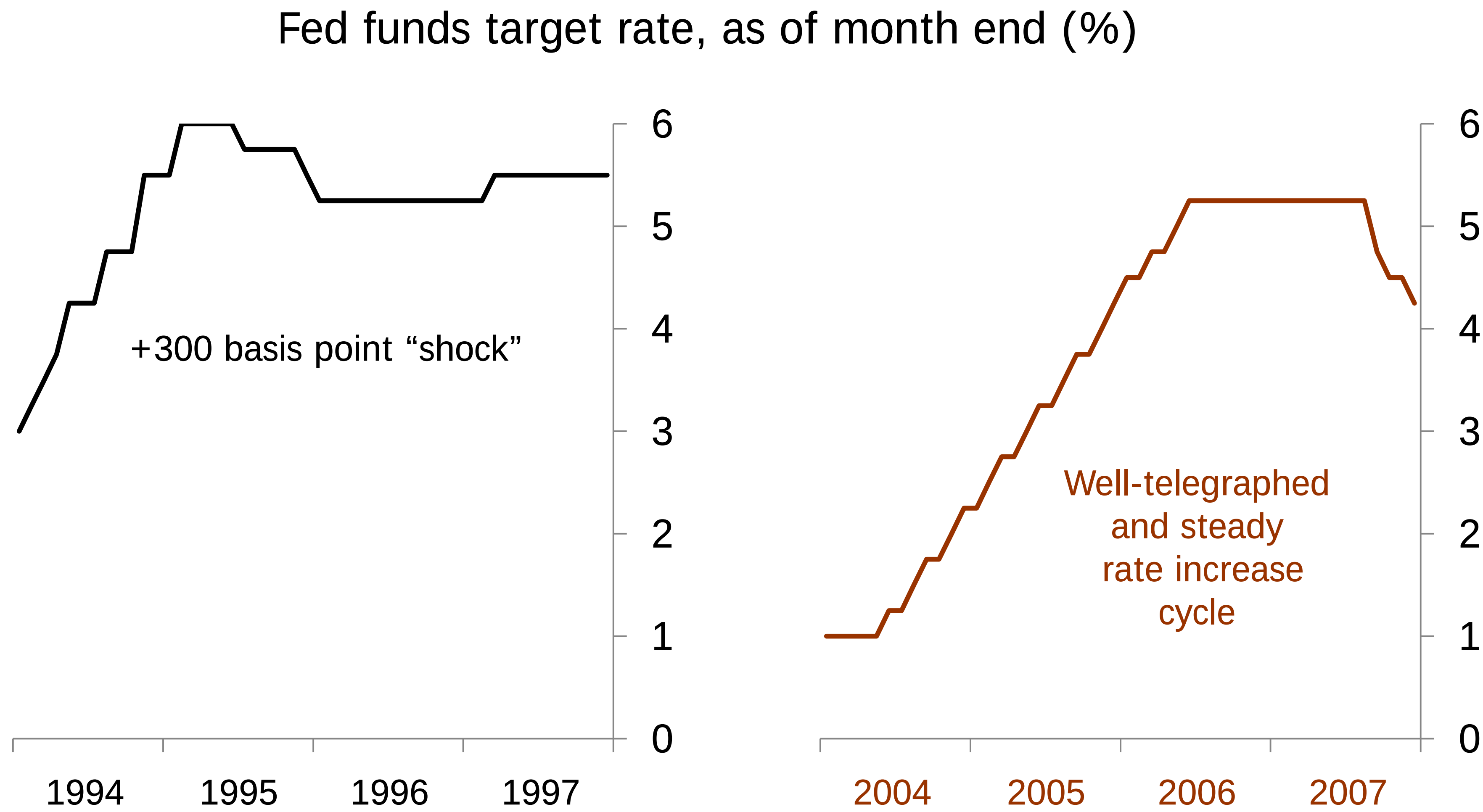
* High LTA (long-term asset) = institutions in top quartile of long-term assets as % of total assets (banks > 42% of assets; thrifts > 59%). Long-term assets are securities and loans with remaining maturity or next repricing interval of five years or more. Non-maturity deposits include transaction, MMDA, and other savings accounts. Data as of December 31, 2014.

# Markets and Fed still differ on path and timing of increase in short-term rates




Sources: Bloomberg futures as of London open April 21, 2015;
Federal Open Market Committee Projections

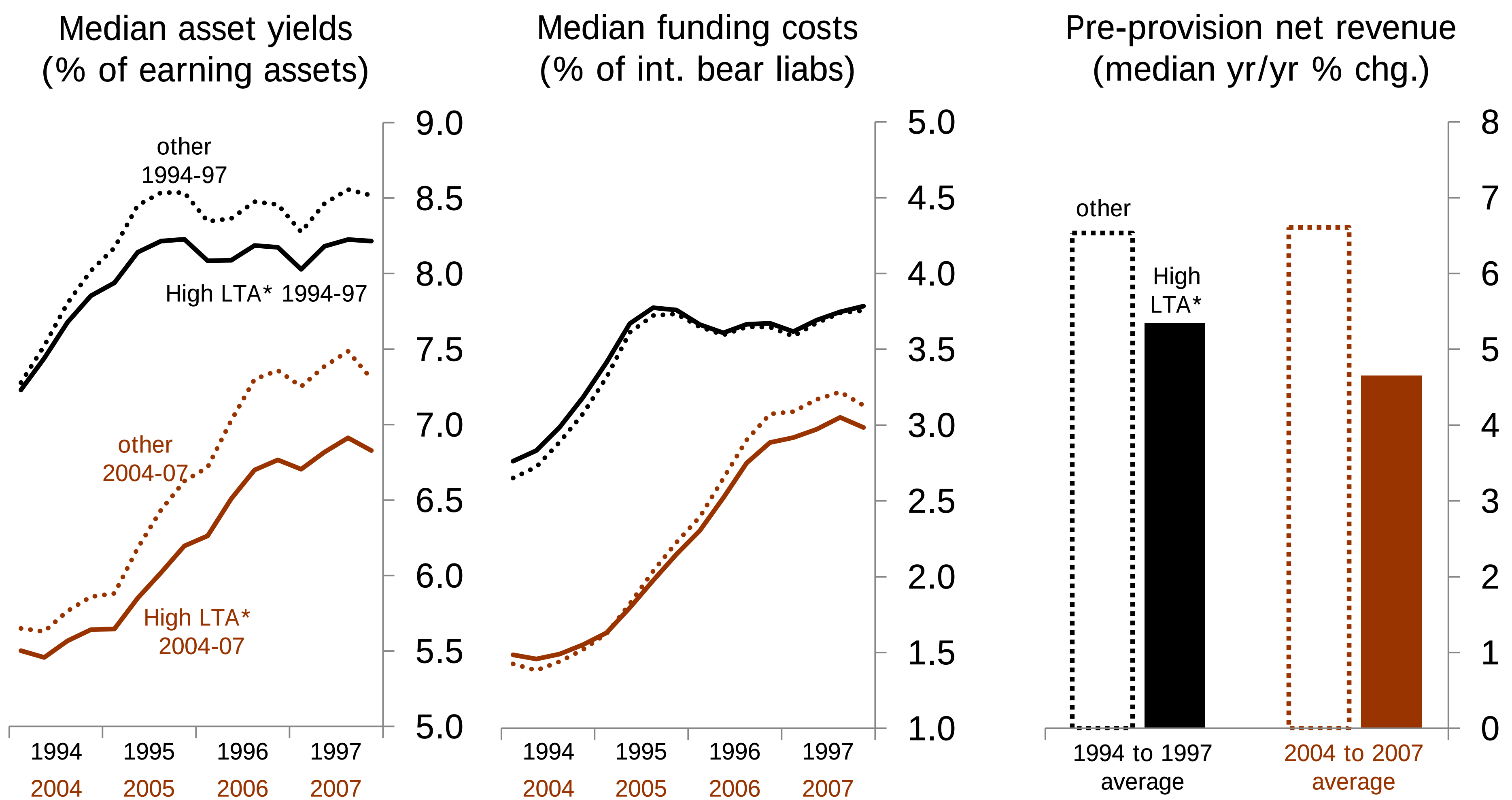
# Two different rate increase cycles offer potential to study long-term asset strategy implications




Source: Haver Analytics

# In past, banks with high long-term asset holdings saw lagging yields and revenues as rates rose

FDIC-insured commercial banks with assets < $10 billion

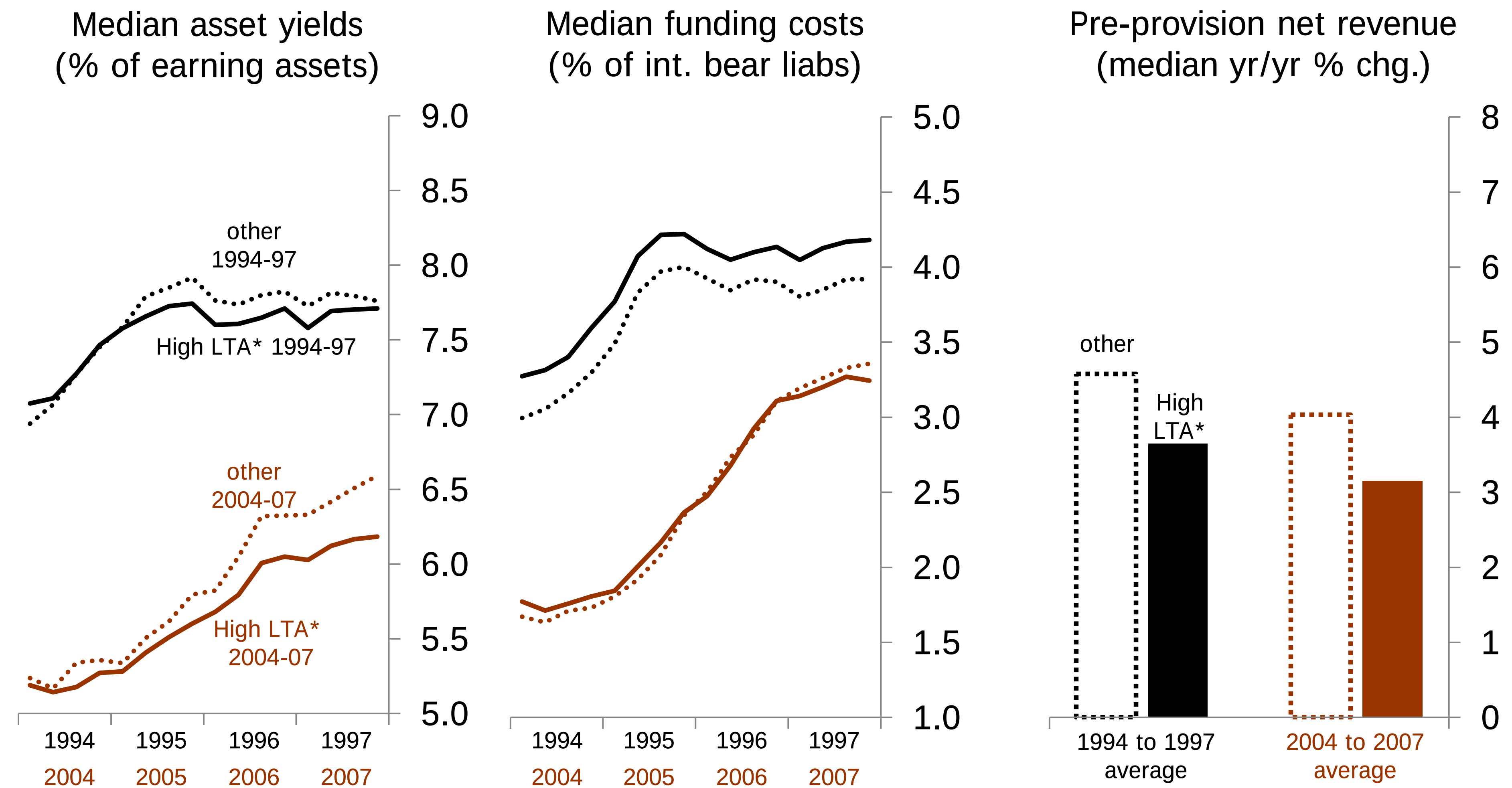



Source: Integrated Banking Information System (OCC)

* High LTA (long-term asset) = institutions in top quartile of long-term assets as % of total assets, or 1,748 banks in 1994 and 1,363 in 2004 after these filters applied: data exclude commercial banks with noncurrent loans/loans >3%, those under 3 years old, or ag, credit card, and trust specialists. (Ag specialists hold 25% or more of total loans in ag production or ag RE.) Pre-provision net revenue (PPNR) is net interest income + noninterest income less noninterest expense.

# Savings banks (proxy for thrifts) with long-term asset strategy saw similar patterns as rates rose

FDIC-insured savings banks with assets < $10 billion



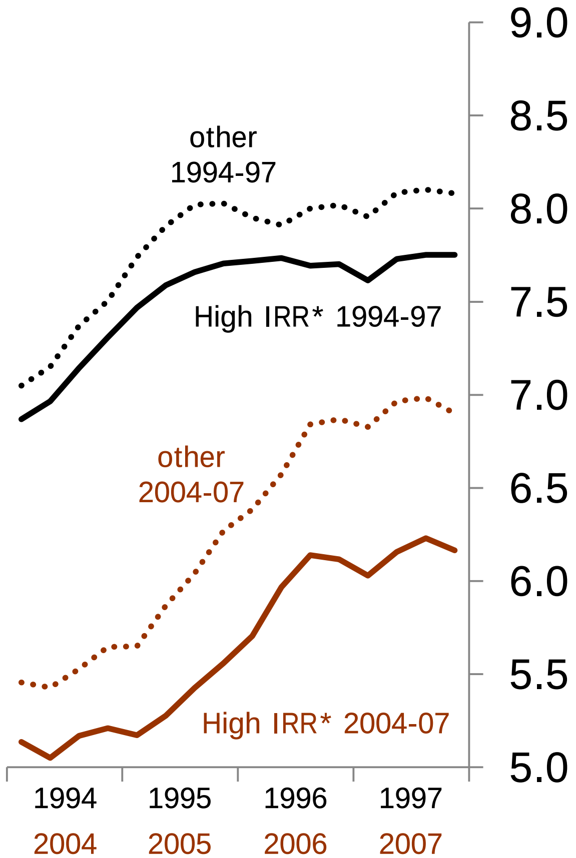

Source: Integrated Banking Information System (OCC)

* High LTA (long-term asset) = institutions in top quartile of long-term assets as % of total , or 113 savings banks in 1994 and 110 in 2004 after these filters applied: data exclude savings banks with noncurrent loans/loans >3%, those under 3 years old, or ag, credit card, and trust specialists. (Ag specialists hold 25% or more of total loans in ag production or ag RE.) Pre-provision net revenue (PPNR) is net interest income + noninterest income less noninterest expense.

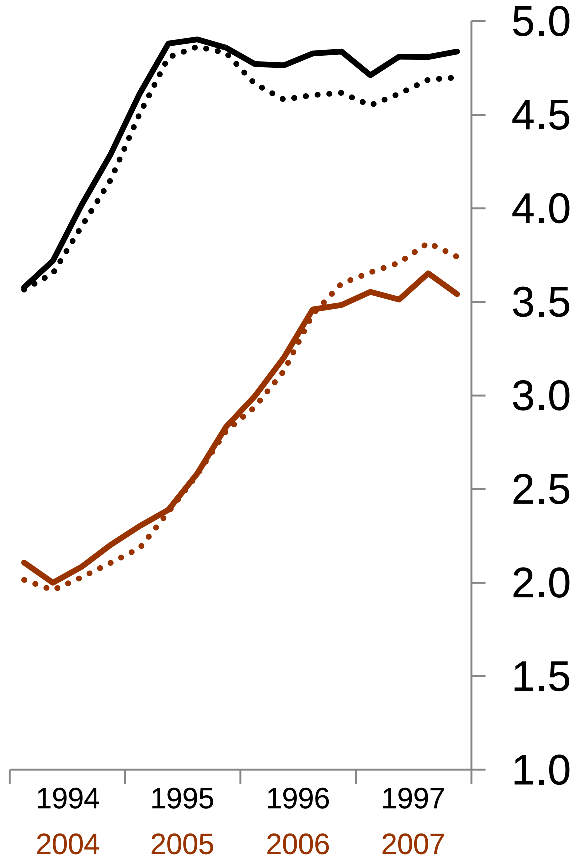
# Stock thrifts with highest OTS-model risk from +300 bps rate shock saw similar results in past

## Federal stock thrifts with assets < $10 billion

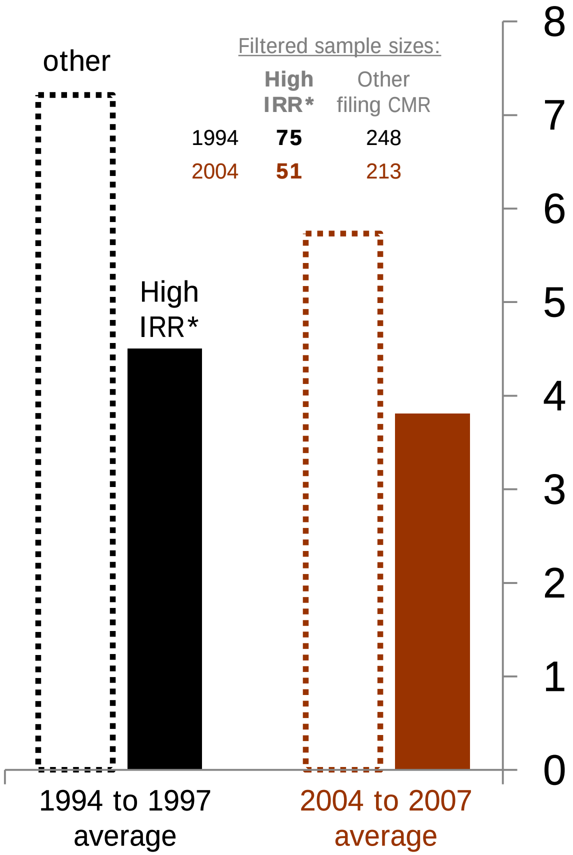
### Median asset yields (% of earning assets)




### Median funding costs (% of int. bear liabs)




### Pre-provision net revenue (median yr/yr % chg.)



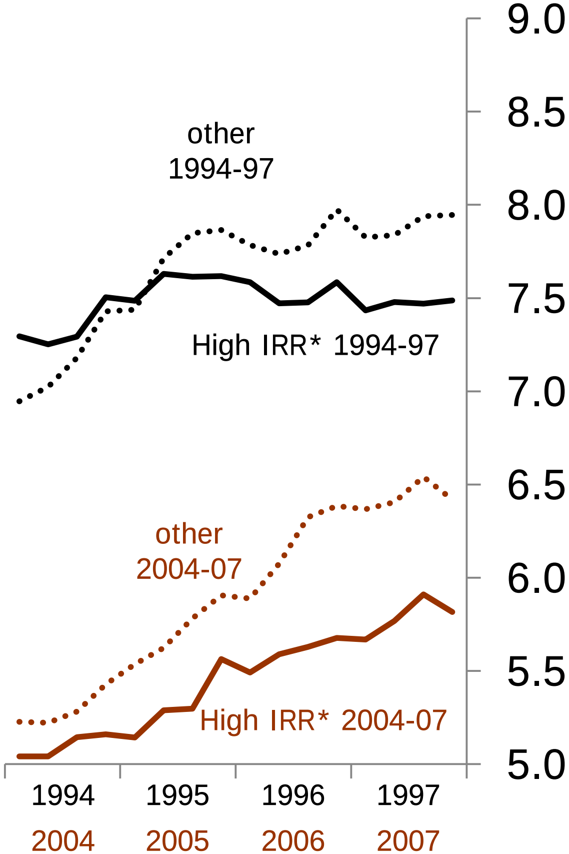

Source: Integrated Banking Information System (OCC); TFR; OTS Interest Rate Risk Model

* High IRR = thrifts in top quartile of negative reaction to a +300 bps rate shock according to OTS interest rate risk model in use at the time. Only includes thrifts filing schedule CMR, which excludes most thrifts <$300 million and with RBC >12% for 2 consecutive quarters. Analysis also removed thrifts with noncurrent loans/loans >3% and those under 3 years old. Pre-provision net revenue (PPNR) is net interest income + noninterest income less noninterest expense.

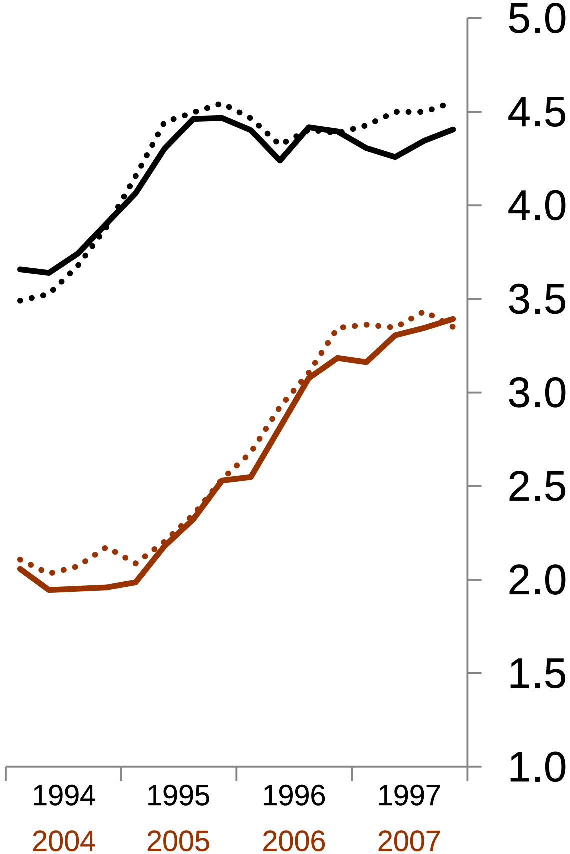
# ...as did similarly-situated mutual institutions

## Federal mutual thrifts with assets < $10 billion

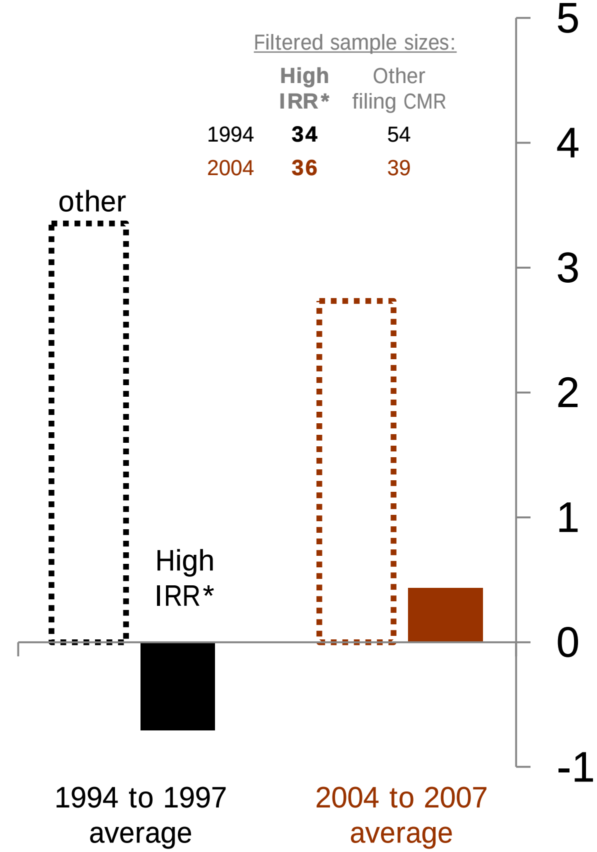
Median asset yields
(% of earning assets)




Median funding costs
(% of int. bear liabs)




Pre-provision net revenue
(median yr/yr % chg.)




Source: Integrated Banking Information System (OCC); TFR; OTS Interest Rate Risk Model

* High IRR = thrifts in top quartile of negative reaction to a +300 bps rate shock according to OTS interest rate risk model in use at the time. Only includes thrifts filing schedule CMR, which excludes most thrifts <$300 million and with RBC >12% for 2 consecutive quarters. Analysis also removed thrifts with noncurrent loans/loans >3% and those under 3 years old. Pre-provision net revenue (PPNR) is net interest income + noninterest income less noninterest expense.

# Takeaways

- Rate increase cycle likely to be gradual, but effects of sustained low-rate period could be a complication
  - Risk of atypical repricing of nonmaturity deposits
  - Risk of atypical extension of asset durations

- Rising interest rate climate could add additional challenges for banks with a long-term asset focus
  - As durations extend and asset yields lag, amidst rising funding costs