

THE FDIC PRELIMINARY BANK EARNINGS REPORT

- **COMMERCIAL BANKS EARN \$17.8 BILLION IN 4TH QUARTER**
- **LOAN-LOSS PROVISIONS UP SHARPLY AT A FEW LARGE BANKS**
- **FULL-YEAR EARNINGS FALL FOR FIRST TIME IN NINE YEARS**
- **MOST BANKS REPORT HIGHER PROFITS**
- **NET INTEREST MARGIN DECLINES TO TEN-YEAR LOW**

Insured commercial banks reported \$17.8 billion in net income in the fourth quarter of 2000, an increase of \$91 million (0.5 percent) over industry earnings in the fourth quarter of 1999. The slight gain was made possible by a \$471-million improvement in results from sales of securities. In the fourth quarter, securities sales produced pretax net gains totaling \$196 million; a year ago, securities sales resulted in \$275 million in net losses. The decline in the industry's net operating income (which excludes proceeds from securities sales and extraordinary items) stemmed from rising expenses for loan-loss provisions at a number of large banks and a slowdown in growth of banks' noninterest income.

Banks' provisions for loan losses rose to \$9.5 billion in the fourth quarter, an increase of \$3.4 billion (54.7 percent) from the level of a year earlier. This is the largest quarterly loss provision since the fourth quarter of 1991. It absorbed 10.4 percent of the industry's net operating revenue (net interest income plus total noninterest income) in the quarter. In the fourth quarter of 1999, loss provisions absorbed 7.0 percent of net operating revenue. Earnings were helped by slower growth in overhead costs -- noninterest expenses were only \$484 million (0.9 percent) higher than a year ago -- but were penalized by a slowdown in noninterest income growth. Noninterest revenues were only \$643 million (1.7 percent) higher than in the fourth quarter of 1999, mainly because of a lack of growth in fee income.

The average return on assets (ROA) was 1.16 percent in the fourth quarter, down from 1.27 percent a year ago. Slightly more than half (50.5 percent) of all banks reported a quarterly ROA of 1 percent or higher, and 53.6 percent reported a higher ROA compared to a year earlier.

Net interest margins declined for the fifth consecutive quarter. Asset yields increased only for the largest size group of banks (assets greater than \$10 billion), while funding costs rose for all asset-size groups. At 3.90 percent, the industry's net interest margin was only 3 basis points lower than in the third quarter. A year ago, it was 4.08 percent. The current level represents the lowest quarterly net interest margin since the second quarter of 1988. Despite the margin decline, net interest income was \$2.6 billion (5.3 percent) higher than a year ago, because of an 8.7-percent increase in the industry's interest-earning assets over the past 12 months.

Commercial banks' string of eight consecutive years of record earnings came to an end in 2000, as full-year net income of \$71.2 billion fell \$380 million (0.5 percent) short of 1999's total. Net operating income, which excludes proceeds from sales of securities

and extraordinary items, was actually \$1.4 billion (2.0 percent) higher in 2000 than in 1999. But securities sales in 2000 produced net losses of \$2.3 billion, compared to \$181 million in net *gains* in 1999, as higher interest rates reduced the values of banks' fixed-rate securities holdings. The industry's earnings decline was mostly attributable to problems at a few large banks. More than two out of every three commercial banks (67.9 percent) reported higher earnings than in 1999, and a majority (53.5 percent) reported higher full-year ROAs.

Sharply higher loan-loss provisions had a significant effect on industry earnings in 2000. For the full year, loss provisions totaled \$29.3 billion, an increase of \$7.4 billion (34.1 percent) over 1999. There has not been a larger annual increase in loss provisioning by the industry since 1988-89. Industry earnings were also hurt by sluggish growth in noninterest income. After posting double-digit growth rates in each of the previous four years, noninterest revenues increased by only 5.8 percent in 2000. On the positive side, noninterest expenses increased at a slower rate (5.7 percent) in 2000, despite some large individual restructuring expenses. The industry's full-year net interest margin declined for the seventh time in the last eight years, falling below 4 percent for the first time since 1990. Net interest income increased by 6.0 percent over 1999, as an 8.7-percent rise in interest-earning assets outweighed the declining net interest margin. The industry's net interest margin of 3.95 percent in 2000 was the lowest level since 1990. The full-year ROA of 1.19 percent was down from the record 1.31 percent registered in 1999, but it extended the industry's streak of consecutive years with an ROA above 1 percent to eight. Almost 60 percent of the 8,315 commercial banks reporting year-end results posted an ROA of 1 percent or higher in 2000.

The amount of commercial banks' loans that were noncurrent -- 90 days or more past due or in nonaccrual status -- rose by \$4.1 billion (10.5 percent) in the fourth quarter. This quarterly increase is the largest since the first quarter of 1991. The percentage of banks' loans that were noncurrent rose from 1.03 percent to 1.12 percent during the quarter. Loans to commercial and industrial borrowers accounted for the largest portion of the increase.

Noncurrent commercial and industrial loans (C&I loans) increased by \$1.6 billion, and the noncurrent rate on banks' C&I loans rose from 1.52 percent to 1.67 percent, the highest it has been since the first quarter of 1994. Noncurrent loans in the "all other loans" category, which includes loans for purchasing and carrying securities, more than doubled in the fourth quarter. The amount of "all other loans" that were noncurrent increased from \$764 million to \$1.7 billion, and the noncurrent rate rose from 0.59 percent to 1.31 percent. Noncurrent loans increased in most other loan categories as well during the fourth quarter, but not to the degree seen in C&I loans. During the full year, noncurrent loans increased by \$9.9 billion (30.0 percent). Commercial and industrial loans accounted for \$6.1 billion (61.4 percent) of the increase. The rising trend in troubled C&I loans was not especially broad-based. During 2000, slightly more than one in three commercial banks (38.8 percent) reported an increase in the percentage of

their C&I loans that were noncurrent. However, these banks account for more than three-quarters (77.9 percent) of all the commercial and industrial loans held by the banking industry.

Banks charged-off \$7.7 billion in bad loans in the fourth quarter, a 27.1-percent (\$1.6 billion) increase over the fourth quarter of 1999. C&I loans accounted for \$3.0 billion (39.2 percent) of the quarter's charge-offs. This was the highest level for C&I charge-offs in nine years (since the fourth quarter of 1991). A year ago, banks charged-off \$1.9 billion in C&I loans. The annualized net charge-off rate on C&I loans rose to 1.15 percent, from 0.79 percent a year ago. The only other loan category where the net charge-off rate showed a significant increase was home equity loans. The net charge-off rate was 0.24 percent in the fourth quarter, up from 0.16 percent in the fourth quarter of 1999. Almost all other loan categories had minor increases in their net charge-off rates compared to a year earlier, except for credit-card loans. The net charge-off rate on credit-card loans in the fourth quarter was 4.35 percent, down from 4.48 percent a year earlier.

Loan growth slowed in the fourth quarter, as banks' holdings of residential mortgage loans declined and C&I loans registered their smallest quarterly increase in seven years. Loans secured by 1-4 family residential properties fell by \$4.2 billion during the quarter; if home equity loans are excluded, all other 1-4 family residential loans declined by \$8.8 billion. Commercial and industrial loans increased by \$3.9 billion, the smallest quarterly change since the third quarter of 1993. Of the major loan categories, only credit card loans showed normal seasonal growth. Credit-card loans increased by \$20.7 billion (9.1 percent) during the quarter.

Banks' domestic deposits rose strongly in the fourth quarter. Brokered deposit growth continued to be propelled by the sweeping of cash management accounts into insured deposit accounts at banks affiliated with brokerage firms. Brokered deposits rose by \$26.9 billion (16.1 percent) during the quarter, and were up by \$95.2 billion (96.6 percent) over the last 12 months. Two banks accounted for 63.9 percent of the quarterly increase and 51.2 percent of the annual growth in brokered deposits. Demand deposits increased by \$41.6 billion (8.5 percent) during the fourth quarter.

Equity capital increased by \$8.4 billion (1.6 percent) in the fourth quarter. The rise was made possible by a \$9.5-billion increase in unrealized gains on banks' available-for-sale securities. During the quarter, dividends paid by the industry exceeded net income by \$801 million, so there was no contribution to equity from retained earnings. The increase in equity did not keep pace with growth in total assets, and the industry's equity-to-assets ratio declined from 8.59 percent to 8.49 percent. A year ago, the ratio stood at 8.37 percent.

Banks increased their loss reserves by \$1.5 billion in the fourth quarter. Except for the \$2.1-billion increase in reserves in the second quarter, this is the largest quarterly addition to reserves since the fourth quarter of 1990. It lifted the industry's ratio of

reserves to loans from 1.66 percent to 1.68 percent. However, because of the large increase in noncurrent loans, the industry's "coverage ratio" declined to \$1.49 in reserves for every \$1.00 of noncurrent loans from \$1.61 at the end of the third quarter. This is the lowest level for the coverage ratio since the middle of 1994.

The number of insured commercial banks reporting financial results fell from 8,376 to 8,315 in the fourth quarter. There were 51 new charters, while 109 banks were merged into other institutions, and two banks failed. During the year, the number of commercial banks declined by 265. There were 192 new charters in 2000. Mergers absorbed 453 banks, and 6 insured commercial banks failed. At the end of the year, there were 76 commercial banks on the FDIC's "Problem List," up from 75 at the beginning of the quarter and 66 at the beginning of the year. The combined assets of these "Problem" banks totaled \$17 billion at year-end, compared to \$14 billion at the beginning of the quarter, and \$4 billion at the beginning of the year.

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