

Community Banking
in the 21st Century



The Effect of the JOBS Act on Community Banks

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Exchange Act Registration and Community Banks

- Unlike most firms, banks and bank holding companies (BHCs) must publicly report financial data in regulatory filings
- Exchange Act registration imposes additional costs, e.g., Sarbanes-Oxley Act compliance
- Investors prefer registration if marginal gains from disclosure and governance exceed losses from costs of compliance
- Empirical question: do marginal gains for banks and BHCs exceed the costs of Exchange Act compliance?

Legal Framework

- Section 12(b): Voluntary registration for listing on exchange
- Section 12(g): Mandatory registration if (1) assets over \$10 million and (2) number of shareholders of record exceed 2,000
- Prior to JOBS Act, deregistration under 12(g) required less than 300 shareholders
- Section 601(a)(2) of JOBS Act eases deregistration by raising threshold to 1,200 shareholders, leading to a wave of deregistration for banks and BHCs with 300-1,200 shareholders.

Hypothesis

- For banks and BHCs, benefits of additional reporting under Exchange Act are limited
- Deregistered firms should have lower expenses, higher net income, and greater efficiency than:
 - Banks and BHCs on the other side of the cutoff
 - Own prior performance
- Qualitative and quantitative evidence of cost savings from JOBS Act deregistration

Interview with Anonymous Community Bank

- "Community banks have had significant regulatory burden hoisted upon them over the past few years and even going back 10 years with SOX, with no end in sight. Regulatory burden raises costs, which in a competitive market gets passed on to consumers in one way or another. The JOBS Act did lessen that burden for us."
- Specific cost reductions? "Yes, legal, accounting, consulting, printing, XBRL (we hire a firm to assist us in this significant reporting burden), internal audit, other---including various soft costs related to preparing and submitting the SEC filings (i.e., my, our assistance controller, our chief credit officer, etc. time in that process---here we are able to better use that time to work on productivity)."

CFO Magazine Interview

- March 12, 2013 article in CFO Magazine: Coastal Banking Company deregistered in May 2012 and is "saving \$150,000 to \$200,000 a year on such costs as converting filings to XBRL, paying attorneys to review them, filing a Section 16 form every time an insider trades stock, and meeting some of the provisions of Sarbanes-Oxley. 'The cost savings keep compounding,' says Paul Garrigues, Coastal Banking's CFO."

Empirical Study

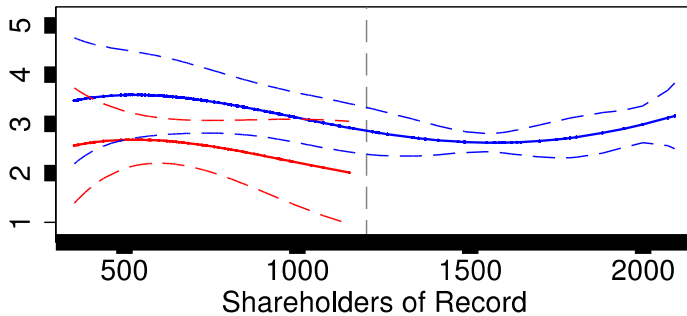
- Statistics: arbitrary cutoff = causation, not just correlation
- Legislative history
 - Efforts to raise deregistration cutoff began in 2008 when ABA lobbied for an increase to “between 900 and 1,800 shareholders of record”
 - 1,200 cutoff introduced in Himes-Womack Act (May 24, 2011)
 - Unlikely that many banks anticipated precise number prior to Act’s introduction
- No bank or BHC crossed the 1,200 shareholder threshold in either direction since Dec. 31, 2010
 - Exception: 3 cases of formal share repurchase or other restructuring program, excluded from dataset

Data

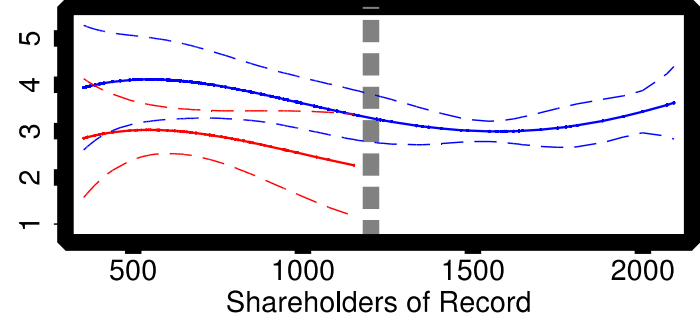
- 187 banks and BHCs registered under section 12(g) as of 12/31/11 with 300+ shareholders of record and (a) remained registered or (b) deregistered and continued to report financial performance to prudential regulators
- Exclude firms registered under 12(b), acquired, or dissolved
- Banks and BHCs hand-collected from SEC EDGAR filings by SIC classification code and filing statute (12(g)/12(b)), subsidiaries downloaded from FDIC
- Quarterly financial data (2003q1-2013q2) downloaded from FDIC and linked to banks by certificate number
 - “Treatment” = deregistered quarters
 - “Control” = all other quarters
- Financial data are ratios from Uniform Bank Performance Report, fraction of average net assets for quarter

Results

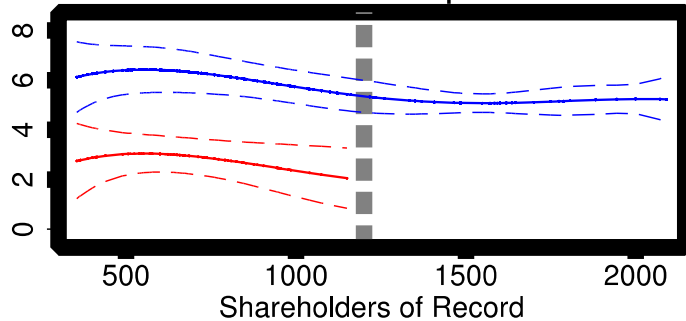
Personnel & Other Noninterest Expense



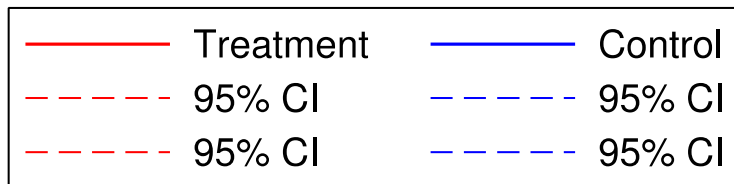
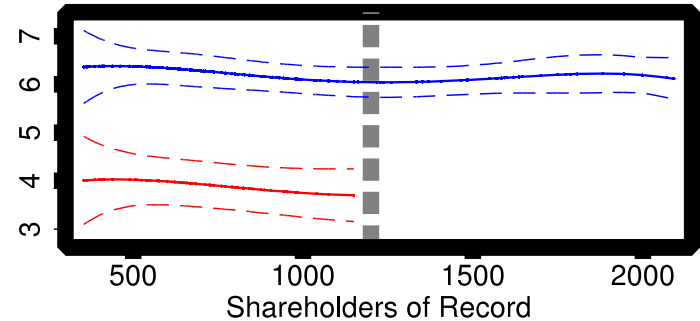
Total Noninterest Expenses



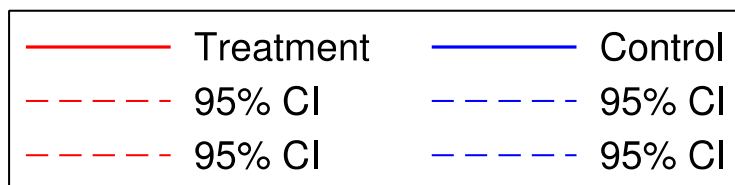
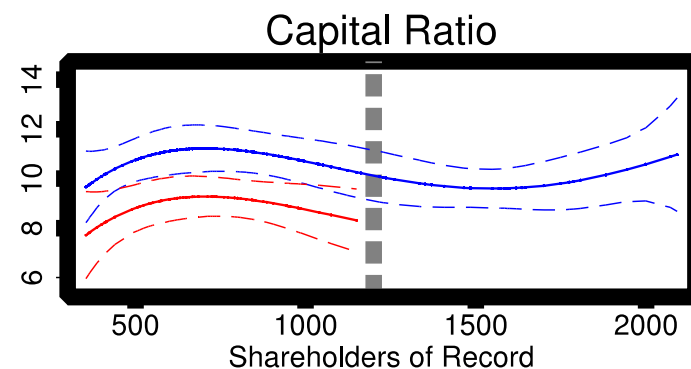
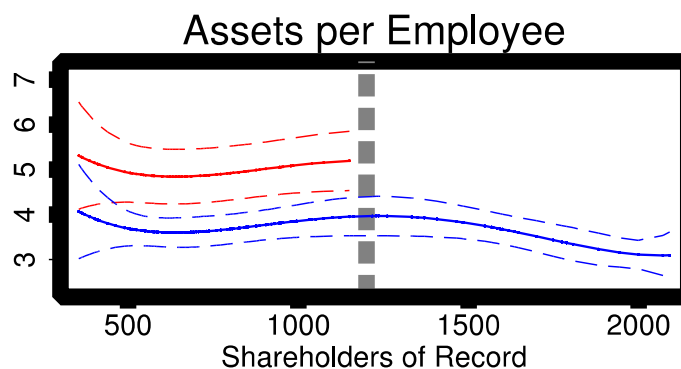
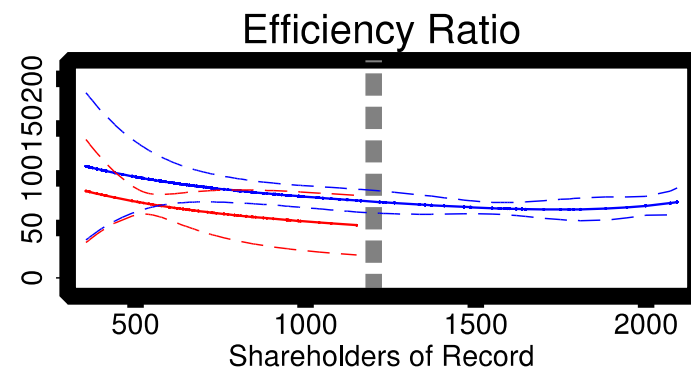
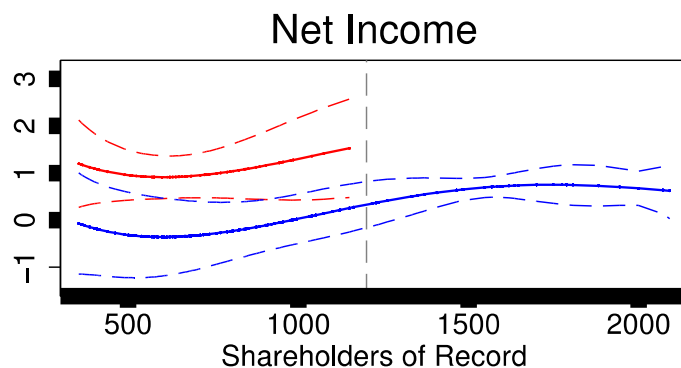
Total Pretax Expenses



Total Income



Results



Results

- Deregistration reduced total pretax expenses by \$3.38 and increased net income by \$1.27 per \$1 of assets
- Cost savings apparently derived from personnel and other noninterest expenses, which decreased \$0.91 per \$1 in assets
- Deregistration increased assets per employee by \$1.24 million but efficiency ratio ($\text{Overhead Exp.} / [\text{Net Int. Inc} + \text{Non-int. Inc}]$) is unchanged
- Deregistration decreased total pretax income by \$2.35 and total equity capital by \$1.95 per \$1 of assets

Policy Implications

- Findings suggest JOBS Act had beneficial effect on community banks that deregistered in response to the cutoff change
- Results suggest experimenting with higher deregistration cutoff than 1,200 shareholders
- Congress should pass the Holding Company Registration Threshold Equalization Act of 2013, equalizing deregistration threshold for S&Ls
- Maybe worth considering other alternative reporting regimes and higher deregistration threshold for non-bank small firms