Introduction to the Uniform Bank Performance Report (UBPR)

Ratio analysis may not always lead to answers, but to follow-up questions.

- As an examiner, you perform a financial analysis to assess a bank's current condition, diagnose problem areas, and determine the best possible estimate of the institution's future condition.
- Your analysis of a bank's financial condition should begin with a review of its balance sheet structure.
- A thorough understanding of a bank's structure is critical to accurately assess the institution's risk profile, appropriately rate its CAMELS components, and have informed discussions with bank management.

The Uniform Bank Performance Report

The UBPR is an analytical tool created for bank supervisory, examination, and bank management purposes. In a concise format, it shows the impact of management decisions and economic conditions on a bank's performance and balance-sheet composition. The performance and composition data contained in the report can be used as an aid in evaluating the adequacy of earnings, liquidity, capital, asset and liability management, and growth management. Bankers and examiners alike can use this report to further their understanding of a bank's financial condition and through such understanding perform their duties more effectively.

The UBPR is now available online at no charge at WWW.FFIEC.GOV. A UBPR for any bank in the country may be viewed online, printed or downloaded. The site includes 5 years of history including all intermediate quarters.

A UBPR is produced for each commercial bank in the United States that is supervised by the Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, or the Office of the Comptroller of the Currency. UBPRs are produced for FDIC insured savings banks also. The report is computer-generated from a data base derived from public and nonpublic sources. It contains several years' worth of data, which are updated quarterly. Those data are presented in the form of ratios, percentages, and dollar amounts computed mainly from Reports of Condition and Income submitted by the bank. Each UBPR also contains corresponding average data for the banks peer group and percentile rankings for most ratios. The UBPR therefore permits evaluation of a bank's current condition, trends in its financial performance, and comparisons with the performance of its national peer group.

In addition to the individual bank report, the following is also available:

- A Peer Group report, which presents all peer averages;
- A State Average Report, which presents ratio and averages within States;
- A Distribution report is also produced using the peer groupings in the state average and peer group average reports. Selected percentile values are displayed for individual ratios to provide additional insight into the range of bank performance that comprises an average; and,
- UBPR data tapes, which present all types of UBPR data in bulk format on magnetic tape.

The UBPR "users" guide contains basic guidelines for using the UBPR, including a suggested method of analyzing the report, technical information, and ratio definitions. The UBPR, related statistical reports and the User's Guide are available on line at no charge via FFIEC Website, (WWW.FFIEC.Gov).

How the UBPR is Used

The Uniform Bank Performance Report is designed to be used by bank examiners and bank management evaluating the financial condition of banks. By analyzing the data contained in the UBPR, the user can obtain an overall picture of the bank's financial health and can discover conditions that might require further analysis and investigation. The UBPR is not designed to replace on-site examination or investigations, but to supplement present examination procedures. It also functions as a common point of financial analysis between regulator and banker and can be useful as a part of a bank's own internal bank process.

The UBPR presents three types of data for use in the financial analysis of a bank: (1) the bank's data; (2) data for a peer group of banks similar in size and economic environment; and, (3) percentile rankings. A thorough understanding of those data groups and their interrelationships and limitations is essential in order to use the UBPR effectively. As a general rule, any analysis should compare the bank to its peer group, consider the bank's trends over time, and also be aware of trends and changes in peer group averages. In general, the more a ratio deviates from the peer average, the more scrutiny examiners give that ratio. The significant deviation from the peer should cause you to ask the question *"Why is this bank so much better or worse than peer?"* In the UBPR next to the peer data, you will see the percentile (pct.) ranking. For positive line items, (things favorable to the bank like revenue), the higher the pct. ranking, the better. Conversely, for things less desirable, (like charge offs, expenses), the lower the pct. ranking, the better. By comparing the bank's ratio to the respective peer ratio, you can see if the bank is higher or lower than peer. The pct. ranking tells you how much higher or how much lower.

Review of CAMELS Components during an Examination

Asset Quality, Earnings, Capital, Liquidity, Sensitivity, and then Management is the correct order.

Financial Analysis Concepts

The UBPR is a key tool to utilize when analyzing balance sheet structure. The financial data and ratios in the UBPR provide a good picture of structure and financial condition of the bank.

Now, when looking at UBPR data, remember that you should focus on two things - level and trend.

- **Level:** Are the ratios at, above, or below comparative standards/benchmarks? How do they compare to peer?
- **Trend:** Are the ratios increasing, decreasing, or static over a period of time?

Once you are comfortable with the level and trend, you need to move to the heart of financial analysis – the **why** piece.

Why: What is causing the ratios to be what they are? What are the underlying factors? Why is the trend increasing, decreasing, or static? Why is the ratio you are looking at above or below peer? Why is the bank equal to, better than, or worse than peer?

Remember that a ratio by itself is meaningless. It must be taken in a context such as movement over time or comparison to another institution.

Balance Sheet – Assets

1. Overview

- A bank's balance sheet consists of earning and nonearning assets.
- Earning assets, such as loans or securities, generate interest income, which you will remember is the major source of bank revenue. Ideally, the higher the level of earning assets, the better. However, this is unrealistic, as some level of nonearning assets is necessary for the bank to operate. Examples include bank building, furniture, computers, etc.
- Since all assets don't have the same level of credit risk, a bank's asset mix tells us where credit exposure exists. For example, U.S. Treasury securities have virtually no credit risk, while a loan to a start-up company may have a high level of credit risk.

Balance Sheet – Loan Portfolio

Loans are typically a bank's largest major earning asset and as such, generate the greatest amount of income. The loan portfolio can be subject to all six safety and soundness risks, but three are the most prevalent:

Credit risk is the largest risk and varies by the type of loans and the supporting collateral (if any). For example, commercial real estate loans typically have more credit risk than residential real estate loans. A larger volume of CRE would mean more credit risk. That is, with the exception of the most recent market dislocation where we saw residential real estate loans cause the majority of the write offs, not owner occupied CRE.

- The loan portfolio is also subject to **market risk**. Loan interest income can fluctuate with changes in interest rates. Many loans pay interest on a floating basis, and if rates fall, the income received by the bank will be lower. Also, in a falling interest rate environment, some loans will prepay to take advantage of the lower rates.

- Also, loans are not usually considered to be liquid assets, so there is some **liquidity risk**. While these three are the most prevalent, all six risks apply: operational risk can apply to back office processing; and, legal and reputational risks are incurred as a result of the

- entire lending process. For instance, improperly handling loan disclosures could subject the bank to legal and/or reputational risk.

Balance Sheet – Securities Portfolio

- The next largest earning asset held is a bank's securities portfolio.
- Banks are restricted in the types of securities they may purchase – securities must be of investment grade.
- You will mainly see U.S. Treasuries, Agencies and municipals securities in smaller bank portfolios.

Remember that when reviewing bank structure; don't forget to consider federal funds sold, Repos, and interest-bearing bank balances.

Balance Sheet – Liabilities
The majority of funding for a bank comes from liabilities. Management's use of different funding sources can reveal a lot about its attitude toward risk.
Deposits are generally grouped into two categories: core and noncore.

What are the categories of core deposits? Core deposits include DDA, NOW, MMDS, savings, and CDs less than $100M.

Why are they considered core? These are generally considered to be stable and less expensive funding sources and as such, should be the bank's primary funding source for loans and long-term assets.

What are the categories of noncore deposits? Noncore funding sources include CDs greater than $100M, federal funds purchased, repo accounts, and other borrowed money.

Why are these sources considered to be noncore funding? Because they are highly sensitive to changes in market interest rates and can be an expensive source of funding. These liabilities can be considered "hot money". CDs greater than $100M can be placed in an institution for the interest rate. If rates at another institution are better, or if the viability of the institution is in doubt, the monies will be moved.

In many cases, a bank's reliance on noncore funding may be indicative of a problem. However, this would need to be carefully reviewed on-site. For some banks, these sources are actually stable, such as large CDs which are internally generated. Both trend analysis and discussions with management can help determine the volatility of accounts such as large CDs or public funds.

How Examiners Look at Risk

Safety and Soundness

SR Letter 95-51 identifies six specific risks associated with financial institutions. For each financial institution, Safety and Soundness examiners assess the level and trend, (increasing, decreasing, or stable), of each of these six risks.

Credit risk arises from the potential that a borrower or counterparty will fail to perform on an obligation.

Market risk is the risk to a financial institution's condition resulting from adverse movements in market rates or prices, such as interest rates, foreign exchange rates, or equity prices.

Liquidity risk is the potential that an institution will be unable to meet its obligations as they come due because it is unable to liquidate assets or obtain adequate funding, (referred to as funding liquidity risk), or cannot easily unwind or offset specific exposures without significantly lowering market prices because of inadequate market depth or market disruptions (market liquidity risk).

Operational risk arises from the potential that inadequate information systems, operational problems, breaches in internal controls, fraud or unforeseen catastrophes will result in unexpected losses.

Legal risk arises from the potential that unenforceable contracts, lawsuits or adverse judgments will disrupt or otherwise negatively affect the operations or condition of a banking organization.

Reputational risk is the potential that negative publicity regarding an institution's business practices, whether true or not, will cause a decline in the customer base, costly litigation or revenue reductions.

In Summary

A bank's structure has implications on its risk profile. With regard to CAMELS, keep the following in mind when reviewing a bank's structure:

- Asset quality: What kinds of assets are on the books? The more loans, the higher the credit risk. The loan mix also plays an important role in credit quality.
- Earnings: What is the volume of earning assets? What is the volume of the various asset and liability types (high vs. low revenue and cost)?
- Liquidity: What is the level of core deposits? How much noncore funding do they use? What is the breakdown between short- and long-term assets?
- Sensitivity: How does the asset and deposit mix impact the bank's exposure to interest rate changes? Is there a large volume of securities? What about the maturity structure of the investment portfolio?
- Capital: Is the bank growing? Are assets growing faster than capital? How is the bank funding the growth?

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