PMA™
FINANCIAL NETWORK

CREDIT QUARTERLY

SEPTEMBER 2017

INSIDE THIS ISSUE

RECENT NEWS

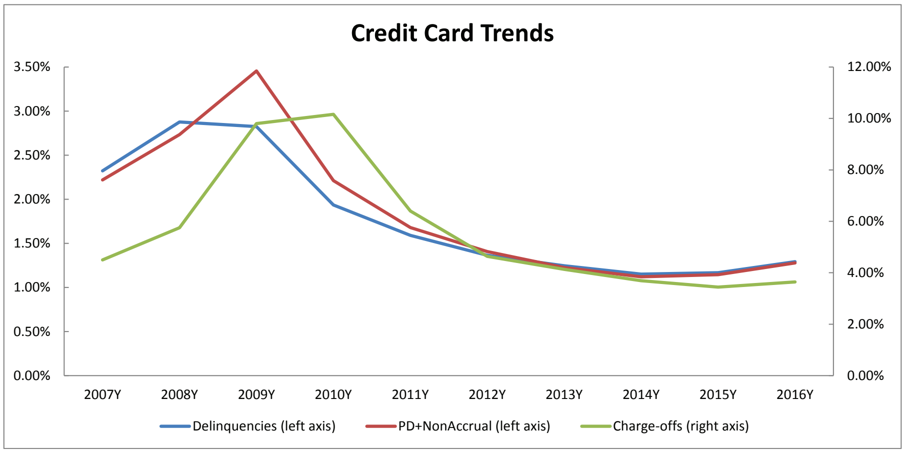
Credit Losses Widen from Historic Lows

Credit card balances have risen to the highest level since the fourth quarter of 2009, representing roughly 6% of U.S. household debt. This has helped propel U.S. household debt to reach a new high of $12.8 trillion in the second quarter.

In response to the financial crisis, banks tightened their credit standards, causing credit card balances to decline. As household balance sheets improved nationally, lenders began expanding their credit card lending in 2014 to generate higher yields from subprime borrowers with lower credit scores. As a result, credit card balances grew nationwide and subsequently, credit card delinquencies and charge-offs have seen a recent uptick.

In the second quarter of 2017, about 1.3% of credit card balances on U.S. bank balance sheets reached 30 days delinquent, an increase from 1.1% in the same quarter a year ago. Although this is well below the credit card delinquency rate of 2.9% during the financial crisis, it may be an early sign of asset quality deterioration for banks to come. Charge-offs also increased to 4.11% in the last twelve months from 3.65% in 2016. An increase in delinquencies typically leads to higher charge-offs, suppressing profitability.

These trends may be an indicator of a weakening credit environment after a prolonged period of abnormally strong credit.

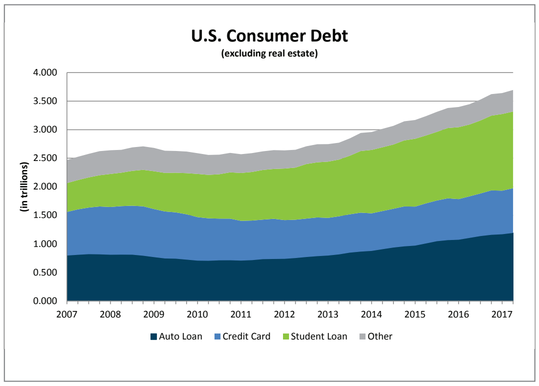


Source: SNL Financial (All U.S. Banks)

U.S. CONSUMER DEBT

Total outstanding debt by loan type in trillions of dollars, excluding debt secured by real estate.

CREDIT TRENDS AND COMMENTARY



U.S. consumer debt, excluding debt secured by real estate, continues to climb reaching a new high of $3.96 trillion in the second quarter. Growth in auto loans has decreased to 8% in the past year compared to 10% two years ago, while growth in credit card debt has seen an increase to 8% from 4% in that same period.

Source: Federal Reserve Board of New York

BANKING TRENDS

2nd Quarter 2017 Highlights

Second quarter 2017 net income rose 10.7% from a year earlier as almost two-thirds of banks reported year-over-year earnings improvement, while only 4.1% were unprofitable. Average return on assets (ROA) rose to 1.14% from 1.06% a year ago. This is the highest quarterly ROA since second quarter 2007. An increase in the industry's net interest margin (NIM) to 3.22% from 3.08% a year ago contributed to the higher ROA. The improvement in NIM was greatest at larger institutions, which were better positioned to benefit from rising short-term interest rates.

During the second quarter, bank charge-offs increased 11.2% over the second quarter of 2016. This was purely driven by credit-card charge-offs, as charge-offs in other major loan categories declined. Meanwhile, the amount of loans noncurrent or in nonaccrual status fell for the 28th time in the last 29 quarters, declining by 6.7% in the last three months. Noncurrent balances declined in all major loan categories in the second quarter.

Total loans and leases increased by 1.7% during the three months ended June 30. All major loan categories increased, led by residential mortgage loans (up 1.8%), credit card balances (up 3.1%), and C&I loans (up 1.8%). The 12-month loan growth rate has slowed to 3.7%.

In the second quarter of 2017, mergers absorbed 62 insured institutions, while 3 banks failed. No new charters were added during the quarter. The number of insured institutions on the FDIC's Problem Bank List fell from 112 to 105 during the first quarter. This is the smallest number since the first quarter of 2008.

Source: FDIC Quarterly Banking Profile

PRUDENT MAN PROCESS

The Prudent Man Analysis

The Prudent Man Process includes the initial analysis of a bank's credit quality and the ongoing risk management throughout the life of a deposit. The process helps public funds investors avoid repayment, reinvestment and reputation risk that may be associated with a bank failure.

1 | BANK CREDIT ANALYSIS

- Gather Data
- Analyze Data

2 | RISK MANAGEMENT

- Assign PMA Rating and Deposit Limits
- Ongoing Risk Management

The process begins with gathering bank, industry and economic data from an extensive list of sources. Bank financial data is received from a variety of regulatory filings. Industry tools like Bloomberg and SNL Financial are utilized in obtaining data and other relevant information. Additionally, a number of publications focusing on the banking industry and local and national economy are monitored daily.

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