MIAMI TODAY 35 Years

August 28, 2017

As banks under pressure merge, small banks’ futures murky

By Catherine Lackner

‘The recession exposed a lot of weaknesses..., but the regulatory pendulum has swung too far.’
Hal Lewis

As pressures on community bank increases, some are choosing to be merged into larger institutions. Observer differ on whether it will lead to the eventual extinction of smaller banks.

“Consolidation within a mature industry, such as financial institutions, is natural process,” said Angel Medina Jr., president & CEO of Gibraltar Private Bank and Trust, via email. “Consolidation is occurring because of regulation and commoditization of many traditional banking products and services through technology.

“The financial services industry is a highly regulated industry,” he continued. “In the past 10 years, the regulatory burden on financial institutions has grown dramatically, as the industry has been deputized to assist law enforcement in ‘following the money’ through compliance with the US Patriot Act and Bank Secrecy Act.

“Additionally, consumer advocacy has further increased demands on institutions for compliance in many areas of financial services, not the least of which has been in the area of lending (residential mortgage lending specifically) and financial services fees,” he said.

“Advancements in technology have begun to play an ever-increasing role in how financial services and products are delivered to the consumer, including business; thus commoditizing many of these services. FinTech (financial technology) companies are playing an increasing role in today’s economy.

“Net interest income (the difference between what a bank earns from its loans and pays to its deposits) has been the principal driver of bank gross income. Over the past several years, these margins have been compressed, and this compression continues as banks and FinTech compete for deposits and loans.

The result is less income and more costs, thus decreased net income for financial institutions, and less profitability for the shareholders,” Mr. Medina said.

In that case, consolidation becomes an option, he said. “US economic growth is strongly dependent on small and medium-size business. While FinTech and mega banks play an important role in our economy, community banks play a critical role. Community banks area and will continue to support the needs of small and mid-sized businesses and consumers because of their understanding of their community’s unique opportunities, their local decision-making capabilities, and their ability to offer more individualized attention to their clients, which translate to improved responsiveness and greater flexibility.

“Consolidation will continue to occur simply because of economies of scale. However, with size, the effectiveness of catering to individual community needs decreases and thus the continued need for a strong community banking market sector to drive economic growth,” Mr. Medina said. “Some smaller banks may simply not be able to compete effectively. But this country can and will continue to support a

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variety of banking institutions, simply because of the significant differences of the economic drivers of our great and vast country."

"We're down to 120 bank headquarters in the state," said Gregory K. Bader, attorney and practice leader of Gunster's banking & financial services practice.

"The driving factors include small banks having a difficult time with compliance," he said. "In some banks, their compliance department is larger than their lending group. You're growing your costs without bringing dollars in. that can make a bank less sustainable," he said.

"I don't think we're going to the Canada model, with just a handful of bank for the entire country. At some point, we're going to hit bedrock. Acquirers are going to run out of targets."

Nor does he see community banks going away. "People really like that sector," Mr. Bader said. "There may be the ability to make more money with the administration. If interest rates rise, you can make more money on the spread. And as you shrink the banking market, there become posckets and gaps that can be exploited."

"The recession exposed a lot off weaknesses in the system, but the regulatory pendulum has swung too far," said Hal Lewis, co-founder and co-managing partner of the Pathman Lewis law firm, whose practice includes bank litigation, acquisitions and mergers. "In some cases, the compliance officer is the most critical person in the bank."

The Trump administration is expected to back off some rules, which should give some relief to community banks, which don't have deep pockets to hire a reporting and compliance staff, he said. "There has to be more normalcy, but there also has to be some structure."

Some consolidations, like IberiaBank's acquisition of Sabadell United Bank, occur because the larger bank sees an opportunity. "A lot of banks want to come into the Miami market," he said. It was Iberia's first venture into Miami-Dade County; the bank has branches throughout Florida.

Community banks, often the target of acquisitions, make about $10 billion in loans to small businesses each year, Mr. Lewis said. "It's a fantastic system that must remain vibrant. It shouldn't be overburdened by rules, some of which are really not necessary. That is a real threat to this sector."

"We expect to see consolidations continue, but at a slower pace than we expected post-crisis," said Adam Ingles, director of the regulatory risk solutions group of the Morrison, Brown, Argiz & Farra accounting firm in Miami.

From 2010 and 2012, bank consolidations were more common. "Five years removed, there's less uncertainty," he said "We've gone from the early post-crisis era of discount pricing to more premium pricing."

The cost of compliance, among other factors, makes it advisable for banks that have $500 million to $1 billion in assets to seek out a partner that has a larger loan and deposit base, he explained.

"Buyers want to be opportunistic, and they're looking for the best economic return. Buyers and sellers are each waiting for the other to blink."