

Community Bankers of Washington Convention and Trade Show

September 14, 2023

Regulatory Update

Department of Financial Institutions (DFI)

Roberta Hollinshead –Director of Banks

Agenda

- Economic Conditions and Bank Performance

- [2023 FDIC Risk Review](#)

The banking industry demonstrated resilience despite weaker economic conditions, sharply higher interest rates, high inflation, and financial market stress in early 2023.

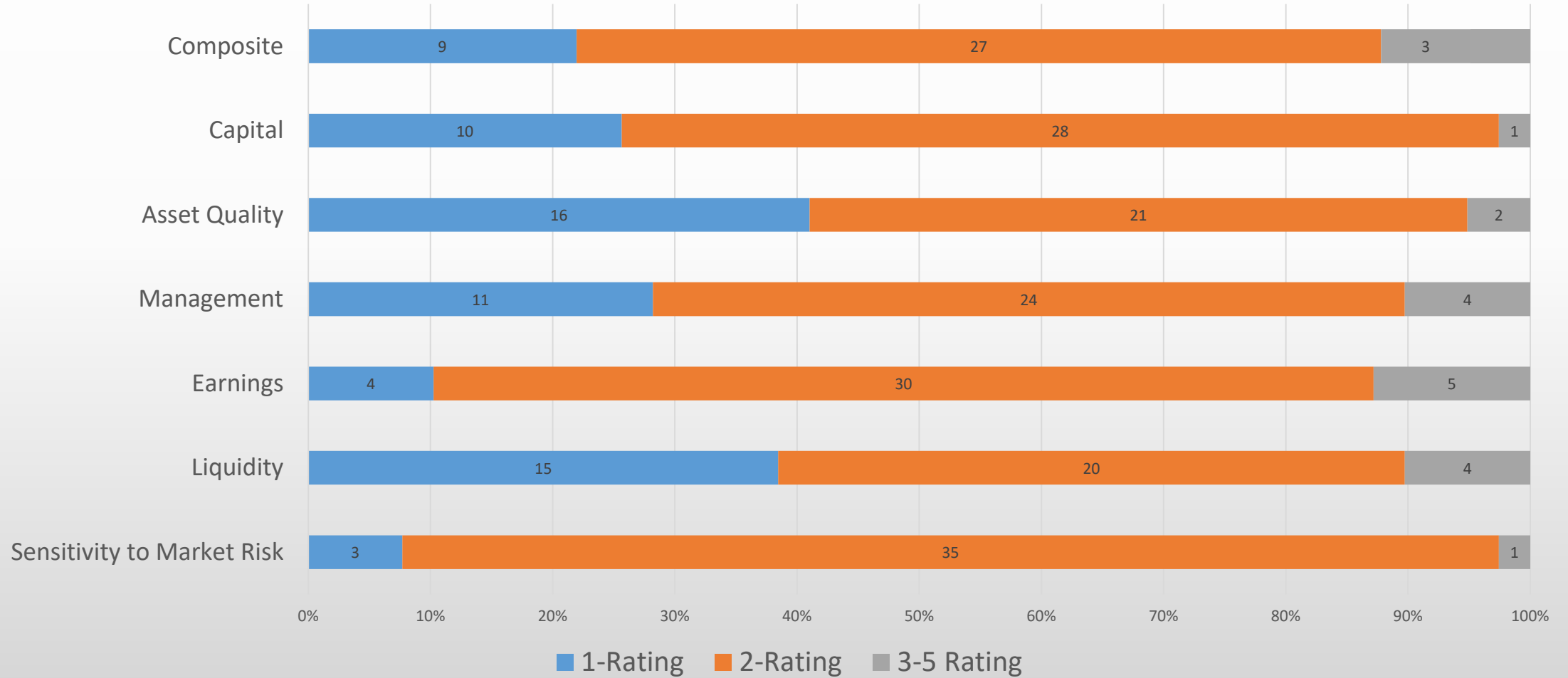
- Equitable Access to Credit – Department of Commerce

Bank Performance

- **Capital**
- **Asset Quality**
 - Rising rates – refinancing risk, collateral value declines, slow down in lending and SFR activity
 - Real Estate Concentrations
 - + Delinquency remains low - very property specific
- **Management and Board Oversight**
- **Earnings**
 - Strained earnings performance, increasing cost of funds, overall pessimistic outlook
- **Liquidity**
 - Funding mix changes: run off in non-maturity deposits, move into higher yielding
 - Uninsured deposits
- **Sensitivity to Market Risk**
 - Dramatic Interest Rate Increases

Bank Performance – Ratings

Q2 2023 Bank CAMELS Ratings



AQ: CRE Heightened Concerns

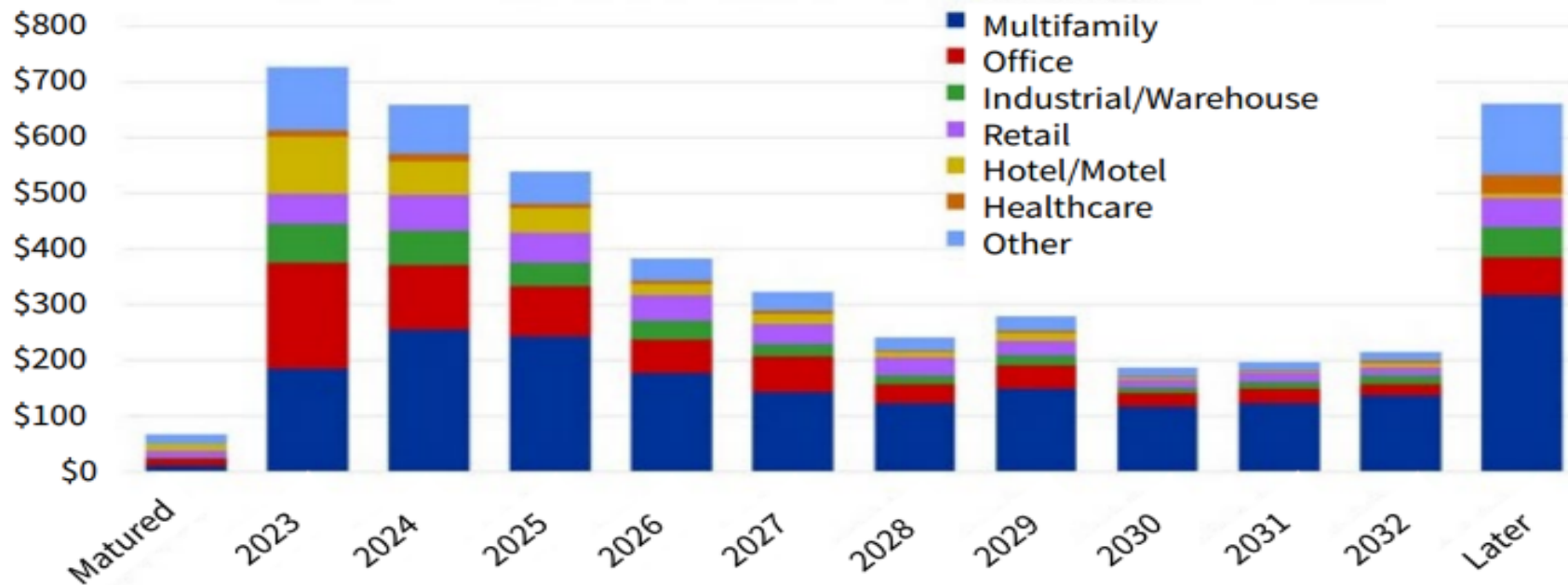
- CRE loans as a share of total industry assets have grown and approached their 2009 peak
- CRE values often lag economic drivers
- Under competitive pressure from new projects
- Values are declining
- Rising rates are placing downward pressure on NOI and increasing refinance risk
- WA banks, 2nd highest in the nation (behind CA) in CRE Concentrations at 321% vs 194% nationally

Focus on capital buffers and sound CRE monitoring oversight

AQ: Maturity Wall – Refinancing Risk

The Maturity Wall Poses Refinancing Challenges Amid Increased Rates

Total Commercial Mortgage Maturities
\$ Billions



Source: Mortgage Bankers Association (MBA).

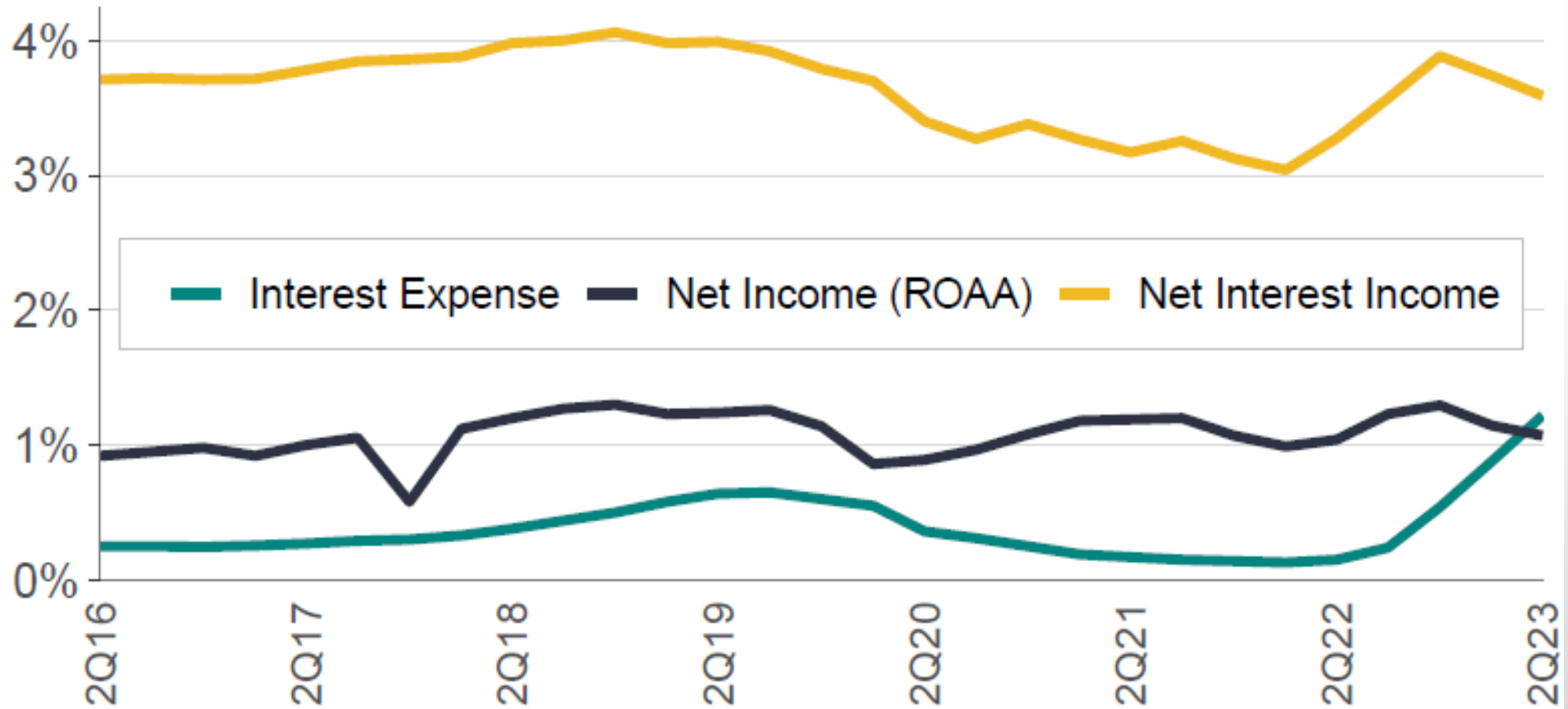
Note: Chart data as of March 10, 2023, as published in MBA's Chart of the Week.

IRR and Liquidity Challenges

- Speed and magnitude of interest rate increases
 - Speed at which the money can move in digital environment
 - Increasing funding costs and competition for deposit retention and growth
 - Growing unrealized losses in investment portfolios
 - Customers seeking higher paying alternative investments
 - Uncertainty around future fed rate increases
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- *Importance of robust IRR, liquidity and balance sheet management*

Earnings Analysis

% of avg. assets, 1-quarter annualized



The Community Bank Sentiment Index (CBSI) | CSBS

Q2 – 2023 Number is 73

*This represents a **negative** reading in economic sentiment by community bankers and is **ten points below** the index reading for last quarter, lowest level since the survey began in 2019.*

Key Highlights:

- In a special question, 95% of **community bankers believe the U.S. economy is currently in a recession.**
- Community banker sentiment has been pessimistic for six straight quarters.
- All seven components that comprise the CBSI decreased from the previous quarterly survey. **At 68, the profitability component had the greatest quarterly decline for the third consecutive quarter.**
- Community bankers rated the following as their top concerns for 2023: government regulation, cyberattacks, inflation, federal debt/deficit and the cost/availability of labor.

Other Risk Areas

- Cyber – Increasing Threat Level
 - BSA – Compliance and Fraud
 - Third-Party Risk Management
- Fintech Partnerships – Increasing Enterprise Complexity
 - Consumer Compliance
- Crypto Assets – Isolated in the Industry

FDIC 2023 Risk Review

- Credit Risks: **Asset quality remained generally favorable** as of first quarter 2023 despite modest deterioration. Weaker economic conditions and higher interest rates may challenge bank loan portfolios, including credit card, commercial and industrial, residential real estate, and commercial real estate (CRE) loans.
- Market Risks: Market risks were primarily related to the effects of **higher interest rates**. **Deposit outflows** along with high levels of unrealized losses could pressure liquidity for some banks in 2023. The banking industry benefited from strong loan growth and higher NIMs in 2022, but higher funding costs **reduced NIMs** in early 2023.
- Operational Risk: Operational risks, including **cybersecurity risks** and risks related to illicit financial activity, remained elevated across the banking industry.
- Crypto-Asset Risk: Crypto-assets present novel and complex risks that are difficult to fully assess.
- Climate-Related Financial Risk: Climate-related financial risk includes physical risk and transition risk. The Risk Review is a retrospective look at risks, and the discussion in this section focuses on physical risk from severe weather and climate events.

Equitable Access to Credit Program - Washington State Department of Commerce

- Authorized by HB 1015 - tax credit program that awards grants to qualified lending institutions (CDFIs) to provide businesses and individuals in historically underserved communities with access to credit.
- Using funds generated by contributions in exchange for tax credits, the program will award up to \$8 million in grants annually.
- Provides those who have a Business & Occupation tax (B & O) liability a unique opportunity to *direct their tax dollars to support communities* by contributing to the program. Contributors will receive a dollar-for-dollar tax credit up to \$1 million annually from the Department of Revenue (DOR)

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Q&A

Thank you!