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COMMUNITY BANK GAINS OUT-PACE REST OF INDUSTRY

FDIC figures released Sept. 5 for the second quarter show earnings at the nation's community banks surpassed year-ago numbers by 8.1 percent, a significantly greater gain than experienced across the entire industry. The nation's 5,303 banks insured by the FDIC reported net income totaling $62.6 billion in the second quarter, an improvement of $2.5 billion from the same quarter a year ago, or an increase of 4.1 percent.

The nation's 4,874 community banks reported net income of $6.9 billion in second quarter, an increase of $522.2 million from second quarter 2018. Growth in net interest income (up 5.1 percent), noninterest income (up 4.7 percent), and gains on securities sales (up 656.7 percent) drove the annual increase in net income, which was partially offset by an increase in noninterest expense (up 5.6 percent) and a modest increase in provision expense (up 2.3 percent).

As a result of the strong quarter, the Deposit Insurance Fund balance grew 4 basis points to 1.40 percent of insured deposits. This means community banks will receive a credit toward their FDIC premium payments.

Small banks earned a total of $765 million in DIF credits for the portion of their assessments that contributed to growth in the reserve ratio from 1.15 percent to 1.35 percent, the FDIC explained. The credits are automatically applied to offset the assessments of small banks when the reserve ratio is at least 1.38 percent. The FDIC will apply approximately $320 million of credits to offset the second quarter assessments of small banks.

Community banks reported a pretax return on average assets of 1.48 percent in second quarter 2019, up 7 basis points from a year ago, as the gap between community banks and non-community banks narrowed by 12 basis points over the same period. Ninety-six percent of community banks reported a profit during the quarter. Fifty-four banks merged, one community bank opened and one community bank failed during the quarter.

"In July, this economic expansion became the longest on record in the United States," commented FDIC Chair **Jelena McWilliams**. "With the recent lowering of short-term rates and inversion of the yield curve in the second quarter, new challenges for banks in lending and funding may emerge. The competition to attract and maintain loan customers and deposits is strong, and therefore, banks need to maintain rigorous underwriting standards and prudent risk management."

Rebeca Romero Rainey, president and CEO of the Independent Community Bankers of America, called attention to the DIF credits earned by community banks with less than $10 billion in assets.

"As advocated by ICBA and community bankers, this provision of the Dodd-Frank Act of 2010 required larger banks to offset the cost of increasing the DIF reserve ratio from 1.15 percent to 1.35 percent on banks under $10 billion. These assessment credits will be automatically applied each quarter that the reserve ratio is at least 1.35 percent.

"At the time of the original debate, the Deposit Insurance Fund was in negative territory amid the fallout of the Wall Street financial crisis. Looking at the big picture, ICBA fought hard to ensure that most community banks wouldn't be stuck footing the cost of a crisis they didn't cause," Romero Rainey said.

"The FDIC's second quarter report shows that the banking industry remains healthy and continues to support ongoing economic growth," commented **James Chessen**, chief economist for the American Bankers Association. "Banks saw the strongest year-over-year loan growth since the first quarter of 2018, led by the commercial and industrial sector.

"Lending by community banks was particularly strong, which demonstrates the breadth of bank engagement in every community. In addition, small business loans under $1 million increased by $13 billion compared to a year ago, which represents tens of millions of new loans to Main Street businesses that help to create jobs and stimulate local economic activity. Consumer lending was also strong, reflecting the cumulative effect of the solid growth in jobs and consumer confidence remaining high. Continued consumer spending, aided by the prudent provision of credit by banks, will help sustain economic growth," Chessen said.

DIRECT, ONLINE BANKING GAINS FURTHER TRACTION WITH CONSUMERS

Of the more than 600 consumers who participated in a recent BAI survey, 52 percent use a large bank as their primary financial services organization, 19 percent use a direct bank, 16 percent use a community bank or credit union, and 13 percent use a regional bank. The survey, which was presented in a recent BAI webinar, focused on the perception of banking with a direct, or online, institution.

The findings of the survey paint a stark contrast between why financial services leaders at traditional financial services organizations think consumers are moving to direct banks and the true driving forces. While many industry leaders believe that low rates and fees are the driving force behind direct bank adoption, consumers reported convenience (19 percent) as the most important factor. This finding indicates a shift in consumer attitudes about the definition of convenience, moving from physical branches to digital capabilities.

In addition to shifting consumer attitudes towards direct banks, consumers' technological desires are not fully aligned with the industry's. Consumers among the millennials, Gen X and boomer generations overwhelmingly cited that they want a clear, easy-to-use app for check deposit and bill pay (44 percent). However, Gen Z — often defined as a generation of digital natives — felt differently, citing quick transfers (57 percent) and faster payments (45 percent) as a high priority. Notably, voice banking, which is highly discussed in the industry, ranked last among all generations with only 3 percent of consumers citing it as a priority for banking tech.

"Direct banks aren't going away anytime soon, and traditional financial services organizations should continue to view them as a real competitor," said **Karl Dahlgren**, managing director of research for BAI. "The way consumers define 'convenience' is rapidly changing from branch location to digital capabilities. Our research indicates that organizations that aren't actively finding new ways to meet this need are at risk of being left behind."

The aforementioned webinar further discussing the survey findings is available at https://www.bai.org/research/bai-banking-outlook.