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Community Banks are Flipping Over a State Charter

by Gregory J. Hudson and Kory Killgo

Over the past 20 years, bank mergers and failures have resulted in fewer national charters. But choice has played a role, too. Very few commercial banks—only about 1 percent—change charters in any given year. However, of those that do change charters, twice as many are choosing a state charter. Community banks, in particular, are opting for a state charter over a national charter.[1] Of the 780 community banks that changed charters between 1995 and 2015, 529 left the Office of the Comptroller of the Currency (OCC)—the regulator of nationally chartered banks. In this article, we review pure charter changes, which are defined as a charter change without a simultaneous change in bank ownership, to see if any trends emerge over time.

Banks in the United States are established under either a national or state charter. While state banking departments grant charters at the state level, the OCC is the chartering agency at the national, or federal, level. The Federal Deposit Insurance Corp. (FDIC) is the primary federal regulator for state nonmember banks, and the Federal Reserve is the primary federal regulator of state-chartered banks that elect to become members of the Federal Reserve System. The Federal Reserve also supervises all bank and savings and loan holding companies. The opportunity for a bank to choose its chartering authority and regulator is the cornerstone of the dual-banking system.[2]

Bank Charter Parity over the Years

When choosing a charter previously, banks simply had to consider different reserve requirements, lending limits and capital requirements. However, over the years, congressional action and state "wildcard" statutes have resulted in substantial parity between the two charters. Today, the primary differences between a state and national charter are the assessment fees charged to supervise the bank and the role of federal preemption over certain state laws.

Generally, the federal regulators will institute an alternating exam schedule with their state counterparts. Although state-chartered banks pay an assessment fee to their chartering authority, they are not charged for supervision by either the FDIC or the Federal Reserve.[3] Thus, state-chartered banks are often charged less in assessment fees than national banks.[4]

The other main difference between the two charters is that nationally chartered banks conduct business under a federal law framework that largely preempts state law and permits them to operate on a uniform basis in multiple states. The OCC has used this preemption authority to ensure that national banks with interstate operations are generally subject to one set of laws and regulations.[5] In this regard, the national bank charter offers an advantage for banks with operations in multiple states.

The past few decades have also seen the powers of national banks and state-chartered banks converge. The differences in supervision, reserve requirements, lending limits and capital requirements have narrowed or disappeared entirely. In 1980, federal law was enacted requiring all depository institutions to maintain reserves pursuant to Federal Reserve regulations.

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April 11

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April 12–14

National Community Depository Institution Advisory Council Meeting
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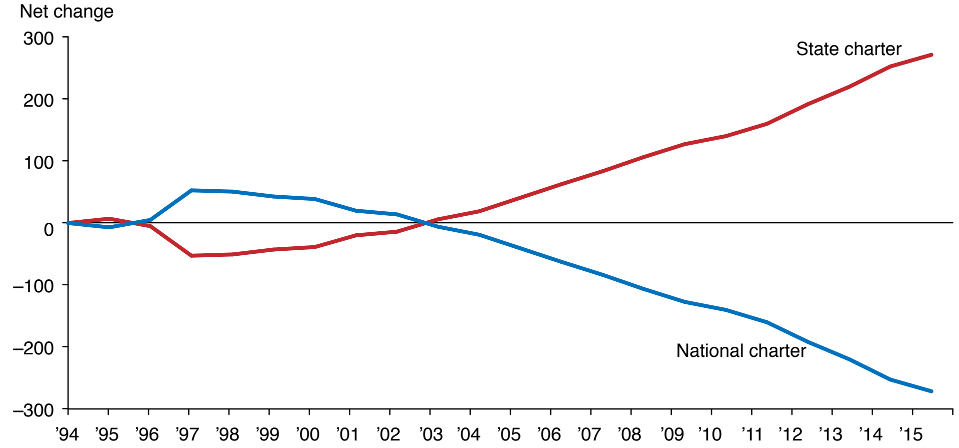
It also permitted all depository institutions to utilize Federal Reserve services such as borrowing privileges and check clearance.[6] In 1982, the Garn–St. Germain Depository Institutions Act raised national bank lending limits, allowing national banks to better compete with state-chartered banks.[7] In 1991, the FDIC Improvement Act limited the investments and other activities of state banks to those permissible for national banks.[8] In response, many states enacted so-called "wildcard" statutes that allowed their state-chartered banks to engage in all activities permitted for national banks.[9]

Banks Choosing State Charter

To explore possible trends in charter changes, we analyzed structure data from the National Information Center (NIC) for eight groups of banking entities (cooperative banks, federal savings banks, federal savings and loans, national banks, state nonmember banks, state member banks, state savings banks, and state savings and loans) from Jan. 1, 1995, through Dec. 31, 2015. We then isolated national banks, state nonmember banks and state member banks, flagging those that moved from one of the three groups to another.[10] The data show a 20-year trend of national banks changing to state charters, with a net reduction of 273 OCC-supervised banks between 1995 and 2015 (*Chart 1*). This net migration is led by community banks. Among banks with assets greater than $10 billion, national banks saw an aggregate increase of five institutions.

Chart 1 Banks Changing Charters 1995–2015



SOURCES: National Information Center; authors' calculations.

Furthermore, banks that changed federal regulators tended to choose the Federal Reserve as their new federal supervisor. Between 1995 and 2015, the FDIC experienced a net decrease of 407 banks while the Federal Reserve saw a net increase of 680 banks (*Chart 2*).

In Texas, an aggregate 24 national banks switched to a state charter between 1995 and 2015. Over the same period, the FDIC experienced a net outflow of 15 Texas banks while the Federal Reserve saw a net inflow of 39 Texas banks. Of those 39 new state member banks, all but one were community banks, further supporting the idea that community banks are choosing a state charter with the Federal Reserve as their primary federal regulator. Because the Federal Reserve supervises all holding companies, institutions that are part of a holding company could be seeking one less regulator. For example, a bank holding company with a state nonmember bank that chooses to become a Fed member would be reducing the overall organization's number of regulators from three to two.

ABOUT *FINANCIAL INSIGHTS* AND FIRM

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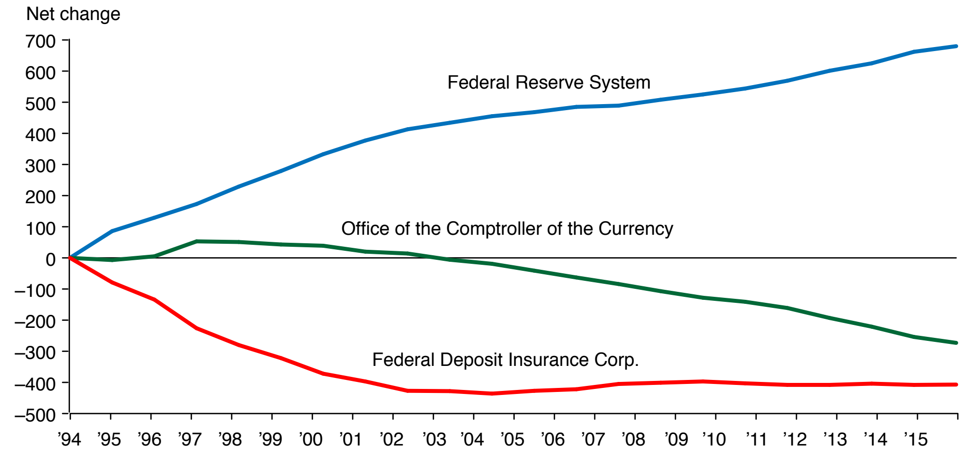
FIRM was organized in 2007 by the Federal Reserve Bank of Dallas as an outreach function to maintain mutually beneficial relationships with all financial institutions throughout the Eleventh Federal Reserve District. FIRM's primary purpose is to improve information sharing with district financial institutions 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 and Corporate Payments Council, 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.

Chart 2 Banks Changing Federal Regulators 1995–2015



SOURCES: National Information Center; authors' calculations.

Conclusion

Unfortunately, the NIC data do not provide a motivation for banks switching charters. Explanations for changing to a state charter range from cost to culture. Bankers have noted that state charters often provide cost savings in assessment fees, local supervisor decision-making, and examiners who are more familiar with the local economy and the bank's business plan.[11] Banks may also be able to take advantage of a higher legal lending limit under state law.[12] Broadly speaking, charter choice is generally a question of whether the higher assessment cost often associated with a national charter is offset by the benefits of operating under a single set of laws and regulations.

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NOTES

[1] The Federal Reserve defines community banks as those with less than $10 billion in assets.
[2] *Community Banking: From Crisis to Prosperity*, by Timothy W. Koch, pp. 42–3, Makawk Books, 2014.
[3] "Challenges to the Dual Banking System: The Funding of Bank Supervision," by Christine E. Blair and Rose M. Kushmeider, FDIC Banking Review, vol. 18, no. 1, 2006. (The FDIC derives its funding from the deposit insurance funds and the Federal Reserve is funded through the interest earned on Treasury securities that it purchases.)
[4] "Frost Files to Become State Chartered," by Patrick Danner, *San Antonio Express-News*, Feb. 9, 2012 (Frost Bank, which had $20.3 billion in assets, expected to save approximately $1.5 million in assessment fees).
[5] The term preemption refers to the constitutional principle that federal law overrides, or preempts, state laws that are incompatible with federal law. See 12 CFR Sections 7.4008, 7.4009, 34.4. (A national bank and its operating subsidiaries are not subject to state laws that obstruct, impair or condition the bank's federally authorized powers to accept deposits or make loans.)
[6] Depository Institutions Deregulation and Monetary Control Act of 1980 (Pub. L. 96–221).
[7] Garn–St. Germain Depository Institutions Act of 1982 (Pub. L. 97–320).
[8] Federal Deposit Insurance Corporation Improvement Act of 1991 (Pub. L. 102–242).
[9] For example, Article XVI, Section 16(c) of the Texas constitution provides that Texas chartered state banks have the same rights and privileges that are or may be granted to national banks. In addition, Section 32.010 of the Texas Finance Code contains a "super parity" provision that provides a framework for a state bank chartered in Texas to conduct any of the activities allowed by any other insured state or federal financial institution in the nation.
[10] National Information Center, www.ffiec.gov/nicpubweb/nicweb/NicHome.aspx.
[11] "Two-Decade Trend Squeezes Choice from Dual Banking System," by Barbara A. Rehm, American Banker, Oct. 26, 2011.
[12] In Texas, state-chartered banks can loan up to 25 percent of their capital to one individual (Texas Financial Code Section 34.201). The legal lending limit for national banks is 15 percent of capital; however, the Office of the Comptroller of the Currency does grant banks the ability to lend up to 25 percent to qualified borrowers (12 CFR Section 32).

Noteworthy Items

Federal Reserve Chair Janet Yellen Delivers a Speech to the National Community Reinvestment Act Coalition in Washington, D.C. (March 28, 2017)
Yellen discusses how the overall economy has improved since the Great Recession, yet other challenges such as areas of high employment remain. She discusses programs that can help address these issues in a more targeted way.

Federal Reserve Releases Federal Open Market Committee Statement March 15, 2017)

Eleventh District Banking Conditions Survey Results—March 2017
The Federal Reserve Bank of Dallas conducts the Banking Conditions Survey twice each quarter to obtain a timely assessment of activity at banks and credit unions headquartered in the Eleventh Federal Reserve District.

Dallas Fed President Rob Kaplan Publishes an Essay Titled, "Assessment of Current Economic Conditions and Implications for Monetary Policy" (Feb. 13, 2017)
President Kaplan discusses his assessment of economic conditions in the U.S. and globally and their implications for monetary policy. He discusses key secular trends that can have a powerful influence on unfolding economic conditions: the aging workforce in the U.S., the global debt super cycle, globalization and technology-enabled disruption.

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