America's Mutual Banks

Mutual Alert

FDIC 2020 Community Banking Study

This week the FDIC published their 2020 Community Banking Study. This is a new large-scale study examining the state of the nation's community banks. As we have reported in previous alerts throughout the year, the FDIC also reports that community banks provided a key role in lending and relative to the rest of the banking industry continued to have positive financial performance during the COVID-19 pandemic. This speaks to how important community banks are and how they are able to interact differently than big banks with their communities during a time of need. Community banks are able to build relationships with their community and originate loans that require local knowledge and individual attention, rather than loans made by a formula. This has greatly contributed to the positive performance of mutual community banks throughout the pandemic. America's Mutual Banks (AMB) has always strongly emphasized the importance of mutual banks and their benefits to policy makers and legislators and their success and ability to help their communities during the pandemic echoes their critical role that we continuously fight for. Unfortunately, the study does little to breakout mutual data in any category an oversight we will continue to seek to be remedied.

Key takeaways from the study include:

- From 2012 to 2019, the number of community banks fells from 6,802 to 4,750. This change is attributed to mergers between unaffiliated institutions. During the period of the study, over two-thirds of community banks that closed were acquired by other community banks. This percentage decline is actually greater than the decline in mutuals but on an asset level larger mutual conversions are effecting the percentage in assets held by mutual. There was also a decline in non-community banks from 555 to 427 since 2012.

- New chartering fell to post-1985 record low rates between 2012 and 2019, which led to the average annual rate of net consolidation increasing to 4.3 percent from the 3.2 percent which was common between 1985 and 2011. Of course, no mention is made of the complete absence of any new chartering of mutuals since the 1960s.

- The number of merger announcements during the first nine months of 2020 (82 mergers) was down 59 percent compared to the first nine months of 2019 (200 mergers).

- Demographic changes have a profound impact on community banks. Community banks and the services they provide are dictated by the demands of the population in that community. In areas with a younger demographic and population inflows, community banks are growing quickly and profitably. Because the report fails to distinguish data from mutual community banks, it does not address the capital needs of mutual banks in high growth areas. Consequently, relative market share does not keep pace with their stock brethren. This is a key fact in making the case for alternative forms of capital for mutual banks. In areas with net outflows, there is concern about continued growth. Community banks based in rural areas that have population outflows have slower growth and lower commercial lending portfolios which could lead to higher consolidation rates in the future.

- As AMB has shared throughout the years, community banks and mutual banks face disproportionate regulatory burden. Smaller banks have limited compliance resources and are adversely affected by regulatory burden. The regulatory actions taken by the six federal agencies, which often implement statutory mandates from Congress, cumulate over time and pose a daunting task for banks with modest staff and resources. Regulatory compliance has become a factor contributing to higher rates of exit from the banking industry by community banks, increase in target asset size of new small banks, and an increase in the proportion of small residential mortgage lenders that are reducing their residential mortgage holdings.

- A large number of regulatory changes between 2008 and 2019 dealt with mortgage lending and servicing. During those years, 36 substantial final rules were issued governing aspects of 1-4 family residential mortgage lending and servicing. Community banks' mortgage lending since the banking crisis has outpaced lending from non-community banks. As of year-end in 2019, over 99 percent of community banks reported some level of 1-4 family residential mortgages. This data would seem to strengthen the case for size exemptions from the reporting burdens which AMB has had some success with in the past. We will continue to seek further relief.

- In addition to the regulatory changes in residential mortgage lending, another large chunk of rules addressed consumer credit and retail payments. From 2008 to 2019 there were 27 distinct rules in this category.

- The COVID-19 pandemic has brought on a great deal of regulatory activity with a focus on rules and programs that encourage and facilitate banks' provision of financial services. The statutory backdrop driving many of the pandemic related rules was the CARES act which was a $2.2 trillion relief package signed in to law in March. Rules following the CARES act included the PPP, extension of the regulatory capital transition period, reducing the Community Bank Leverage Ratio threshold temporarily to 8 percent, modification of capital rules to neutralize the regulatory capital effects on banks participating in the PPP, deferring certain required real estate appraisals, and the modification of FDIC deposit insurance premiums. Accounting relief for forbearance is likely to continue.

- Commercial real estate (CRE), small business, and agriculture lending far exceeds community banks' relative size within the overall banking industry. Community banks account for only 15 percent of the banking industry, yet hold 30 percent of all CRE loans, 36 percent of small business loans, and 70 percent of agricultural loans. Current provisions in the Covid-19 relief extension Bill to be voted on today will affect this data going forward.

- Community banks have had to adopt new technologies in response to bank characteristics, the economic environment, competitive factors, and expectations of bank leadership and consumers. Based on data collected by the Conference of State Bank Supervisors (CSBS) from community banks across 43 states, as of 2019, 90.9 percent of community banks had adopted mobile banking, 83.2 percent adopted electronic bill payment, 78.8 percent adopted remote deposit capture, 37.2 have online loan applications, 11.6 have automated loan underwriting, 10.8 have interactive teller machines, and 4.8 percent have online loan closure.

- In the CSBS study, when asked to describe challenges in adopting new technology, the single most common word was "cost", followed by "security", "risk", "regulation", and "compliance". This is reflected in the variance between banks that are considered high-adopting banks and low-adopting banks. The higher-adopting banks tend to be the bigger community banks with more resources and those in areas with increased population inflow and increased younger populations. The average high-adopter reported assets that were $324 million greater than medium adopters, and $535 million greater than low-adopters. Only 6 percent of community banks with assets less than $100 million were high-adopters compared to 70 percent of community banks with assets of more than $1 billion.

It is interesting to note that in the 129 page report, mutual banks are referenced only four times and only in the appendix which lists regulatory actions as a reference. To view the full report click here. We intend to urge the FDIC to focus more in their collection of data on mutual and their particular needs.

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