COMMERCE DEPARTMENT

NCOIL
State of Banking Update

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When we say Minnesota Banks

Total banks operating in MN: 318

Total Minnesotan deposits: $296 Billion

More than 50 percent of deposits are held by two banks, US and Wells Fargo

Number of Minnesota State Chartered (Commerce Regulated) Banks: 199

Minnesotans' deposits held in Minnesota Chartered Banks: $50 Billion

Why Do Banks Fail

Generally, there are two ways a bank can fail.

1. Market Panic and Rapid Liquidity Risk – This risk can happen very fast and involve the rapid withdrawal of deposits and loss of liquidity sources. Banks and credit unions have very specific requirements for how much cash/liquidity they have on hand every single day. If they fail to meet those requirements, they fail.
2. Overall Economic and Soundness Risk – This is far more common and involves the deterioration of financial condition to the point where the bank no longer has enough capital to remain open. Over the last 15 years, all failures in Minnesota have involved this kind of risk. This is a slower process and regulators have the time to take steps to mitigate fallout.

ALM 101

Definitions:

Sensitivity to Market Risk: The degree to which changes in interest rates…can adversely impact earnings and/or capital. The relative rate characteristics of assets and liabilities.

Liquidity: An institution’s ability to fund assets and meet financial obligations *at low cost.*

Bank Securities Portfolios:

Most are AFS (non-balance sheet losses).

Liquid securities reprice to reflect the market rate. E.g. if the interest rate moves from 9% to 10%, the value of an existing 10% security will drop 10%.

Much, much worse in low-rate environments:

Book Rate	New Rate	Loss in Value ($100)
1%	2%	$50
1%	3%	$67
1%	4%	$75

Recipe for trouble:

- Low initial rate environment: Check ✓
- Influx of deposits: Check ✓
- Dramatic Federal Reserve Monetary Policy: Check ✓

But, only becomes acute if portfolio is liquidated: Thankfully, largely not checked

The majority of banks have sound ALM practices and robust contingency funding plans.

Bank Failures so far in 2023

Silicon Valley Bank – Apparent Liquidity Failure

Signature Bank – Apparent Liquidity Failure

First Republic Bank – Apparent Liquidity Failure

Each bank had significant weaknesses but run on deposits in excess of the liquid assets resulted in rapid failure. The post-mortem on the first two bank failures are a valuable read.

Lessons Learned

OLD LESSONS: Many lessons learned reinforced existing liquidity risk management practices that MN examiners have consistently communicated for years.

- Contingency funding plans and management (think of your credit card or a rich uncle that will lend you money if you ask)
- Balance sheet liquidity (Think of your debit card or the cash in your wallet)
- Interest Rate Risk Management
- The importance of the examination process and repeat recommendations

NEW LESSONS: Ways we have learned that today's risk is different than prior risks.

- Social media's role in perception of risk/panic
- Technology's role in accelerating deposit runoff
- The need to increase the speed of supervisory monitoring

Overview of Minnesota Banks

Last 10 Years: The years before the pandemic saw strong economic growth for our banks, with asset size, liquidity, and capital showing growth. The pandemic resulted in a 30 percent increase in bank asset size, which recently has put pressure on capital ratios.

Recently: As the federal reserve starting raising rates in early 2022, the risk profile of our banks increased. Rising rates negatively impact securities investments and rapidly rising rates are detrimental to bank. We have a few banks with heavily deteriorated balance sheet liquidity; however, the federal reserve created a lending facility to protect against this risk.

	Dec 2019	Dec 2022
Net capital as a percent of assets	10.13%	8.04%
Unrealized securities net position*	$0	($1.3 Billion)
Net Income	$562 Million	$682 Million
Nonperforming assets to total assets	0.71%	0.28%

*Not a booked entry, but an indicator of liquidity risk

Current Minnesota Bank Risk and Mitigation

Overall Current Risk Profile: Moderate

Highest Immediate Risk: Liquidity

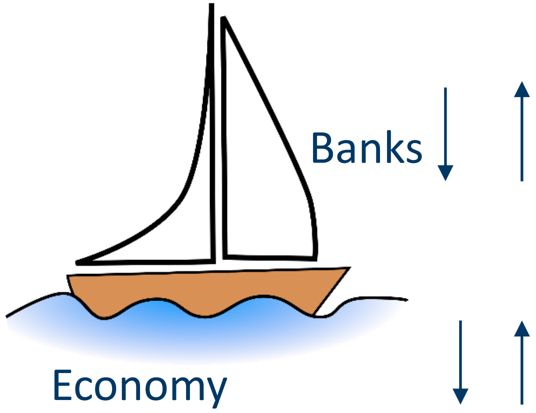
Upcoming Risk Concerns: Asset Quality, Capital, and Cyber

Current Diligence Profile: Enhanced but not to a banking crisis level

Top Risk Mitigation Practices:

- Federal partner and interstate engagement and policy development
- Examination Program
- Off sight data analysis
- Industry engagement and education

Looking Ahead



The health of national and local economies are determinative of the health of our banks. Economic downturn is expected over the next 12-18 months but to an unknown degree. The period of 2009 – 2013 saw severe stress to banks due to housing and business decline.

Impacted banks are going to need time to work through high quality, but low value securities portfolios.

Earnings are going to be challenged.

Asset quality will drive the bus.

Questions?

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