Garland W. Binns, Jr.
Dover Dixon Horne PLLC
Attorneys at Law
425 West Capitol, 37th Floor
Little Rock, Arkansas 72201
Telephone: (501) 375-9151
Facsimile: (501) 375-6484
Email: gbinns@ddh-ar.com
Web Site: www.GWBinns.com

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U P D A T E

News of Developments in the Financial Sector and Related Areas

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FDIC Study on Bank Consolidation

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The Federal Deposit Interest Corporation ("FDIC") recently released a research study on long-term consolidation in banking and the implications of this trend for community banks. Drawing from data over the past thirty years, the study found that community banks have remained highly resilient amid the long-term trend of banking industry consolidation. The study concluded that the recent uptick in the rate of consolidation is attributable to factors that are likely to subside once the effects of the recent financial crisis are fully behind us. It also found that consolidation has had much less impact on the community banking sector than is commonly believed.

The key finding of the study is that institutions with assets between $100 million and $10 billion, most of which can be considered community banks, have increased in both number and in total assets since 1985. The number of banks with assets between $100 million and $1 billion increased by 7 percent between 1985 and 2013, while the number of banks between assets $1 billion and $10 billion increased by 5 percent. These groups of institutions also experienced growth in terms of total assets. The assets of banks between $100 million and $1 billion increased by 27 percent between 1985 and 2013, while the assets of banks between $1 billion and $10 billion grew by 4 percent.

The study found that consolidation had its biggest effect on the very smallest and the largest banks. The number of institutions with assets less than $100 million declined by 85 percent between 1985 and 2013. Meanwhile, institutions with assets greater than $10 billion have seen their number almost triple.

The study reflected that the total number of institutions declined from around 20,000 in 1980 to 6,812 at the end of 2013. The study found that the decline in the number of financial institutions during this period was as a result of voluntary disclosure of bank charters, which accounted for around 80 percent of the total attrition in charters since 1985. The voluntary closure of banks was a result of such things as consolidation of commonly owned charters, inter-company mergers and in some cases, self-liquidation. The second most important factor contributing to consolidation of banks since 1985 has been through failures. Between 1985 and 2013, a total of 2,580 federally insured banks and institutions failed.

The study found that another main component of consolidation is new banking charters. The rate of which new charters have been added has been proven to be highly cyclical. Since year-end 1985, the banking industry has established new federally insured institutions at an average annual rate of 1.3 percent. Only 15 new charters were established between the end

of 2009 and the end of 2013. The study found that chartering activity can be expected to recover over the next few years as the effects of the recent financial crisis recede. As the pace of chartering activity does increase, the rate of net consolidation in financial institutions is expected to slow in coming years.

All of the net reduction in the number of bank and thrift charters between 1985 and 2013 can be accounted for by the decline in the number of institutions with assets less than $100 million which fail by 85 percent over this period. The number of institutions with assets less than $25 million declined by 96 percent during this period, from 5,717 to just 205. While the number of institutions with assets between $25 million and $100 million also declined by 77 percent during this period, some 1,851 institutions continued to operate in this size category in 2013.

The study found that community banks are more accurately described in terms of how and where they conduct business. Community banks tend to focus on providing essential banking services in their local communities. They obtain most of their core deposits locally and make many of their loans to local businesses. For this reason, they are often considered to be "relationship" bankers as opposed to "transactional" bankers. This means that they have specialized knowledge of their local community and their customers. Because of this expertise, community banks tend to base credit decisions on local knowledge and nonstandard data obtained through long-term relationships and are less likely to rely on the models-based underwriting used by larger banks.

The implementation of the term "community banks" reflects that as of the year-end 2012, there were 6,544 community banking charters operating within 6,141 community banking organizations. The study found that the most obvious indicator of community banks in the face of industry consolidation is the fact that some 93 percent of insured banking institutions met the community bank definition at year-end 2013, up from 87 percent at the end of 1985.

Compared to the mid-1980s, today's community banking sector is composed of somewhat larger institutions that continue to provide essential banking services to a limited geographic market. The study found that community banks have experienced relatively low rates of attrition and, when the do exit the industry, are usually acquired by other community banks. Analysis of the 2,579 community bank charters that were acquired between year-end 2003 and year-end 2013 shows that 65 percent were acquired by other community banks. Among community banks with assets less than $100 million, the share acquired by other community banks was 85 percent, and among those with assets between $100 million and $1 billion, the share acquired by community banks was 56 percent. After nearly 30 years of industry consolidation, the median community bank in 2013 had grown to $167 million, more than four times the median size in 1985.

The increase in the median size of community banks is consistent with both the large declines that have been observed in the number of very small charters (especially those with assets less than $25 million) and the existence of economies of scale at these very small asset sizes. It does not comport with claims that only community banks with assets of $1 billion or more could be considered viable. In fact, almost 90 percent of community banks operating at the end of 2013 held total assets of less than $730 million.

It will be interesting to see if the results of the study prove to be correct over the next few years.

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