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FOCUS

Community banks will survive, but in a different form

Some question the future of community banks, but their local role remains important

GUEST COLUMN

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Community banks in the Pacific Northwest have spent the past two years working through daunting challenges, from extraordinary regulatory pressures and sweeping new legislation, to the worst economy in decades.

Since January 2009, banking regulators have closed 20 banks in Washington and Oregon, all of which were community banks. In the face of this adversity, some have questioned whether community banks will survive.

Community banks are historically organized and owned by local investors, and the banks benefit by focusing on the needs of the local community and its businesses. Community banks rely heavily on local deposits and lend locally, consequently contributing to the economic growth of their communities.

Community banks may also be better positioned than national competitors to understand factors beyond financial models, enabling them to make quicker credit decisions. Although the community banking landscape is changing, community banks will remain an important and vital part of the financial system and the local economy.

Industry consolidation is inevitable and happening now. The consolidation trend will continue due to additional bank failures and few, if any, new bank charters. With improving economic conditions, coupled with fatigue among struggling banks and their shareholders, traditional merger and acquisition activity is expected to accelerate further, reducing the number of community banks.

The community bank of the future will likely be a larger, regional institution with greater resources. In order to remain competitive, it will have a continued focus on local decision making, community involvement and a more personal relationship with its customers.

The FDIC's list of troubled institutions, those with the potential to fail, remains at elevated levels. Some Pacific Northwest banks won't be able to raise capital to absorb credit losses, and the region will see more closures in 2011.

In the typical bank closure, the Federal Deposit Insurance Corp., as receiver, finds another financial institution to acquire a significant portion of the assets of the failed bank. The winning bidder often maintains much of the branch network and hires many of the employees of the failed bank.

Regional institutions such as Umpqua Bank, Whidbey Island Bank, Columbia Bank and Heritage Bank have been active participants in the FDIC's process in order to grow and strengthen their franchises.

Of the 20 bank closures over the past two years in the region, most of the acquirers have been regional banks headquartered in the Pacific Northwest. Local community banks are the candidates more likely to continue to acquire franchises in the region through the FDIC resolution process.

As banks continue to fail, there will be no new banks filling in the ranks for some time. The last bank formation in the Pacific Northwest occurred in June 2009 (Liberty Bay Bank of Poulsbo, Wash.). Regulators closely scrutinize applications for forming new banks. And, with newer banks being overrepresented on the list of failed institutions in 2008 and 2009, the FDIC and state banking regulators have effectively imposed a moritorium on new banks.

Even if a group forming a new bank could pass regulatory muster and gather a skilled management team, the significant capital requirements for a new bank may turn investors away. The current interest rate environment, low loan demand and continuing credit challenges present a less attractive investment opportunity to organizers and investors.

Successful formation of new banks like Puget Sound Bank, Centerpointe Community Bank and Willamette Community Bank will be fewer and farther between. As smaller banks fail or decide to partner with other institutions, there will be few, if any, truly local banks organized to take their place.

An improved economy will change the community banking landscape and further the trend toward consolidation.

Banks continue to clean up their balance sheets and work through problem loans. As struggling banks resolve problems, and when the number of bank failures declines, healthy banks will be more willing to look at traditional merger deals without FDIC assistance.

Healthier banks that have strong capital levels may see stock values increase and have a valuable currency with which they can do deals. Struggling banks, despite improvements, could still be subject to regulatory restrictions that hamper their ability to grow or pay dividends to shareholders.

Also, the FDIC is well into the process of reviewing why financial institutions have failed, and is specifically focusing on the actions of directors and officers at those institutions. The FDIC has begun to bring claims for breach of fiduciary duty against bank directors and officers. Board members and management of struggling banks may see a sale of the institution as a welcome relief from regulatory pressure and potential personal liability.

2011 and beyond will undoubtedly see many changes to the community bank landscape, but the demand for their services will remain, as will the importance of their contributions to the health of the communities they serve.

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