BOK FINANCIAL CORP ET AL
Form 10-Q
April 29, 2016

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q
(Mark One)
ý QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended March 31, 2016
OR
¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _____________ to ______________

Commission File No. 0-19341

BOK FINANCIAL CORPORATION
(Exact name of registrant as specified in its charter)

Oklahoma	73-1373454
(State or other jurisdiction of Incorporation or Organization)	(IRS Employer Identification No.)

Bank of Oklahoma Tower	
Boston Avenue at Second Street	
Tulsa, Oklahoma	74192
(Address of Principal Executive Offices)	(Zip Code)

(918) 588-6000
(Registrant’s telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ý No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ý No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of “accelerated filer and large accelerated filer” in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer ý Accelerated filer ¨ Non-accelerated filer ¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes ¨ No ý

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: 66,155,103 shares of common stock ($.00006 par value) as of March 31, 2016.

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Management’s Discussion and Analysis of Financial Condition and Results of Operations
Performance Summary

BOK Financial Corporation (“the Company”) reported net income of $42.6 million or $0.64 per diluted share for the first quarter of 2016, compared to $74.8 million or $1.08 per diluted share for the first quarter of 2015 and $59.6 million or $0.89 per diluted share for the fourth quarter of 2015. The decrease in net income was largely based on an increase in the provision for credit losses and a decrease in the fair value of mortgage servicing rights, net of economic hedges.

Highlights of the first quarter of 2016 included:

- Net interest revenue totaled $182.6 million for the first quarter of 2016, compared to $167.7 million for the first quarter of 2015 and $181.3 million for the fourth quarter of 2015. Net interest revenue increased over the prior year primarily due to growth in average earning assets. Average earning assets were $28.6 billion for the first quarter of 2016 and $27.3 billion for the first quarter of 2015. Net interest margin was 2.65 percent for the first quarter of 2016. Net interest margin was 2.55 percent for the first quarter of 2015 and 2.64 percent for the fourth quarter of 2015.
- Fees and commissions revenue totaled $165.6 million for the first quarter of 2016, largely unchanged compared to the first quarter of 2015. Mortgage banking revenue decreased $4.9 million primarily due to lower loan production volume. This decrease was offset by increases in all other revenue categories. Fees and commissions revenue increased $9.8 million over the fourth quarter of 2015, primarily due to a $9.4 million increase in mortgage banking revenue.
- Changes in the fair value of mortgage servicing rights, net of economic hedges, decreased pre-tax net income in the first quarter of 2016 by $11.4 million, decreased pre-tax net income in the first quarter of 2015 by $5.0 million and increased pre-tax net income by $2.6 million in the fourth quarter of 2015. Net changes in the fair value of mortgage servicing rights for the first quarter of 2016 were largely driven by a decrease in mortgage interest rates during the first quarter and a narrowing in the forward-looking spread between the primary mortgage interest rates offered to borrowers and secondary mortgage interest rates required by investors.
- Operating expenses totaled $244.9 million for the first quarter of 2016, an increase of $24.6 million over the first quarter of 2015. Personnel expense increased $7.3 million and non-personnel expense increased $17.3 million. The first quarter of 2016 included several litigation accruals and post-acquisition valuation adjustments to a consolidated merchant banking investment. Deposit insurance expense increased due to increased criticized and classified assets levels, an input into the deposit insurance assessment calculation. Operating expenses increased $12.3 million compared to the previous quarter.
- The Company recorded a $35.0 million provision for credit losses in the first quarter of 2016. The additional provision was largely a result of the extended decline in commodity prices and its impact on our energy loan portfolio. The Company recorded a $22.5 million provision in the fourth quarter of 2015. No provision for credit losses was recorded in the first quarter of 2015. Gross charge-offs were $24.0 million in the first quarter of 2016, $2.2 million in the first quarter of 2015 and $4.9 million in the fourth quarter of 2015. Recoveries were $1.5 million in the first quarter of 2016, compared to $10.5 million in the first quarter of 2015 and $1.9 million in the fourth quarter of 2015.
- The combined allowance for credit losses totaled $240 million or 1.50 percent of outstanding loans at March 31, 2016, compared to $227 million or 1.43 percent of outstanding loans at December 31, 2015. The portion of the combined allowance attributed to the energy portfolio totaled 3.19 percent of outstanding energy loans at March 31, 2016, an increase from 2.89 percent of outstanding energy loans at December 31, 2015.
- Nonperforming assets that are not guaranteed by U.S. government agencies totaled $252 million or 1.59 percent of outstanding loans and repossessed assets (excluding those guaranteed by U.S. government agencies) at March 31, 2016 and $156 million or 0.99 percent of outstanding loans and repossessed assets (excluding those guaranteed by U.S. government agencies) at December 31, 2015. Nonperforming energy loans increased $98 million during the first quarter.
- Average loans increased by $405 million over the previous quarter due primarily to a $244 million increase in commercial loans and a $177 million increase in commercial real estate loans. Period-end outstanding loan balances

were $16.0 billion at March 31, 2016, a $81 million increase over December 31, 2015. Commercial real estate loans increased $111 million, and commercial loan balances increased $36 million. Personal loans decreased $58 million.

- Average deposit balances were largely unchanged compared to the previous quarter. Decreased demand and time deposit balances were offset by growth in interest-bearing transaction accounts. Period-end deposits were $20.4 billion at March 31, 2016, a decrease of $670 million compared to December 31, 2015. The overall decrease in period-end deposits was due to normal post-year-end activity and reductions in balances held by energy-related customers.
- The Company's common equity Tier 1 ratio was 12.00% at March 31, 2016. In addition, the Company's Tier 1 capital ratio was 12.00%, total capital ratio was 13.21% and leverage ratio was 9.12% at March 31, 2016. The Company's common equity Tier 1 ratio was 12.13% at December 31, 2015. In addition, the Company's Tier 1 capital ratio was 12.13%, total capital ratio was 13.30% and leverage ratio was 9.25% at December 31, 2015.
- The Company paid a regular quarterly cash dividend of $28 million or $0.43 per common share during the first quarter of 2016. On April 26, 2016, the board of directors approved a regular quarterly cash dividend of $0.43 per common share payable on or about May 27, 2016 to shareholders of record as of May 13, 2016.

Results of Operations

Net Interest Revenue and Net Interest Margin

Net interest revenue is the interest earned on debt securities, loans and other interest-earning assets less interest paid for interest-bearing deposits and other borrowings. The net interest margin is calculated by dividing tax-equivalent net interest revenue by average interest-earning assets. Net interest spread is the difference between the average rate earned on interest-earning assets and the average rate paid on interest-bearing liabilities. Net interest margin is typically greater than net interest spread due to interest income earned on assets funded by non-interest bearing liabilities such as demand deposits and equity.

Net interest revenue totaled $182.6 million for the first quarter of 2016 compared to $167.7 million for the first quarter of 2015 and $181.3 million for the fourth quarter of 2015. Net interest margin was 2.65 percent for the first quarter of 2016, 2.55 percent for the first quarter of 2015 and 2.64 percent for the fourth quarter of 2015.

Net interest revenue increased $14.8 million over the first quarter of 2015. Net interest revenue increased $12.9 million primarily due to the growth in average loan balances, partially offset by increased borrowings. Net interest revenue increased $3.4 million due to a change in rates primarily from the full quarter impact of the increase in the federal funds rate by the Federal Reserve in the fourth quarter of 2015.

The tax-equivalent yield on earning assets was 2.92 percent for the first quarter of 2016, up 12 basis points over the first quarter of 2015. The available for sale securities portfolio yield increased 10 basis points to 2.08 percent. The yield on interest-bearing cash and cash equivalents increased 26 basis points. Loan yields decreased 2 basis points, primarily due to growth in variable-rate loans and continued repricing in the low rate environment. Funding costs were up 2 basis points over the first quarter of 2015. The cost of interest-bearing deposits decreased 3 basis points and the cost of other borrowed funds increased 25 basis points largely due to the mix of funding sources. The cost of subordinated debentures decreased 126 basis points as $122 million of fixed-rate subordinated debt matured on June 1, 2015. The cost of this subordinated debt was 5.56 percent. The benefit to net interest margin from earning assets funded by non-interest bearing liabilities was 13 basis points for the first quarter of 2016, unchanged compared to the first quarter of 2015.

Average earning assets for the first quarter of 2016 increased $1.3 billion or 5 percent over the first quarter of 2015. Average loans, net of allowance for loan losses, increased $1.4 billion due primarily to growth in average commercial and commercial real estate loans. The average balance of available for sale securities decreased $150 million and the average balance of restricted equity securities increased $115 million. The average balances of trading securities and fair value option securities held as an economic hedge of our mortgage servicing rights also increased, offset by decreases in residential mortgage loans held for sale, investment securities and interest-bearing cash and cash equivalents.

Average deposits decreased $622 million over the first quarter of 2015. Average interest-bearing transaction accounts decreased $582 million and average time deposits decreased $293 million, partially offset by a $220 million increase in average demand deposit balances. Average savings account balances also grew over the prior year. Average borrowed funds increased $2.2 billion over the first quarter of 2015, primarily due to increased borrowings from the Federal Home Loan Banks. The average balance of subordinated debentures decreased $122 million.

Net interest margin increased 1 basis point over the fourth quarter of 2015. The yield on average earning assets increased 6 basis points. The loan portfolio yield increased 2 basis points to 3.57 percent. The yield on the available for sale securities portfolio increased 4 basis points to 2.08 percent. Funding costs were 0.40 percent, up 6 basis points over the prior quarter. The benefit to net interest margin from earning assets funded by non-interest bearing liabilities increased 1 basis point. Increased earning asset yields and funding costs were primarily related to the full quarter impact of the increase in the federal funds rate by the Federal Reserve in the fourth quarter of 2015.
Average earning assets increased $464 million during the first quarter of 2016, primarily due to growth in average outstanding loans of $405 million over the previous quarter. Average commercial loan balances increased $244 million and average commercial real estate loan balances increased $177 million. The average balance of interest-bearing cash and cash equivalents increased $57 million. Trading securities balances were up $38 million and the average balance of restricted equity securities increased $32 million. This growth was partially offset by a $21 million decrease in the average balance of residential mortgage loans held for sale, a $20 million decrease in the average balance of the available for sale securities portfolio and a $15 million decrease in average investment securities balances.
Average deposits decreased $79 million compared to the previous quarter. Demand deposit balances decreased $207 million and time deposit balances decreased $116 million, partially offset by a $229 million increase in interest-bearing transaction account balances. The average balance of borrowed funds increased $704 million over the fourth quarter of 2015, primarily due to increased borrowings from the Federal Home Loan Banks and increased federal funds sold and repurchase agreement balances.

Our overall objective is to manage the Company’s balance sheet to be relatively neutral to changes in interest rates as is further described in the Market Risk section of this report. More than three-fourths of our commercial and commercial real estate loan portfolios are either variable rate or fixed rate that will re-price within one year. These loans are funded primarily by deposit accounts that are either non-interest bearing, or that re-price more slowly than the loans. The result is a balance sheet that would be asset sensitive, which means that assets generally re-price more quickly than liabilities. Among the strategies that we use to manage toward a relatively rate-neutral position, we purchase fixed rate residential mortgage-backed securities issued primarily by U.S. government agencies and fund them with market rate sensitive liabilities. The liability-sensitive nature of this strategy provides an offset to the asset-sensitive characteristics of our loan portfolio. We also may use derivative instruments to manage our interest rate risk.

The effectiveness of these strategies is reflected in the overall change in net interest revenue due to changes in interest rates as shown in Table 1 and in the interest rate sensitivity projections as shown in the Market Risk section of this report.

Table 1 -- Volume/Rate Analysis
(In thousands)

	Three Months Ended March 31, 2016 / 2015		
		Change Due To[1]	
	Change	Volume	Yield / Rate
Tax-equivalent interest revenue:			
Interest-bearing cash and cash equivalents	$1,284	$(48)	$1,332
Trading securities	42	64	(22)
Investment securities:			
Taxable securities	(151)	(161)	10
Tax-exempt securities	420	(205)	625
Total investment securities	269	(366)	635
Available for sale securities:			
Taxable securities	1,827	(528)	2,355
Tax-exempt securities	(45)	(152)	107
Total available for sale securities	1,782	(680)	2,462
Fair value option securities	586	486	100
Restricted equity securities	1,714	1,662	52
Residential mortgage loans held for sale	(249)	(519)	270
Loans	13,228	13,410	(182)
Total tax-equivalent interest revenue	18,656	14,009	4,647
Interest expense:			
Transaction deposits	852	(162)	1,014
Savings deposits			