Accounting for the Decline in the Number of Community Banks since the Great Recession*

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* This talk is based on McCord and Prescott, “The Financial Crisis, the Collapse of Bank Entry, and Changes in the Size Distribution of Banks.” FRB Richmond Economic Quarterly, First Quarter 2014.

** The views expressed in this talk are those of the authors and not necessarily those of the Federal Reserve Bank of Cleveland or the Federal Reserve System.
Number of Independent Banks in the U.S.

Source: Author’s calculations/Federal Reserve National Information Center
Increase in Concentration

Authors’ calculations. National Information Center/Call Report
Biggest Decline Since Crisis is Among Smallest Banks

<table>
<thead>
<tr>
<th>Asset Size (millions)</th>
<th>2007</th>
<th>2013</th>
</tr>
</thead>
<tbody>
<tr>
<td>&lt; 100</td>
<td>2538</td>
<td>1771</td>
</tr>
<tr>
<td>100 – 1,000</td>
<td>3161</td>
<td>3087</td>
</tr>
<tr>
<td>1,000 – 10,000</td>
<td>386</td>
<td>383</td>
</tr>
<tr>
<td>10,000 – 50,000</td>
<td>39</td>
<td>44</td>
</tr>
<tr>
<td>&gt;50,000</td>
<td>29</td>
<td>32</td>
</tr>
<tr>
<td>Total</td>
<td>6153</td>
<td>5317</td>
</tr>
</tbody>
</table>

Note: Assets normalized to 2010 dollars.
Data

- **Definition of a bank**
  - Combine all commercial bank charters under top BHC
  - No credit unions, S&Ls, savings banks, credit card banks, foreign bank branches

- **Assets**
  - Converted off-balance sheet activities into balance sheet equivalents
    - Important for larger banks starting in the 90s ($3.5 trillion in 2012)
    - E.g., derivatives, securities lending, loan commitments
Goal of This Talk

- Account for decline in number of community banks
- Due to collapse of entry
- Not increase in exit
Number of Banks: Role of Entry and Exit

- Entering Banks
- Number of Active Banks
- Exiting Banks
Bank Entry and Exit as Fraction of Total Banks

Fraction of Banks

Entries
Failures/Mergers

Source: Author’s calculations/Federal Reserve National Information Center
Before and After the Financial Crisis

- Exit rates stay the same
- Entry rates collapse
A Counterfactual Calculation

- Estimated annual transition rates of banks between size classes for 2008-2013
- Estimated annual exit rates by size class over 2008-2013
- Used historical annual entry rates
- Simulated number of banks in 2013
If Entry Rates Had Stayed at Historic Average

- **2007 - 2013**
  - Data - drop of 836 banks
  - Counterfactual – drop of only 269 banks

- **Drop**
  - 2/3 is lack of entry
  - 1/3 is long-term trend
Drop in Number of Community Banks

- Most new banks start small
- New banks add to stock of community banks
- Stock not being replenished now
Types of Entry

- Charter conversions
  - 2012 – 20

- Spinoffs
  - 2012 – 5
    - Capital Bancorp bankruptcy – spins off banks

- De Novo banks ...
Number of *De Novo* Banks by Year (1961-2013)

Source: Author’s calculations/Federal Reserve National Information Center
Recent *De Novo* Banks

- **2011 – 3**
  - New charters to buy failed banks by private equity
    - Alostar, Cadence, Certusbank

- **2012 – 0**

- **2013 – 1**

- **2014 – 0**
The 2013 *De Novo Bank!*
Stories for the Lack of Entry

- Weak economy
  - Net interest margins correlated with entry

- Increased barriers to entry
  - De Novo entry harder - FDIC (FIL-50-2009)
    - De novo supervision period extended to seven years
    - Material changes in business plans require FDIC approval
    - Note: a 2014 Q&A publication relaxed this a bit

- Increase in scale needed to operate efficiently
  - Changes in regulations – what bankers say
Summary

- Decline in number of community banks
- Mainly due to collapse of entry