

REAL NUMBERS FOR REAL BANKS

Continuing Case Assignment for Chapter 5

FIRST LOOK AT YOUR BHC'S FINANCIAL STATEMENTS

In Chapter 5, we focus most heavily on the financial statements for banking companies. As you read this chapter, you progress through a lengthy, yet interesting, discussion of the items found on the Report of Condition (balance sheet) and the Report of Income (income statement). In the chapter you find financial statements providing dollar amounts and then comparative financial statements where the ratios of items-to-assets are presented. The data was collected from Statistics for Depository Institutions at the FDIC's website (www2.fdic.gov/sdi/) and organized into tables using Excel. You will first create financial statements using dollar figures collected from SDI for your banking company for year-to-year comparisons, and you will then create financial statements for your banking company and its Peer Group using the ratios of items-to-assets.

A. Add a spreadsheet entitled "Year-to-Year Comparisons" to your Excel workbook. Enter the data for your BHC in the format illustrated for BB&T.

To fill in the dollar amounts for the Year-to-Year Comparisons spreadsheet, go to www2.fdic.gov/sdi and enter SDI. You will create a report with two columns and you are presented with two pull-down menus. From the first pull-down menu, select "Bank Holding Company," then enter your company's BHC number, and select the report date for the most recent year-end. From the second pull-down menu, repeat the process, only you will select reports for December, one year prior. Follow the cues to generate a report selecting to "View" in "Dollars" for the first spreadsheet. For the Report of Condition you will be able to enter most data directly from the Assets and Liabilities report generated at the FDIC website; however, you will have to explore the Net Loans and Leases

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REAL NUMBERS FOR REAL BANKS

Continuing Case Assignment for Chapter 5 (continued)

| | BB&T | Peer Group | BB&T | Peer Group |
|---|------------|------------|------------|------------|
| | 12/31/2010 | 12/31/2010 | 12/31/2009 | 12/31/2009 |
| Report of Condition - Percentage of Average Assets | | | | |
| Total assets | 100.0% | 100.0% | 100.0% | 100.0% |
| Cash and due from depository institutions | 1.1% | 7.0% | 1.2% | 6.8% |
| Securities | 14.0% | 12.2% | 21.4% | 35.5% |
| Federal funds sold & reverse repurchase agreements | 4.8% | 4.2% | 3.2% | 2.8% |
| Loans, leases & leases | 68.1% | 67.3% | 64.3% | 57.9% |
| Bank loan loss allowance | 1.8% | 1.3% | 1.5% | 1.8% |
| Equity unearned income | 0.2% | 0.3% | 0.2% | 0.2% |
| Net loans and leases | 66.3% | 66.0% | 62.8% | 56.1% |
| Trading securities | 1.4% | 1.3% | 1.4% | 1.4% |
| Other securities and investments | 1.1% | 0.3% | 3.3% | 12.2% |
| Other real estate owned | 1.0% | 0.2% | 1.2% | 0.1% |
| Receivables and other intangibles | 4.2% | 3.2% | 4.1% | 3.2% |
| All other assets | 8.1% | 6.4% | 8.3% | 6.2% |
| TOTAL LIABILITIES AND CAPITAL | 100.0% | 100.0% | 100.0% | 100.0% |
| Total liabilities | 89.6% | 89.6% | 87.1% | 88.2% |
| Total deposits | 71.1% | 69.2% | 71.2% | 69.2% |
| Federal funds purchased & reverse repurchase agreements | 1.1% | 4.2% | 1.4% | 2.3% |
| Trading liabilities | 5.8% | 2.8% | 3.2% | 2.1% |
| Other borrowed funds | 13.7% | 9.3% | 10.4% | 6.4% |
| Liabilities of debt | 1.0% | 1.4% | 1.2% | 1.1% |
| All other liabilities | 3.2% | 2.3% | 2.8% | 2.8% |
| Total equity capital | 10.4% | 10.4% | 12.9% | 11.8% |
| Preferred stock | 0.0% | 0.0% | 0.0% | 0.0% |
| Common stock | 0.0% | 0.0% | 0.0% | 0.0% |
| Reserves | 0.0% | 0.0% | 0.0% | 0.0% |
| Accumulated profits | 2.8% | 7.8% | 2.8% | 1.7% |
| Nonaccumulated profits in consolidated subsidiaries | 1.2% | 0.2% | 1.2% | 0.1% |
| Report of Income | | | | |
| Total interest income | 4.7% | 3.8% | 4.2% | 3.9% |
| Total noninterest expense | 3.2% | 0.2% | 1.1% | 0.8% |
| NET INTEREST INCOME | 1.5% | 3.6% | 3.1% | 3.1% |
| Provision for loan and lease losses | 1.0% | 1.2% | 1.1% | 2.3% |
| Total noninterest income | 1.4% | 1.3% | 1.9% | 2.0% |
| Subsidy activities | 0.0% | 0.2% | 0.1% | 0.2% |
| Service charges, net deposit activities | 0.8% | 0.3% | 0.4% | 0.3% |
| Fees and commissions | 0.4% | 0.4% | 0.3% | 0.4% |
| Additional noninterest income | 0.2% | 0.2% | 0.2% | 0.2% |
| Total noninterest expense | 0.7% | 2.9% | 2.8% | 3.9% |
| Salaries and employee benefits | 1.2% | 1.2% | 1.4% | 1.1% |
| Provision for equipment expense | 0.8% | 0.1% | 0.3% | 0.3% |
| Additional noninterest expense | 1.1% | 1.6% | 1.1% | 1.1% |
| Pre-tax net operating income | 0.2% | 0.2% | 0.2% | 0.2% |
| Provision for income taxes | 0.3% | 0.2% | 0.3% | 0.2% |
| Applicable income taxes | 0.0% | 0.0% | 0.0% | 0.0% |
| Income before extraordinary items | 1.9% | 0.2% | 1.9% | 0.2% |
| Income before extraordinary items, net | 0.2% | 0.2% | 0.2% | 0.2% |
| Net income (after taxes on loans and interest) | 0.5% | 0.5% | 0.5% | 0.5% |

link to get Gross Loans and Leases and Unearned Income. For the Report of Income, you will find the information you need in the section called "Income and Expense."

B. Create a second worksheet in the same workbook, but collect data in "Percent of Assets" rather than in dollars. This will be useful for comparative analysis, and you will collect data both for your BHC and a group of peer banks as illustrated for BB&T. To fill in the percentages of total assets, return to www2.fdic.gov/sdi and enter SDI. This time, you will create a report with four columns and you are presented with four pull-down menus. From the first pull-down menu, select "Bank Holding Company," then enter your company's BHC number and select the report date for the most recent year-end. From the second pull-

down menu, choose "Standard Peer Group" and select "All Commercial Banks with Assets of More than \$10 Billion" for the most recent year-end. You will repeat this process using the last two pull-down menus, only you will select reports for December, one year prior. Follow the cues to generate a report selecting to "View" in "Percent of Assets" and enter the same items as in Part A. By working with these statements, you will be familiarizing yourself with real-world financial statements and developing the language to talk with finance professionals from all types of financial institutions.

C. To develop an understanding of the relationships on the Reports of Condition and Income and to double-check for data collection errors, we will use our formula functions to

REAL NUMBERS
FOR REAL BANKSContinuing Case Assignment for Chapter 5 (*continued*)

calculate total assets, total liabilities and capital, total liabilities, total equity capital, net interest income, pretax net operating income, income before extraordinary items, and net income, using the spreadsheet developed in Part A. First Step: copy Columns B and C to Columns D and E. Second Step: clear the values in the cells containing total assets (i.e., Cells D4 and E4), total liabilities and capital, total liabilities, total equity capital, net interest income, pretax net operating income, income

before extraordinary items, and net income. Then use the formula functions in Excel to create entries for the empty cells. For example, the formula for total liabilities used in Column D would be =SUM(B20:B25). If the formulas and entries are correct, you will get the same numerical values as in columns B and C, and you can be reassured that you are developing an understanding of the financial statements of banks and similar financial firms.

REAL NUMBERS FOR REAL BANKS

Continuing Case Assignment for Chapter 6

EVALUATION OF YOUR BANK'S FINANCIAL STATEMENTS

Part A: Comparison across Years Using Volume Data

In Chapter 5, we focused on collecting financial statement information from the FDIC's Statistics for Depository Institutions. Now, you will be using that data to evaluate your BHC.

Calculating dollar changes and percentage changes across years using dollar data and interpreting this information. Open your Excel Workbook and go to the spreadsheet containing dollar amounts for year-to-year comparisons. Delete any numbers in columns D and E. Calculate the dollar changes in column D and the percentage changes in column E for each item. You now have data similar in format to Tables 6–5, 6–6, and 6–8 in the appendix. (Whereas the appendix utilizes the BHCPR

data you will be working with the FDIC's SDI data, which utilize slightly different terminology.) Review your data for significant changes in dollar and percentage terms. Create bulleted lists of the most significant changes of (1) uses of funds from the Report of Condition, (2) sources of funds from the Report of Condition, and (3) components of the Report of Income. Include the two most significant changes in dollar amounts and the two most significant percentage changes. See the following example for the evaluation of BB&T's uses of funds.

The most significant dollar changes in uses of funds from 2009 to 2010 for BB&T:

- Net loans and leases increased by almost \$818 million.
- The securities portfolio decreased by more than \$10 billion.

| | 2010 | 2009 |
|---|---------|---------|
| Profitability Ratios | | |
| Return on Equity | 4.42% | 4.23% |
| Return of Assets | 0.59% | 0.52% |
| Net Interest Margin | 3.42% | 2.88% |
| Net Noninterest Margin | -1.15% | -2.42% |
| Net Operating Margin | 0.27% | 0.46% |
| Breakdown of ROE | | |
| Net Profit Margin | 10.03% | 8.87% |
| Asset Utilization Ratio | 5.91% | 5.86% |
| Equity Multiplier | 7.46 | 8.14 |
| Breakdown of NPM | | |
| Tax management efficiency ratio | 216.46% | 112.82% |
| Expense control efficiency ratio | 4.63% | 7.86% |
| Breakdown of ROA | | |
| Net Interest Margin | 3.42% | 2.88% |
| Noninterest Margin | -1.49% | -0.81% |
| Special transactions affecting its net income | 1.34% | 1.55% |

The most significant percentage changes in uses of funds from 2009 to 2010 for BB&T:

- Federal Funds Sold and Reverse Repurchase Agreements grew 140.22 percent.
- The Securities portfolio contracted 30.47 percent.

Part B: Comparison with Peer Institutions Using Composition Data (Percentages of Report of Condition and Income Statement Items to Total Assets)

Open your Excel Workbook and go to the spreadsheet containing items expressed as percentages of assets developed for comparisons with the peer group in Chapter 5's Real Numbers

for Real Banks assignment. Your information is very similar to the data provided for BB&T from the BHCPR in Tables 6–7 and 6–9 found in the appendix. In column F subtract the peer group ratios from your BHC ratios for the most recent year. Use this to identify the most significant differences. Create three bulleted lists of the most significant differences between your BHC and its peer group for (1) uses of funds from the Report of Condition, (2) sources of funds from the Report of Condition, and (3) components of the Report of Income. Include the two most significant differences in each list. See the following example for the evaluation of BB&T's uses of funds relative to its peer group for 2010.

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REAL NUMBERS
FOR REAL BANKSContinuing Case Assignment for Chapter 6 (*continued*)

The most significant differences in asset composition for 2010 for BB&T versus its peer group of banks with more than \$10 billion in assets:

- BB&T has a higher proportion of net loans and leases—66.64 percent of total assets versus 50.48 percent for the peer group.
- BB&T has a lower proportion of trading account assets to total assets—BB&T has 0.54 percent of its funding invested in trading accounts whereas the peer group has 7.35 percent invested in trading accounts.

Part C: A Trend Analysis of Profitability: A Breakdown of Returns

- A. Open the dollar-denominated spreadsheet. Immediately below the income and expense data, add the rows illustrated in the spreadsheet.
- B. Calculate the ratios for the most recent year in Column B and then for the prior year in Column C using the formula functions in Excel and the data in rows 1 through 52 to create the entries. For example, the formula for ROE entered in cell B54 would be: “=B52/B27.”
- C. In rows 54 through 58, calculate the key profitability ratios from Equations (6–4) through (6–9) in the chapter. Write one paragraph comparing profitability across years.
- D. Rows 59 through 62 provide the framework for a breakdown of equity returns using Equations (6–14)–(6–17) in this chapter. Write one paragraph discussing the change in ROE using this breakdown. Incorporate the basic equation and interpret the information for your BHC.
- E. Rows 63 through 65 call for a breakdown of the net profit margin, as illustrated by Equation (6–18). Write one paragraph discussing the components of net profit margin for your BHC and the implications of the changes occurring across the years.
- F. Rows 66 through 69 provide the framework for a breakdown of ROA (Equation (6–20) in this chapter). Write one paragraph discussing the change in ROA and its components for your bank.

Selected References

For an explanation of how to measure and evaluate risk in banking and financial services see, for example:

1. Gilbert, R. Alton, Andrew P. Meyer, and Mark D. Vaughan. “How Healthy is the Banking System? Funneling Financial Data into Failure Probability,” *Regional Economist*, Federal Reserve Bank of St. Louis, April 2001, pp. 12–13.
2. Kristad, Jeffrey and Pat Donnelly. “An Examiner’s View of Operational Risk,” *Bank News*, July 31, 2001, pp. 25–27.

For information on how to read bank financial statements and make comparisons among different financial institutions see especially:

3. Federal Financial Institutions Examination Council. *A User’s Guide for the Uniform Bank Performance Report*, Washington, D.C. 2002.
4. Gilbert, R. Alton; and Gregory Sierra. “The Financial Condition of U.S. Banks: How Different Are Community Banks,” *Review*, Federal Reserve Bank of St. Louis, January/February 2003, pp. 43–56.
5. Gunther, Jeffrey W.; and Robert R. Moore. “Financial Statements and Reality: Do Troubled Banks Tell All?” *Economic and Financial Review*, Federal Reserve Bank of Dallas, Third Quarter 2000, pp. 30–35.