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Q1 De Novo Bank Trends

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There has been recent turmoil in the U.S. stock markets over the past few weeks as the country starts to take steps toward reopening as a result of the pandemic. However, financial institution stocks have been buoyed by anticipated increases in interest rates. The KBW Nasdaq Bank Index and the KBW Nasdaq Regional Banking Index continues to trend positive, maintaining their 35% gains. As the country reopens, people are investing, and investors are focusing on one of the few industries that will benefit from rising rates — banks. Additionally, investors are looking for a safe, stable investment, and banks exhibited caution over last years' financial instability.[1]

Regardless of the reasoning, this positive trend for financial institutions has translated particularly well for one specific banking sector — de novo banking institutions. Several years ago, the Federal Deposit Insurance Corporation (FDIC) revamped the application process by publishing new guidelines and handbooks leading to an uptick in de novo bank formations.[2] Additionally, a recent governmental push to promote banking access in low income communities has made de novo banks a prime benefactor. In April 2021, Rep. Andy Barr (R-KY) introduced the Promoting Access to Capital in Underbanked Communities Act, which would establish a three-year phase-in period for new banks to comply with federal capital standards, thus making de novo bank formation more accessible in smaller communities.[3]

Along with the potential governmental benefits, de novo banks are turning a profit at a quicker pace than in previous years, making them more appealing to organizers and investors alike. While historically it has taken de novo banks 8.6 quarters on average to reach monthly operating profitability, over the last several years, that has dropped to 6.8 quarters.[4] In combination with the trend toward digital banking transactions, the reduced investment required for facilities and staff has aided de novo banks, which appear to be in the right place at the right time. While many of these de novo banks have formed in areas with a population size of more than 500,000 people and vibrant local economies, the legislative push for access to banking may encourage more de novo bank formations in smaller communities.[5]

With the number of banks in the U.S. contracting significantly through M&A activity over the last several decades, the push by investors seeking rising interest rate environments and legislative initiatives to establish more de novo banks are clearly having an effect. In the last 12 months alone, 11 de novo bank applications have been approved, nine de novo banks have opened, and 12 additional applications are currently under review.[6] As a result of the positive legislative environment, as well as changes in the economy, we may expect to see a significant increase in the number of de novo banks.

[1] “U.S. Bank Stocks Shine as Investors Bet on an Economic Recovery,” *The Wall Street Journal* (May 19, 2021).

[2] “FDIC Pledges to Jump Start the De Novo Bank Approval Process,” Davis Polk & Wardwell LLP (December 12, 2018).

[3] “Congress Looks to Address Banking Access Shortfalls,” Banking Exchange (May 10, 2021).

[4] “De Novo Banks Posting 1st Profit More Quickly,” S&P Global Market Intelligence (October 19, 2020).

[5] “De Novo Bank Chartering Trends,” Banking Strategist.

[6] “De Novo Bank Chartering Trends,” Banking Strategist; “Decisions on Bank Applications,” FDIC.

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