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Economy, Deregulation Raise the Appeal of Starting a New Bank

- FDIC approves four de novo applications in two months
- Only five were approved in a six-year span after crisis

By Jeff Bater - August 13,2018

The Federal Deposit Insurance Corp. has approved four new bank applications in the past two months as a strong economy and reduced regulatory burdens fuel an interest in startups not seen since before the financial crisis.

With at least 10 more applications in the pipeline and a new chairman who wants to speed up the review process, the FDIC is likely to approve the greatest number of de novo banks for deposit insurance in more than a decade.

“It’s a better economic proposition to start a new bank than it has been since 2007,” David Freeman Jr., who heads the financial services practice at Arnold & Porter, told Bloomberg Law.

President Donald Trump’s pick to run the FDIC, Jelena McWilliams, is also bringing new urgency to the task. She told a banking and securities conference in mid-June that she has instructed agency staff to take a serious look at applications and move swiftly.

Since McWilliams became chairman June 5, the deposit insurer has approved de novo applications for Catalyst Bank in Las Vegas, Coastal Community Bank in Hollywood, Fla., Grasshopper Bank in New York, and Studio Bank in Nashville, Tenn.

“She has been pretty clear that she thinks they should become more active in approving new charters,” Freeman said. “That doesn’t mean they won’t be careful and conservative. It means they’re not going to drop them in a black hole and let them die.”

The FDIC does not charter financial institutions. It decides whether to grant federal deposit insurance, a requirement for any institution that collects deposits from individuals. Banks are chartered by the individual states or, in the case of national banks, by the Office of the Comptroller of the Currency.

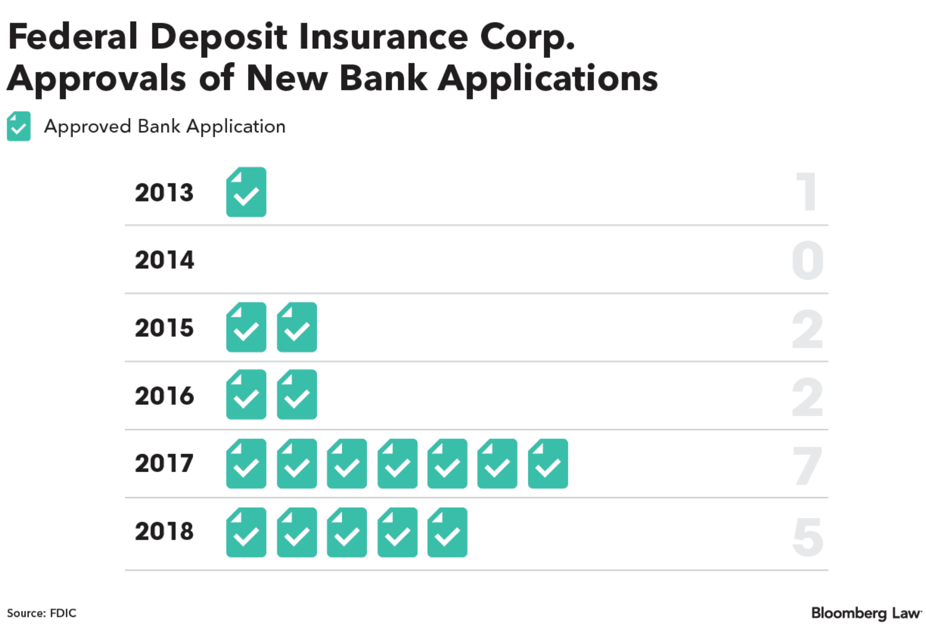
Critics at a House Oversight and Government Reform Committee hearing in 2016 accused the FDIC of dragging its feet and discouraging would-be applicants.

Joe Dorsey, who shepherded Coastal Community Bank through its review this year, told Bloomberg Law he thinks regulators were “a little gun-shy after the great recession.”

“They have to insure the bank,” said Dorsey, who received regulatory approvals this summer and hopes to open to customers this year. “The FDIC is the one that’s going to be holding the bag if a bank fails.”

Dorsey said he didn’t find the review overly burdensome even though regulators are “very meticulous” and require a lot of paperwork. Applicants have to show a need for a bank in their geographical area, for instance, and also develop a plan describing how they will comply with money laundering laws.

“If it were easy, everyone would open a bank,” Dorsey said. “It is not easy.”



Rise in Demand

An average of more than 100 charters a year were approved by the FDIC during the decade leading to the 2008 financial crisis. Then, applications for insurance dried up. No approvals occurred from 2009 to 2012. There was one approval in 2013, two in 2015, and two in 2016.

Approvals ticked up from the post-crisis lows in 2017 as the FDIC approved seven charters. The hiatus in new bank formation has caused pent-up demand, said Kenneth Till, the CEO of CommerceOne Bank in Birmingham, Ala., which secured FDIC approval in March and opened in June.

“We’re the first bank in Alabama in 10 years,” Till told Bloomberg Law, adding that there was “was not a lot of appetite at the federal or state level for a new bank” in the aftermath of the crisis.

Economic growth, spurred by Trump’s new tax cut law, is emboldening investors to put money into banking. Another incentive is the Trump administration’s vow to relax banking rules. Discussions among regulators are underway, for instance, over revising how banks are measured for compliance with the Community Reinvestment Act, a 1977 law that gauges lending to low-income neighborhoods.

Changes to the Dodd-Frank Act signed into law by Trump in May will likely reduce compliance costs and make it more efficient to set up a new bank, Freeman said. The new law, for example, increases the number of small banks eligible for less frequent supervisory examinations.

“You’re removing a layer of upfront costs,” he said.

David Baris, a partner at Buckley Sandler, said he thinks there will be additional charter approvals in the near future, even if it’s unlikely to return to pre-financial crisis levels.

No Easy Feat

To make good on her promise to help spur bank formation, McWilliams will have to “dig deep into the organization,” and “do more than just make public statements,” said Baris, who is president of the American Association of Bank Directors.

Peter Gwaltney, president of the North Carolina Bankers Association, told Bloomberg Law he is optimistic. “I think she can bring leadership to the agency and create a culture of wanting to get things done, expediting applications,” he said.

The American Bankers Association set up a task force this year to address the challenges to de novo banks. The group is working with the FDIC and new bank applicants, with the idea of reducing uncertainty facing startups.

The FDIC can speed up the application process by improving communications with investors and making decisions earlier on the viability of a startup’s business plans, Freeman said. The big challenge for an investing group is “getting comfortable you won’t go down a very expensive path and get to a ‘no,’” he said.