COMMUNITY BANKING IN THE 21ST CENTURY

As the post-election economy has continued to improve over the last year, so has the need for new, or *de novo*, banks. With the FDIC scaling back regulations and with the Trump administration actively peeling back Dodd-Frank, community banking has started to come bank to life. 2017 saw the highest number of applications and approvals for *de novo* banks in years, with 2018 shaping up to be yet another developing year.

Where have all the banks gone?

Since 2007, and through the Great Recession, 77, or more than 23%, of banks in Florida failed, while 555, or 6%, of banks in the country failed.[1] Also during that time many other banks were consumed by surviving banks through mergers and acquisitions. All told, the number of Florida banks dropped from 306 at the beginning of 2007, to 129 today. Likewise, the total number of banks in the country dropped by almost 35%, from 8,681 at the start of 2007 to 5,658 today.[2]

Failures, mergers and acquisitions don't tell the entire story though. While mergers and acquisitions are an accepted and welcomed part of the banking industry, the widespread failures were something new and helped define the Great Recession. What was also new was the near absence of new banks during that same time period. This was the result of a combination of several different factors: the economy and interest rates; the regulatory climate; the increased burden and cost of regulatory compliance; and fear held by investors.

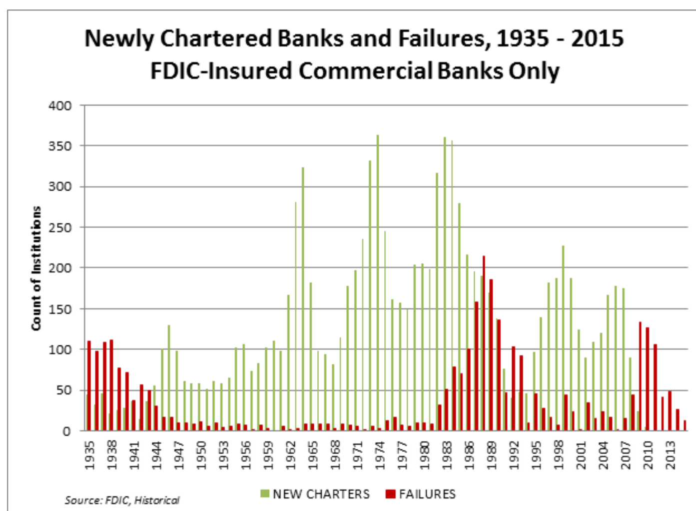

Chart 1

Chart 1 shows the cyclical nature of *de novo* banks in relation to bank failures over the past seventy (70) years. While the number of new banks has ebbed and flowed over time, the current dearth of new banks is unprecedented over this period. Historically, new bank numbers increased as the economy improved, but in this last cycle that has not been true. [3] However, with the economy continuously hitting record high benchmarks – the new banks are finally starting to follow.

Clearly the economy during the Great Recession had a negative effect on the number of new banks, but according to many sources, the recession is over and the country has been in recovery for six and a half years. The number of applications for *de novo* banks started gaining momentum in 2017. In the eight years before the recession (2000-2007), the Federal Deposit Insurance Corporation ("FDIC") received, on average, more than 200 applications for new banks each year, for a total of 1,637 applications.[4] From 2010 to the present, the FDIC has received a total of 26 applications, 10 of which have been submitted in the last year. *Table 1*[5], below, breaks out the applications by year:

De Novo Applications Received by Year January 1, 2000 – December 31, 2017	
Year Received	Total Applications
2000	205
2001	156
2002	147
2003	161
2004	214
2005	299
2006	232
2007	223
2008	101
2009	33
2010	6
2011	1
2012	0
2013	4
2014	1
2015	2
2016	2
2017	8
2018	2

Table 1, Source: FDIC

Not only were there fewer applications, but the approval rate for the few applications that were submitted dropped from the 70-75% approval rate from the recent past leading up to the Great Recession, down to the post-recession 20-30% approval rate.[6] Although,

half of the applications that were submitted between 2011 and 2016 were withdrawn by the Applicants, not rejected, as depicted in *Table 2* below. The most recent statistics are unavailable, though we do know that in 2017, 8 applications were approved, and 2 more are pending as of the date of this article.

De Novo Applications Received by Year, and The Disposition of Those Applications By Percentage					
Applications Received January 1, 2000, through June 30, 2016*					
Year Received	Count	Approve	Return	Withdrawn	Pending
Total	1,787	70.6	13.4	15.8	0.2
Pre-2008	1,637	75.1	11.9	13.0	0.0
2008-2010	140	20.0	32.1	46.4	1.4
2011-2016	10	30.0	0.0	50.0	20.0

Table 2, Source: FDIC

While there was only one *de novo* bank application filed and opened in Florida in 2017 (national bank in Winter Park, Florida), the interest in new bank charters has increased with at least three organizing groups in the planning stages in different parts of Florida. With the passage of what was to be known as the "Tax Cuts and Jobs Act," which reduced the tax rates for small businesses and companies to 21%, investors are seeing advantages in investing in community banks.

As seen in *Chart 2*, there was a drop in the number of start-up businesses during the Great Recession, but they have increased and have surpassed pre-recession levels. So why did the banking industry behave differently? One of the primary reasons was the increase in both the number of regulations and the scrutiny by regulators on banks.

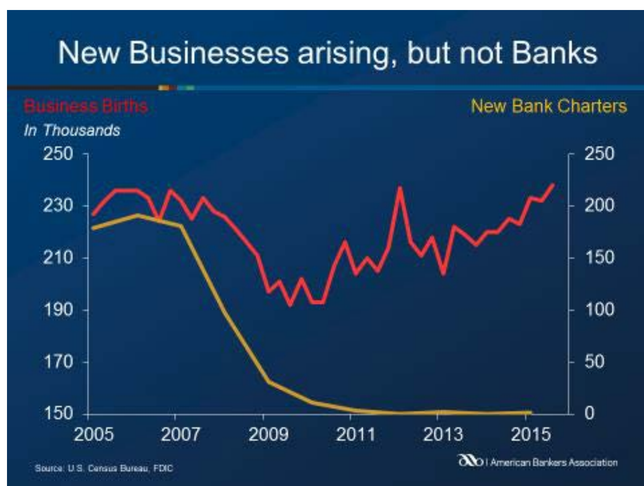

Chart 2[7]

The regulatory climate did not stimulate interest in new banks during the Great Recession, in fact, it became inhospitable. For newly insured banks, the FDIC imposes "Enhanced Supervisory Procedures"[8] for a number of years (the "*de novo* period"). During the *de novo* period, banks are subject to more frequent "examination activities" by the FDIC, are required to maintain elevated capital levels and are required "to provide written notice of proposed changes to business plans."[9] In response to the substantial increase in bank failures, in 2009, the FDIC extended the *de novo* period from the historical three (3) years to a new seven (7) years, and did so retroactively for all banks still within the three year period at the time of the change.[10] In addition, during the newly extended *de novo* period, the FDIC required that new banks maintain Tier 1 capital levels of 8% and "obtain prior approval from the FDIC for any proposed material change or deviation in the business plan."[11]

The regulatory environment for businesses has changed under the new President and his Administration. Regulations are being rolled back and eliminated. The policy is that for every new regulation, two existing regulations have to be removed, reducing regulatory burdens on businesses, including banks. As announced by President Donald Trump at the 2018 World Economic Forum in Davos, Switzerland, to date for every one new regulation, twenty-two regulations have been eliminated. The negativity toward *de novo* banks has now reversed with the number of community banks disappearing through active merger and acquisition cycle. Transactions such as CenterState Banks, Inc.'s acquisition of Sunshine Bancorp, Inc. and HCFB Holding Company, Inc. (Harbor Community Bank), Home BancShares, Inc.'s (Centennial Bank) acquisition of Stonegate Bank and National Commerce Corp.'s acquisition of First Atlantic Holdings, Inc., and the announcements of FCB Financial Holdings, Inc.'s acquisition of Floridian Community Holdings, Inc., and Ameris Bancorp's acquisition of Atlantic Coast Financial Corporation, the void of community banks has become pronounced.

New banks are needed.

Since November 8, 2017, growth in the U.S. economy has been significant, with the GDP at or just over 3% for the first time in over eight years and unemployment level at an all time low of 4.1% as of October, 2017.

New banks begin as community banks in the markets which they serve. Generally banks with less than $1 billion in total assets are considered community banks. While there have always been naysayers that believe there is no future for community banks, they continue to prosper across the country. As FDIC Commissioner Martin Gruenberg recently affirmed, "Community

banks are the very core of the U.S. financial system."[12] In that speech regarding the importance of new community banks he also stated that "community banks play a critically important role in the financial system and economy of the United States."[13]

So why are community banks so important? For one thing, many individuals and small businesses prefer the personal service and the relationship-based experience that a community bank is well suited to provide. In addition, community banks, due to their size alone, are more flexible and can more easily adapt to meet the business and economic challenges of their local markets. For instance, a community bank can modify loan requests and tailor them to a customer's needs, like bigger banks do for large corporations.

While community banks are responsible for only a small percentage of all loans made in the country, they are responsible for approximately 44% of small business loans.[14] That is an important fact that clearly impacts the economy. Not only are community banks small businesses, but they serve the needs of other small business and together they employ nearly half of the country's work force (49.2%) and provide 42.9% of the total U.S. payroll.[15] One on one service and flexibility allow community banks to compete and provide value to customers. Providing good service to customers in turn breeds loyalty in the customer base, which in time will cause the bank to grow. Simply put, employees are providing the customer service that defines community banks. That service grows the banks.

Rumors of the obstacles to forming a new bank have been greatly exaggerated.

Over the last several years there have been rumors about how much more difficult and expensive it would be to start a bank now as compared to pre-recession. Those rumors were based on several premises: higher costs of regulatory compliance; low and stagnant interest rates; increased capital requirements; increased regulatory scrutiny of the application and business plan; and the difficulty in reaching profitability within three years. Fueling those rumors were the lack of new applications to the FDIC for insurance over the last five years and the extension of the *de novo* period. That has changed. In 2016, the FDIC rolled back the *de novo* period from seven to three years. For purposes of business plans, *de novo* banks are now only required to maintain 8% Tier-One Leverage Capital for the first three years of operation as was required in the pre-recession era.

It is understandable that regulators were gun-shy about approving new banks given the number of banks failing in the recession and no one knowing when it would end. Things have calmed down now, and the sun has come up about 3,000 times since the National Bureau of Economic Research declared the Great Recession to be over. The economy has finally begun to hit its stride with companies reinvesting in the U.S. economy.

The premises for the rumors are no longer viable. While regulatory costs increased, there have always been regulatory costs in the banking industry. No doubt regulatory costs increased with the government's reactionary passing of the *Dodd-Frank Wall Street Reform and Consumer Protection Act*, but much of the cost absorbed by existing banks is spent on upgrading operations to maintain compliance. Any new bank will be able to begin with appropriate compliance staff, software and operations in place.

The pendulum is also swinging back the other way. The appointment of Mick Mulvaney as the new head of the Consumer Protection Bureau is seen as a relief to the "gotcha" mentality that had been promoted by the prior administration under Senators Elizabeth Warren, Senator Chris Dodd and Congressman Barney Frank. Consumer protection laws are very important, but they were overbearing. Penalties that were assessed were not refunded to the consumers, but were kept by the Consumer Protection Bureau. Regulatory reasonableness appears to be coming back into light. The new administration is set to present a bill next month that will further cut the Dodd-Frank Act, with the ultimate goal being to fully repeal Dodd-Frank and the regulations that come with it.

Many have said that in order to be profitable today, a bank would have to be at least $500 million to $1 billion in total assets because of regulatory compliance costs and increased capital requirements. This premise has been promoted by larger banks to obtain, justify and explain further growth through acquisitions and by certain investment firms focused on mergers and acquisitions. The fact is that community banks are profitable. As of the end of the first quarter of 2016, nearly 62% of community banks nationwide increased their net income over the previous year and only 5.1% of community banks were unprofitable during the first quarter.[16] Only 17 (7.3%) of Florida's 154 banks were unprofitable in that same quarter.[17] Even excluding

larger banks, the 13 remaining unprofitable banks make up only 11.4% of the 114 Florida banks currently with total assets of less than $500 million. For the year 2015, more than 88.5% of Florida banks with less than $500 million in total assets were profitable. All but one of the 13 banks that were not profitable had substantial asset quality issues with Non Performing Asset (NPA) levels well over the state average and in most cases multiple times the state and regional averages. These appear to be suffering from lingering effects of the Great Recession. Banking is still profitable business.[18]

On the other side of the spectrum, while more than half (51%) of the 5,658 U.S. banks have total assets of $200 million or less, there are currently only 104 banks in the country on the FDIC's "Problem List."[19] Size does not appear to be the determinative factor of a bank's financial performance. Likewise, 65% of the banks in Florida have total assets less than $500 million and a little under half are under the $300 million mark. Despite this fact, the teams at these "smaller" banks have made them profitable.

The fear related to capital requirements is unfounded for a couple of reasons. First, the capital requirements for a *de novo* bank are not much different than they ever were: 8% Tier 1 Capital (unless higher risk in a business plan requires more). Florida law requires at least $8 million in start-up capital, unless more is required in order to be considered adequate.[20] What is different is a mindset by many that a bank has to be at a certain size to be profitable and must reach that size by the end of the three year *de novo* period. For instance, current conventional thinking is that you have to grow to at least $300 million in total assets in three years to be profitable. In order to maintain 8% capital during that time and absorb initial losses, one would need initial capital of at least $26 million. However, as seen above, most banks in Florida are not that large.

Total Assets of De Novo Banks After Three Years		
Year Established	Average Total Assets	Median Total Assets
1990	$ 66,228	$ 49,103
1991*	$ 158,178	$ 76,604
1992*	$ 39,439	$ 36,383
1993*	$ 27,409	$ 27,409
1994*	$ 141,117	$ 69,346
1995	$ 85,528	$ 68,864
1996	$ 92,458	$ 104,175
1997	$ 129,428	$ 93,109
1998	$ 147,929	$ 95,498
1999	$ 99,532	$ 126,078
2000	$ 159,231	$ 77,152
2001	$ 154,655	$ 120,704
2002	$ 314,417	$ 205,558
2003	$ 122,937	$ 121,074
2004^	$ 236,813	$ 107,886
2005	$ 154,396	$ 150,701
2006^	$ 207,603	$ 158,612
2007	$ 198,790	$ 149,533
2008	$ 179,654	$ 161,174
2009*	$ 171,408	$ 171,408
2010*	$ -	$ -

* Excludes charters used for acquisitions.
^ Includes largest amount of capital raised to date.

Table 3, Source: FDIC

The reality is that very few banks grow quickly enough to make the initial capital requirement prohibitive. Of the 50 active banks that were chartered in Florida over the last eighteen (18) years, only 23 or 46% have still not surpassed $300 million in total assets and another three are just barely over that amount.[21] Over the last twenty-five (25) years, Florida *de novo* banks fell more in the range of $100 to $200 million in total assets after three years in operation as seen in *Table 3*.[22] In fact, of the 243 true *de novo* banks chartered over that time, only 16 reached or exceeded $300 million in total assets within three years and at least two of those raised record amounts of capital for their time.[23]

With a more realistic plan for growth over the first three years of operation, the initial capital requirements will be less than many have feared. For instance, if the proposed business plans projects the bank to reach $150 to $200 million in total assets by the end of the *de novo* period, initial capital requirements would be in the range of $14 to $18 million.

Why Now? Why Florida?

The time is right for new banks to once again begin serving communities where previous banks have failed or been merged out of existence. The regulatory climate has improved to the point that the FDIC is making efforts to encourage new applications for bank insurance. As noted by FDIC Chairman Martin Gruenberg, over the last few months, the FDIC has announced "initiatives to support the efforts of viable organizing groups. . . which support the development, submission, and review of proposals to organize new institutions."[24] The FDIC has released a handbook for Organizers of *de novo* institutions applying for deposit insurance. It is an attempt to provide plain language requirements and explanation of the application process. Further, of the eight decisions that the FDIC made in 2017 regarding *de novo* banks, all of them were approvals. The FDIC Atlanta Regional Office recently advised that deposit insurance applications filed by a *de novo* bank with a non-controversial business plan and experienced management can be approved within short a time as four (4) months. This push by the FDIC to help guide and accept new banks is an obvious statement that they believe the economy is ready.

Likewise the Florida Office of Financial Regulation ("OFR") is also receptive to the idea of a new state-chartered bank in Florida. The Office of the Comptroller of the Currency is also promoting new bank charters, having suspended the application fees for 2018.

Technology has improved and is affordable enough to allow a new bank to offer the products, services and protection that larger banks can provide, making them competitive from the very beginning. In addition, new banks will be buying technology at current versions which will likely be more advanced than most banks and other businesses that delay upgrades because of the cost associated with upgrading and retraining personnel.

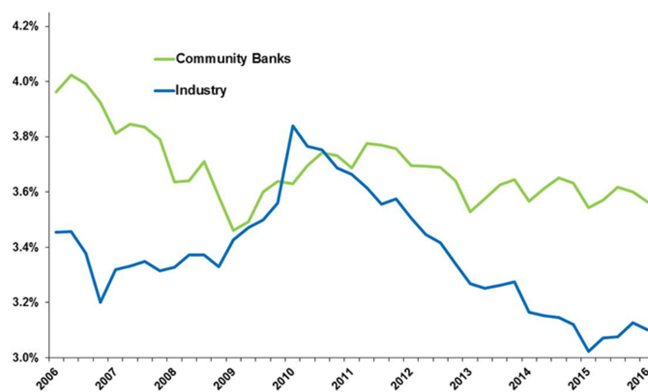

Chart 4, Source: FDIC[25]

The loss of so many banks in the bad times has resulted in new opportunities both in terms of locations and markets to serve and for displaced bank executives and lenders. The bank personnel that fought through the difficult times are now more seasoned and able to avoid some of the previous pitfalls and deal with problem loans more quickly if they do arise.

Conclusion

The time is right to begin applying for new charters. The regulatory climate is now more welcoming, the market opportunities and good personnel are available and the economy now booming at record levels being hit in the stock market and unemployment levels at an all time low there is an opportunity for new banking life.

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[1] FDIC. "FDIC Failed Bank List." Web. January 25, 2018. Retrieved from: https://www.fdic.gov/bank/individual/failed/banklist.html
[2] FDIC. "FDIC Details and Financials – Institution Directory." Web. January 25, 2018. Retrieved from: https://www5.fdic.gov/idasp/advSearchLanding.asp.
[3] Gruenberg, Martin J., Chairman, FDIC. "De Novo Banks and Industrial Loan Companies." U.S. House of Representatives, Washington D.C. July 13, 2016. Statement to Committee on Oversight and Government Reform.
[4] *Id.*
[5] *Id.*
[6] *Id.*
[7] Williams, Guy T. Testimony before the Oversight and Reform Committee of the U.S. House of Representatives on behalf of the American Bankers Association, Washington DC, July 13, 2016.
[8] FDIC. (2009). "FIL-50-2009." *Financial Institution Letter*. August 28, 2009. Web. July 25, 2016.
[9] *Id.*

[10] *Id*.
[11] *Id*.
[12] Gruenberg, Martin J. "Strategies for Long-Term Success." FDIC Community Banking Conference. Arlington, VA, April 6, 2016. Remarks by FDIC Chairman.
[13] *Id*.
[14] Williams, Guy T. Testimony before the Oversight and Reform Committee of the U.S. House of Representatives on behalf of the American Bankers Association, Washington DC, July 13, 2016.
[15] Hecht, Jared. "Are Small Businesses Really the Backbone of the Economy?" *Inc.com*. December 17, 2014. Web. July 25, 2016.
[16] FDIC. (2016). "Quarterly Banking Profile*."* March 30, 2016. Web. Retrieved from: https://www.fdic.gov/bank/analytical/qbp/2016mar/chart8.html.
[17] FDIC. "FDIC Details and Financials – Institution Directory." Web. August 16, 2016.
[18] *Id.*
[19] FDIC. (2016). "Quarterly Banking Profile*."* September 30, 2017..
[20] Section 658.21(2), *Florida Statutes*.
[21] FDIC. "FDIC Details and Financials – Institution Directory." Web. January 18, 2018.
[22] *Id.*
[23] *Id.*
[24] Gruenberg, Martin J., July 13, 2016.

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