

CALENDAR OF EVENTS

March 19

Corporate Payments Council Meeting
Dallas, TX

March 21–22

Economic Roundtable
Fort Worth, TX

March 26

Community Depository Institutions Advisory Council Meeting
Dallas, TX

March 28

Economic Roundtable
Sulphur Springs, TX

April 10

Dialogue with the Dallas Fed
Louisiana Tech University

April 11

Dialogue with the Dallas Fed
Tarleton State University

April 16

Economic Roundtable
Midland, TX

April 18–19

Economic Roundtable
Kilgore, TX

April 25

Economic Roundtable
El Paso, TX

May 17

Economic Insights: Conversations with the Dallas Fed
Webcast

May 29–30

Economic Roundtable
Amarillo, TX

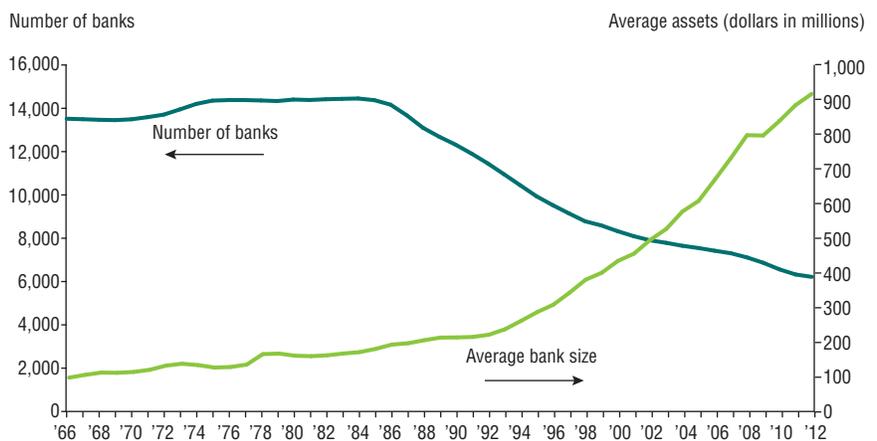
For more information about these events, email FIRM at Dallas_Fed_Firm@dal.frb.org.

The Time-Proven Community Bank Model

by Thomas F. Siems

From the mid-1960s through the mid-1980s, the number of commercial banks in the United States did not change much, fluctuating generally in the range from 13,500 to 14,500. But in 1984, the number of commercial banks peaked at 14,470 and has gradually declined to around 6,100 today. Chart 1 shows that, during the same time, the average inflation-adjusted bank size increased from under \$200 million in the mid-1980s to more than \$900 million today.

Chart 1 | The Trend Is Toward Fewer and Larger Banks



Moreover, the share of banking industry assets held by the largest banks has become increasingly concentrated, while the share of assets held by smaller institutions has contracted. In 1992, 72 percent of the commercial banks were small institutions with total assets under \$100 million. These small banks controlled nearly 10 percent of total banking industry assets. By 2012, only 33 percent of banks were considered small, and they held under 1 percent of banking industry assets.

By contrast, the largest banks—those with total assets of more than \$1 billion—made up 3.3 percent of the banks in 1992 and controlled 71 percent of industry assets. In 2012, the billion-dollar banks constituted 8.5 percent of the banking institutions and held 91 percent of the industry's assets.

Today, many consumers, business leaders, bankers and policymakers are questioning whether the dual trends of fewer and larger commercial banks are good for the national economy. Are the biggest banks too big? Are they too complex? If so, do big and complex banks create any special problems? And what about the smaller community banks? What role do small banks play in the economy? Is this role unique? What is the future for smaller community banks?

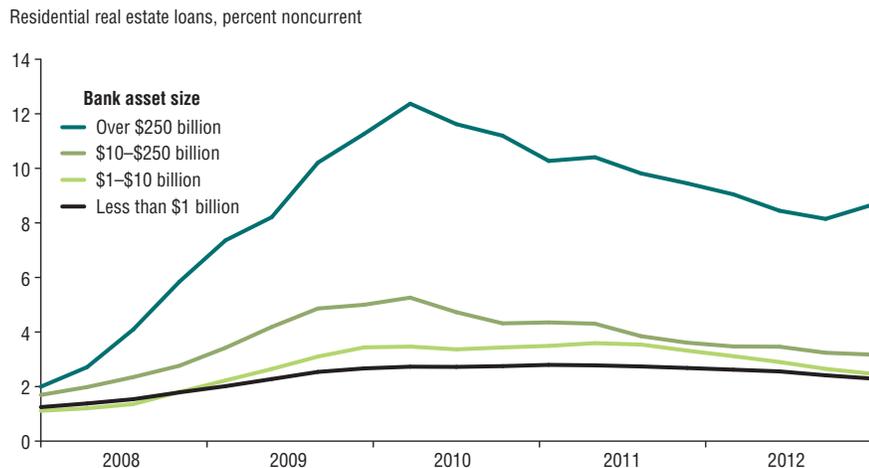
Financial Stability: Traditional Banks Pave the Way. Earlier this year, the Federal Reserve Bank of Dallas released a series of five online essays that consider these broad trends and rethink America’s banking system. These essays provide evidence that the best path to addressing much of the uncertainty that continues to plague the U.S. economy and returning it to prosperity is to:

1. restore market discipline to banks of all sizes and ensure that no institution is “too big to fail” (TBTF), and
2. return to the old and familiar traditional community bank model—built on long-term relationships and time-tested judgment—that results in better lending decisions, more small business lending and greater financial stability.

While each essay is briefly summarized below, readers are encouraged to follow the links in this article to read all of the essays and get the most complete picture for these arguments.

Community Banks Withstand the Storm examines the inherent stability of smaller, customer-focused institutions. Locally owned and operated banks are generally financially conservative and depend on a relationship lending model. That is, community banks know their customers and, when making lending decisions, look beyond credit scores and quantitative assessments used by their larger competitors. Firsthand knowledge of a borrower’s creditworthiness and vital customer information not readily or easily captured quantitatively appear to be far more valuable in generating and maintaining higher loan quality. Chart 2 is likely the most demonstrative chart in all of the essays. The chart clearly shows that the performance of community banks in maintaining residential real estate loan quality during and after the Great Recession (2008–09) has been far superior to that experienced by the nation’s largest institutions.

Chart 2 Community Banks Maintain Residential Real Estate Loan Quality



NOTE: Data for commercial banks. Residential real estate loans are closed-end, first-lien one- to four-family mortgages. Asset size is based on the total assets (expressed in June 2012 prices) of a U.S. banking organization (holding company, when applicable). Noncurrent loans are loans past due 90 days or more and loans no longer accruing interest. Noncurrent loan rates have been adjusted to exclude loans rebooked from Government National Mortgage Association securitizations.

SOURCES: Call Report, Federal Financial Institutions Examination Council; Consolidated Financial Statements for Bank Holding Companies (FR Y-9C), National Information Center data, Federal Reserve System.

DALLAS FED RESOURCES

Special Report

“Financial Stability: Traditional Banks Pave the Way”

Economic Insights: Conversations with the Dallas Fed (webcast)

“Ending Too Big to Fail: A Program for Financial Reform”

Texas Economic Indicators

Economic Updates

Regional—“Regional Economy Grows at a Moderate Pace”

National—“Factors Restraining U.S. Economy Should Lessen”

International—“Financial Risks Ease, but Effects May Be Slow to Reach Global Economy”

Dallas Beige Book

Texas Business Outlook Surveys

Agricultural Survey

Southwest Economy

“Determining Creditworthiness and Texas’ Case for a Top Rating”

Economic Letter

“Falling Off the Fiscal Cliff”

Building Wealth

“A Beginner’s Guide to Securing Your Financial Future”

Community Banking Connections

Find other resources on the Dallas Fed website at www.dallasfed.org.

ABOUT FINANCIAL INSIGHTS AND FIRM

Financial Insights is published periodically by FIRM – Financial Institution Relationship Management – to share timely economic topics of interest with financial institutions.

FIRM was organized in 2007 by the Federal Reserve Bank of Dallas as an outreach function to maintain mutually beneficial relationships with all financial institutions throughout the Eleventh Federal Reserve District. FIRM's primary purpose is to improve information sharing with district financial institutions so that the Dallas Fed is better able to accomplish its mission. FIRM also maintains the Dallas Fed's institutional knowledge of payments, engaging with the industry to understand market dynamics and advances in payment processing.

FIRM outreach includes hosting economic roundtable briefings, moderating CEO forums hosted by Dallas Fed senior management, leading the Dallas Fed's Community Depository Institutions Advisory Council (CDIAC) and Corporate Payments Council (CPC), as well as creating relevant webcast presentations and this publication. In addition, the group supports its constituents by remaining active with financial trade associations and through individual meetings with financial institutions.

Contact us at Dallas_Fed_FIRM@dal.frb.org.

A Lender for Tough Times shows how smaller institutions support their customers during recessions. Unlike the biggest financial institutions, smaller community banks continued to provide credit to firms, especially small businesses, during and after the recent financial crisis. These smaller banks depended heavily on their relationship lending model and provided credit to many businesses when it was needed most, proving that they were a more stable source of credit. Smaller community banks were able to continue lending during these tough times because they were far more adept at making good loans.

Small Banks Squeezed discusses small banks' uphill struggle for market share. The community bank model seems superior with its better loan quality and ability to weather economic crises. However, economic factors and political forces have resulted in fewer community banks and a decreasing share of industry assets. Most noteworthy are the so-called "too big to fail" policies that sustain and support the largest financial institutions. These policies have weakened community banks by creating an unlevel playing field with respect to funding, risk taking and creditor protection. Furthermore, regulatory "solutions" designed to prevent another financial crisis and solve the TBTF dilemma have unfairly overburdened smaller institutions because of their "one-size-fits-all" approach and great complexity.

Regulatory Burden Rising illustrates the growing burden smaller banks face because of regulations aimed at policing the activities of the large institutions. Smaller institutions are affected more from complicated and burdensome regulations. Recent banking laws have grown in scope, size and complexity. This has forced community banks to increase staff relative to assets to a greater degree than at large banks, further undermining their ability to compete. A better approach would be to create a regulatory framework that more fully accounts for the operational differences between small and large banks.

Leveling the Playing Field analyzes how market discipline and public policy reform can influence bank size and contain the risk of TBTF banks. The market increasingly perceives that a large, complex bank will be protected by the federal safety net because it's considered systemically important (that is, its failure could send shocks throughout the financial system and cause other failures and harm to the economy). The bank has become "too big to fail." The problem is—for banks perceived to be TBTF—that market discipline no longer has much impact on restraining excessive risk taking, often leading to poor decisions and reckless behavior. Smaller community banks, in contrast, face a great degree of market discipline because the bank's owners frequently have a significant portion of their wealth invested in the bank. For market discipline to be restored, the federal government's financial safety net should be rolled back to cover only a bank's essential commercial banking activities and their role in the payments system.

In summary, the time-proven community bank model based on relationship lending and a strong customer focus is superior to the large bank model, where market discipline has eroded. As a result, financial reform must be redirected toward solutions based on greater market discipline. This will lead to a more stable financial system and enable stronger economic growth.

Thomas F. Siems is senior economist and economic outreach officer in the Financial Institution Relationship Management Department at the Federal Reserve Bank of Dallas. Send comments or questions about this article to the author at Tom.Siems@dal.frb.org.

Noteworthy Items

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Richard Fisher's speech on "Ending 'Too Big to Fail': A Proposal for Reform Before It's Too Late" before the Committee for the Republic in Washington, D.C. (Jan. 16, 2013)

President Fisher contends that the Dodd-Frank Act has not done enough to corral "too-big-to-fail" (TBTF) banks and that, on balance, the act has made things worse, not better. The government-sanctioned policy of coming to the aid of TBTF firms has undermined the discipline that market forces normally assert on management decisionmaking. The Dallas Fed's proposal relieves small banks of unnecessary burdens arising from the Dodd-Frank Act that unfairly penalize them and reshapes TBTF banking institutions into smaller, less-complex institutions, which allows both regulatory and market discipline to restrain excessive risk taking.

<http://www.dallasfed.org/news/speeches/fisher/2013/fs130116.cfm>

Governor Duke's speech on "The Future of Community Banking" at the Southeastern Bank Management and Directors Conference at the University of Georgia (Feb. 5, 2013)

Governor Duke discusses the important role that community banks play in our nation's financial system. She cites research that supports the community bank model and confirms her own experience that community banks with deep ties to the community, engaged managers and directors, conservative underwriting and strong risk management can not only survive, but thrive, even in adverse conditions. Duke understands community bankers' concerns that the burden of new regulations may inhibit their ability to lend in their communities and urges bankers to continue to communicate about the challenges that regulations pose.

<http://www.federalreserve.gov/newsevents/speech/duke20130205a.htm>

Economic Insights: Conversations with the Dallas Fed webcast on "Ending Too Big to Fail: A Proposal for Financial Reform" (Feb. 1, 2013)

Harvey Rosenblum, the Dallas Fed's executive vice president and director of research, presents a proposal to end the "too-big-to-fail" policy that has effectively removed market discipline as a force to control behavior at the largest institutions.

<http://presentations.dallasfed.org/frm130201/index.htm>

Federal Reserve Board announces preliminary, unaudited income and expense results for 2012 (Jan. 10, 2013)

Under Board policy, the residual earnings of each Federal Reserve Bank are distributed to the U.S. Treasury after providing for the costs of operations, payment of dividends and the amount necessary to equate surplus with capital paid-in. The Reserve Banks provided for payments of approximately \$88.9 billion of their estimated 2012 net income to the U.S. Treasury, derived primarily from interest income on securities acquired through open market operations. The link below includes a chart illustrating the Reserve Banks' residual earnings distributed to the U.S. Treasury from 2003 through 2012.

<http://www.federalreserve.gov/newsevents/press/other/20130110a.htm>