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U P D A T E

News of Developments in the Financial Sector and Related Areas

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Consolidation in Banking

The banking industry continues to consolidate throughout the United States. Consolidation occurs from a number factors with banks experiencing loan and securities portfolio problems resulting in inadequate capital on one hand the pricing of banks in acquisition transactions on the other hand. In some cases, the regulatory compliance cost for small community banks has caused them to seek merger partners.

Recent surveys indicate that the minimum asset level a community bank must achieve to remain independent is at least $1 billion or more. Because of regulatory reform and compliance costs, many community banks either are or will be active in seeking a merger partner. Surveys reflect regulatory compliance continues to be an impediment for growth in community banks.

The FDIC reports that there were more than 18,000 insured institutions in the 1980s compared to 6,348 in the second quarter of 2015 representing a decline of over 65 percent. On a positive note, the number of problem institutions on the FDIC's Problem List has fallen to 253 during the second quarter of 2015 from a peak of 888 in the first quarter of 2011. Problem banks are characterized as those institutions having a risk of failing and being closed by the FDIC.

Prior to 2007 there had not been a bank failure since the second quarter of 2004. During the period beginning in 2007 and ending in July 2015, there were 516 bank failures. The good news is that there were only 18 bank failures in 2014, and there were only 6 bank failures through July of this year. It is noteworthy that of the 18 bank failures during 2014 that only 5 had assets of more than $150 million, and of the 6 bank failures during the first seven months of this year only 2 banks had assets of more than $150 million.

During the financial crisis there was a decline in merger and acquisition activity with probably the most significant factor in the decline being the closure of banks by the FDIC resulting in acquirers for banks purchasing the assets of the closed bank at a modest premium of the deposits, and the FDIC entering into loss-sharing agreements with the acquirers on potential loan and asset losses.

This year marked the fifth year in a row that there has been only three new bank charters. Except for a bank charter approved by the FDIC earlier this year, the first de novo charter occurred in the fourth quarter of 2010, and the second was approved by the FDIC in 2013. Bank of Bird-in-Hand was approved by the FDIC in 2013 and serves primarily a small farming community located east of Lancaster, Pennsylvania. Bank of Bird-in-Hand was organized with $17 million of capital by Amish businessmen with the shareholders being evenly split between Amish and non-Amish investors. The New Hampshire Banking Department approved the application of Primary Bank located in Bedford, New Hampshire earlier this year. Recently an application was filed with the California Department of Business Oversight for the formation of a bank by the name of Core Commercial Bank to be located in Newport Beach, California.

In its research study in April 2014 on long-term bank consolidation, the FDIC concluded that based on prior experience that chartering activity can be expected to recover over the next few years as the effects of the financial crisis recedes. Late in the year 2014, the FDIC updated its Statement of Policy on applications for FDIC deposit insurance with the hope that more organizing groups will apply for a new bank charter based on the updated policy. The policy provides that the initial capital raised by a proposed institution should generally be sufficient to provide a Leverage Ratio of at least 8 percent throughout the first three years of operation, but the amount of cash capital necessary to organize an institution will be largely derived from the proposed institution's size, complexity and business strategy.

In connection with the decline in community banks, we contacted a number of people involved in the banking sector asking them if the Dodd-Frank Wall Street Reform and Consumer Protection Act which was signed into law by President Obama on July 21, 2010, was the primary reason for the shrinkage in the number of small banks. A compilation of the responses that were received to our question are as follows:

- I don't think it's the whole reason for the demise of small banks, but I do know it's added a burden to this already overburdened rural bank.

- Certainly a contributing factor.

- I believe there always will be a market for locally owned and managed smaller banks even though we continue to lose them due to the economies of scale brought on by increased regulatory burden.

- It may not be the sole reason, but it sure isn't helping.

- I would fall in the "a reason, but maybe not the primary reason" category.

- I don't believe that the reason for the decline is Dodd Frank, but clearly it's a contributor.

- Yes. Dodd Frank is the reason for the decline in small banks.

- Both Dodd Frank and the lack of succession planning is leading to much of the consolidation.

- Between bank regulations and crude oil price volatility, there is quite a bit for southwestern bankers to be concerned about these days.

- Smaller banks that treat customer service and relationships as top priorities will survive because of customer loyalty that results.

- There is no doubt that Dodd Frank is playing a large role in changing the banking landscape.

It is interesting to note that in its research study in April 2014 on long-term bank consolidation, the FDIC concluded that the recent uptick in the rate of consolidation is attributable to factors that are likely to subside once the effects of the financial crisis are fully behind us, and that consolidation has had much less impact on the community banking sector than is commonly believed.