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MINNESOTA BANKERS ASSOCIATION
THE CHAMPION FOR MINNESOTA BANKERS

September 12, 2016

The Honorable Jason Furman, Ph.D.
Chairman
President's Council of Economic Advisors
1650 Pennsylvania Ave., NW
Washington, DC 20504

Dear Chairman Furman:

The Minnesota Bankers Association (MBA) represents 95% of the banks in our state, and the vast majority of our members are community banks. I am writing you today to express our member banks' extreme disappointment with the "Issue Brief" on community banking, published by the President's Council of Economic Advisors (the Council).

Our counterparts at the Texas Bankers Association recently wrote you a letter. The MBA concurs with the comments in that letter. We also look forward to seeing your answers to the specific questions raised in that letter, as they are of great interest to us. We will not restate the same arguments and questions in this letter. Instead, we will give you Minnesota's perspective on the issue of community banking and the impact of the current regulatory environment.

Minnesota's Community Banks and Consolidation

Minnesota is a community banking state. We currently have the third most banks in the country. Nearly all our banks are closely held banks, and many of those institutions have been owned and operated by the same family for generations. The median-sized bank in Minnesota is $101 million in assets. Fully half our banks are under $100 million in assets.

We understand that consolidation within the industry is a long-term trend, nationally and in Minnesota. However, the pace of consolidation has dramatically increased over the past 7 years. On June 30, 2000, Minnesota had 513 separately-chartered banks. As of June 30, 2016 we had just 319. 194 institutions are gone, and they are never coming back. In the nine years from 2000 to 2009, we lost 88 banks, or just under 10 per year. In the seven years from 2010 to 2016, we lost 106 banks, over 15 per year. The annual pace of consolidation is clearly accelerating.

Most of that consolidation is happening as small, family-owned banks are being merged out of existence. When a family makes a decision to sell its bank, the family does not make that decision lightly. It is not doing so based on the current interest rate environment or because of other current economic factors. The family members are weighing the long-term prospects for their bank and then actively deciding to exit the banking business and deploy their capital elsewhere. After talking to dozens of people who have recently sold their banks, the current regulatory environment is definitely one of the main factors. The researchers who wrote the Council's "Issue Brief" would

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have benefited from talking to some of these long-term bankers who made the difficult decision to sell their bank.

The Council's "Issue Brief" concludes that community banking is "healthy." One indicator of an industry's health is whether the industry is attracting new capital and new investors. There have been very few de novo banks to offset all the recent bank mergers and acquisitions. We have not had a de novo bank created in Minnesota for nine years. It is also instructive to look at who is purchasing banks as they are sold. In Minnesota, virtually every transaction involves an existing bank as the purchaser. While we very much support the existing community banks that are buying their counterparts, we do not like the fact that there is no new money coming into the industry. We are not seeing people concluding that investing a community bank is a good risk. The fact that the community banking sector is not attracting new, outside capital is an indicator that the sector is not as healthy as your report suggests.

The FDIC's Recent Report—Good News, Really?

In 2014, The FDIC published a report entitled "Community Banks Remain Resilient Amid Industry Consolidation." That report included lots of facts and figures, and it included the following conclusion, "Our analysis shows that the projected decline of the community banking sector has been significantly overstated." Like the Council's "Issue Brief," the FDIC report argues in favor of maintaining the status quo with respect to banking regulation.

We questioned whether the conclusions in that FDIC report were fully supported. For example, The FDIC report discussed the change in the community banks' total market share. It noted that in 1985, community banks held 37 percent of banking industry assets. The community banking market share fell to just 14 percent by 2013, and it is certainly lower today. That statistic is clearly not a positive one for community banks. It was very disappointing that the FDIC would dismiss that clear, documented decline of community banking as being "significantly overstated." The FDIC, and other thought leaders like the Council, should take an honest look at what caused that 62% reduction in community bank market share.

One chart in that 2013 FDIC report was entitled, "Only the Smallest Institutions Have Seen an Aggregate Decline in Total Assets Since 1985." The chart showed the growth rates for the different classes of banks. Community banks were divided into 3 groups: banks under $100 million in assets, banks $100 million to $1 billion in assets, and banks $1 billion to $10 billion in assets. The chart also included data on large banks, those banks over $10 billion in assets.

The FDIC tried hard to put a positive spin on the community banks' growth rates. The largest community banks ($1 billion to $10 billion in assets) grew at a +4% in the 28 years from 1985 to 2013, while the middle category of community banks ($100 million to $1 billion in assets) grew at a +27%. The smallest community banks (under $100 million) actually shrunk during that time period, with a growth rate of -76%.

Are those rates impressive? Do those growth rates prove that community banking is alive and well? Not really. Obviously the negative growth for the smallest community banks is a problem, but even the +4% and +27% growth rates seem pretty weak over such a long period of time. Those meager growth rates become downright depressing when you learn that during that same time period, the large banks (over $10 billion) grew +972%. The Farm Credit System grew +328%, and the credit unions grew at an eye-popping +1,258%. Yet the FDIC somehow concluded that the decline of community banking is "significantly overstated."

The Banking Industry's Growing Regulatory Burden

The cumulative regulatory burden on the banking industry has increased significantly over the past 15 years. Dodd-Frank certainly added to that burden, but it was not the only cause. There have been dozens of new or significantly enhanced regulations, including anti-terrorism rules, anti-money laundering rules, Know-Your-Customer rules, much more stringent mortgage lending rules, the privacy rules, higher capital requirements, expanded HMDA reporting requirements and information technology security rules.

All these new regulations increase a bank's regulatory costs, and those costs have a huge impact on the smallest banks, which cannot realize economies of scale. The FDIC report attempted to paint a positive picture for larger community banks, but made no attempt to give a positive outlook for banks under $100 million. The report noted that, "All of the net reduction in the number of bank and thrift charters between 1985 and 2013 can be accounted for by the decline in the number of institutions with assets less than $100 million, which fell by 85% over the period."

Your "Issue Brief" took a similar approach. When highlighting the positives of the community banking sector, you specifically excluded the smallest community banks because they would not have allowed you to draw those positive conclusions. For example, your report states "Many community banks - particularly those with assets between $100M and $10B - have continued to grow steadily." Why would you publish a document that excludes the performance of banks under $100 million in assets, the part of the industry that makes up half the banks in my state?

Regulatory Reform is Needed Now

The Minnesota banking industry is changing, as our community banks are merged out of existence. If we want to slow or even reverse that trend, there needs to be a discussion of how to appropriately regulate community banks. These institutions need regulatory relief, and they need to be regulated based upon their level of complexity, risk profile and business model. Right now, there is mostly a one-size-fits-all regulatory approach. The regulators write their regulations in a way that ensures they address the complexity and business model of Citigroup. Unfortunately, those long, complex regulations often do not make sense when they are applied to a $25 million community bank that has five employees. Until regulations are tailored to fit community banks, we will continue losing community banks at our current pace, almost one bank per day.

The MBA applauds the Council for considering this topic. Community banks are the economic engine that drives small business development and job growth all throughout the country. If this current rate of consolidation continues to occur, community banking as we know it will be a thing of the past. Reports and issue papers that fail to acknowledge that there is a problem will make finding a workable solution much more difficult.

Thank you for your attention.

Sincerely,

Joe Witt

Joe Witt
President/CEO

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