BOK Financial Corp.

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Major Rating Factors

Strengths:

- Good earnings with healthy revenue diversification
- Dominant Oklahoma bank with growing presence in several southwestern markets
- Strong, though declining, capital

Weaknesses:

- High percentage of energy loans in portfolio, which could lead to credit quality deterioration if oil prices remain depressed
- Geographic concentration in Oklahoma and Texas, markets that could be vulnerable to broader economic weakness resulting from downturn in energy industry
- Heightened sensitivity to interest rate risk relative to peers

Outlook

The negative outlook on BOK Financial Corp. is based on both the recent drop in the company's capital ratios and its exposure to energy markets. The company's capital position fell in 2015 as a result of stock repurchases, and Standard & Poor's Ratings Services expects that pending acquisitions could pressure capital further. We expect BOK's risk-adjusted capital (RAC) ratio to settle at about 10% (our lower threshold for a strong assessment) in the next two years. However, if its capital ratios continue to decline and we believe the company's RAC ratio will weaken and remain below 10%, we could lower the ratings.

The outlook also reflects the potential for a broader impact on the company's portfolio if energy prices continue to slide, affecting both the direct energy portfolio and commercial and retail loans in local markets reliant on the energy industry. If asset quality weakens more than we currently expect, or the company reports net losses resulting from outsize provision needs, we could lower the ratings. Alternately, if energy markets stabilize and BOK maintains strong capital levels, above-average asset quality measures, and stable earnings, we could revise the outlook to stable.

Rationale

Standard & Poor’s ratings on BOK reflect the company’s strong capital, consistent profitability, and diversified business and revenue mix. A geographic concentration in Oklahoma and Texas, large exposure to energy-related loans, and heightened extension risk due to its large investment portfolio, which accounts for 33% of assets, somewhat offset these rating strengths.

BOK has good business and revenue mix, solid performance relative to peers, and a superior market position in Oklahoma, which support its business position. We expect its Standard & Poor's RAC ratio to stabilize at about 10%, and that it will maintain its strong regulatory capital ratios and generally good earnings performance over the next several years. Its large concentration in energy loans weighs on its risk position, though this is balanced by its track record of conservative underwriting and robust asset quality. BOK's liquidity is average and funding is adequate based on its solid core deposit base and liquid balance sheet.

Anchor: 'bbb+' starting point as a U.S.-domiciled bank

Our criteria use our Banking Industry Country Risk Assessment (BICRA) economic and industry risk scores to determine a bank’s anchor stand-alone credit profile (SACP), the starting point for an issuer credit rating. Our anchor for a bank operating mainly in the U.S. is ‘bbb+’, based on an economic risk score of ‘3’ and an industry risk score of ‘3’. We view the trends for both economic risk and industry risk as stable.

We view the U.S. as a diversified high-income economy, with an adaptable and resilient economic structure. We believe the U.S. continues in an expansionary phase, and households appear to have moved beyond their multiyear deleveraging phase and are slightly more receptive to taking on debt, albeit more cautiously than in prior cycles. Our view of credit risk in the economy factors in our expectation that when interest rates normalize, we believe latent loan losses could emerge in banks’ corporate loan books, from levels that are presently exceptionally low.

Since the 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act's passage, we believe the new regulations are reshaping the competitive environment for banks, and that a more stringent focus by U.S. regulators on qualitative factors (for example, risk management and governance) as well as on forward-looking post-stress capital ratios will continue to constrain banks' risk appetite. We view funding risk favorably because U.S. banks typically benefit from a high and stable share of core deposits and exceptionally deep capital markets. Our assessment of industry risk also considers the ongoing constraints to competitive dynamics from a sizable nonbank sector and the continued prominence of the government-sponsored entities.

Business position: Strong market position in Oklahoma and diversified business mix

Our assessment of BOK's business position reflects its stable market position, consistent performance, and strong management and strategy.

Based in Tulsa, Okla., BOK is a regional financial holding company that offers a diversified mix of credit, depository, and related financial services. It operates predominantly as a relationship-based commercial lender, with a niche in energy lending, which comprises a relatively high 19% of its total loan book. The company also has several nonbank businesses, including broker/dealer, wealth management, and trust operations, which diversify its revenue mix.

The company operates through seven banking divisions in eight states. Nevertheless, the bulk of BOK's business is based in Oklahoma, where it has a No. 1 market position in deposits, commercial banking, consumer banking, and electronic funds transfer. As of Dec. 31, 2015, 39% of BOK's loans were based in Oklahoma and 35% in Texas, followed by 8% in Colorado, 5% in New Mexico, 7% in Arizona, 5% in Kansas/Missouri, and 1% in Arkansas.

Much of BOK's loan and deposit growth over the past five years has come from markets outside Oklahoma as management has worked to diversify its business mix and geographic exposure. Management has grown its franchise organically, or, as necessary, through smaller nonbank or regional bank acquisitions located in faster-growing markets such as Dallas-Fort Worth, Houston, Denver, Phoenix, and Kansas City, Mo. Recent activity includes the January 2016 acquisition of Weaver Wealth Management, a wealth management company based in Fort Worth, Texas, with $340 million in assets under management, as well as the announcements of deals to acquire MBT Bancshares, a $645 billion asset bank based in Kansas City, and E-Spectrum Advisors, a Dallas-based energy mergers and acquisitions adviser, later in 2016.

George Kaiser, chairman of BOK, holds about 58% of the company, which he bought in 1992. We view his large private ownership stake as a positive rating factor since Mr. Kaiser has focused the bank's management on its long-term prospects rather than on quarterly earnings. He does not draw a salary and keeps more than half of his personal wealth outside of the bank. The Kaiser family holds another 10% in a family foundation that is not of direct benefit to the Kaiser family but was set up to support the Tulsa Community Foundation.

Capital and earnings: Profitability compares favorably with regional bank peers'

Despite a drop in capital in the past six months following share repurchase activity, we continue to view BOK’s capital and earnings as strong, reflecting its good earnings performance and its healthy capital structure.

BOK repurchased 3,634,578 shares for a total of $229.5 million in 2015. The company’s RAC ratio was just over 10% as of Sept. 30, 2015, though we anticipate that the fourth quarter share repurchases and the pending acquisition of MBT Bancshares in 2016 will result in the ratio falling below 10%. However, we expect BOK will suspend share repurchases, partially rebuild capital, and maintain a healthy capital position commensurate with its balance sheet growth, with a RAC ratio of about 10%, over the next two to three years. Even after recent share buybacks, BOK's regulatory capital ratios remain strong, with tangible common equity to tangible assets of 9.02% and common equity Tier 1, leverage, Tier 1, and total risk-based ratios of 12.14%, 9.25%, 12.14%, and 13.31%, respectively, as of Dec. 31, 2015. Dividend payouts are typically about 35-40% of earnings. There is no holding company double leverage.

In our view, BOK's profitability compares favorably with that of regional bank peers. BOK's earnings tend to be less heavily reliant on spread income, with net interest revenues accounting for approximately 52% of total revenues in 2012-2015. Although the company's net interest margin (NIM) remains relatively low, (2.60% in 2015 and 2.64% in 2014), reflecting the high proportion of lower-yielding securities on its balance sheet as well as the low interest rate, net interest revenues have been generally stable as the company has increased its total balance of earning assets. We expect the NIM to remain lower than average, as the company's large book of securities constrains full returns. Noninterest income represents about half of revenues and includes the contribution of strong brokerage, trust, and mortgage banking income, as well as solid contributions from transaction card and deposit fees. The company's efficiency ratio is typically 60%-65%. BOK's net earnings over the past several years benefited from its good credit quality performance, resulting in no provisions for loan losses in 2010-2014. BOK reinstated provisions in 2015 because of loan growth and some deterioration in its energy portfolio, and we expect it will continue to report loan loss provisions in the next few years.

Risk position: Large exposure to energy loans

We believe BOK's risk position is adequate relative to other regional banks. As with most regional banks, the primary risk BOK faces is credit risk. In addition, because of the size of its securities portfolio, which represented approximately one-third of total assets as of Dec. 31, 2015, and is heavily weighted with residential mortgage-backed securities (RMBS), we view BOK's vulnerability to extension risk in a rising rate environment as somewhat higher than that at the typical regional bank.

The company's loan portfolio represented 51% of assets as of Dec. 31. The portfolio is 63% commercial loans, 20% commercial real estate (CRE) loans, 13% residential real estate, and 4% other consumer loans. BOK has a niche in energy lending, with energy loans accounting for 19% of total loans, or 9.8% of total assets (and 89% of equity and reserves). Approximately 82% of this portfolio consists of loans to oil and gas producers, and the balance is wholesale and retail sales, services, and manufacturing. Despite BOK's strong performance in this portfolio over the past 20 years, in late 2015 the company recognized an increase in criticized loans resulting from the slump in oil and gas prices beginning in 2014. As a result, it increased its reserve for loan losses against this portfolio to 2.57% as of Dec. 31, 2015. Given the extent of the drop in prices, we believe the company will see additional deterioration and an increase in energy-related net charge-offs (NCOs) in 2016. Other significant commercial loan types are services (17% of total loans), which include loans to a variety of businesses such as governmental, finance and insurance, educational, services, religious and similar entities; health care (12%); and wholesale/retail loans (9%).

BOK has a large shared national credit (SNC) portfolio of $3.4 billion, or 21% of loans. It is the lead bank on 16% of its SNC loans, and substantially all are in local markets where BOK can generate additional business relationships with the customer. SNC loans are underwritten under the same guidelines as BOK's internally generated loans. Approximately 46% of the SNC portfolio consists of energy loans.

BOK's asset quality through the cycle has been strong compared with other regional banks. Excluding government-guaranteed nonperforming loans (NPLs), nonperforming assets represented a healthy 1.12% of loans plus other real estate owned at year-end 2015. Reserves of $225 million (1.41% of loans) buttress capital and cover NPLs (excluding government-guaranteed NPLs) by 1.5x. The company reported net recoveries of loans previously charged off in 2014-2015 and minimal NCOs of only 2 basis points (bps) in 2013. However, we expect NCOs to increase in 2016 from a combination of the full impact of the slump in energy markets, as well as from a general return to more normal loss levels.

The company has been reducing the size of its securities portfolio in the past two years to fund loan growth and reduce its interest rate risk. Even so, BOK's securities portfolio accounts for a relatively high 33% of its total assets. We believe the large securities portfolio (as a percentage of earning assets) can introduce some risk when rates rise, which we expect they will continue to do in 2016. The securities portfolio consists primarily of RMBS and commercial mortgage-backed securities (CMBS), the majority of which are issued by U.S. government agencies. Approximately 65% of the available-for-sale (AFS) portfolio consists of RMBS and 32% of CMBS fully backed by U.S. government agencies. Management estimates the duration of the RMBS portfolio at about 3.25 years, and that it would extend to 3.7 years assuming an immediate 200-bps upward shock in rates. The company manages interest rate exposure to remain fairly neutral to shifts in rates, although it remains slightly liability sensitive. Currently, management estimates a 200-bps increase in rates would decrease net interest income by 0.97% and a 50-bps decline in rates would lower net interest revenues by 2.87%.

Funding and liquidity: Average funding and adequate liquidity, with good core deposit base and strong cash position

BOK's stable funding ratio, which measures the company's ability to fund long-term assets with long-term funding, was 123% as of Dec. 31, 2015, while its broad liquid assets, as measured by Standard & Poor's, comfortably covered its short-term wholesale funding by about 2.03x. In addition, BOK has adequate core deposit funding, an unencumbered balance sheet, and a strong cash position. Core deposits represent a robust 78% of its funding base. Loans to core deposits were a moderate 75% as of Dec. 31, 2015. We expect the company will try to manage this ratio higher over the longer term as loan growth continues. Other major sources of funds include repos and Federal Home Loan Bank advances. As of Dec. 31, 2015, the estimated unused credit available to the subsidiary bank from collateralized sources was approximately $5.1 billion. In addition, about $3.1 billion of the $10.2 billion securities portfolio is unencumbered. Subsidiary bank BOKF N.A. also has outstanding subordinated debt of $226 million due in May 2017.

As of Dec. 31, 2015, parent company liquidity was adequate, with $282 million in cash on hand and annual expenses of less than $3 million. Additionally, the bank can upstream $100 million in dividends to the holding company without regulatory approval. The parent has no outstanding debt.

Support: None

We do not factor any external support into the ratings on BOK.

Additional rating factors: None

We do not include any additional rating factors in our analysis.

Related Criteria And Research

Related Criteria

- Bank Hybrid Capital And Nondeferrable Subordinated Debt Methodology And Assumptions, Jan. 29, 2015
- Group Rating Methodology, Nov. 19, 2013
- Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013
- Revised Market Risk Charges For Banks In Our Risk-Adjusted Capital Framework, June 22, 2012
- Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- Banks: Rating Methodology and Assumptions, Nov. 9, 2011
- Bank Capital Methodology And Assumptions, Dec. 6, 2010
- Methodology For Mapping Short- And Long-Term Issuer Credit Ratings For Banks, May 4, 2010
- Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Commercial Paper I: Banks, March 23, 2004

Related Research

- Rating Actions Taken On Several U.S. Regional Banks With Large Energy Exposures On Expectation For Higher Loan Losses, Feb. 9, 2016