Condition of the Texas State Banking System March 2021





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Symbols Used Throughout this Report:	Abbreviations Used Throughout this Report:
Improving or strong conditions Deteriorating or weak conditions Mixed conditions	FDIC – Federal Deposit Insurance Corporation OCC – Office of the Comptroller of the Currency FRB – Federal Reserve Board

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ECONOMIC REVIEW AND OUTLOOK

After battling the impact of the coronavirus (COVID-19) pandemic for more than four months, the Texas economy began a slow, uneven recovery in the second half of 2020. This recovery was made more difficult by a series of spikes in the number of infections over the summer months and traditional holiday season.

All Texas industry sectors were affected by the pandemic in the first half of 2020. As a result of the economy's shutdown, reduced demand for oil and gas products significantly disrupted the energy sector while manufacturing and retail sales declined steeply due to local and state restrictions on businesses resulting in closures and weak demand. The price per barrel of West Texas Intermediate (WTI) oil began 2020 at \$61.18 but slid to \$39.27 by the end of June. The Texas unemployment rate was 8.4% at the end of the second quarter, more than doubling January's rate of 3.5%.

Signs of recovery began to appear in several sectors of the state's economy in the second half of the year. Oil prices enjoyed a mild rebound to \$48.52 per barrel by December. The unemployment rate dipped 0.8% between July and year's end, moving from 8.0% to 7.2%. The Texas Workforce Commission reported weekly unemployment claims declined from 117,244 in the first week of July to 28,896 in the last week of December.

The Texas economy was in-line with that of the U.S. The nation's real gross domestic product (GDP) increased at an annual rate of 33.4% in the third quarter of 2020, according to the U.S. Bureau of Economic Analysis. Real GDP grew an additional 4.1% in the fourth quarter.

The U.S. unemployment rate, which was 10.2% in July, gradually fell to 6.7% by year's end. Average hourly earnings held steady over the final two quarters of 2020, ending \$0.46 higher. By December, the FRB was reporting higher than-average growth nationally in manufacturing, distribution and logistics, homebuilding, and existing home sales.

While the economy is still not fully recovered, some of the credit for the extent to which it has stabilized can be attributed to the \$349 billion Paycheck Protection Program (PPP) created in April 2020 through the Coronavirus Aid, Relief and Economic Security Act.

Congress extended the PPP on June 30, meaning loans were issued in two tranches. The Small Business Administration (SBA), which is administering the program, eventually approved 5.2 million loans totaling \$525 billion by the program's August 8, 2020, deadline. Of this amount, \$41.3 billion in loans went to businesses in the Lone Star State.

The program reopened January 11, 2021, initially to first-time borrowers with second-time borrowers eligible to apply beginning January 13. Congress authorized the program relaunch with \$284 billion in funding as part of its latest \$900 billion coronavirus stimulus package passed in December.

Further discussion on the impact of the coronavirus and these economic recovery programs on Texas businesses and banks is offered under the <u>Supervisory Concerns</u> section.

Meanwhile, cybersecurity concerns remained at a heightened level during the second half of 2020, as attacks targeting employees working remotely increased. These concerns were further elevated with the hack of SolarWinds' suite of network and computer management tools.

Although the breach likely began in March 2020, it went undetected until December by which time an estimated 18,000 customers were affected, among them the U.S. Department of the Treasury, the U.S. Department of Homeland Security, the U.S State Department, and the U.S. National Nuclear Security Administration.

2021 began with a new administration in the nation's capital and potential changes to the leadership of the financial institution regulatory agencies and banking policies as part of the Biden administration's new objective. Bankers will be closely watching for any policy changes driving the future of housing finance, marijuana banking, anti-money laundering reform, and Community Reinvestment Act reform.

As the year ended, COVID-19 vaccines began to be distributed. This resulted in growing optimism for the economic outlook for 2021. However, a devastating winter storm in February caused significant damage to Texas consumers and businesses impeding these economic recovery efforts.

STATE-CHARTERED BANKING PROFILE (DEPARTMENT OF BANKING)

There were 217 Texas state-chartered banks as of December 31, 2020, which was unchanged from June 30, 2020. The number of state banks remained static during the reporting period due to the net effect of the following banking transactions:

- Four state banks merged with and into other Texas state-chartered banks;
- Two national banks converted into Texas state-chartered banks; and
- Two state savings banks converted to Texas state-chartered banks.

During the same period, the Department processed 118 filings related to banks, with approximately 58% involving opening and closing of offices and loan production facilities, 16% involving changes in ownership/control or chartering authority, 14% involving bank identification and corporate governance issues, 11% involving subsidiary formations, and 1% involving foreign bank activity.

While the number of Texas state-chartered banks was unchanged, the overall asset size increased from \$319.8 billion as of June 30, 2020, to \$345.3 billion at year-end 2020. The asset growth occurred from a combination of approximately \$12.9 billion in conversion activity and \$12.6 billion of internal asset growth.

STATE-CHARTERED THRIFT PROFILE (DEPARTMENT OF SAVINGS AND MORTGAGE LENDING)

State-chartered thrift assets under the Department's jurisdiction totaled \$395.3 billion as of December 31, 2020, an increase of \$46.2 billion or 13.2% over the prior six months. As of year-end, state thrifts had \$3 billion in year-to-date net income compared to June's \$1.6 billion in year-to-date net income. Earnings gains occurred in 52% of the thrift institutions through December 2020 due to the increased size of the industry and decreased cost of funds. Thrifts' net interest margin (NIM) as an industry have decreased to 1.74%; however, this is primarily driven by the largest institution's NIM of 1.67%.

The level of nonperforming loans and other real estate owned (OREO) remains low in state-chartered thrifts at 0.07% of total assets, which declined from 0.1% in June 2020. Despite these low levels, state and federal regulators continue to monitor past due and nonaccrual loans, as well as OREO. The level of OREO has decreased by \$15 million or 59.2% since June 2020 to \$10 million.

The Department continued to receive and process applications, administering one state savings bank charter/merger (withdrawn during the period), four branch office applications, one reorganization application, two branch office sale applications, three subsidiary formations, one change of control, one rebuttal of control, and various other applications during the past six months.

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TEXAS ECONOMIC PROFILE

The Texas economy got off to a shaky start at the beginning of the third quarter of 2020. A surge of COVID-19 cases weakened retail sales and kept oil prices flat as demand continued to sag. However, crude oil and manufacturing commodity exports rebounded in quarter four, even as trade activity continued well below previous year-end levels. Construction payrolls deteriorated, but residential construction remained strong as housing sales reached record-breaking levels.

The Federal Reserve Bank of Dallas (FRB Dallas) Texas Business-Cycle Index, which measures underlying economic activity in the state, grew 6.3% in July on a seasonally adjusted annualized rate, its first positive reading since February. However, the growth index decelerated in September as the coronavirus began to surge again, edging down from 10.0% in August to 8.4%.

The state's economy continued to improve at a moderate rate entering the fourth quarter of 2020 as the index rose by 11.9% in October, with growth leveling off at 10.8% in November, and ended 2020 essentially unchanged. The year-end figure, however, was 8.9% below its February pre-pandemic level.

The FRB Dallas Texas Manufacturing Outlook Index, a key measure of state manufacturing conditions, moved up to 25.5 points in December from 16.1 points in July. The new orders index, which represents the total number of new orders from manufacturer's customers, increased from 6.9 points at the beginning of the third quarter to 17.8 at year's end.

July capacity utilization and shipments indexes were up 14 points and 17.3 points, respectively, their highest readings in nearly a year. By December, the capacity utilization index advanced to 17.7, and the shipments index moved up to 21.9.

The FRB Dallas Texas Service Sector Outlook Index jumped from -8.5 points in July to 14 points in September and another 4.2 points by the end of the fourth quarter 2020. The wages and benefits index declined seven points, from 7.4 points to 0.4 in July but rose 8.6 points in October and to a post-pandemic high of 11.2 in November, before ending 2020 back at 8.6.

Retail sales activity, meanwhile, declined sharply in July, according to the FRB Dallas Texas Retail Outlook Survey, plunging nearly 60 points to -26.7 points, its weakest reading since April. However, the index finished 2020 by rising from -0.7 in November to 4.2 in December.

Texas has become a powerful magnet for technology industry jobs and capital, as *Texas Monthly* points out, often at the expense of California's Bay Area.

In rapid succession, Elon Musk announced he had selected Austin as the site for a \$1.1 billion Tesla factory that will employ at least 5,000 people. Amazon then unveiled news it was locating a 700,000 square-foot robotics fulfillment center in Waco, which is expected to create more than 1,000 jobs.

In December, Oracle Corporation and Hewlett Packard Enterprise announced relocation of their headquarters to Texas from California.

The good economic news continued as *Site Selection Magazine* in September named Texas the top state on its Global Groundwork Index for its blend of infrastructure project investment and corporate facility investment. On February 8, 2021, Governor Greg Abbott announced the U.S. Census Bureau ranked Texas the top exporting state for the 19th consecutive year, with \$279.3 billion in exports in 2020.Texas accounted for more exports last year than California and New York combined while also leading the nation in tech exports for the eighth year in a row.

EMPLOYMENT

The state's unemployment rate improved slightly beginning in the third quarter of 2020 after a dismal second guarter.

Nearly 2.7 million people in the state filed for unemployment relief from the onset of the coronavirus in mid-March through the end of June which was more than all unemployment claims in 2019. This included individuals, such as restaurant and hotel employees, who had a job but were unable to work or work full-time because their business remained closed due to COVID-19 restrictions.

The state lost approximately 210,000 jobs in the civilian workforce during this period but managed to make up those losses by the end of 2020. The state began the third quarter with a civilian labor force of 13.8 million, ending the year with 14.1 million persons employed.

By December 31, initial weekly unemployment claims had fallen to 28,896, down significantly from the peak of 313,832 for the week ending April 4. Texas' unemployment rate was 8.0% at the beginning of the third quarter before ending 2020 at 7.2%. This figure represented an improvement from April's peak of 13.5%, but it was still higher than recent historic norms.

Overall, nine of the 11 industry sectors the U.S. Bureau of Labor Statistics tracks experienced year over year (YOY) job losses by the end of 2020 with only Business and Professional Services (up 2%) and Financial Activities (up 1%) finishing in positive territory.

Even with negative YOY statistics, all but one sector managed either to remain static or experience some improvement between June and December. Among the bright spots were Trade, Transportation, and Utilities (from -4.1% to -1.9% YOY); Information (from -6.2% to -3.7% YOY); and, somewhat surprisingly, Leisure and Hospitality (from -17.8% to -12.3% YOY).

Only the Education and Health Services sector experienced a YOY decline in jobs from the third quarter to the fourth, trending downward from -3.6% in June to -4.0% by the end of 2020.

At the local level, Austin led in terms of job creation in the second half of 2020 with a 5.1% growth rate, thanks to its strong technology sector, according to the FRB Dallas. Buoyed by its strong connection to the financial services industry, Dallas was second in job growth, up 3.4%. Fort Worth generated 2.8% of the state's job growth in the second half of 2020, while Houston's energy-based economy led to a job growth of just 2.2% over this period.

POPULATION

The state's final 2020 population figures were not available at the time this report was produced, the U.S. Census estimates the 2019 population was nearly 29 million, a number which is anticipated to increase when additional data is released later this year.

Much of the expected population increase will likely be from residents who moved to Texas from another state. Texas was the second most active state for relocations in the U.S. in 2020, according to *Business Insider* magazine. The state gained thousands of residents amid the pandemic, with many settling in the suburbs of Austin, Dallas, and Houston.

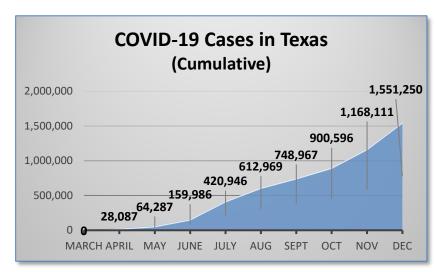
It is impossible to discuss the state's population without mentioning COVID-19. From March 4, 2020, when the first case was diagnosed, to December 31, more than 1.5 million residents tested positive and nearly 29,500 died from the virus. A significant number of these cases occurred in the final quarter of the year.

Prior to June, the highest daily count for new diagnoses was 1,949 reached on May 31. From July 14-18, the state saw five straight days of 10,000+ new cases. The situation continued to worsen in quarter four with the arrival of the traditional holiday season.

The pandemic had an enormous impact on the economy, as noted in previous sections. On a national scale, The Perryman Group estimates that in the coming years, fatalities tied to COVID-19 will cause losses of \$356 billion in GDP, nearly \$218 billion in personal income, and 3.6 million job-years.

Housing

The housing market had a banner second half of 2020, despite a worsening of the coronavirus pandemic. Total housing sales in July climbed 17.1% over June figures, surpassing pre-pandemic levels with a record breaking 36,165



Source: Texas Department of State Health Services

sales on the strength of historically low interest rates and strong demand. Every major metro area posted historic sales numbers, rebounding fully from a lackluster performance earlier in the year.

Existing home sales climbed sharply early in the third quarter. In the new home market, homebuilders continued to enjoy widespread strength in sales, allowing for higher prices. Strong demand and decreasing inventory pushed home price growth upward. The state's median home price surged to \$261,600 in July, increasing 9.3% YOY.



Source: Real Estate Center at Texas A&M University

Austin led the growth with the highest median home price of \$347,200, followed by Dallas at \$313,500. Houston surpassed the statewide median price at \$268,000, while median prices in Fort Worth and San Antonio were slightly lower at \$257,200 and \$252,300, respectively.

Single family construction permits accelerated by 21.8% at the beginning of the third quarter. Texas remained the national leader in this category, representing 16.0% of the national total. Inventory levels, however, continued to trend downward, falling to an all-time low of 2.6 months.

The multifamily sector improved as well, as permits rose 28.2% to start the third quarter. Apartment leasing improved further in July, but rents were flat to down compared to the previous year while concessions increased, particularly in communities with newer units.

New home sales continued to outpace expectations entering the fourth quarter, although at a slower pace following record-setting levels in the previous quarter. Many builders raised prices to cover higher construction costs and cool down sales as backlogs remained high. Crew shortages, high lumber prices, and supply chain issues – particularly for appliances and windows – led to even tighter inventories.

Despite soaring input costs, total Texas housing starts were up 9.5% annually at year-end. Single family housing starts ended the year up 18.9% YOY and total housing sales rose 9.4% YOY.

Apartment demand exceeded expectations in the second half of 2020; however, demand could not keep pace with completions, placing downward pressure on occupancy and rents. The result was a slight deterioration in apartment rent payments by December.

OIL AND GAS

Activity in the oil and gas (O&G) sector continued a modest decline in third quarter 2020, according to the FRB Dallas Energy Survey. The business activity index – the survey's broadest measure of conditions facing energy firms – remained in negative territory but showed a remarkable rebound, moving from -66.1 points in the second quarter to -6.6 points in the third quarter.

Production indexes increased significantly yet remained in negative territory, suggesting the deterioration in production was easing. The oil production index rose from -62.6 points in the second quarter to -15.4 points in the third quarter. The natural gas production index increased 38 points to -10.1 points.

Conditions among oilfield services firms continued to decline. The equipment utilization index jumped 50 points to -18.9 in the third quarter, suggesting continued utilization deteriorated but at a much slower pace than during the previous quarter.

By the end of the fourth quarter, O&G activity moved into positive territory, as the business activity index soared from -6.6 points in the third quarter to 18.5 points in the fourth. This represented the first positive reading for the business activity index since the first quarter of 2019.

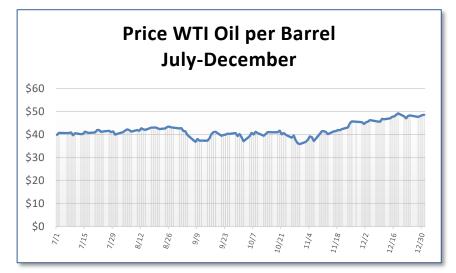
Oil production stabilized after three quarters of decline, with the index increasing to 1.0 from -15.4 in the

fourth quarter. The natural gas production index rose eight points to -2.1.

Oilfield services firms also saw improvement during this period. The equipment utilization index moved into positive territory, increasing 25 points to 6.4 in the fourth quarter, the first positive reading since the second quarter of 2019.

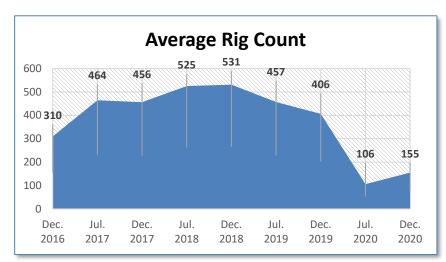
The price per barrel of WTI oil leveled off over the second half of 2020, recouping approximately 70% of the losses experienced earlier in the year.

Prices opened in July at \$39.81 per barrel before moving into the \$40



Source: MacroTrends

range for the remaining two quarters of the year, ending 2020 at \$48.52 per barrel. For the second half of the year, the average price per barrel was \$41.82.



Source: Baker Hughes

The Texas average rig count edged upward in quarter four after plunging from nearly 400 earlier in the year to July's low of just 106. The count moved up to 122 rigs in October and to 144 in November, before closing 2020 at 155.

AGRIBUSINESS

Continued drought conditions intensified in several north, west, and south Texas counties entering the third quarter of 2020, prompting Governor Greg Abbott to issue a disaster proclamation in October (since extended) to mitigate the threat to public health, property, and the economy.

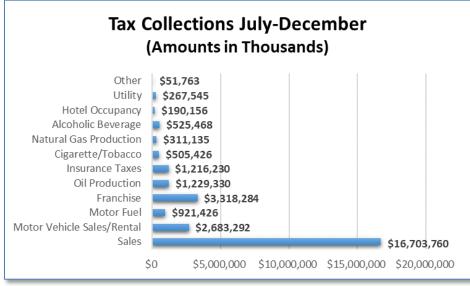
Persistent drought conditions and low commodity prices continued to be a concern, as producers of every crop saw yield and price damage. Loan renewals and extension increased in the third and fourth quarters. However, loan repayments steadily decreased during this period. Overall, loan volumes decreased across all major categories compared the previous year.

According to the FRB Dallas Agricultural Survey, producers in the fourth quarter of 2020 remained concerned about a possible dry winter diminishing 2021 crop prospects, while the livestock sector was facing a combination of lower cattle prices and higher feed costs.

The farmland values index grew in the second half of 2020; however, bankers reported the land was often not for agriculture purposes but for residential development. Some regions saw an influx of people interested in moving to rural areas from larger cities to the benefit of land prices.

TAX REVENUE

Tax collections over the last two quarters showed mixed results. Total tax revenue for the second half of 2020 equaled 29.2 billion, an increase over the \$26.7 billion the state collected in the first half, and up from \$28.4 billion the state collected in the second half of 2019.



Source: Texas Comptroller of Public Accounts

Third quarter tax and fee collections declined in multiple categories; however, data on net state revenue and tax collections across all funds showed signs of improvement in some areas by the end of 2020.

By December, sectors taxes on insurance increased 45.4% from the previous year to \$32.8 million, cigarette and tobacco taxes rose 11.2% YOY to \$126 million, and taxes on motor vehicle sales rentals increased 2.7% YOY to \$439 million.

Revenue decreased in other categories during the last month of 2020. Sales taxes, which comprise the largest category of general revenue taxes, fell from \$3 billion in November to \$2.9 billion in December. Other taxes and fees losing steam at year's end included motor fuel taxes, which declined 10.6% YOY; taxes on oil production, which dropped 45.5% YOY; and franchise taxes, which decreased 60.6% YOY.

SUPERVISORY CONCERNS

The departments strive to monitor and identify concerns surrounding the stability of the state's financial services industry and the impact on our regulated entities. Of primary concern in the second half of 2020 were the effects s of the COVID-19 pandemic.

Like all businesses, financial institutions faced uncertainties in interacting directly with consumers while trying to create a safe environment for employees and customers. Banks and thrifts exercised flexibility granted them to modify operations to continue serving the needs of their customers while monitoring the level of COVID-19 infections in their service area.

Considering the economic impact to Texas stemming from widespread shutdowns experienced during the pandemic, the departments were concerned that bank and thrift asset quality would deteriorate. However, by year's end, the level of past due and nonaccrual loans and leases increased only modestly during the pandemic. Loan deferrals were granted on a more limited basis, and the dollar volume of deferrals declined significantly from the first half of 2020.

Vaccines became available to certain demographics of the population in December 2020, and on Monday, March 29, 2021, the Texas Department of State Health Services announced that all individuals 16 and older were eligible to receive the COVID-19 vaccine. Both departments continue to monitor the distribution and use of these vaccines to determine when it is safe to return to pre-pandemic operations.

Examinations

As of the writing of this report, the Department of Banking continues to conduct examinations entirely offsite, examinations which are centered on core risks while still allowing examiners to properly evaluate the bank's condition. Current loan samples now include a portion of the bank's loans that may be more susceptible to the effects of the pandemic. Examiners maintain the ability to expand the scope of an examination if risk or circumstances warrant.

Using this new process, the Department finds it essential to contact bank management approximately two to three months before the examination start date. Further, examiners have found additional time is needed to resolve examination logistics such as obtaining requested information electronically and resolving potential technical issues that may impede gaining access to large volumes of imaged loan files.

The Department of Savings and Mortgage Lending, meanwhile, continues to conduct exams in accordance with traditional risk focused procedures. Technology improvements and close coordination with regulated entities has resulted in efficiencies in the examination process during the pandemic.

Lastly, both departments' examiners are planning ahead to establish periodic touch points or meetings with management to ensure that open communication remains in place throughout the examination.

Cybersecurity

Another negative effect of the pandemic was the significant rise in the number of reported cybersecurity incidents. Of particular concern was the rise of ransomware attacks.

Ransomware attacks, which can result in a sudden and unplanned suspension of critical core banking services, accelerated during the pandemic. Criminals began taking advantage of security vulnerabilities and the disruption caused by the massive shift toward working from home. As a result, ransomware became increasingly profitable for cyber thieves.

In response to this increase in cybercrime, the Department of Banking and other state financial regulators, in conjunction with the Bankers Electronic Crimes Task Force and the U.S. Secret Service, issued a self-assessment tool in October 2020 to help supervised financial institutions mitigate ransomware attacks.

The Ransomware Self-Assessment Tool (R-SAT) features 16 questions designed to help institutions assess their efforts to mitigate risks associated with ransomware and identify gaps for increasing security. The R-SAT provides a bank's executive management and board of directors with an overview of their preparedness toward identifying, protecting, detecting, responding, and recovering from a ransomware attack.

PPP Round 2

To continue assisting businesses through the pandemic, Texas state savings banks and commercial banks participated in the SBA PPP at the following levels as of year-end 2020, per information obtained from the FDIC database:

- State Savings Banks 11,846 PPP loans outstanding, with an outstanding balance of approximately \$1.2 billion.
- State Commercial Banks 110,481 PPP loans outstanding, with an outstanding balance of approximately \$14.6 billion.

The SBA, in consultation with the U.S. Treasury Department, reopened the PPP for First Draw Loans the week of January 11, 2021. First Draw Loans were reserved specifically for those businesses that did not participate in the first round of PPP. The SBA began accepting applications for Second Draw PPP Loans on January 13, 2021, for those businesses that participated in the first round of PPP in the spring of 2020.

On February 24, 2021, the SBA established a 14-day exclusive period for businesses and nonprofits with fewer than 20 employees to apply for PPP funding. To further facilitate underserved small businesses, the SBA announced four additional changes to the program:

- Allow sole proprietors, independent contractors, and self-employed individuals to receive more financial support by revising the PPP's funding formula for these categories of applicants;
- Eliminate an exclusionary restriction on PPP access for small business owners with prior nonfraud felony convictions, consistent with a bipartisan congressional proposal;
- Eliminate PPP access restrictions on small business owners who have struggled to make student loan payments by eliminating student loan debt delinquency as a disqualifier to participating in the PPP; and
- Ensure access for non-citizen small business owners who are lawful U.S. residents by clarifying that they may use their Individual Taxpayer Identification Number to apply for the PPP.

The second round of PPP is set to end March 31, 2021. However, there is a potential for the expiration date to be extended to May 31, 2021. As of March 7, 2021, total net PPP dollars lent since the program began in 2020 was approximately \$687 billion. Of this amount, \$165 billion was loaned in 2021. Loan forgiveness totals \$179 billion as of March 11, 2021.

87th Texas Legislature

The Texas Legislature convened on January 12, 2021, for its 140-day biennial session. The bill filing deadline was March 12, 2021 (60th day of session). Legislators filed 6,919 bills and joint resolutions by the deadline. Both departments are closely monitoring legislative activity and the potential impact to Texas banks and thrifts.

A summary of the most impactful legislative proposals to the departments and the industry is included below:

- Senate Bill (SB) 86 and companion bills House Bill (HB) 1668 and HB 2012, would establish annual reporting requirements to the Finance Commission for loans made to a business that is majority owned by one or more African Americans.
- SB 1714 would create the Texas Community Reinvestment Act and require the Department of Banking to assess a financial institution's efforts to meet the financial needs of the local community. The Department could examine for compliance with the Texas Fair Housing Act, the Equal Credit Opportunity Act, and the Home Mortgage Disclosure Act of 1975.
- HB 1195 and its companion SB 372 relate to the forgiveness of loans made through the PPP for state franchise tax purposes. These bills follow similar federal legislation contained in the Economic Aid to Hard-Hit Small Businesses, Nonprofits, and Venues Act (Economic Aid Act) passed in December 2020 which makes forgiven PPP loans exempt from federal income taxes.
- SB 516 and companion HB 3323 relate to increasing the criminal penalty for the offense of
 criminal mischief involving impairment or interruption of access to an ATM. These bills were filed
 due to an increasing number of ATM "smash and grab" crimes. As a result, the Texas Bankers
 Association created a task force on ATM crime which recommended <u>Best Practices</u> in the face of
 this growing problem.

DEPARTMENTAL SUPERVISORY MEASURES BEING TAKEN

TEXAS DEPARTMENT OF BANKING

- Assess and monitor the impact of COVID-19 on the Texas banking system and the financial service providers under the Department's supervision;
- Maintain regular contact with bank management regarding the bank's condition and the economic fallout from the COVID-19 pandemic;
- Assess bank management's efforts to properly identify and manage risks associated with the pandemic;
- Encourage banks to prudently work with their borrowers throughout the pandemic;
- Assess institutions' preparedness to identify, detect, respond to, protect against, and recover from cyber-attacks and perform follow-up evaluations for those below a base-line level of readiness:
- Investigate, assess, and oversee remediation and compliance efforts in response to institutions' material cybersecurity incidents;
- Monitor banks' transition from LIBOR to a substitute reference rate:
- Monitor efforts to prudently assess and mitigate concentration risks in commercial real estate, oil and gas, and agriculture lending;
- Assess risks posed by compressed interest margins in this historical low-rate environment;
- Monitor bank preparations for the industry's transition to CECL;
- Conduct off-site monitoring of institution's key financial performance metrics and analyze exceptions;
- Initiate measured and tailored regulatory responses and enforcement action as warranted;
- Conduct scheduled examinations of all institutions, and more frequent examinations or visitations of problem institutions;
- Communicate and coordinate joint enforcement actions and other supervisory activities with federal regulators;
- Monitor state, national, and world political and economic events impacting the industry; and
- Engage and increase internal communication and training to improve examiner awareness of pertinent issues.

DEPARTMENT OF SAVINGS AND MORTGAGE LENDING

- Assess and monitor industry and economic impacts to state savings banks;
- Engage in regular correspondence with state savings banks regarding institution-specific issues due to COVID-19 or other factors;
- Respond promptly to state or national events that can impact the state savings bank industry;
- Conduct off-site monitoring of each institution's activity (i.e., regulatory correspondence and approvals, independent audit reports, reports of examination, and institution responses to examination comments, criticisms, and recommendations);
- Assess interest rate risk:
- Assess short and long term funding strategies of state savings banks in the current economic environment;
- Monitor capital levels relative to risk profiles of state savings banks;
- Monitor lending, investment, and funding concentrations;
- Develop regular assessments of each institution's activities, strengths, weaknesses, revise the Department's plan of examination and monitoring for the institution, including the downgrading of institutions, if deemed necessary, by the Department and the primary federal regulator;
- Perform targeted examinations of high-risk areas of state savings bank in coordination with federal regulators;
- ❖ Participate in federal compliance examinations of each institution;
- Issue enforcement actions and place supervisory agents when deemed necessary;
- Engage in regular communication with state savings banks to raise awareness of evolving risks and trends, including cybersecurity, by means such as Emerging Issues monthly calls, and Thrift Industry Day on industry wide issues; and
- Provide training for thrift division staff on evolving risks and trends in the banking industry and changes in regulation.

PERFORMANCE SUMMARY AND PROFILE: TEXAS BANKING SYSTEM

STATE-CHARTERED BANKS

State-chartered banks' financial condition remained stable during 2020. For the year ending 2020, state-chartered banks reported a declining return on assets (ROA). The loss allowance for loans and leases (ALLL) to total loans remained at a reasonable 1.4%, while noncurrent assets plus other real estate owned stood at 0.5% of total assets. The core capital ratio position remained healthy.

State-chartered banks showed an anticipated decline in their ROA from 2019 to 2020 due to COVID-19. Commercial banks reported a ROA of 1.1% in 2020 compared to 1.5% in 2019. The core capital ratio for banks decreased from 10.8% to 9.8% during this period. Similarly, NIMs eroded 57 basis points (bp) due to a decreasing yield on earning assets. Overall, 48% of our state-chartered banks reflect earnings gains over the prior year. Conversely, 5.1% of the banks ended the year unprofitable, which is a slight increase from 2.7% last year.

Net charge-offs increased during the last 12 months, but were lower than initially expected due to the effects of COVID-19 on the Texas economy. Bank charge-offs increased to 0.2% of total loans from 0.1% a year ago. This compares favorably to the nationwide average of 0.5%. State-chartered banks appear to have adequate reserves to absorb potential losses.

For the year 2020, the number of state bank charters reduced by seven through mergers and acquisitions while total assets increased by \$60.8 billion. The number of other states' state-chartered banks doing business in Texas rose by three. Total assets of these institutions increased \$13.1 billion. The number of national banks chartered in Texas decreased by three while national banks chartered in other states and operating in Texas remained at the same level. Total assets of national banks in Texas increase by \$139.6 billion.

The financial results to date are in line with economic comments throughout this report that indicate the banking system in general is sound, and despite some hardships our bankers and the Texas economy sustained over the last year, state-chartered banks managed to perform with remarkable strength.

STATE-CHARTERED THRIFTS

From June 30, 2020, to December 31, 2020, state thrifts had \$1.5 billion in net income and a total of \$3.0 billion in net income for all of 2020, with the largest institution's year-to-date net income of \$2.6 billion. The pretax return on average assets remains strong at 1.2%. From June 30, 2020, to December 31, 2020, non-interest income to assets remained the same, but non-interest expense to assets decreased 6 bp.

The Texas thrift ratio of nonperforming loans plus other real estate owned to total assets has declined from 0.1% to 0.07% since June 30, 2020, and remains minimal. Loan and lease loss provisions for 2020 totaled \$98 million with the qualitative economic factors for the pandemic being the primary driver.

Total risk-based capital ratio for the total industry increased 61 bp to 19% from June to year-end, primarily due to the low-risk asset growth at the largest thrift institution. Additionally, total capital levels improved due to increased retained earnings as dividends were reduced. Three state savings banks elected to use the Community Bank Leverage Ratio in the fourth quarter 2020, and therefore, do not report any capital ratios other than the leverage ratio.

As of December 31, 2020, 100% of the thrifts continued to be rated a Composite 1 or 2 based on the Uniform Financial Institutions Rating System. The Department considers any institution with a composite rating of a 3, 4, or 5 a problem institution.

NUMBER OF INSTITUTIONS AND TOTAL ASSETS

FDIC financial data is reflective of FDIC insured institutions only.

Assets in Billions

	12-31	-2020	12-31	-2019	Differ	ence
	No. of <u>Institutions</u>	<u>Assets</u>	No. of <u>Institutions</u>	<u>Assets</u>	No. of <u>Institutions</u>	<u>Assets</u>
Texas State-Chartered Banks Texas State-Chartered Thrifts	217 <u>23</u> 240	\$345.3 <u>\$395.3</u> \$740.6	224 <u>23</u> 247	\$284.5 <u>\$27.4</u> \$311.9	-7 <u>0</u> -7	+\$60.8 +\$367.9 +\$428.7
Other states' state-chartered: Banks operating in Texas* Thrifts operating in Texas*	45 <u>0</u> 45	\$83.9 <u>0</u> \$83.9	42 <u>0</u> 42	\$70.8 <u>0</u> \$70.8	+3 <u>0</u> +3	+\$13.1 <u>0</u> +\$13.1
Total State-Chartered Activity	285	\$824.5	289	\$382.7	-4	+\$441.8
National Banks Chartered in Texas Federal Thrifts Chartered in Texas Other states' federally-chartered:	166 <u>4</u> 170	\$167.0 <u>\$111.1</u> \$278.1	169 <u>4</u> 173	\$142.8 \$90.8 \$233.6	-3 <u>0</u> -3	+\$24.2 +\$20.3 +44.5
Banks operating in Texas* Thrifts operating in Texas*	30 <u>5</u> 35	\$547.2 <u>\$0.9</u> \$548.1	30 <u>6</u> 36	\$431.8 <u>\$1.0</u> \$432.8	0 <u>-1</u> -1	+\$115.4 - <u>\$0.1</u> +\$115.3
Total Federally-Chartered Activity	205	\$826.2	209	\$666.4	-4	+159.8
Total Banking/Thrift Activity	490	\$1,650.7	498	\$1,049.1	-8	+\$601.6

^{*}Indicates estimates based on available FDIC information.

RATIO ANALYSIS

As of December 31, 2020 FDIC financial data is reflective of FDIC insured institutions only.

	State- Chartered <u>Banks</u> 217	Texas National <u>Banks</u> 166	All Texas <u>Banks</u> 383	State- Chartered <u>Thrifts</u> 23	Texas Federal <u>Thrifts</u> 4	All Texas <u>Thrifts</u> 27
% of Unprofitable Institutions	5.07%	0.60%	3.13%	NA	50.00%	7.41%
% of Institutions with Earnings Gains	47.93%	46.99%	47.52%	52.17%	NA	44.44%
Yield on Earning Assets	3.60%	3.59%	3.60%	1.81%	4.11%	2.33%
Net Interest Margin	3.21%	3.15%	3.19%	1.74%	3.91%	2.23%
Return on Assets	1.14%	1.01%	1.10%	0.92%	-0.26%	0.64%
Return on Equity	9.27%	9.73%	9.41%	12.87%	-2.79%	8.35%
Net Charge-offs to Loans	0.24%	0.35%	0.28%	0.05%	1.20%	0.70%
Earnings Coverage of Net Loan C/Os	11.38	6.87	9.49	234.51	0.73	7.63
Loss Allowance to Loans	1.44%	1.33%	1.41%	0.58%	2.75%	1.71%
Loss Allowance to Noncurrent Loans	182.99%	151.08%	171.79%	90.94%	47.84%	51.82%
Noncurrent Assets+OREO to Assets	0.52%	0.55%	0.43%	0.07%	2.21%	0.54%
Net Loans and Leases to Core Deps	75.14%	74.00%	74.76%	11.22%	47.58%	18.50%
Equity Capital to Assets	11.84%	10.28%	11.34%	6.75%	8.49%	7.13%
Core Capital (Leverage) Ratio	9.77%	9.45%	9.66%	5.73%	7.84%	6.20%
Total Risk-Based Capital Ratio	14.73%	15.03%	14.82%	19.04%	16.72%	18.30%

Data for other state-chartered institutions doing business in Texas is not available and therefore excluded. Information derived from the FDIC website.

RATIO ANALYSIS BY ASSET GROUPS FOR STATE-CHARTERED BANKS

As of December 31, 2020 FDIC financial data is reflective of FDIC insured institutions only. Assets in Billions

	< <u>\$1</u> 177	<u>\$1 - \$10</u> 34	<u>>\$10</u> 6
% of Unprofitable Institutions	6.21%	NA	NA
% of Institutions with Earnings Gains	46.33%	58.82%	33.33%
Yield on Earning Assets	4.16%	4.04%	3.27%
Net Interest Margin	3.62%	3.48%	2.99%
Return on Assets	1.24%	1.20%	1.09%
Return on Equity	10.66%	9.88%	8.71%
Net Charge-offs to Loans	0.09%	0.18%	0.31%
Earnings Coverage of Net Loan C/Os	27.88	14.45	9.44
Loss Allowance to Loans	1.21%	1.33%	1.55%
Loss Allowance to Noncurrent Loans	233.15%	134.81%	202.92%
Noncurrent Assets+OREO to Assets	0.40%	0.68%	0.48%
Net Loans and Leases to Core Deps	74.58%	84.03%	71.77%
Equity Capital to Assets	11.31%	12.17%	11.84%
Core Capital (Leverage) Ratio	10.90%	10.61%	9.12%
Total Risk-Based Capital Ratio	17.61%	16.63%	13.74%

RATIO ANALYSIS BY ASSET GROUPS FOR STATE-CHARTERED THRIFTS

As of December 31, 2020 FDIC financial data is reflective of FDIC insured institutions only. Assets in Billions

	< <u>\$1</u> 14	<u>\$1 - \$10</u> 7	<u>>\$10</u> 2
% of Unprofitable Institutions	NA	NA	NA
% of Institutions with Earnings Gains	35.71%	100.00%	NA
Yield on Earning Assets	4.61%	5.12%	1.62%
Net Interest Margin	3.85%	4.39%	1.60%
Return on Assets	0.85%	1.29%	0.90%
Return on Equity	8.06%	11.59%	13.06%
Net Charge-offs to Loans	0.13%	0.13%	0.00%
Earnings Coverage of Net Loan C/Os	12.71	20.18	NA
Loss Allowance to Loans	0.89%	1.36%	0.13%
Loss Allowance to Noncurrent Loans	138.51%	121.74%	33.33%
Noncurrent Assets+OREO to Assets	0.48%	0.84%	0.02%
Net Loans and Leases to Core Deps	92.06%	117.73%	7.15%
Equity Capital to Assets	9.89%	10.78%	6.53%
Core Capital (Leverage) Ratio	10.18%	10.29%	5.48%
Total Risk-Based Capital Ratio	17.26%	13.24%	19.85%

COMPARISON REPORT

Select Balance Sheet and Income/Expense Information FDIC financial data is reflective of FDIC insured institutions only.

December 31, 2020

	State Banks*		State T	hrifts
	End of Period	% of Total Assets	End of Period	% of Total Assets
Number of Institutions	217		23	
Number of Employees (full-time equivalent) (In millions)	41,233		3,946	
Total Assets	\$345,340		\$395,293	
Net Loans and Leases	\$200,888	58.17%	\$39,139	9.90%
Loan Loss Allowance	\$2,937	0.85%	\$227	0.06%
Other Real Estate Owned	\$188	0.05%	\$10	0.00%
Goodwill and Other Intangibles	\$8,281	2.40%	\$329	0.08%
Total Deposits	\$286,638	83.00%	\$364,247	92.15%
Federal Funds Purchased and Repurchase Agreements	\$3,839	1.11%	\$21	0.01%
Other Borrowed Funds	\$9,177	2.66%	\$2,017	0.51%
Equity Capital	\$40,908	11.85%	\$26,697	6.75%
Memoranda:				
Noncurrent Loans and Leases	\$1,605	0.46%	\$249	0.06%
Earning Assets	\$316,448	91.63%	\$391,943	99.15%
Long-term Assets (5+ years)	\$86,972	25.18%	\$279,010	70.58%
	Year-to-Date	<u>% of Avg.</u> <u>Assets</u> †	Year-to-Date	% of Avg. Assets†
Total Interest Income	\$10,497	3.29%	\$5,901	1.79%
Total Interest Expense	\$1,135	0.36%	\$213	0.06%
Net Interest Income	\$9,362	2.93%	\$5,688	1.73%
Provision for Loan and Lease Losses	\$1,356	0.42%	\$98	0.03%
Total Noninterest Income	\$3,849	1.21%	\$180	0.05%
Total Noninterest Expense	\$7,714	2.42%	\$1,899	0.58%
Securities Gains	\$215	0.07%	\$33	0.01%
Net Income	\$3,644	1.14%	\$3,027	0.92%
Memoranda:				
Net Loan Charge-offs	\$483	0.15%	\$17	0.01%
Cash Dividends	\$2,293	0.72%	\$37	0.01%

^{*}Excludes branches of state-chartered banks of other states doing business in Texas. As of December 31, 2020, there are an estimated 45 out-of-state state-chartered institutions with \$83.9 billion in assets. Assets are based upon the June 30, 2020, FDIC Summary of Deposits.

†Income and Expense items as a percentage of average assets are annualized.

No branches of state-chartered thrifts of other states conducted business in Texas as of December 31, 2020.

PERFORMANCE SUMMARY: UNITED STATES BANKING SYSTEM

FDIC QUARTERLY BANKING PROFILE

Fourth Quarter 2020 - <u>www.fdic.gov</u>
All Institutions Performance

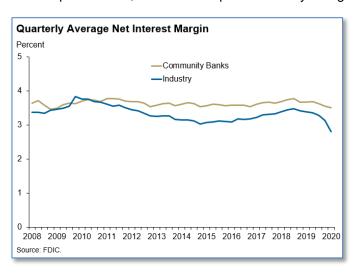
For the commercial banks and savings institutions insured by the FDIC, aggregate net income totaled \$59.9 billion in fourth quarter 2020, an increase of \$5 billion (9.1%) from a year ago. The improvement in quarterly net income was led by a reduction in provision expenses.

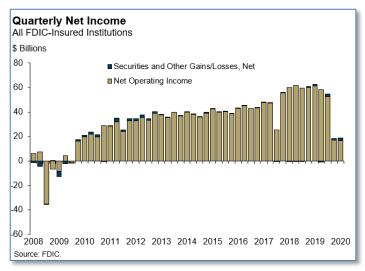
↓ Full-Year 2020 Net Income Declines 36.5 Percent to \$147.9 Billion

For the 5,001 FDIC-insured commercial banks and savings institutions, full-year 2020 net income totaled \$147.9 billion, a decline of \$84.9 billion (36.5%) from 2019. The decline was primarily attributable to higher provision expenses in the first half of 2020 tied to pandemic-related deterioration in economic activity. Provision expenses increased by \$77.1 billion (140%), and net interest income declined by \$20 billion (3.7%). Average NIM declined by 54 basis points from 2019 to 2.82%, as the yield on average earning assets declined at a faster rate than the cost of funds. The average ROA declined from 1.29% in 2019 to 0.72% in 2020.

↑ Quarterly Net Income Increases 9.1 Percent From a Year Ago to \$59.9 Billion

Fourth quarter 2020 quarterly net income totaled \$59.9 billion, an increase of \$5 billion (9.1%) from a year ago. The primary driver of higher net income this quarter was the reduction in provision expenses. More than half of all banks (57.4%) reported YOY increases in quarterly net income. The share of unprofitable institutions remained relatively stable from a year ago at 7.3%. The average ROA ratio was 1.11% during fourth quarter 2020, down 8 basis points from a year ago





but below a recent high of 1.41% in third quarter 2018.

Net Interest Margin Remains Unchanged From Third Quarter and at a Record Low Level

The banking industry reported aggregate net interest income of \$131.3 billion during the fourth quarter, a decline of \$5.4 billion (3.9%) from a year ago. This marks the fifth consecutive quarter that net interest income declined. Almost 43% of all banks reported

annual declines in net interest income. The average NIM was 2.68% in fourth quarter 2020, unchanged from the third quarter but down 60 basis points from fourth quarter 2019. Banks of all asset size groups featured in the Quarterly Banking Profile (QBP) reported average NIM compression relative to a year ago, as the contraction in earning asset yields exceeded the decline in funding costs. At fourth quarter 2020, both earning asset yields and funding costs dropped to the lowest levels ever reported in the QBP.

Noninterest Income Expands 6.5 Percent From the Year-Ago Quarter

Noninterest income rose by \$4.3 billion (6.5%) from a year ago, with nearly 61% of all banks reporting annual increases. The annual improvement in noninterest income was led by the growth in net gains on loan sales, which rose by \$3.9 billion (104%), and net gains on sales of other assets, which increased by \$1.6 billion. Trading revenue, which was the largest dollar contributor to the overall increase in noninterest income during second quarter 2020, declined for the second consecutive quarter and was down \$799.7 million (11%) from fourth quarter 2019.

■ Noninterest Expense Increases Almost 3 Percent From a Year Ago

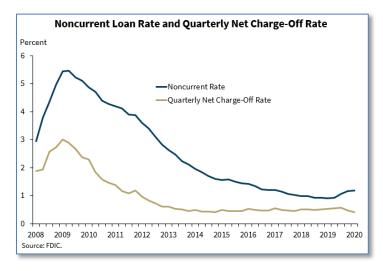
Noninterest expense rose by \$3.3 billion (2.7%) from a year ago, as almost two-thirds of all banks (66.4%) reported annual increases. The rise in noninterest expense was driven by higher salary and employee benefit expenses, which expanded by \$3.7 billion (6.6%). The average assets per employee increased from \$9 million in fourth quarter 2019 to \$10.6 million in fourth quarter 2020.

Provisions for Credit Losses Decline to the Lowest Level Since Second Quarter 1995

With the improving economic outlook, provisions for credit losses decreased by \$11.4 billion (76.5%) from a year ago to \$3.5 billion, the lowest level since second quarter 1995. The decline in provisions for credit losses was not broad-based, as less than one-third (31.2%) of all banks reported year-over-year declines. In the fourth quarter, 279 banks used the current expected credit losses (CECL) accounting standard and reported an aggregate \$1.4 billion in provisions for credit losses, down \$11.2 billion (88.9%) from a year ago. For non-CECL adopters, provisions for credit losses totaled \$2.1 billion, down \$186.6 million (8.2%) from a year ago.

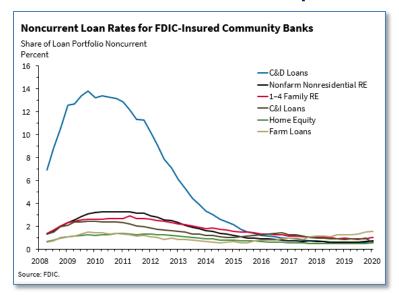
↑ The Net Charge-Off Rate Falls 13 Basis Points From Fourth Quarter 2019

The net charge-off rate fell by 13 basis points from fourth quarter 2019 to 0.41%. Net charge-offs totaled \$11.2 billion, down \$2.8 billion (19.7%) from a year ago. The vear-over-vear decline in net charge-offs was driven by the reduction in credit card loan charge offs (down \$3.4 billion, or 39.7%). Net charge-offs on nonfarm nonresidential (NFNR) properties increased by \$657.9 million (348.3%) from a year ago. The net charge-off rate for NFNR properties increased by 17 basis points from a year ago to 0.22 % but remained below the high of 1.40 % in fourth guarter 2010. The net charge-off rate for the commercial and industrial (C&I) loan portfolio increased by 4 basis points



from a year ago to 0.47%, below the recent high of 0.64% in second quarter 2020.

The Noncurrent Loan Rate Expands Modestly to 1.18 Percent

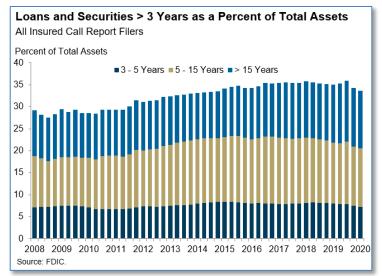


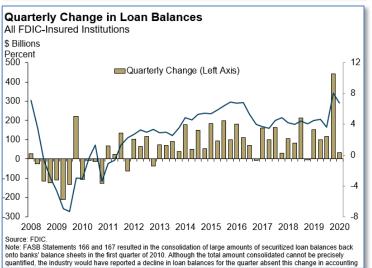
The noncurrent rate rose by 1 basis point from third quarter 2020 to 1.18%. Noncurrent loan balances (90 days or more past due or in nonaccrual status) increased by \$944.9 million (0.7%) from the previous quarter. One-third of all banks (33.3%) reported quarterly increases in noncurrent loan balances. The quarterly increase in noncurrent loan balances was led by NFNR properties (up \$2.1 billion, or 15.7%) and credit card balances (up \$1.4 billion, or 17%). The noncurrent rate for NFNR properties increased by 13 basis points to 1.00% in the fourth quarter 2020, while the noncurrent rate for credit card balances rose by 13 basis points to 1.16%.

Total assets increased by \$664 billion (3.1%) from third quarter 2020. The banking industry's liquidity position continued to strengthen. Cash and balances due from depository institutions rose by \$357 billion (12.6%), and security holdings posted a record high quarterly dollar increase of \$321.4 billion (6.7%). Mortgage-backed securities increased by \$244.9 billion (8.8%).

Loan Balances Decline From the Previous Quarter, Led by Lower Commercial and Industrial Lending Activity

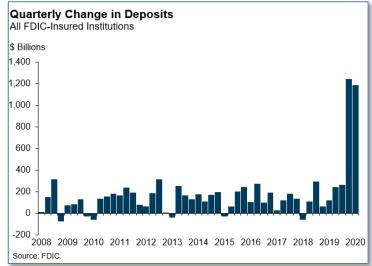
Total loan and lease balances totaled \$10.9 trillion in fourth quarter 2020, \$47.7 billion (0.4%) less than third quarter 2020. The quarterly decline in total loan and leases balances was led by the C&I loan portfolio, which fell by \$103.8 billion (4.1%). Small Business Administrationguaranteed Paycheck Protection Program loans declined by \$83.9 billion (17.1%) from the previous guarter. The decline in the C&I loan portfolio was partially offset by increases in loans to nondepository financial institutions (up \$30.2 billion, or 5.5%) and credit card balances (up \$25.6 billion, or 3.2%). Total loan and lease balances increased by \$345 billion (3.3%) from a year ago, the lowest annual growth rate since fourth guarter 2013. The annual increase in total loan and lease balances was driven by the C&I loan portfolio, which rose by \$232.8 billion (10.6%), primarily in the first half of 2020.





1 Deposits Increase 4.1 Percent From Third Quarter 2020

Total deposit balances rose by \$706.9 billion (4.1%) between the third and fourth quarters of 2020. While the quarterly growth in deposits is below the levels reported in the first half of 2020, it is the third largest quarterly dollar increase ever reported in the QBP. Interestbearing account balances rose by \$399.2 billion (3.5%), and noninterest-bearing account balances expanded by \$220.5 billion (5%). Deposits in accounts with balances larger than \$250,000 increased by \$467.5 billion (5.4%) from the previous quarter. Nondeposit liabilities fell by \$124.2 billion (11.1%) from the previous quarter, led by Federal Home Loan Bank advances that declined by \$48.5 billion (15.9 %).



Equity capital totaled \$2.2 trillion in fourth quarter 2020, up \$41.9 billion (1.9%) from the previous quarter. Declared dividends totaled \$21.8 billion, down \$27.4 billion (55.7%) from fourth quarter 2019. Seven insured institutions with \$498.4 million in total assets were below the requirements for the well-capitalized category as defined for Prompt Corrective Action.

Three New Banks Open in Fourth Quarter 2020

The number of FDIC-insured commercial banks and savings institutions that filed quarterly Call Reports declined from 5,033 in third quarter 2020 to 5,001 in fourth quarter 2020. Three new banks were added, 31 institutions were absorbed by mergers, two banks failed, one bank sold most of its assets to a credit union, and one bank did not file in time for this analysis. For full-year 2020, six new banks were added, 168 institutions were absorbed by mergers, and four banks failed. The number of institutions on the FDIC's "Problem Bank List" remained unchanged from the previous quarter at 56. Total assets of problem banks increased from \$53.9 billion in third quarter 2020 to \$55.8 billion in fourth quarter 2020.

SNAPSHOT STOCK PERFORMANCE SOUTHWEST REGIONAL BANKS (MSECTOR415) MARCH 2021

Name	Last	Trade	52 Wk Ra		PE	EPS	Mkt Cap	Div/Shr	Div Yld
ACNB Corporation	03/05	30.32	19.00	32.66	14.23	2.13	263.841M	1.00	3.53%
BancFirst Corporation	03/05	68.03	26.00	69.66	22.68	3.00	2.228B	1.36	1.99%
BOK Financial Corporation	03/05	92.47	34.57	94.00	14.94	6.19	6.434B	2.08	2.26%
Cass Information Sys, Inc.	03/05	44.90	28.85	45.45	25.95	0.84	646.304M	1.08	2.41%
Commerce Bancshares, Inc.	03/05	75.05	43.34	79.08	25.82	2.91	8.787B	1.05	1.39%
Cullen Frost Bankers, Inc.	03/05	107.57	47.69	110.17	21.06	5.11	6.795B	2.88	2.68%
Enterprise Fin Serv Corp	03/05	45.25	21.70	46.68	16.31	2.76	1.406B	0.72	1.58%
First Community Corp S C	03/05	19.61	12.23	19.74	14.53	1.35	146.936M	0.48	2.70%
First Financial Bankshares, Inc.	03/05	44.94	20.70	47.45	31.64	1.42	6.392B	0.52	1.12%
First Financial Northwest, Inc.	03/05	13.94	7.90	14.00	15.86	0.88	135.752M	0.44	3.20%
Great Southern Bancorp, Inc.	03/05	56.46	32.23	57.08	13.41	4.21	776.472M	1.36	2.46%
Guaranty Fed Bancshares, Inc.	03/05	18.62	12.70	23.50	11.86	1.57	81.26M	0.60	3.19%
Heartland Financial USA, Inc.	03/05	49.93	25.26	50.88	13.99	3.57	2.102B	0.88	1.78%
International Bancshares Corp	03/05	47.71	15.60	48.47	18.21	2.62	3.02B	1.10	2.45%
Landmark Bancorp, Inc.	03/05	27.00	14.95	27.78	6.59	4.10	128.273M	0.80	3.08%
Mackinac Financial Corp	03/05	14.63	6.52	14.92	11.52	1.27	154.142M	0.56	4.20%
MidWest One Finl Group, Inc.	03/05	29.78	15.25	30.50	72.63	0.41	476.98M	0.90	3.07%
North Dallas Bank & Trust Co.TX	03/05	80.00	72.00	80.00	22.41	3.57	98.396M	1.00	1.25%
Prosperity Bancshares, Inc.	03/05	74.84	42.02	77.30	13.18	5.68	6.955B	1.96	2.60%
QCR Holdings, Inc.	03/05	43.38	22.39	44.50	11.42	3.80	685.73M	0.24	0.56%
Solera National Bancorp, Inc.	03/05	11.95	8.00	12.00	8.43	1.42	16.349M	N/A	N/A
Texas Capital Bancshares, Inc.	03/05	81.59	19.10	83.92	72.85	1.12	4.126B	N/A	N/A
Two Rivers Fin Group	03/05	34.75	22.16	36.00	12.50	2.78	77.618M	0.66	1.90%

Source: Yahoo Finance (March 2021)

N/A – Indicates information was not available.

SNAPSHOT STOCK PERFORMANCE SOUTHWEST REGIONAL BANKS (MSECTOR415) MARCH 2020

Name	Last	Trade	52 Wk Ra		PE	EPS	Mkt Cap	Div/Shr	Div Yld
ACNB Corporation	03/11	27.82	27.64	39.57	8.28	3.36	241.46M	1.00	3.55%
BancFirst Corporation	03/11	37.12	35.89	63.96	9.17	4.05	1.214B	1.28	3.38%
BOK Financial Corporation	03/11	47.39	45.31	88.70	6.74	7.03	3.35B	2.04	3.97%
Cass Information Sys, Inc.	03/11	37.66	37.14	60.97	18.19	2.07	728.812M	1.08	2.73%
Commerce Bancshares, Inc.	03/11	53.53	51.68	71.92	14.96	3.58	6B	1.08	1.91%
Cullen Frost Bankers, Inc.	03/11	56.45	50.17	104.53	8.22	6.86	3.538B	2.84	4.64%
Enterprise Fin Serv Corp	03/11	29.89	29.68	48.81	8.42	3.55	793.98M	0.72	2.24%
First Community Corp S C	03/11	17.10	16.81	22.00	11.79	1.45	127.225M	0.48	2.74%
First Financial Bankshares, Inc.	03/11	24.06	23.61	36.45	19.88	1.21	3.422B	0.48	1.84%
First Financial Northwest, Inc.	03/11	11.87	11.31	17.24	11.52	1.03	121.703M	0.40	3.30%
Great Southern Bancorp, Inc.	03/11	42.60	42.01	64.48	8.29	5.14	605.465M	1.36	3.05%
Guaranty Fed Bancshares, Inc.	03/11	23.02	21.89	26.93	10.91	2.11	99.287M	0.60	2.61%
Heartland Financial USA, Inc.	03/11	33.65	33.18	51.85	8.13	4.14	1.237B	0.80	2.22%
International Bancshares Corp	03/11	27.45	27.12	44.00	8.80	3.12	1.79B	1.10	3.73%
Landmark Bancorp, Inc.	03/11	20.40	19.01	26.00	8.83	2.31	93.787M	0.80	3.81%
Mackinac Financial Corp	03/11	12.20	11.26	17.75	9.46	1.29	131.134M	0.56	4.17%
MidWest One Finl Group, Inc.	03/11	24.31	23.94	39.03	8.30	2.93	392.822M	0.88	3.11%
North Dallas Bank & Trust Co.TX	03/11	73.99	70.05	84.51	15.54	4.76	95.793M	1.00	1.32%
Prosperity Bancshares, Inc.	03/11	50.98	48.88	75.22	11.29	4.52	4.836B	1.84	2.80%
QCR Holdings, Inc.	03/11	33.20	31.56	44.76	9.22	3.60	525.493M	0.24	0.60%
Solera National Bancorp, Inc.	03/11	9.11	9.11	11.80	10.44	0.87	13.483M	N/A	N/A
Texas Capital Bancshares, Inc.	03/11	32.29	31.11	66.61	5.20	6.21	1.626B	N/A	N/A
Two Rivers Fin Group	03/11	30.29	30.10	33.50	8.58	3.53	67.656M	0.64	1.99%

Source: Yahoo Finance (March 2020)

N/A – Indicates information was not available.

NATIONAL ECONOMIC TRENDS

Real Gross Domestic Product



Consumer Price Index

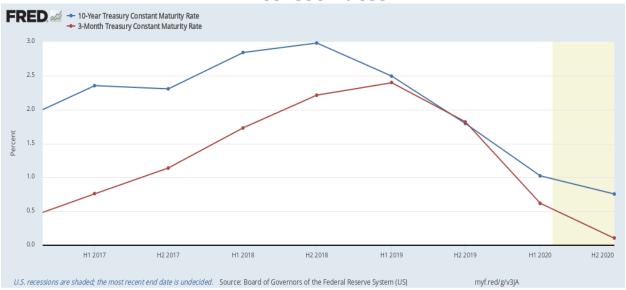


Source: Federal Reserve Bank of St. Louis, National Economic Trends, March 2021.





Interest Rates



Source: Federal Reserve Bank of St. Louis, National Economic Trends, March 2021.

ECONOMIC REPORTS AND FORECASTS: UNITED STATES

FEDERAL RESERVE BANK, DALLAS NATIONAL UPDATE

March 2021 - www.dallasfed.org 1

COVID-19 Risks Expose Vulnerabilities, Downside Risks to U.S. Outlook

The COVID-19 crisis has adversely affected the U.S. economy, helping account for a projected 3.4% contraction in 2020. The Congressional Budget Office (CBO) anticipates a strong 4.6% rebound in 2021, making up for those losses.

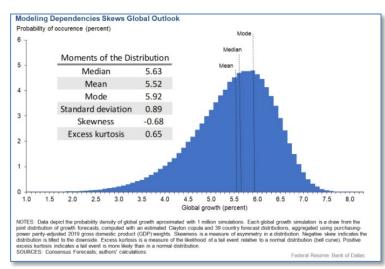
To assess the risks to the U.S. outlook and expose some of the underlying vulnerabilities, we make use of statistical tools to stress test U.S. gross domestic product (GDP) growth. We argue that a conservative assessment of the interdependencies highlighted by the COVID-19 crisis across countries suggests that projections for 2021 may be susceptible to the systemic risk that the pandemic poses.

Downside Risks Weigh on 2021 Global Outlook

We previously explored the importance of tail-risk events in the outlook for 2021 global growth; we examined historical evidence about cross-country dependencies in annual GDP growth from 1994 to 2019 for a sample of 39 countries, representing 78.4% of global GDP in 2019.

The joint forecast distribution over all likely outcomes is based on an estimated Clayton copula—a distribution function utilizing probability theory to highlight dependencies among tail events across countries. It covers December 2020 forecast distributions of 2021 annual GDP growth for the 39 countries, as reported by Consensus Forecasts.

We estimate a distribution of the global output growth forecasts for 2021—incorporating significant left-tail dependencies (systemic risk)—while weighting each country according to its share of purchasing-power-parity adjusted global output in 2019. Purchasing power parity provides a common basis of valuing output across countries.



Source: Federal Reserve Bank of Dallas (Chart 1)

In some respects, Chart 1 is a conservative scenario, because recent data don't appear to include widespread cross-country, correlated tail events such as those associated with the pandemic. Nonetheless, even these estimates of cross-country tail dependence result in a distribution of global growth forecasts tilted to the downside.

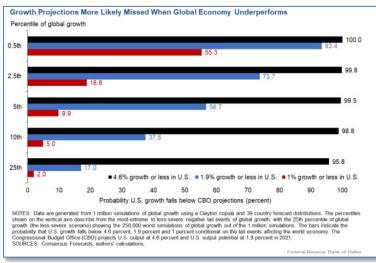
¹ Jarod Coulter and Enrique Martínez-García

In a distribution with the long left tail of Chart 1, the severity and likelihood of growth underperformance increases. Such systemic risk—negative outcomes correlated across countries—suggests greater likelihood of downside risk to the global outlook.

Stress Testing the U.S. Outlook Amid Global Risks

This conservative scenario involving systemic risk can be applied when looking at the U.S. outlook. Stress testing for adverse tail events is used regularly to evaluate the vulnerability of the financial system. It can also provide valuable insights about the resilience—or lack thereof—of the U.S. economy.

To stress test the U.S. outlook, we simulate 2021 global growth 1 million times—using our estimated Clayton copula and data from Consensus Forecasts—and focus on a subset of the worst global outcomes. The mean growth rate for this simulation was 5.5%. We break down the outcomes by their severity, ranging from the worst 0.5% of outcomes (global growth below 2.7%) to the worst 25% of outcomes (global growth below 5%).



Source: Federal Reserve Bank of Dallas (Chart 2)

By analyzing how the U.S. performs in simulations where the global economy performs poorly, we can assess how robust the U.S. is to globally correlated negative shocks at the left tail of the distribution.

We consider three benchmark scenarios for the U.S. economy in Chart 2. In the first one, we consider how likely it is that the U.S. economy would underperform the CBO's 4.6% projected growth in 2021. We also consider two others: the probability that the U.S. grows below the CBO's estimate of U.S. output potential—the CBO's estimate of maximum sustainable U.S. output—set at 1.9% for 2021, and the probability that U.S. growth falls below 1%.

The three scenarios illustrate U.S. economic performance and that of the rest of the world—in particular, the impact should worst-case scenarios of the global growth outlook materialize.

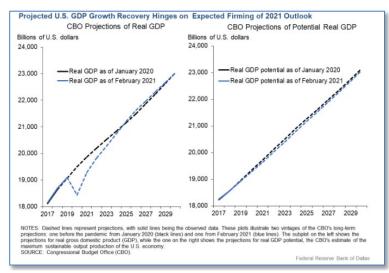
Learning from Vulnerabilities that Systemic Risk Poses

In this stress-testing exercise, the U.S. expansion appears quite vulnerable when poor global growth occurs. Our evidence suggests that even tail events that are not particularly severe are expected to often coincide with U.S. output growth below the CBO's 4.6% estimate. In fact, the odds are quite great that U.S. output growth could end up below the CBO's 1.9% GDP potential in the worst-case global growth scenarios that we have considered.

The more extreme the negative global growth outcome becomes, the more likely that the U.S. recovery would falter in 2021. For the starkest case of rare negative tail events—the worst 0.5% of scenarios—the odds of U.S. growth below potential are 93.4%, and the likelihood that U.S. growth falls below 1% is 55.3%.

If we zoom out a little, 25% of the time the U.S. has at best a 4.2% chance of meeting its CBO growth estimate. This has significant implications for policymakers. Global spillovers, whether through trade or financial channels, expose the U.S. to the consequences of globally correlated (systemic) shocks such as those that arose during the pandemic.

Even if the virus could be contained domestically, the U.S. economy would still suffer the impact of weak global demand and global supply chain and financial disruptions, as well as heightened uncertainty and likely greater asset price volatility.



Source: Federal Reserve Bank of Dallas (Chart 3)

The left panel of Chart 3 is the CBO's forecast of real (inflation-adjusted) GDP for the next decade. The right panel plots the CBO's estimate of the maximum sustainable output for the U.S. economy (U.S. GDP potential).

The pandemic may have resulted in a modest erosion of the U.S. long-term potential. However, 2021 is going to be a pivotal year on the road to a sustained recovery of the real GDP toward prerecession levels, long-term CBO projections suggest.

If U.S. growth falters in 2021 as a result of pandemic-related vulnerabilities, the path of recovery will likely require reassessment. The longer the recession

drags on, the more significant the impact on the U.S. economy's potential can become—mostly through its impact driving up long-run unemployment—and the longer it may take for real GDP to return to its prerecession path.

Cautiously Looking at 2021 and Beyond

Modeling tail-event dependencies and deploying stress-testing practices can bring to light not just the vulnerabilities of the global economy but also the exposure of the U.S. economy to globally correlated shocks.

After the COVID-19 crisis unexpectedly hit the global economy in 2020, it became apparent that a more transparent and quantitative way of risk modeling can be useful to spot vulnerabilities caused by tail events and cross-country dependencies. Such a toolkit can also be useful to better manage the risk and maintain public confidence.

U.S. ECONOMY AT A GLANCE U.S. BUREAU OF LABOR STATISTICS

Data Series	July 2020	Aug 2020	Sept 2020	Oct 2020	Nov 2020	Dec 2020
Unemployment Rate (1)	10.2	8.4	7.8	6.9	6.7	6.7
Change in Payroll Employment (2)	1,761	1,583	716	680	264	(P) -227
Average Hourly Earnings (3)	29.35	29.47	29.50	29.52	29.61	^(P) 29.90
Consumer Price Index (4)	0.6	0.4	0.2	0.1	0.2	0.2
Producer Price Index (5)	0.6	0.2	0.3	(P) 0.5	(P) 0.1	(P) 0.3
U.S. Import Price Index (6)	1.2	0.9	0.2	-0.1	^(R) 0.1	^(R) 1.0

Footnotes:

- (1) In percent, seasonally adjusted. Annual averages are available for Not Seasonally Adjusted data.
- (2) Number of jobs, in thousands, seasonally adjusted.
- (3) Average Hourly Earnings for all employees on private nonfarm payrolls.
- (4) All items, U.S. city average, all urban consumers, 1982-84=100, 1-month percent change, seasonally adjusted.
- (5) Final Demand, 1-month percent change, seasonally adjusted.
- (6) All imports, 1-month percent change, not seasonally adjusted.
- (P) Preliminary.
- (R) Revised.

Data Series	4th Qtr 2019	1st Qtr 2020	2nd Qtr 2020	3rd Qtr 2020	4th Qtr 2020
Employment Cost Index (1)	0.7	0.8	0.5	0.5	0.7
Productivity (2)	1.6	-0.3	10.6	^(R) 5.1	-4.8

Footnotes:

- (1) Compensation, all civilian workers, quarterly data, three-month percent change, seasonally adjusted.
- (2) Output per hour, nonfarm business, quarterly data, percent change from previous quarter at annual rate, seasonally adjusted.
- (R) Revised.

Data extracted: March 2, 2021

THE FEDERAL RESERVE BOARD THE BEIGE BOOK — MARCH 3, 2021, EXCERPT

Overall Economic Activity

Economic activity expanded modestly from January to mid-February for most Federal Reserve Districts. Most businesses remain optimistic regarding the next 6-12 months as COVID-19 vaccines become more widely distributed. Reports on consumer spending and auto sales were mixed. Although a few Districts reported slight improvements in travel and tourism activity, overall conditions in the leisure and hospitality sector continued to be restrained by ongoing COVID-19 restrictions.

Despite challenges from supply chain disruptions, overall manufacturing activity for most Districts increased moderately from the previous report. Among Districts reporting on nonfinancial services, activity was mixed, though most reported modest growth over the reporting period. Some Districts noted that financial institutions experienced declines in loan volumes, but most cited lower delinquency rates and elevated deposit levels.

Historically low mortgage interest rates continued to spur robust demand for both new and existing homes in most Districts, and home prices continued to rise in many areas of the U.S. On balance, commercial real estate conditions in the hotel, retail, and office sectors deteriorated somewhat, while activity in the multifamily sector remained steady and the industrial segment continued to strengthen. Districts reporting on energy observed a slight uptick in activity related to oil and gas production and energy consumption. Overall, reports on agricultural conditions were somewhat improved since the previous report. Transportation activity grew modestly for many Districts.

Highlight of Dallas Federal Reserve

The District economy expanded at a moderate pace, though output in most industries remained below normal levels. Unprecedented winter storms and widespread power outages in mid-February severely disrupted economic activity, though the impact is mostly expected to be transitory. The housing market continued to be a bright spot, and energy activity improved further. Employment rose and wages increased moderately. Outlooks were generally positive, but uncertainty persisted.

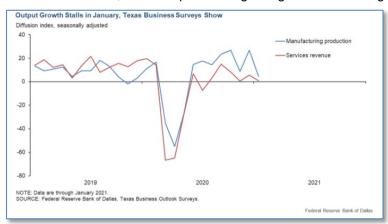
ECONOMIC REPORTS AND FORECASTS: STATE OF TEXAS

FEDERAL RESERVE BANK, DALLAS

February 2021 - www.dallasfed.org 1

TEXAS ECONOMY SOFT IN JANUARY, BUT OUTLOOK OPTIMISTIC FOR LATER IN 2021

Regional economic conditions appeared to deteriorate in January after picking up at year-end, data show. Nonetheless, there is optimism regarding the outlook for growth later this year. Federal stimulus



payments, paycheck protection program loans and greater COVID-19 vaccination availability are supportive of expansion later in 2021.

Results from the Federal Reserve Bank of Dallas' Texas Business Outlook Surveys (TBOS) show that output growth largely stalled in January in the manufacturing and service sectors, with indexes signaling little change in output from December.

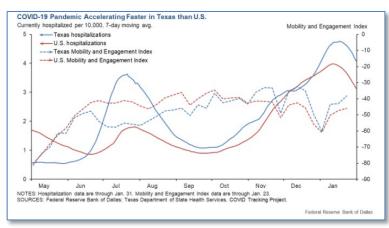
Service sector revenues were flat overall in January, with some high-contact industries such as transportation and accommodation

and food services experiencing declines. Survey respondents said rising COVID-19 cases restrained activity.

While the Texas Manufacturing Outlook Survey surprised to the upside in December, production and demand growth decelerated sharply in January. The raw materials prices index reached an almost 10-year high, and some contacts noted supply-chain constraints.

High-Frequency Indicators Reflect Virus Activity

High-frequency indicators, which present a snapshot of ongoing conditions, were downbeat in January. The pandemic accelerated faster in Texas than in the U.S. in December and early January, with the state reaching new highs for daily new COVID-19 infections and deaths in mid-January. Hospitalizations per capita were more than 20% higher in Texas than in the U.S.



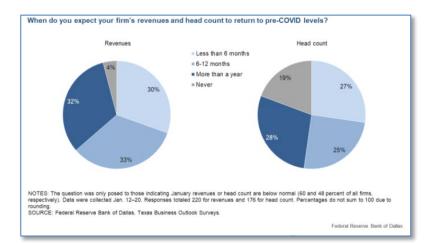
¹ Emily Kerr and Chloe Smith

The seven-day average of new daily COVID-19 cases in Texas hovered around 20,000 in the first three weeks of January, nearly double the previous peak in July. While new cases and hospitalizations began ebbing in late January, average daily COVID-19 deaths rose and surpassed 300 as of mid-January.

Despite the pandemic's severity, the Texas Mobility and Engagement Index exceeds that of the U.S. However, the Texas reading is lower in January than it was in December (exclusive of holiday-impacted periods).

TBOS Respondents Expect Revenues, Head Counts to Improve

A majority of firms expected business revenues to return to pre-COVID-19 levels by year-end, according to TBOS. Despite the economic recovery that began in June, roughly 60% of all firms reported that their revenues as of January remained below what they were before the outbreak. When this group was asked when they expect revenues to return to prepandemic levels, 30% said within six months and 63% said within a year. There was some variance by sector, with manufacturers slightly more bullish than services firms.



Services firms in January's TBOS cited surging COVID-19 cases and political unrest as headwinds. Additionally, among the 48% of TBOS firms reporting reduced head counts, 19% said they do not expect personnel levels to return to pre-COVID levels even though the vast majority anticipate an eventual full revenue recovery. Upon follow-up, those respondents expecting to maintain lower head counts pointed to increased efficiency and productivity, or streamlining due to technology adoption. A couple of respondents reported they were overstaffed before the pandemic.

1 Other Sectors See Continued Growth

Texas export growth moderated in the fourth quarter after expanding strongly in the prior three months. Declining oil and gas exports drove the deceleration. The value of manufacturing exports continued its steady rise, and agriculture exports surged—a combination of robust global demand and dramatically higher crop prices.

Bankers are optimistic about the second half of 2021, according to the Dallas Fed Banking Conditions Survey. Total loan volume increased in December as declines in consumer loans and commercial and industrial loans were offset by increases in residential and commercial real estate loans.

Nonperforming loans rose, though at a markedly slower rate than in mid-2020. Loan pricing continued to decrease, and some contacts voiced concern about margin compression. While sentiment about current general business activity was mixed, nearly 70% of respondents expect an increase in business activity six months from now.

The Texas housing market remains strong, with home sales and building permits at very high levels. Home price appreciation has accelerated, and the homebuilding pipeline remains full amid strong demand.

Apartment demand surprised to the upside in the fourth quarter after weakening earlier in 2020, with absorptions exceeding typical fourth-quarter numbers. However, elevated supply continues to pressure occupancy and rents downward. On the nonresidential side, industrial space remains a star.

Demand is elevated for warehouse and e-commerce/logistics space. The office market continues to weaken, but vacancy rates are expected to stabilize in the second half of 2021.

Energy Sector Stronger but Below Year-Ago Levels

The rebound in the Federal Reserve's Eleventh District energy sector solidified further, though the level of activity remained well below year-ago levels. Headline activity indexes in our Energy Survey turned positive in the fourth quarter after a year and a half in contractionary territory. Oil prices and rig counts pushed higher in the latest data.

Price expectations for year-end 2021 average \$50 per barrel, slightly above the average breakeven level for drilling new wells. Outlooks improved notably, and capital expenditures are anticipated to increase.

TEXAS ECONOMIC STATISTICS U.S. BUREAU OF LABOR STATISTICS

Data Series	July 2020	Aug 2020	Sept 2020	Oct 2020	Nov 2020	Dec 2020
Labor Force Data						
Civilian Labor Force (1)	13,834.7	14,386.7	14,219.5	14,084.0	14,161.9	^(P) 14,164.5
Employment (1)	12,721.1	13,405.3	13,045.7	13,115.8	13,009.5	^(P) 13,139.1
Unemployment (1)	1,113.6	981.4	1,173.8	968.2	1,152.5	^(P) 1,025.4
Unemployment Rate (2)	8.0	6.8	8.3	6.9	8.1	^(P) 7.2
Nonfarm Wage and Salary Employme	ent					
Total Nonfarm ⁽³⁾	12,112.6	12,224.5	12,272.6	12,387.2	12,450.0	^(P) 12,514.2
12-month% change	-5.5	-4.8	-4.5	-3.9	-3.7	(P) -3.3
Mining and Logging (3)	190.2	189.0	191.2	193.5	193.0	^(P) 194.0
12-month% change	-23.9	-23.9	-22.2	-20.4	-20.1	^(P) -17.9
Construction (3)	736.5	741.5	746.1	752.3	758.3	^(P) 761.4
12-month% change	-5.2	-4.8	-4.8	-4.1	-4.3	^(P) -4.2
Manufacturing (3)	867.9	868.1	875.6	880.3	878.4	^(P) 881.1
12-month% change	-4.5	-4.5	-3.7	-2.6	-3.5	^(P) -3.2
Trade, Transportation, and Utilities (3)	2,409.6	2,439.7	2,438.7	2,454.4	2,478.8	(P) 2,498.9
12-month% change	-4.1	-2.9	-3.0	-3.0	-2.3	^(P) -1.9
Information (3)	194.9	195.3	197.5	197.9	197.9	^(P) 201.4
12-month% change	-6.2	-6.6	-5.6	-5.6	-5.4	^(P) -3.7
Financial Activities (3)	805.2	807.5	807.9	819.6	825.1	(P) 820.3
12-month% change	0.2	0.2	0.0	1.8	2.3	^(P) 1.0
Professional & Business Services (3)	1,745.3	1,776.5	1,782.6	1,827.0	1,830.3	^(P) 1,857.3
12-month% change	-3.0	-1.4	-1.2	0.9	1.0	^(P) 2.0
Education & Health Services (3)	1,678.0	1,676.4	1,674.4	1,687.1	1,688.9	^(P) 1,695.5
12-month% change	-3.6	-3.9	-4.1	-4.0	-4.4	^(P) -4.0
Leisure & Hospitality (3)	1,146.2	1,148.3	1,178.7	1,207.8	1,231.6	^(P) 1,237.9
12-month% change	-17.8	-17.7	-15.6	-14.6	-12.6	^(P) -12.3
Other Services (3)	409.3	422.3	418.7	424.5	428.2	^(P) 430.3
12-month% change	-8.0	-5.5	-6.6	-5.4	-5.4	^(P) -5.2
Government (3)	1,929.5	1,959.9	1,961.2	1,942.8	1,939.5	^(P) 1,936.1
12-month% change	-2.3	-1.2	-1.1	-2.0	-2.2	^(P) -2.3
Footnotes (1) Number of persons, in thousands, seaso (2) In percent, seasonally adjusted.	nally adjusted.	' '	mber of jobs, in eliminary.	ı thousands, se	asonally adjust	ted.

Data extracted: March 2, 2021

FEDERAL RESERVE BANK SENIOR LOAN OFFICER OPINION SURVEY

The January 2021 Senior Loan Officer Opinion Survey on Bank Lending Practices addressed changes in the standards and terms on, and demand for, bank loans to businesses and households over the past three months, which generally correspond to the fourth quarter of 2020.

Regarding loans to businesses, respondents to the January survey indicated that, on balance, they tightened their standards on commercial and industrial (C&I) loans to firms of all sizes, with notable differences in reported changes across bank sizes. Banks reported weaker demand, on balance, for C&I loans to firms of all sizes. Meanwhile, banks tightened standards across all three major commercial real estate (CRE) loan categories—construction and land development loans, nonfarm nonresidential loans, and multifamily loans—over the fourth quarter of 2020, while reporting weaker demand for most CRE loan categories.

For loans to households, banks left standards unchanged across most categories of residential real estate (RRE), while, on net, they eased standards across all three consumer loan categories—credit card loans, auto loans, and other consumer loans—over the fourth quarter of 2020. Banks reported either somewhat strengthening or unchanged demand for most types of RRE loans. Meanwhile, demand for credit card and other consumer loans remained basically unchanged, and demand for auto loans moderately weakened.

In addition, the survey included a set of special questions inquiring about banks' expectations for lending standards, loan demand, and loan performance over 2021. Banks, on balance, reported expecting to tighten standards for most business loans, although responses differed across bank sizes, with the largest banks mostly expecting to ease standards. For household loans, banks of all sizes generally expect to ease standards. Banks expect demand to strengthen and loan performance to deteriorate for most loan categories over 2021. One notable exception is C&I loans to large and middle-market firms, for which banks, on net, expect loan performance to improve.

BUSINESS LENDING

C&I Loans

Over the fourth guarter of 2020, banks reported having tightened standards for C&I loans to firms of all sizes, with notable differences in reported changes across bank sizes. On net, modest shares of large banks reported having eased standards to large and middle-market firms, while modest shares of large banks reported having tightened standards to small firms. In contrast, moderate shares of small banks reported having tightened their C&I lending standards to firms of all sizes. At the same time, banks either tightened or left unchanged all lending terms on balance. Significant net shares of banks increased the use of interest rate floors for loans to small firms. Foreign banks reported

having left standards and nearly all lending terms for C&I loans unchanged.

Major net shares of banks that reported tightening standards or terms cited a less favorable or more uncertain economic outlook, worsening of industry-specific problems, and reduced tolerance for risk as important reasons for doing so. Significant net shares of banks also mentioned increased concerns about the effects of legislative changes, supervisory actions, or changes in accounting standards; less aggressive competition from other banks or nonbank lenders; and decreased liquidity in the secondary market for these loans as important reasons for tightening lending standards and terms.

Regarding demand for C&I loans over the fourth quarter, a moderate net share of banks reported weaker demand for C&I loans to firms of all sizes. At the same time, banks reported that the number of inquiries from potential borrowers regarding the availability and terms of new credit lines or increases in existing lines remained basically unchanged over the fourth quarter. Meanwhile, a moderate net fraction of foreign banks reported that both demand for C&I loans and the number of inquiries from potential borrowers strengthened over the fourth quarter.

Major net shares of banks that reported weaker demand cited a decrease in customers' inventory financing needs, a decrease in customers' accounts receivable financing needs, a decrease in customers' investment in plant or equipment, an increase in customers' internally generated funds, and a decrease in customers' precautionary

demand for cash and liquidity as important reasons for weaker demand. In addition, significant net shares of banks reported a decrease in customers' merger or acquisition financing needs as an important reason for weaker demand.

CRE Lending

Over the fourth quarter, significant net shares of domestic banks tightened standards for all three CRE loan categories. At the same time, a significant net share of banks reported weaker demand for loans secured by nonfarm nonresidential properties, and a moderate net share of banks reported the same for construction and land development loans. Demand for loans secured by multifamily residential properties was reported to be basically unchanged on net. Similarly, significant net shares of foreign banks tightened standards on CRE loans and reported weaker demand for such loans.

LENDING TO HOUSEHOLDS

Residential Real Estate Lending

Over the fourth quarter, banks left lending standards unchanged for most mortgage loan categories and for revolving home equity lines of credit (HELOCs), with important differences across bank sizes. Modest shares of large banks eased standards for governmentsponsored enterprise (GSE)-eligible mortgages—which make up the majority of bank mortgage originations—for qualified mortgage (QM) jumbo loans, and for QM nonjumbo, non-GSE-eligible residential mortgages, while leaving standards unchanged for the remaining categories of RRE loans. At the same time, modest net shares of small banks tightened standards for QM non-jumbo, non-GSE-eligible loans and for non-QM non-jumbo loans, while moderate net shares of small banks tightened standards for subprime mortgages.

Regarding demand for RRE loans, large banks reported unchanged demand across all mortgage categories. In contrast, modest or moderate net shares of small banks reported strengthening demand across most RRE loan categories, except government residential mortgages, for which demand remained reportedly unchanged, and HELOCs and subprime mortgages, for which modest and moderate net shares of small banks, respectively, reported weaker demand.

Consumer Lending

Over the fourth quarter, a moderate net share of banks reported easing standards for credit card loans, and modest net shares of banks eased standards for auto loans and for other consumer loans. Consistent with easier lending standards, modest net shares of banks increased credit limits for credit card accounts, and moderate and modest net shares of banks narrowed the rate spreads charged on outstanding balances over their cost of funds for auto loans and for other consumer loans, respectively.

Regarding demand for consumer loans, a moderate net share of large banks reported stronger demand for credit card and other consumer loans but, at the same time, a modest net share of large banks experienced weaker demand for auto loans. In contrast, modest or moderate net shares of small banks reported weaker demand for all consumer loan categories.

SPECIAL QUESTION ON BANKS' OUTLOOK FOR 2021

A set of special questions asked banks about their expectations for lending standards, loan demand, and loan performance as measured by delinquencies and charge-offs over 2021, assuming that economic activity would evolve in line with consensus forecasts. On balance, banks reported expecting tighter standards for most business loans and easier standards for all household loans. Banks reported expecting loan demand to strengthen and loan performance to deteriorate for most loan categories over 2021.

Regarding the outlook for loans to businesses, modest or moderate net shares of banks reportedly expect to tighten standards across most loan categories, except C&I loans to large and middle-market firms, for which banks expect to leave standards unchanged over 2021. However, expectations for standards differ by bank size. Modest or moderate net shares of large banks reportedly expect to ease standards on C&I loans to firms of all sizes and on CRE loans secured by multifamily residential properties. At the same time, large banks anticipate unchanged standards, on net, for the other CRE loan categories. In contrast, significant net shares of small banks expect to tighten standards across most business loan categories, except C&I loans to large and middle-market firms, for which a moderate net share of small banks expect tighter standards over 2021. Meanwhile, significant net shares of banks expect stronger demand across all business loan categories. Additionally, banks expect loan performance to deteriorate for all types of business loans, with the notable exception of C&I loans to large and middle-market firms, for which credit quality is expected to improve over 2021.

Regarding the outlook for loans to households, a significant net share of banks expect to ease standards for credit card loans, and moderate net shares of banks expect to ease standards for the other types of household loans. Meanwhile, the demand outlook for loans to households was mixed across RRE and consumer loans. Modest net shares of banks reported expecting weaker demand for GSE-eligible residential mortgages, whereas for nonconforming jumbo residential mortgage loans banks expect demand to remain unchanged. In contrast, moderate or significant net shares of banks expect stronger demand for consumer loans. In addition, significant net shares of banks reported expecting loan performance to deteriorate for consumer loans across borrower risk categories, and moderate net shares of banks expect performance to worsen for RRE loans and HELOCs.

Banks that reported expecting to change standards for any loan category were additionally asked to assess the importance of several potential reasons for the expected change. Major net shares of banks that reported expecting to ease standards cited an expected improvement in credit quality of the loan portfolio and an expected increase in risk tolerance as important reasons for the expected easing in lending standards. In contrast, major net shares of banks that reported expecting to tighten standards pointed to expected deterioration in the quality of their loan portfolios and in collateral values, expected reduction in their risk tolerance and in competition from banks or nonbank lenders, as well as increased concerns about the effects of legislative or regulatory changes as important reasons for the expected tightening in lending standards.

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Conference of State Bank Supervisors, Washington, D.C.

Federal Deposit Insurance Corporation, Washington, D.C.

Federal Reserve Bank of Dallas, Dallas, Texas

Federal Reserve Bank of Saint Louis, Saint Louis, Missouri

Gow Media, Houston, Texas

Houston Chronicle, Houston, Texas

MacroTrends, Seattle, Washington

NBC News, New York, New York

New York Times, New York, New York

Office of the Comptroller of the Currency, Washington, D.C.

Office of the Texas Governor, Greg Abbott, Austin, Texas

Real Estate Center at Texas A&M University, College Station, Texas

San Antonio Express-News, San Antonio, Texas

Small Business Administration, Washington, D.C.

Texas A&M AgriLife Extension, College Station, Texas

Texas Bankers Association, Austin, Texas

Texas Comptroller of Public Accounts, Austin, Texas

Texas Department of Banking, Austin, Texas

Texas Department of Savings and Mortgage Lending, Austin, Texas

Texas Department of State Health Services, Austin. Texas

Texas Farm Bureau, Waco, Texas

Texas Monthly, Austin, Texas

Texas Tribune, Austin, Texas

Texas Workforce Commission, Austin, Texas

The Perryman Group, Waco, Texas

The Wall Street Journal, New York, New York

U.S. Bureau of Labor Statistics, Washington, D.C.

U.S. Census Bureau, Suitland, Maryland

US Department of Homeland Security, Cybersecurity and Infrastructure Security Agency, Arlington, Virginia

U.S. Department of the Treasury, Washington, D.C.

Wall Street Journal, New York, New York

Washington Post, Washington, D.C.

Yahoo Finance, online

Visit the Finance Commission of Texas <u>website</u> for previous

Condition of the Texas State Banking System Reports.