CAN COMMUNITY BANKS BE SAVED?

Community banks, vital to the health of local economies, are disappearing – in record numbers. We have developed a strategy to reverse that trend.

Community banks under threat

Community banks (less than $1B in assets) have been in steep decline for the past three decades. Sixty percent have gone under or been acquired by a larger bank.

Post-2008, community banks found themselves under increased regulatory scrutiny, primarily by FDIC. As a result they have been constrained from making credit available to local economies, thus restricting their profit-making ability and impeding economic recovery, exacerbating this trend. In today's environment, only the large banks can survive and the largest are more profitable than ever.

FDIC foresaw problems

As early as 2004, the FDIC was warning that complex new laws and regulations could spell the end of small community banks:

> *"The volume and complexity of existing banking regulations, coupled with new laws and regulations, may ultimately threaten the survival of our community banks." —John M. Reich, Vice Chairman, FDIC.*

Reich's warning is proving all too correct

Main Street relies on local banks

As of 2012, community banks held 21% of banking industry assets, but 54% of small loans to farms and businesses.

If local banks disappear, big banks are not an alternative. Wall Street banks (historically reluctant lenders to small and medium-sized enterprises) have drastically cut small business lending.

Today Wall Street banks devote only 18% of their commercial loan portfolios to small business. Their approval rate for small business loans is below 10%.*

A Common Solution

What can community banks do to survive? The answer – join forces. A group of smaller banks can effectively become a bigger bank if they band together under the common ownership umbrella of a bank holding company (BHC).

Frequently larger banks are owned by a BHC, alongside other kinds of financial institutions such as merchant banks, investment banks, securities broker-dealers, mortgage banks, leasing, insurance, etc., giving them a broader income base than commercial banking alone.

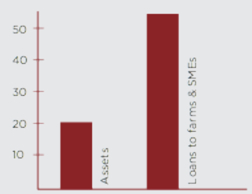
BHCs also have access to lower cost of capital than a traditional bank, especially because most are publicly traded companies with access to public capital, both debt and equity.

BHCs are normally formed as a "top down" structure where they acquire or build subsidiaries designed to function like a large banking enterprise, not to retain the autonomy and individuality of community banks.

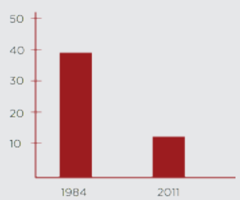
Additional Benefits

Conversely, the BHC proposed here would be a benefit corporation[1] formed by a Business Development Company[2] (BDC).

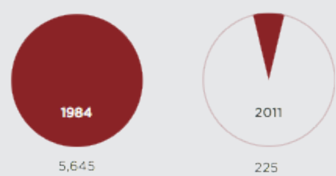
Its purpose is to acquire community banks with the intention of keeping them local while making them part of a larger public company with access to capital and other resources. They would also share in the benefits of parallel businesses like BDC investments and lending, insurance, registered investment advisory services, etc.



Over 10,000 community banks have disappeared since 1984 ~ 60%) and that trend has greatly accelerated since 2008.



The share of U.S. banking assets held by community banks fell from 38% to 14%



The number of banks with assets less than $25 million declined by 96%

Source FDIC

A SOLUTION THAT WORKS FOR ALL

Commonwealth Group's model provides investors who wish to invest in their local financial institutions with the opportunity to do so profitably while also offering them the benefits of owning publicly tradable stock and the increased liquidity and transparency that brings.

Our broader goal is to address the precipitous loss of community banks, and in the process help revive local economies.

Benefits to Banks

- Helps ensure survival as **independent** institution.
- Lowers their individual **cost of capital**.
- Helps **fend off acquisition** by large banks.
- Access to shared services brings **cost savings.**
- Banks have access to business support services that can **improve operations and profitability**.

Benefits to Investors

- Small investors can support their local banks while **building wealth** for themselves.
- Investment is in a public company, therefore shares are **liquid** (freely tradable).
- **Risk is spread** through ownership in multiple banks.
- Investor **confidence** is enhanced through transparency and proximity.
- Provides current investors with a means to **exit** their investment.

Benefits to Communities

- Local banks provide the community with the majority of **small business loans and other beneficial services** not offered by big banks
- Bank jobs and jobs at the companies they serve are **retained**.
- Community banks **foster economic growth** and help to ensure that the financial resources of the local community are put to work on its behalf.
- Locally-owned banks bring some **balance and competition** to a land-scape increasingly dominated by large, remotely owned banks.

ENDNOTES

[1] A benefit corporation is a type of for-profit corporate entity, legal in 26+ states, that includes positive impact on society and the environment in addition to profit as its legally defined goals.

[2] A Business Development Company ("BDC") is a form of publicly registered company that invests in small and mid-sized businesses. It resembles a venture capital firm except that it is open to the public rather than just wealthy private investors. Created by Congress in 1980, BDCs provide the liquidity normally excluded from investments into small businesses, while also expanding the flow of capital to those small companies.

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