Removing community bank barriers essential for growth

By David H. Baris

Regulatory red tape has inhibited the formation of new community banks, the hometown institutions that have been the cornerstone of our nation's financial system for more than a century. With our economic recovery advancing at a frustratingly slow pace in many communities, Washington can support local growth by encouraging the formation of more of these community-based institutions.

Federal regulations have created unreasonable barriers to forming new community banks and have brought new-bank formation to an 80-year low. The Federal Deposit Insurance Corp. has approved just two applications for new federal banking charters, known as de novos, since 2009. From 2000 to 2007, on the other hand, the FDIC approved an average of 159 applications for new banks each year.

While the economic stagnation itself contributes to fewer de novo bank applications, a recent study by the Federal Reserve Bank of Richmond found that regulatory costs, which have increased in recent years due to a financial crisis caused by the very largest banks, also play a key role. Further, community bankers themselves report that FDIC policies and practices are inhibiting the formation of de novo institutions. Apparently, would-be applicants are overwhelmed by the uncertainty of approval and processing of their applications, ultimately deciding not to subject themselves to those uncertainties.

New bank formation increases the availability of credit to small businesses and households, helping to drive local economies. As the only physical banking presence in nearly one in five U.S. counties, community banks are critical sources of financing in communities that are not served by large and regional institutions. And they punch above their weight class, providing more than 50 percent of the nation's small-business loans. Further, as locally owned institutions, community banks are held accountable by the friends and neighbors they serve and do not engage in the kinds of risky Wall Street practices that fueled the recent financial crisis.

The answer to the current dearth of bank applicants is more flexible regulatory policies that are tailored to the risk profiles and business plans of both new bank applicants and existing community banks. Regulators must institute a flexible and tailored supervisory policy, with capital standards, exam schedules and other supervisory requirements based on the risk profile and business plan of the applicant and not on a standard policy that applies to all applicants.

The good news is that Washington has made progress, with the FDIC last fall responding to the industry's concerns with guidance designed to make life easier for applicants and to provide transparency to the application process. Basically, the FDIC now requires de novo applicants to submit upfront capital and business plans for the first three years of operation, instead of the first seven.

This is a great start, but we need to monitor the implementation of this policy to ensure it is having its intended effect and to determine whether further changes are necessary. More broadly, we need to continue working to reduce the excessive regulatory burden on local financial institutions that is stunting economic growth. To truly ensure a recovery from the Wall Street financial crisis in cities, suburbs and small towns across the country, Washington must allow community banks to do their part.

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