



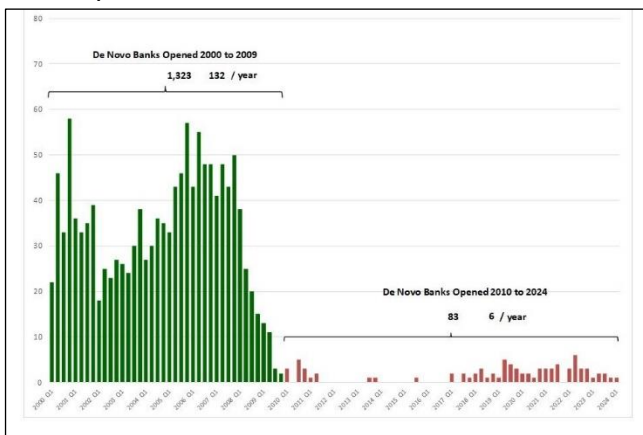
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# De Novo Banks: Policy Issues for the 118<sup>th</sup> Congress

While the size of the banking system has grown in terms of assets, the number of banks has steadily fallen over the past four decades. For example, in the 1980s, there were more than 18,000 banks. Today, there are fewer than 5,000 commercial banks. Consolidation has been facilitated by mergers and acquisitions, bank failures, and, more recently, a downturn in the formation of new banks. New banks are called *de novo* banks (“from the beginning”). Generally, *de novo* banks are smaller institutions, and their formation is a source of competition in the banking system. In the past two decades, the rate of *de novo* formation has bottomed out, and Congress and regulators have long debated methods to revitalize interest in new bank formation while balancing safety and soundness concerns over the health of the newest, least established banks.

More than 1,000 new banks were formed between 2000 and 2008. However, after the 2007-2009 financial crisis, the annual rate of new bank formation stalled and has barely ticked up in recent years. Further, the failure rate of *de novo* banks is relatively high: Research from the Federal Reserve suggests that they failed at more than double the rate of more established institutions in the years leading up to the 2007-2009 financial crisis and are generally more prone to failure than are established banks.

**Figure 1. De Novo Bank Formation**  
Quarterly Data from 2000 to 2024



**Source:** FDIC analysis done by BankingStrategist.com. Data and figure can be found at <https://www.bankingstrategist.com/de-novo-bank-chartering-trends>.

While actual formation has generally slowed, there has been a recent resurgence in applications for *de novo* bank charters in recent years. The following section discusses the criteria by which a regulator considers an application for a new bank charter.

## Forming a New Bank

Organizers of a new bank must apply for a bank charter at either a state regulator (for a state charter) or the Office of the Comptroller of the Currency (OCC) (for a national charter). (Credit unions similarly have state and federal charters, with federal charters issued by the National Credit Union Administration [NCUA].) Simultaneously, the proposed new bank would need to apply for deposit insurance approval from the Federal Deposit Insurance Corporation (FDIC) or share insurance from the NCUA. Regulators approve or deny applications on the basis of a few key factors, including the business plan, the qualifications of the proposed board and senior management, and the adequacy of the proposed capital levels.

## Supervisory Concerns for New Banks

Supervisors are cognizant of the higher likelihood of *de novos* failing and set capital levels on an individual basis, reflecting the risks of a proposed bank’s business model. For example, the OCC “may determine that higher amounts of capital than those the organizers proposed are warranted based on local market conditions or the proposed business plan.” Similarly, the Fed’s supervisory guidance states that “a *de novo* should maintain capital ratios commensurate with its risk profile and, generally, well in excess of regulatory minimums.”

Supervisors are also concerned with how and whether a proposed bank can meet the community’s credit needs, particularly as it applies to the Community Reinvestment Act, and how the bank plans to comply with various banking laws, including those that govern fair lending, anti-money laundering, sanctions, and privacy policy.

Regulators are also concerned about the general decline in the number of banks in the financial system. For example, in April 2023, Fed Governor Michelle Bowman gave a speech on the need for smaller institutions and stated that “preserving and enhancing the number of banks should be a regulatory and legislative imperative, including by encouraging new bank formation.”

## Regulatory Interest in Promoting De Novos

While bank regulators closely regulate *de novos* in an effort to appropriately guard against the risks they present, they also recognize the benefits these banks can generate and have taken steps to encourage their formation. Given that deposit insurance is a critical threshold for a *de novo* to pass, the FDIC states that it is “committed to working with groups interested in organizing a *de novo* institution.” The FDIC has provided resources and guidance for new banks, including a statement of policy on applications for deposit insurance and a handbook for *de novo* charters. Meanwhile,

the Fed, OCC, and NCUA have also published manuals for obtaining a charter. Relatedly, the NCUA has begun piloting a new program to give new credit unions 12 months to obtain necessary capital levels. The NCUA issued its first provisional charter under the pilot in May 2024.

In addition, the Fed has conducted occasional studies on de novo formation in the past decade, finding that while regulatory burden is a driver in “depressed de novo formations,” cyclical in economic output is a stronger factor. That said, regulatory burden is a consistent theme among banks in their interactions with their regulators.

In some instances, the regulators are statutorily mandated to monitor and support the formation of de novos. For example, Section 308 of the Financial Institutions Reform, Recovery, and Enforcement Act (P.L. 101-73), as amended by P.L. 111-203, requires the regulators to report on their mandate to preserve and promote minority depository institutions, including efforts to provide these institutions with information and support regarding de novo formation.

## Policy Considerations

Policymakers generally face a dilemma between promoting new banks and a simultaneously safer banking system while removing barriers to entry, particularly with respect to capital requirements. This is mainly because capital requirements are an expensive regulatory hurdle for banks to clear, but they are also one of the most important tools for prudential regulation. While competition in the banking system is reasonably high, with nearly 5,000 institutions, consolidation may lead to regional or local “banking deserts” where access to banking services is increasingly scarce. In theory, new bank formation could reduce banking deserts. However, there may be other reasons that dissuade a bank from forming in an area with limited financial service provisions. The banking industry has largely supported de novo formation, particularly as such a position relates to reducing regulatory burden on banks. Policymakers are generally in favor of increased competition in the banking system, but there are opposing views over to what extent bank profitability should take priority over capital adequacy and other safety and soundness measures.

## Regulatory Capital Concerns

While each aspect of evaluating an application imposes a cost on the proposed bank, it is likely the capital considerations that present the largest cost and thus the biggest impediment to forming a new bank.

Banks are generally required to hold a certain level of capital to meet minimum regulatory requirements. Capital is a form of funding where losses can legally be transferred to equity holders without constituting a default. This is different than other forms of funding, such as deposits and bond issuance, which must be repaid. Regulators generally require banks to hold a certain percentage of capital as a proportion of their “risk-weighted assets.” *Risk-weighted assets* refers to a way of normalizing the assets on a bank’s balance sheet for the risk they present.

Banks raise capital in a few different ways, but a predominant way is by issuing common stock. Generally, capital is more expensive to raise, particularly in comparison to debt or deposits. When regulators set higher capital requirements for new banks relative to established ones to reduce their risk of failure (as discussed above), this presents a barrier to entry if a potential bank cannot raise the necessary funding.

## Regulatory Timing for Applications

Another issue is the time it takes for regulators to approve applications. Historically, bank applications for a variety of activities (e.g., new charters, mergers, reorganizations) have inconsistent time frames, and some applications can sit for several months without a decision. (Regulators also hold pre-application meetings with prospective institutions. Often problematic applications are withdrawn or never filed.) Some regulators are making efforts to expedite application processes. For example, on June 20, 2024, the FDIC board approved a resolution that automatically places an application that has been pending for more than 270 days on the next board agenda. It is to remain on each subsequent agenda until a decision is made. Some applications are more complex and merit more consideration than others do. The FDIC found that between 2013 and 2021, fewer than 10 applications pended for more than 270 days. That number has increased in recent years.

## Legislation and Congressional Interest

In May 2024, the House Financial Services Committee ordered to be reported an amendment in the nature of a substitute to H.R. 758, *the Promoting Access to Capital in Underbanked Communities Act of 2023*. The bill would, among other things, implement a phase-in of capital standards for new banks over a three-year period for all new banks. Further, the bill would establish a new phase-in period for the Community Bank Leverage Ratio (CBLR; 12 U.S.C. 5371) capital requirement for “rural community banks”—defined in the bill as banks with assets under \$10 billion located in rural areas (defined in 12 C.F.R. §1026.35(b)(iv)(A)), which would be set at 8% (as opposed to 9% for non-rural community banks) in the third year. It would also require regulators to establish lower percentages during the first two years of the three-year phase-in. The CBLR would return to 9% after the third year.

These measures would afford a new bank more time to raise the required amount of capital, thus lowering barriers to entry. Further, for rural community banks, by using the leverage requirement under the CBLR as opposed to traditional risk-weighted capital requirements, the bank would not have to calculate risk-weighted assets, which would also reduce compliance costs. (The CBLR framework is optional, and a rural community bank could opt out of the 8% rural CBLR framework if a risk-weighted approach actually yielded a lower amount of required capital.) However, lowering the amount of capital these banks have to hold may increase their likelihood of failure.

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