



The Banking Landscape, Post-Crisis

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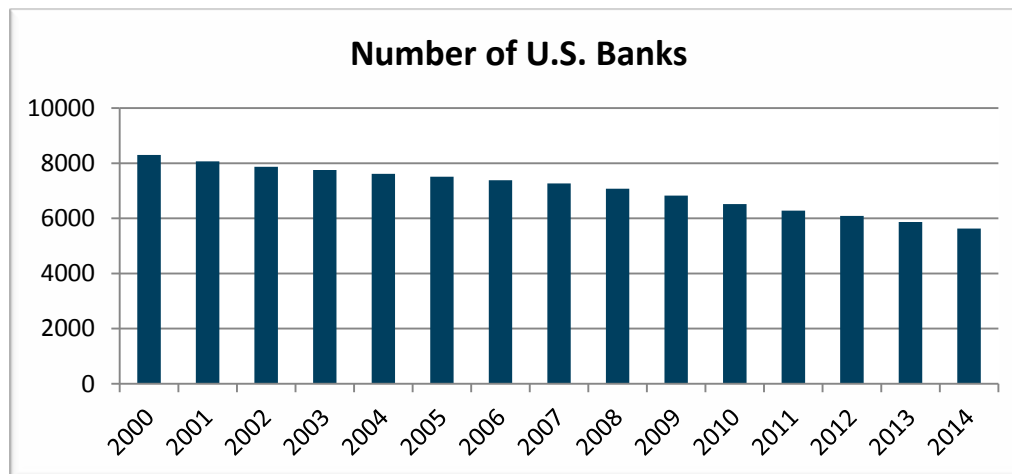
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By: D. James Lutter

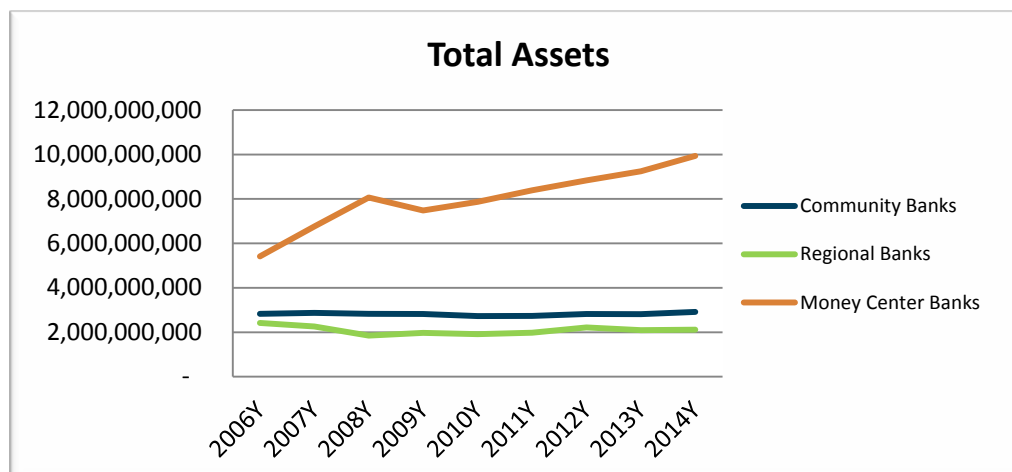
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The banking landscape has transformed drastically since the Great Recession. All facets of the industry (community, regional, and money center banks) have modified their focus/strategy in response to the economic down turn, prolonged low interest rate environment and increased regulatory oversight. As the current economy is entering into the mature phase of this economic cycle, while still in recovery mode, the banking environment is quite different.

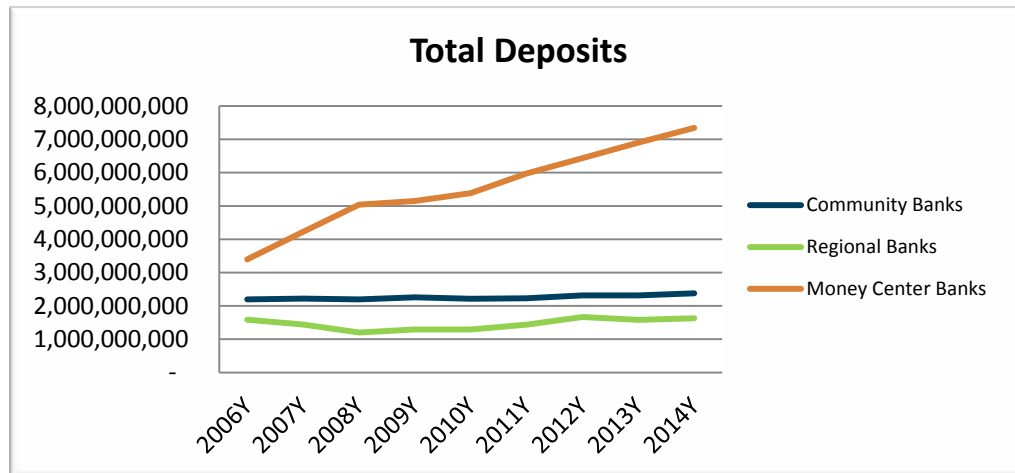
Since 2006, the number of banks in the industry shrunk by 24%, continuing a trend of consolidation. The result is continued pressure on the smaller community banks with significant growth in assets and deposits at money center banks. Total assets at regional banks trail pre-recession levels, and assets at community banks have remained relatively unchanged. Deposits for both regional and community banks have stayed flat since the Great Recession. However, the overall industry has experienced a change in deposit composition.



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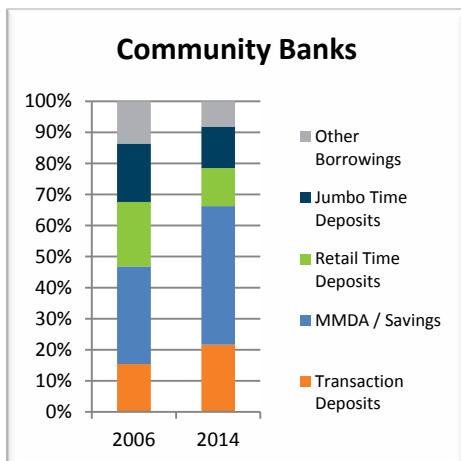


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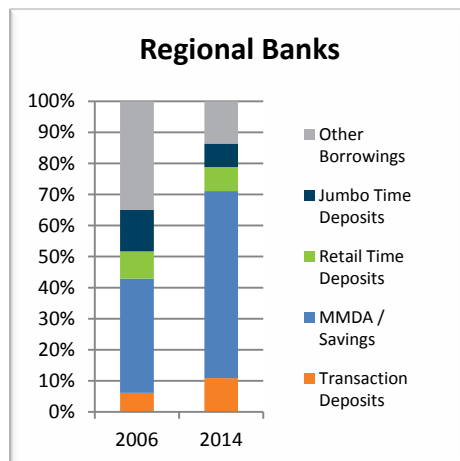


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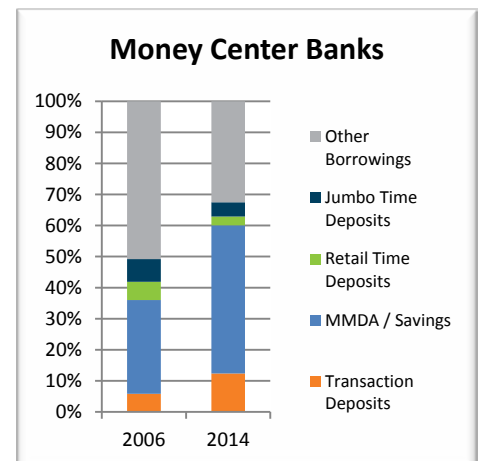
The industry as a whole has witnessed money market demand deposit / savings and transaction accounts grow their share of overall funding, while jumbo, retail and other borrowings have shrunk. This highlights deleveraging and abundant access to lower cost funds across the banking industry. Loan composition at banks has also experienced changes since the Great Recession. Community banks have shrunk their construction portfolios for larger amounts of Commercial Real Estate (CRE), Residential Real Estate (RRE) and Agriculture & Farmland loans. Regional banks have shifted out of RRE and construction loans toward Commercial & Industrial (C&I), CRE and consumer loans. Money center banks have also moved away from RRE loans in favor of C&I and consumer loans.



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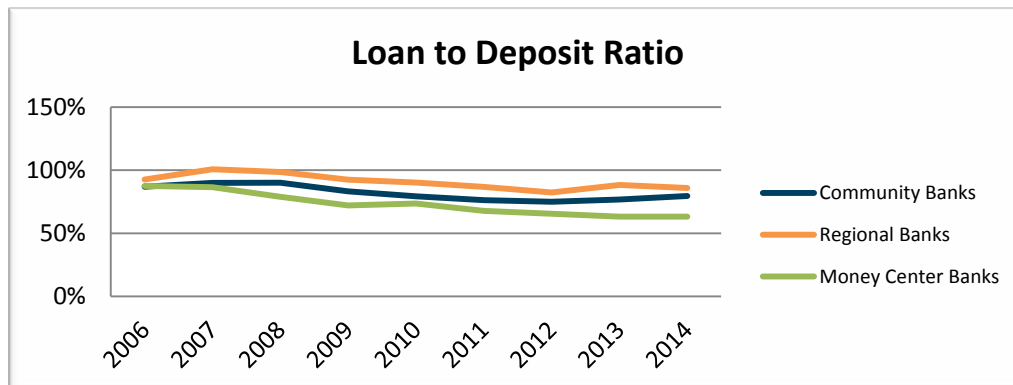


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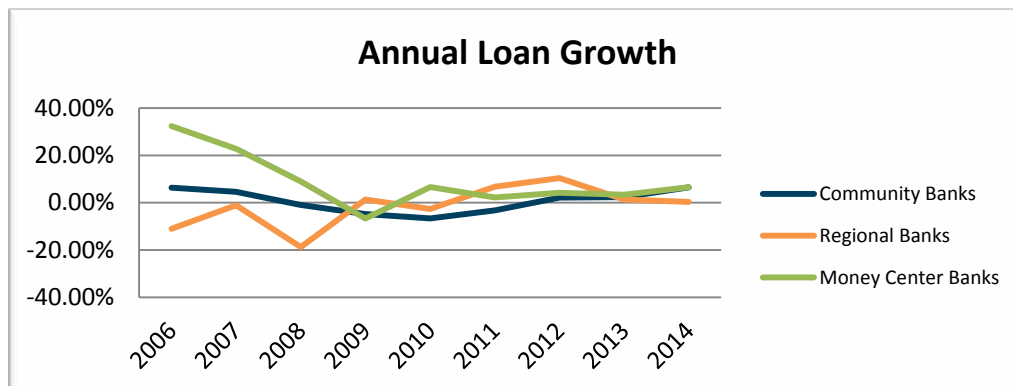


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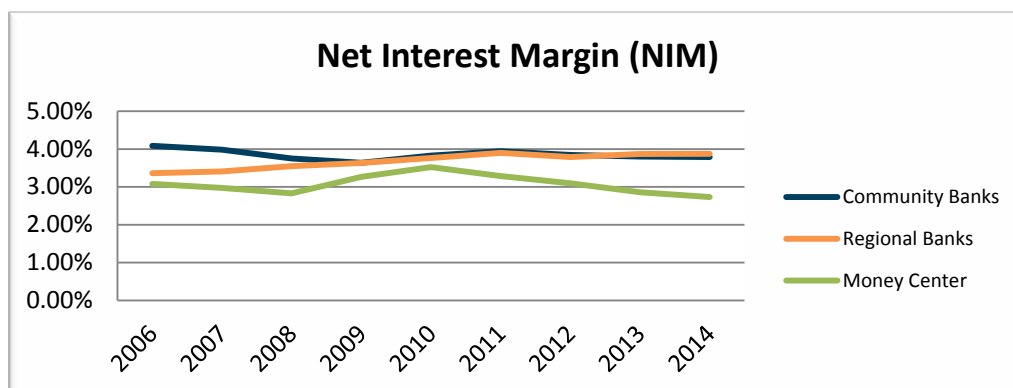
Post crisis, banks have been slower to grow their balance sheets, due to a chronically slow recovery, increased regulation and lack of quality loans. Loans as a percent of deposits continues to lag pre-recession levels, across the banking industry, fueled by widespread deleveraging and extremely slow loan growth. Until recently, the majority of growth has been inorganic at compressed spreads due to historically low rates and increased competition. Money center banks have realized the brunt of the rate compression since the Great Recession, but all banks have felt the squeeze. Lack of meaningful growth in interest income has forced banks to become more efficient through cost control.



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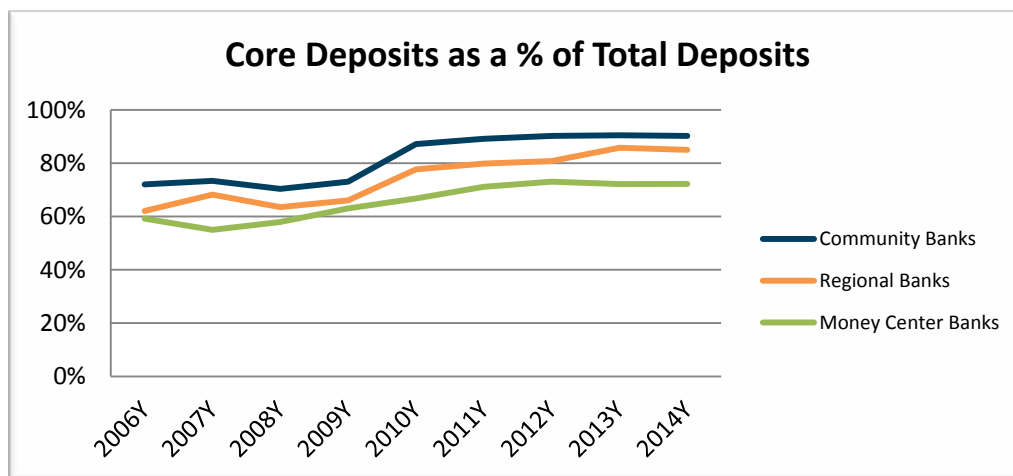


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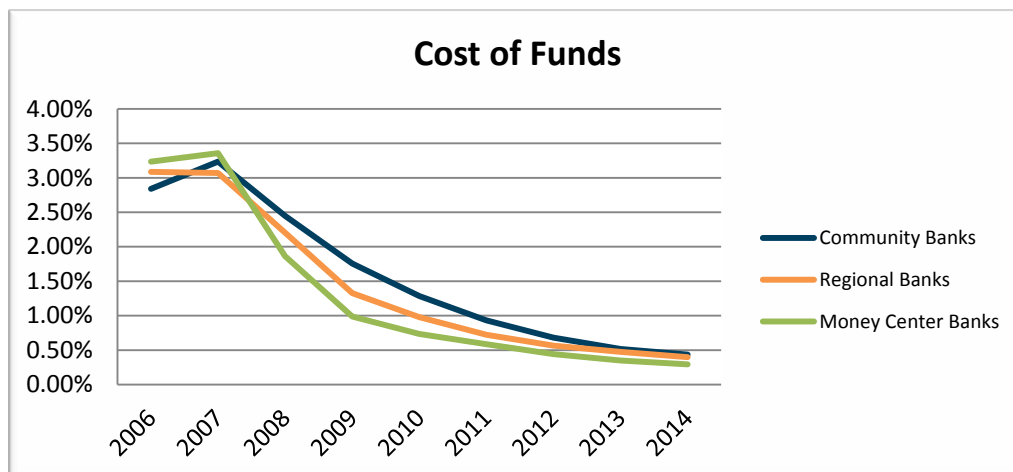


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With continued pressure on margin, banks have focused on the liability side of the balance sheet to reduce funding costs. The trend, post-crisis, has been a continued deleveraging of balance sheet across community, regional, and money center banks with an increase in cash and equivalents and investment securities. Low interest rates and the lingering hangover from the crisis have kept the depositor mindset on security over yield supporting the growth of core deposits. Community, regional, and money center banks have experienced an increase in core funding since the crisis; Community banks have grown 38%, regional banks 27% and money center banks 215%. With core funding at such a high percentages, banks are going to have to look elsewhere to support growth, particularly, community banks.



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SUMMARY:

In conclusion, we continue to see a beleaguered banking industry still suffering from the consequences of the Great Recession. Banks have deleveraged their balance sheets



due to the absence of quality loans and in effort to comply with more stringent regulation that values stability at the expense of growth. The onslaught of regulation (Dodd-Frank Act, Basel III and the new FDIC assessment proposal) makes it particularly hard on community banks to generate stronger loan growth as they do not have the resources to deal with the burden of heavier compliance obligations as their larger counterparts. Also, in recent years banks have not only been competing with each other for loans, but also with credit unions and other nontraditional sources like Lending Club, who are largely exempt from regulation. The competitive pressure from these new non-bank lenders are forcing banks to reconsider their business models.

Another emerging trend across the industry is the transformation of deposit composition to core funding as the cost of funds has reached historically low levels. In the face of stronger loan growth, we expect banks to utilize noncore funding to help efficiently fund loans. Banks will need to seek out stable funding sources who understand the complexities of the regulatory environment. Going forward, banks will not only need to consider how funding affects their capital ratios, in addition to their FDIC assessments. There is justified worry that regulation has shifted too far and may cause unintended instability and further stifle meaningful economic growth. It will be interesting to watch how an ever changing competitive environment and regulatory landscape shapes the banking industry.

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1. Federal Deposit Insurance Corporation (FDIC)
 2. SNL Financial

About D. James Lutter

D. James (Jim) Lutter is the Senior Vice President of Trading and Operations at PMA Financial Network, Inc. and PMA Securities, Inc. where he oversees PMA Funding., a service of both companies that provides over 600 banks with a broad array of cost effective funding alternatives. Mr. Lutter is a Registered Representative with PMA Securities, Inc. and Investment Advisor Representative with Prudent Man Advisors, Inc. Mr. Lutter has the following FINRA licenses with PMA Securities, Inc.: Series 7, 24, 53, 63, 65 and 99.

About Todd A. Terrazas

Todd joined PMA Financial Network, Inc. in 2014 as a Financial Analyst for the firm's Credit Risk Management team. He now serves as Business Development & Product Manager for PMA Funding, where he is responsible for developing bank partner relationships and managing funding product solutions and association affiliations. Mr. Terrazas also engages in strategic planning and identifying market trends through extensive market research. Prior to joining the firm, he was a Market Research Analyst at Common Goal Systems, Inc. Mr. Terrazas earned his Bachelor of Arts in Finance from Calvin College.

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