REPRINTED FROM S&P Global Market Intelligence

Positioning for higher rates might not pay off for banks

BY NATHAN STOVALL and CHRIS VANDERPOOL *JUNE 9, 2016*

The banking industry has positioned itself for rate hikes that seem to keep moving into the future, and higher rates may offer little benefit when they do come to pass.

Banks of all sizes have become asset sensitive in recent years, preparing for the Federal Reserve to raise interest rates. Balance sheets are more asset sensitive today than they were during the last tightening cycle between 2004 and 2006, according to repricing disclosures in call reports.

The prospect of higher rates seems to have moved further out on the horizon. The futures market currently projects the likelihood of the Fed raising rates in June at just 4%, down from 30% just two days before the weak employment report on June 3. The market pegs a 29% chance of higher rates in July and a 63% chance in December. On June 1, the fed funds futures market had projected a 54% chance of higher rates in July and a 74% chance in December.

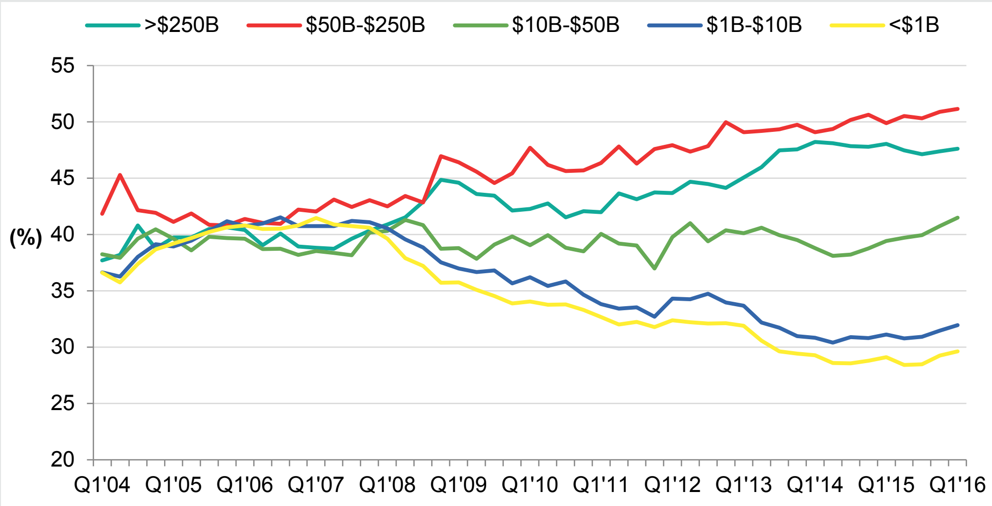
In theory, asset-sensitive banks will enjoy greater margin expansion when interest rates rise, since their assets reprice faster than their liabilities. However, repricing disclosures are static and do not take into account factors such as the competitive environment for loans or how banks' deposit mix could change when rates rise.

Increases in short-term rates have not necessarily caused net interest margins to expand in prior tightening cycles. From 2004 to 2006, when the effective fed funds rate rose to 4.97% from 1.35%, the banking industry's net interest margin actually declined by 18 basis points. The median net interest margin at larger banks declined during that time period as well, but banks with less than $10 billion in assets reported modest increases in their margins.

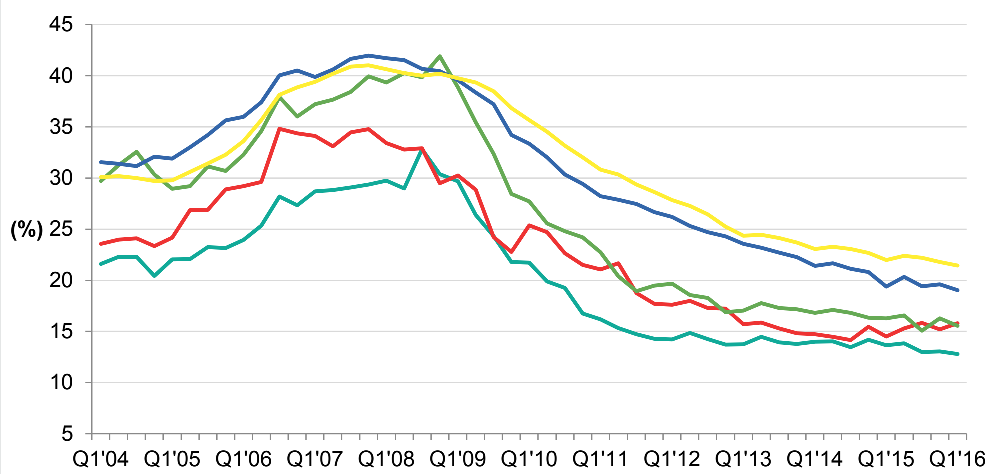
The banking industry as a whole was in an asset-sensitive position at year-end 2015, shortly after the first rate increase

Rate-sensitive asset and liability concentrations at US banks, thrifts

Rate-sensitive assets/total assets



Rate-sensitive liabilities/total liabilities



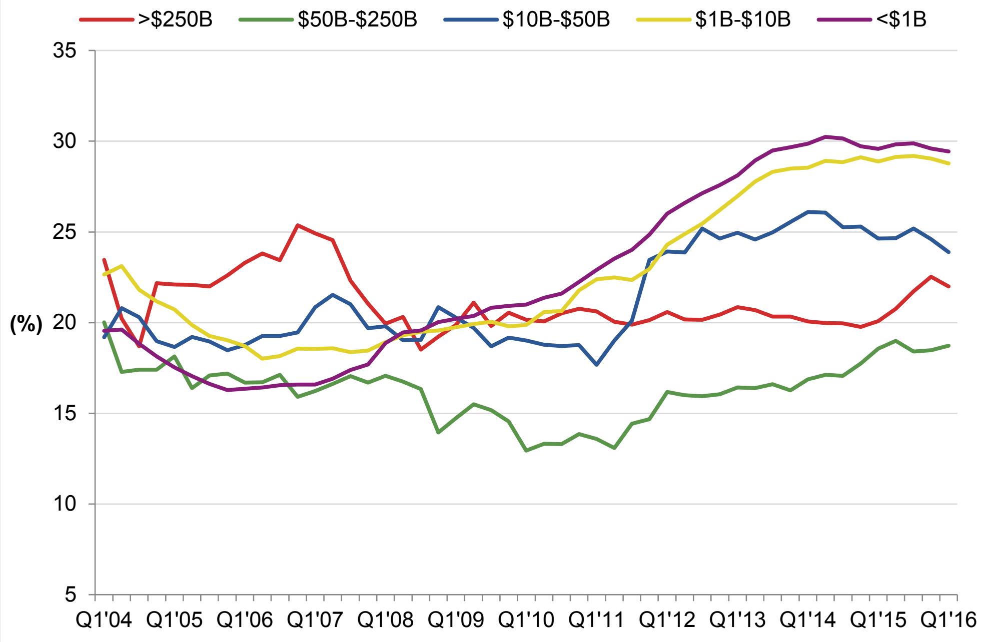
Data compiled May 31, 2016.
Based on regulatory filings.
Analysis includes all commercial banks and savings banks. Excludes nondepository trusts.
Includes assets and liabilities expected to mature or reprice within one year.
Total liabilities exclude minority interest.
Source: SNL Financial, an offering of S&P Global Market Intelligence

in nearly a decade, as assets expected to reprice or mature within one year exceeded similarly rate-sensitive liabilities, with the difference amounting to 31.0% of total assets. The one-year repricing gap was even wider — 31.6% of total assets — at the end of the first quarter of 2016.

Banks are more asset sensitive now than they were heading into the last tightening cycle, reporting a one-year repricing gap of 14.7% at March 31, 2004, and 16.7% at March 31, 2005, according to SNL data.

Larger-bank balance sheets are more asset sensitive than their smaller counterparts, likely due to hedging and higher concentration of commercial loans, which carry floating rates. The largest banks — those with assets over $250 billion and those with assets between $50 billion and $250 billion — had the biggest one-year repricing gaps at March 31, 2016, coming in at 36.2% and 37.3%, respectively. Those measures are roughly double what they were at March 31, 2004, for both groups.

Long-term asset concentration at US banks, thrifts



Data compiled May 31, 2016.
Based on regulatory filings.
Analysis includes all commercial banks and savings banks. Excludes nondepository trusts.
Includes assets expected to mature or reprice in five years or more as a percentage of total assets.
Source: SNL Financial, an offering of S&P Global Market Intelligence

Banks with assets between $1 billion and $10 billion and institutions with less than $1 billion in assets reported one-year repricing gaps of 15.2% and 10.6%, respectively, at the end of the first quarter of 2016. Smaller banks are less asset sensitive, presumably because their liability bases are more concentrated in deposits that are susceptible to changes in rates such as CDs.

Repricing disclosures cannot predict what market rates will be at a given point in time, even if interest rates are expected to move higher. Banks have priced loans aggressively in recent years, putting pressure on yields. Even if rates move higher, competitive pressures might prevent assets from repricing by the same amounts.

While banks are asset sensitive, many have built sizable, longer-duration assets on their balance sheets. At the end of the first quarter, longer-duration assets with maturities over five years grew to 22.8% of assets across the industry, from below 20% heading into the last tightening cycle. Institutions below $1 billion in assets led the way, increasing the concentration of those assets by roughly 10 percentage points during the same time period.

Some assets are tied to long-term rates, which remain low and are not expected to increase soon. Banks with longer duration loans and securities could see their margins squeezed if the yield curve flattens, as short-term rates rise while long-term rates hold steady. Those institutions could even see some earning-assets reprice lower while deposit prices rise.

Deposit composition on bank balance sheets could also change and mitigate the benefit of asset-sensitive positioning. S&P Global Market Intelligence and others have argued that the competition for deposits will be more intense when rates rise as compared to previous tightening cycles, particularly as institutions react to new regulations such as the liquidity coverage ratio, which places higher value on retail deposits among banks with more than $50 billion in assets. It also stands to reason that noninterest deposits will become smaller portions of banks' deposit bases over time, and funds will eventually move to accounts that offer customers some yield.

Assuming that occurs, the amount of liabilities set to reprice in a given time frame would change, and higher short-term rates might not provide the boost that some banks expect.

US banks, thrifts facing potential repricing risk

Companies ranked by rate-sensitive liabilities as a percentage of total liabilities

Company (top-level ticker)	City, state	Total assets ($M)	Rate-sensitive liabilities/ total liabilities (%)	On hand liquidity/ total liabilities (%)	NIB deposits/ total deposits (%)	One-year repricing gap/ assets (%)
Haverford Trust Co.	Radnor, PA	113.4	93.81	41.46	0.00	1.32
Philadelphia Trust Co.	Philadelphia, PA	20.8	92.42	108.53	0.59	9.62
Proficio Bank	Cottonwood Heights, UT	106.7	88.69	15.23	1.76	-53.79
Crestmark Bank	Troy, MI	808.2	78.46	3.25	0.06	-6.85
Republic Bank	Bountiful, UT	124.4	73.22	7.56	0.00	-9.10
Home Federal Savings and Loan Association	Bamberg, SC	42.0	72.71	10.88	0.01	-20.49
First Western Federal Savings Bank	Rapid City, SD	46.7	72.49	5.99	8.59	-13.48
Murphy Bank	Fresno, CA	224.5	71.72	11.28	0.49	-51.36
TCM Bank NA	Tampa, FL	175.5	70.89	10.18	1.58	35.91
New Republic Savings Bank	Roanoke Rapids, NC	62.2	70.78	8.27	2.77	-46.88
Pacific Alliance Bank (PFBN)	Rosemead, CA	247.5	69.95	22.15	5.22	-24.99
Tucumcari Federal Savings and Loan Association	Tucumcari, NM	38.7	69.28	10.20	1.33	-18.40
Kentland Federal Savings and Loan Association	Kentland, IN	4.5	69.26	15.89	0.00	-47.68
California First National Bank (CFNB)	Irvine, CA	820.5	68.12	11.12	1.22	-2.77
Equity Bank	Minnetonka, MN	48.4	67.66	5.91	9.63	-29.54
American Metro Bank	Chicago, IL	62.2	67.53	26.54	11.03	-16.18
Black Mountain Savings Bank SSB	Black Mountain, NC	37.0	67.51	33.81	0.00	-23.80
Jackson Savings Bank SSB	Sylva, NC	34.8	67.47	22.45	0.00	30.51
California International Bank NA (SAGN)	Westminster, CA	51.7	66.30	31.06	6.21	2.93
Maryland Financial Bank	Towson, MD	56.0	66.23	7.94	3.80	-21.00
Group median			**70.37**	**11.20**	**1.28**	**-17.29**
Industry median			**21.35**	**19.01**	**18.70**	**9.64**

Data compiled May 31, 2016.
Based on regulatory filings for the quarter ending March 31, 2016.
Company and industry analysis limited to currently operating top-tier commercial banks, savings banks and savings and loan associations with a loan-to-deposit ratio greater than 50%. Excludes industrial banks, cooperative banks and nondepository trusts.
Total liabilities exclude minority interest.
Rate-sensitive liabilities = liabilities expected to reprice or mature within one year
NIB = noninterest bearing
One-year repricing gap/assets = the cumulative amount of rate-sensitive assets repricing within one year less the amount of rate-sensitive liabilities scheduled to reprice within one year, as a percentage of total assets. The ratio is negative if rate-sensitive liabilities exceed rate-sensitive assets.
Source: SNL Financial, an offering of S&P Global Market Intelligence

US banks, thrifts facing potential repricing gains

Companies ranked by rate-sensitive assets as a percentage of total assets

Company (top-level ticker)	City, state	Total assets ($M)	Rate-sensitive assets/ total assets (%)	Long-term assets/ total assets (%)	NIB deposits/ total deposits (%)	One-year repricing gap/ assets (%)
1st Financial Bank USA	Dakota Dunes, SD	688.2	90.91	0.18	1.58	75.02
Monitor Bank	Big Prairie, OH	42.0	90.25	0.15	29.74	84.02
Alpine Capital Bank	New York, NY	288.3	90.01	0.08	33.03	79.58
Applied Bank	Wilmington, DE	202.8	88.41	1.57	46.59	88.16
Independence Bank	East Greenwich, RI	39.2	88.27	10.73	21.82	79.47
TCM Bank NA	Tampa, FL	175.5	88.17	1.14	1.58	35.91
Bank 7	Oklahoma City, OK	575.5	87.37	1.81	22.66	63.42
Mizuho Bank (USA) (8411)	New York, NY	6,367.5	87.08	1.33	9.70	62.46
Citizens State Bank	Okemah, OK	296.8	86.06	5.84	4.70	33.14
Jackson Savings Bank SSB	Sylva, NC	34.8	85.43	7.03	0.00	30.51
Dysart State Bank	Dysart, IA	16.1	84.79	0.03	36.88	66.43
Seacoast Commerce Bank (SCBH)	San Diego, CA	526.4	84.16	1.85	47.15	82.41
Grant County State Bank	Carson, ND	36.6	84.02	1.99	21.62	65.65
Stanley Bank	Overland Park, KS	100.8	83.87	0.07	0.00	73.87
Ridgestone Bank (RGST)	Brookfield, WI	433.2	83.35	0.92	10.22	31.58
Summit Bank (SMAL)	Oakland, CA	237.7	82.70	1.88	41.08	72.72
Farmers Bank of Willards	Willards, MD	316.5	79.57	3.14	20.88	35.51
Twin River National Bank	Clarkston, WA	99.3	79.09	3.15	23.78	69.02
Haverford Trust Co.	Radnor, PA	113.4	78.76	0.00	0.00	1.32
1st Bank	Broadus, MT	50.4	77.65	1.90	27.47	66.00
Group median			**85.11**	**1.69**	**21.72**	**66.22**
Industry median			**29.37**	**26.74**	**18.70**	**9.64**

Data compiled May 31, 2016.
Based on regulatory filings for the period ending March 31, 2016.
Company and industry analysis limited to currently operating top-tier commercial banks, savings banks and savings and loan associations with a loan-to-deposit ratio greater than 50%. Excludes industrial banks, cooperative banks and nondepository trusts.
Rate-sensitive assets = assets expected to reprice or mature within one year
Long-term assets = assets expected to reprice or mature in over five years
NIB = noninterest bearing
One-year repricing gap/assets = the cumulative amount of rate-sensitive assets repricing within one year less the amount of rate-sensitive liabilities scheduled to reprice within one year, as a percentage of total assets
Ticker is based on top-level entity's home country exchange.
Source: SNL Financial, an offering of S&P Global Market Intelligence