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Small Banks and Deposit Insurance: The U.S. Experience

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Small Banks and Deposit Insurance: The U.S. Experience

- Outline of presentation
 - Role of the FDIC
 - U.S. banking industry: structure and characteristics
 - Small-bank business model
 - Role of deposit insurance
 - Challenges and prospects



Small Banks and Deposit Insurance: The U.S. Experience

- The FDIC plays several roles:
 - Deposit insurer
 - Insure deposits at member institutions
 - approve applications for deposit insurance concurrently with the chartering decision made by the states, OCC and OTS
 - Regulator and supervisor of state-chartered (non-member) banks and state-chartered savings banks
 - Receiver for failed banks
 - Maximize return on failed-bank assets and minimize cost to the deposit insurance fund



U.S. Banking Industry: Structure and Characteristics

- U.S. banking system has some of the world's largest banking organizations and thousands of relatively small banks
 - Large, complex banking organizations
 - the top 25 organizations in terms of assets
 - Regional and other mid-sized banks
 - assets greater than \$1 billion but less than the assets of the smallest of the top 25 banks
 - \$77 billion as of year-end 2007
 - Small or community banks
 - less than \$1 billion in assets



U.S. Banking Industry: Structure and Characteristics

Table 1
FDIC-insured Institutions by Number and Asset Size
December 31, 2007

All FDIC-insured institutions		Asset Size Distribution			
		Less than \$100 million	\$100 million to \$1 billion	\$1 billion to \$10 billion	Greater than \$10 billion
Number of institutions	8,533	3,440	4,425	549	119
Commercial banks	7,282	3,065	3,706	425	86
Savings institutions	1,251	375	719	124	33
Total Assets (in billions)	\$13,038.8	\$181.9	\$1,310.1	\$1,420.3	\$10,126.5
Commercial banks	\$11,176.1	\$162.9	\$1,062.1	\$1,112.7	\$8,838.4
Savings institutions	\$1,862.7	\$19.0	\$247.9	\$307.5	\$1,288.2

Source: FDIC Quarterly Banking Profile Fourth Quarter 2007



U.S. Banking Industry: Structure and Characteristics

Table 2
FDIC-insured Institutions
by Type of Institution and Primary Federal Regulator
December 31, 2007
(\$ in millions)

Commercial Banks and Savings Institutions	Number of Institutions	Total Assets	Domestic Deposits	Estimated Insured Deposits
FDIC-Insured Commercial Banks	7,282	11,176,096	5,806,795	3,426,148
FDIC-Supervised	4,772	1,874,698	1,370,557	927,470
OCC-Supervised	1,632	7,782,387	3,590,744	1,995,866
Fed-Supervised	878	1,519,012	845,494	502,812
FDIC-Insured Savings Institutions	1,251	1,862,669	1,104,986	860,936
OTS-Supervised	826	1,556,670	1,104,986	696,835
FDIC-Supervised	425	305,999	212,394	164,101
Total	8,533	13,038,765	6,920,667	4,293,201

Source: FDIC Quarterly Banking Profile Fourth Quarter 2007



U.S. Banking Industry: Structure and Characteristics

- Exit of banks through mergers and failures
 - Extensive consolidation over past two decades (after product and geographic restrictions on branching were lifted) affected banks of all sizes
 - Although the number of banks fell by 49 percent since 1985, the small-bank share of all U.S. banks has remained stable—about 94 percent
- Entry of new banks
 - Chartering of new banks—called de novo banks—dampened the effect of mergers and failures
 - About 1,250 new community banks were established between 1992 and 2003



U.S. Banking Industry: Structure and Characteristics

Table 3
FDIC-insured Institutions
Structural Changes in 2007

Structural Changes	All FDIC-insured institutions	Asset Size Distribution			
		Less than \$100 million	\$100 million to \$1 billion	\$1 billion to \$10 billion	Greater than \$10 billion
New Charters (de novo institutions)	181	174	6	2	0
Institutions absorbed by mergers	321	114	167	31	9
Failed Institutions	3	2	0	1	0

Source: FDIC Quarterly Banking Profile Fourth Quarter 2007



Small-Bank Business Model

- Economic role of small banks
 - Loan-to-one-borrower limits affect small business lending
 - By law, the amount any bank may lend to a single borrower is limited to a percentage of its unimpaired capital and surplus
 - 15 percent if loan is not fully secured
 - Implication: small banks specialize in small loans

Small-Bank Business Model

- Economic Role of Small Banks
 - Niche banking and innovation
 - Provide credit to important segments of the business-loan and farm-loan markets
 - Small commercial and farm real estate
 - Small business C&I, small farm operating loans

Small-Bank Business Model

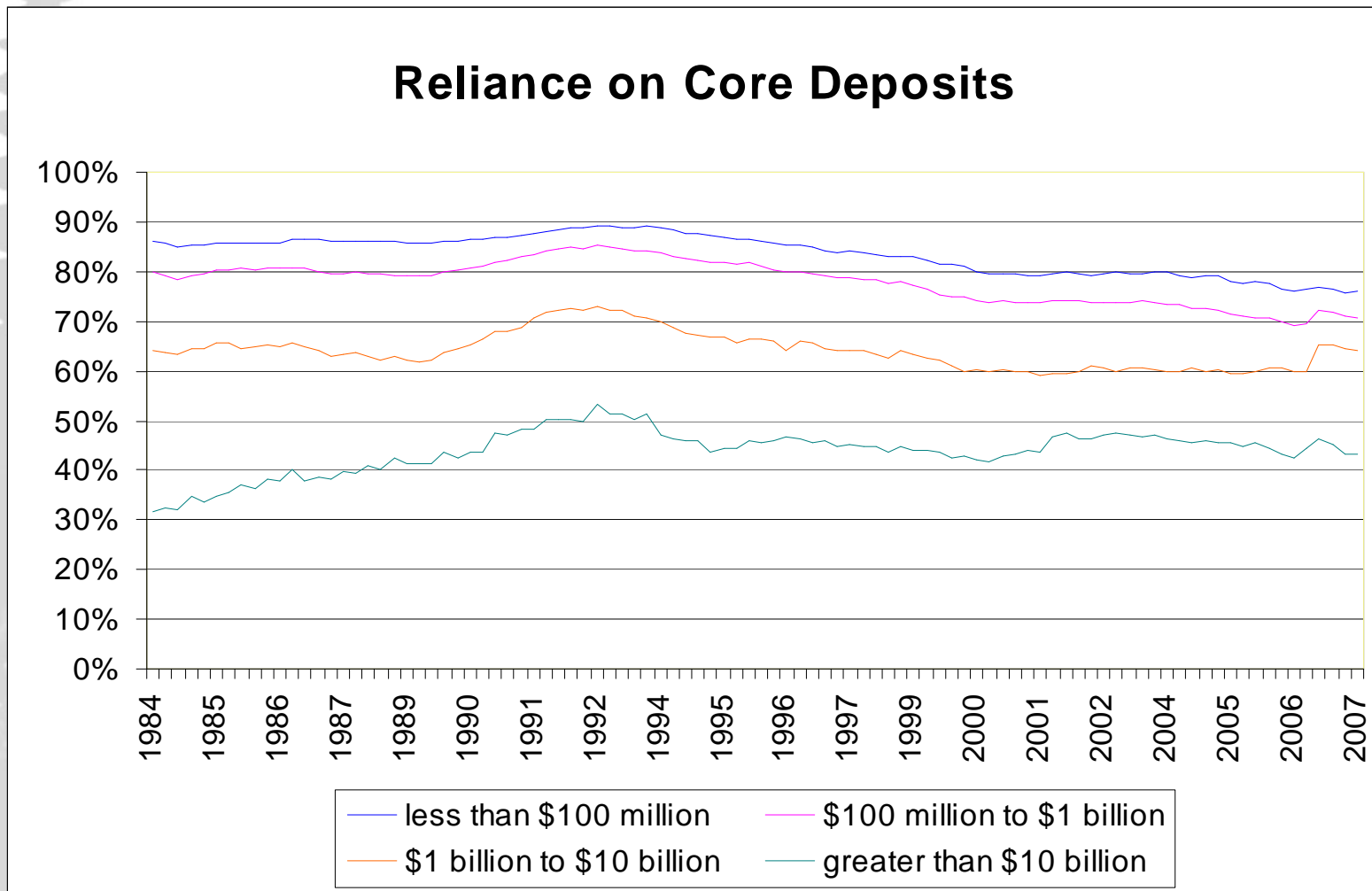
- Economic Role of Small Banks
 - Success is based on ability to successfully lend to what have been termed “informationally opaque” borrowers
 - Know their customer base
 - Excel at underwriting small heterogeneous business loans
 - Where larger banks rely on credit scores, small banks actively review each loan
 - Automated securitization is not their business model



Small-Bank Business Model

- Economic Role of Small Banks
 - Rely on core deposits—domestic deposits less time deposits over \$100,000—for their funding, unlike large banks
 - Charge lower fees for deposit services
 - Pay higher rates on retail deposits
 - Supplement core deposits with Federal Home Loan Bank borrowings

Small-Bank Business Model





Small-Bank Business Model

- Economic Role of Small Banks
 - Most important competitive advantage is personal service
 - Market personal service, local connections
 - Active in communities
 - Serve small relationship-based customers
 - Why de novo institutions thrive in areas where mergers and consolidation have affected the community

Small-Bank Business Model

- Economic role of Small Banks
 - Although profitable, small banks' average ROA is lower than that of large banks
 - Large percentage of assets in non-taxable lower-yielding municipal bonds
 - Commercial real estate development lending
 - Weak point for small banks during the U.S. banking crisis of the 1980s and early 1990s



The Role of Deposit Insurance

- Deposit insurance is important to small banks
 - Public confidence
- Coverage limits matter
 - Core deposits are an important funding source
 - Community banks and their trade associations actively lobby for expanded coverage
 - Federal Deposit Insurance Reform Act of 2005
 - Coverage up to \$250,000 extended to retirement accounts
 - Indexation for inflation begins in 2011



The Role of Deposit Insurance

- Small banks' prospects are important to the FDIC
 - Small-bank failures have represented a disproportionate share of FDIC losses in recent years
 - Rapid growth, high-risk policies can lead to high resolution costs
 - Less likely with larger banks



Challenges and Prospects

- Rapid growth of the largest banking organizations presents challenges to the FDIC and small banks
 - Size relative to the deposit insurance fund
 - Basel II
 - Should small banks be isolated from the effects of large-bank failures?
 - Capital adequacy standards and supervision
 - Optimally pricing deposit insurance
 - Separate safety net for small banks



Challenges and Prospects

- The small or community bank is a viable business model
 - Informational advantages as lenders to “informationally opaque” borrowers
 - Small business, small farmers, borrowers who lack long credit histories
 - Higher risk-adjusted returns on business loans than large banks
 - Private investment in de novo banks



Small Banks and Deposit Insurance: The U.S. Experience

- Sources:
 - *FDIC Quarterly Banking Profile*
 - <http://www2.fdic.gov/qbp/index.asp>
 - Community Banks: Their Recent Past, Current Performance, and Future Prospects
FDIC Banking Review 2004, volume 16, no.2:1-56.
 - <http://www.fdic.gov/bank/analytical/banking/2005jan/article1.pdf>