BOK FINANCIAL CORP ET AL
Form 10-Q
July 31, 2015

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 June 30, 2015
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 (State or other jurisdiction of Incorporation or Organization)	73-1373454 (IRS Employer Identification No.)
Bank of Oklahoma Tower Boston Avenue at Second Street Tulsa, Oklahoma (Address of Principal Executive Offices)	74192 (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: 68,945,139 shares of common stock ($.00006 par value) as of June 30, 2015.

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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 $79.2 million or $1.15 per diluted share for the second quarter of 2015, compared to $75.9 million or $1.10 per diluted share for the second quarter of 2014 and $74.8 million or $1.08 per diluted share for the first quarter of 2015.

Highlights of the second quarter of 2015 included:

- Net interest revenue totaled $175.7 million for the second quarter of 2015, compared to $166.1 million for the second quarter of 2014 and $167.7 million for the first quarter of 2015. Net interest margin decreased to 2.61% for the second quarter of 2015, primarily due to increased deposits at the Federal Reserve Bank funded by Federal Home Loan Bank borrowings and continued competitive loan pricing and low interest rates. Net interest margin was 2.75% for the second quarter of 2014 and 2.55% for the first quarter of 2015.
- Fees and commissions revenue totaled $172.5 million for the second quarter of 2015, an $8.5 million or 5% increase over the second quarter of 2014. Mortgage banking revenue increased $7.5 million based on higher loan production volume. Increased fiduciary and asset management fees were offset by lower brokerage and trading revenue. Fees and commissions revenue increased $6.6 million over the first quarter of 2015, with solid performance in all fee generating lines of business.
- Changes in the fair value of mortgage servicing rights, net of economic hedges, decreased pre-tax net income in the second quarter of 2015 by $1.1 million, decreased pre-tax net income in the second quarter of 2014 by $1.5 million and decreased pre-tax net income by $5.0 million in the first quarter of 2015. Net changes in the fair value of mortgage servicing rights for the second quarter of 2015 were largely driven by an increase in servicing costs.
- Operating expenses totaled $227.1 million for the second quarter of 2015, an increase of $12.4 million over the second quarter of 2014. Personnel expense increased $9.0 million and non-personnel expense increased $3.4 million. Operating expenses increased $6.8 million over the previous quarter.
- The Company recorded a $4.0 million provision for credit losses in the second quarter of 2015 primarily due to growth in the loan portfolio. No provision for credit losses was recorded in the first quarter of 2015 or the second quarter of 2014. Gross charge-offs were $2.9 million in the second quarter of 2015, $3.5 million in the second quarter of 2014 and $2.2 million in the first quarter of 2015. Recoveries were $2.2 million in the second quarter of 2015, compared to $5.5 million in the second quarter of 2014 and $10.5 million in the first quarter of 2015.
- The combined allowance for credit losses totaled $202 million or 1.34% of outstanding loans at June 30, 2015, compared to $199 million or 1.35% of outstanding loans at March 31, 2015. Nonperforming assets that are not guaranteed by U.S. government agencies totaled $123 million or 0.82% of outstanding loans and repossessed assets (excluding those guaranteed by U.S. government agencies) at June 30, 2015 and $123 million or 0.85% of outstanding loans and repossessed assets (excluding those guaranteed by U.S. government agencies) at March 31, 2015.
- Average loans increased by $351 million over the previous quarter due primarily to growth in commercial and commercial real estate loans. Average commercial loans were up $326 million and average commercial real estate loans increased $80 million. Period-end outstanding loan balances were $15.1 billion at June 30, 2015, a $440 million increase over March 31, 2015. Commercial loan balances increased $385 million and commercial real estate loans increased $98 million.
- Average deposits decreased $155 million over the previous quarter, primarily due to a decrease in interest-bearing transaction accounts, partially offset by growth in average demand deposit balances. Period-end deposits were $21.1 billion at June 30, 2015, largely unchanged compared to March 31, 2015.
- New regulatory capital rules were effective for BOK Financial on January 1, 2015 and established a 7% threshold for the common equity Tier 1 ratio. The Company's common equity Tier 1 ratio was 13.01% at June 30, 2015. In addition, the Company's Tier 1 capital ratio was 13.01%, total capital ratio was 14.11% and leverage ratio was 9.75% at June 30, 2015. The Company's common equity Tier 1 ratio was 13.07% at March 31, 2015. In addition, the Company's Tier 1 capital ratio was 13.07%, total capital ratio was 14.39% and leverage ratio was 9.74% at March 31, 2015.

- The Company paid a regular quarterly cash dividend of $29 million or $0.42 per common share during the second quarter of 2015. On July 28, 2015, the board of directors approved a regular quarterly cash dividend of $0.42 per common share payable on or about August 28, 2015 to shareholders of record as of August 14, 2015.

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 $175.7 million for the second quarter of 2015 compared to $166.1 million for the second quarter of 2014 and $167.7 million for the first quarter of 2015. Net interest margin was 2.61% for the second quarter of 2015, 2.75% for the second quarter of 2014 and 2.55% for the first quarter of 2015.

Net interest revenue increased $9.6 million over the second quarter of 2014. Net interest revenue increased $15.8 million primarily due to the growth in average loan balances. Net interest revenue decreased $5.9 million primarily due to lower loan yields, partially offset by lower funding costs.

The tax-equivalent yield on earning assets was 2.84% for the second quarter of 2015, down 18 basis points from the second quarter of 2014. Loan yields decreased 20 basis points primarily due to continued market pricing pressure and lower interest rates. The available for sale securities portfolio yield decreased 2 basis points to 1.94%. Excess cash flows are currently being reinvested in short-duration securities that are yielding nearly 2.00%. Funding costs were down 7 basis points compared to the second quarter of 2014. The cost of interest-bearing deposits decreased 5 basis points and the cost of other borrowed funds increased 3 basis points largely due to the mix of funding sources. The cost of subordinated debentures decreased 31 basis points as $122 million of fixed-rate subordinated debt matured on June 1, 2015. The cost of this subordinated debt, including issuance discounts and hedge loss was 5.56%. The benefit to net interest margin from earning assets funded by non-interest bearing liabilities was 12 basis points for the second quarter of 2015 and 15 basis points for the second quarter of 2014.

Average earning assets for the second quarter of 2015 increased $2.9 billion or 12% over the second quarter of 2014. Average loans, net of allowance for loan losses, increased $1.6 billion due primarily to growth in average commercial and commercial real estate loans. The average balance of interest-bearing cash and cash equivalents was up $1.4 billion over the second quarter of 2014 as borrowings from the Federal Home Loan Banks were deposited in the Federal Reserve to earn a spread of approximately $842 thousand. The average balance of available for sale securities decreased $738 million as we reduced the size of our bond portfolio during 2014 through normal monthly runoff to better position the balance sheet for a longer-term rising rate environment. The average balances of fair value option securities held as an economic hedge of our mortgage servicing rights, residential mortgage loans held for sale, restricted equity securities, and trading securities were all up over the prior year.

Average deposits increased $597 million over the second quarter of 2014, including a $342 million increase in average demand deposit balances and a $213 million increase in average interest-bearing transaction accounts. Average savings account balances and average time deposits both increased over the prior year. Average borrowed funds increased $2.1 billion over the second quarter of 2014, primarily due to increased borrowings from the Federal Home Loan Banks. The average balance of subordinated debentures decreased $40 million.

Net interest margin increased 6 basis points over the first quarter of 2015. The yield on average earning assets increased 4 basis points. The loan portfolio yield increased 6 basis points to 3.65%, primarily due to $2.3 million of nonaccrual interest recoveries during the quarter and increased loan fees compared to the first quarter. Competitive loan pricing and low interest rates continue to impact loan yields. The yield on the available for sale securities portfolio decreased 4 basis points to 1.94%. Funding costs were down 3 basis points to 0.35%. The benefit to net interest margin from earning assets funded by non-interest bearing liabilities decreased by a basis point.

Average earning assets increased $383 million during the second quarter of 2015, primarily due to growth in average outstanding loans of $351 million over the previous quarter. Average commercial loan balances were up $326 million and average commercial real estate loan balances increased $80 million. Residential mortgage loans held for sale increased $116 million. The average balance of restricted equity securities increased $43 million and the average balance of fair value option securities held as an economic hedge of our mortgage servicing rights increased $31 million. This growth was partially offset by a $38 million decrease in the average balance of the available for sale securities portfolio, a $14 million decrease in average investment securities balances and a $14 million decrease in average trading securities balances.
Average deposits decreased $155 million over the previous quarter. Interest-bearing transaction account balances decreased $275 million, partially offset by a $111 million increase in average demand deposit balances. The average balance of borrowed funds increased $684 million over the first quarter of 2015, primarily due to increased borrowings from the Federal Home Loan Banks. The average balance of subordinated debentures decreased $40 million.

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 June 30, 2015 / 2014			Six Months Ended June 30, 2015 / 2014		
		Change Due To[1]			Change Due To[1]	
	Change	Volume	Yield / Rate	Change	Volume	Yield /Rate
Tax-equivalent interest revenue:						
Interest-bearing cash and cash equivalents	$867	$835	$32	$2,024	$1,746	$278
Trading securities	58	204	(146)	213	423	(210)
Investment securities:						
Taxable securities	56	144	(88)	100	264	(164)
Tax-exempt securities	(238)	(166)	(72)	(505)	(318)	(187)
Total investment securities	(182)	(22)	(160)	(405)	(54)	(351)
Available for sale securities:						
Taxable securities	(4,103)	(3,715)	(388)	(8,253)	(9,174)	921
Tax-exempt securities	(169)	(120)	(49)	17	(220)	237
Total available for sale securities	(4,272)	(3,835)	(437)	(8,236)	(9,394)	1,158
Fair value option securities	1,526	1,355	171	2,678	2,313	365
Restricted equity securities	1,953	1,643	310	3,553	2,722	831
Residential mortgage loans held for sale	1,369	2,438	(1,069)	2,728	3,793	(1,065)
Loans	8,095	15,230	(7,135)	12,712	30,062	(17,350)
Total tax-equivalent interest revenue	9,414	17,848	(8,434)	15,267	31,611	(16,344)
Interest expense:						
Transaction deposits	(292)	3	(295)	(386)	132	(518)
Savings deposits	(3)	7	(10)	(7)	13	(20)
Time deposits	(1,216)	46	(1,262)	(1,999)	(97)	(1,902)
Funds purchased	(94)	(99)	5	(239)	(286)	47
Repurchase agreements	(121)	(18)	(103)	(168)	8	(176)
Other borrowings	1,768	2,379	(611)	3,199	4,218	(1,019)
Subordinated debentures	(494)	(238)	(256)	(487)	(239)	(248)
Total interest expense	(452)	2,080	(2,532)	(87)	3,749	(3,836)
Tax-equivalent net interest revenue	9,866	15,768	(5,902)	15,354	27,862	(12,508)
Change in tax-equivalent adjustment	232			636		
Net interest revenue	$9,634			$14,718		

[1] Changes attributable to both volume and yield/rate are allocated to both volume and yield/rate on an equal basis.

Other Operating Revenue

Other operating revenue was $176.3 million for the second quarter of 2015, a $10.1 million increase over the second quarter of 2014 and a $10.3 million increase over the first quarter of 2015. Fees and commissions revenue increased $8.5 million over the second quarter of 2014 and increased $6.6 million over the prior quarter. The change in the fair value of mortgage servicing rights, net of economic hedges, decreased other operating revenue by $1.1 million in the second quarter of 2015, $5.0 million in the first quarter of 2015 and $1.5 million in the second quarter of 2014.

Table 2 – Other Operating Revenue
(In thousands)

	Three Months Ended June 30,				Three Months Ended Mar. 31, 2015		
	2015	2014	Increase (Decrease)	% Increase (Decrease)		Increase (Decrease)	% Increase (Decrease)
Brokerage and trading revenue	$36,012	$39,056	$(3,044)	(8)%	$31,707	$4,305	14 %
Transaction card revenue	32,778	31,510	1,268	4 %	31,010	1,768	6 %
Fiduciary and asset management revenue	32,712	29,543	3,169	11 %	31,469	1,243	4 %
Deposit service charges and fees	22,328	23,133	(805)	(3)%	21,684	644	3 %
Mortgage banking revenue	36,846	29,330	7,516	26 %	39,320	(2,474)	(6)%
Bank-owned life insurance	2,398	2,274	124	5 %	2,198	200	9 %
Other revenue	9,473	9,208	265	3 %	8,603	870	10 %
Total fees and commissions revenue	172,547						