



Charter Stripping and Reform Talks Rise as De Novo Banks Dwindle

regulatory de novo

Summary: As the number of banks continues to shrink, Fed Gov. Bowman says the US needs to find a way to encourage more startups. While some would-be de novo investors resort to buying existing banks and rebuilding them to circumvent the de novo process, Bowman advocates for revisions to de novo regulations. We discuss the logic behind each solution.

Among the works produced by the 16th-century English historian and government administrator John Hooker was a biography of his friend and adventurer Peter Carew. You probably haven't heard of either one. But you have no doubt encountered a version of one line in that 1575 biography: "The more cooks the worse potage." The modernized version of that old proverb is "Too many cooks spoil the broth."

That line not only comes up frequently in modern conversation, but is also debated in research circles. Studies have been done on it. Some concluded that it is an accurate description of how adding manpower to a task can actually slow things down. But other studies have found that more is, in fact, better.

When it comes to banking, the idea that we have too many banks — or too few — is a longstanding debate. No one has yet come up with the ideal number of banks that are needed in the US. But it is clear that nearly twice as many banks existed 20Ys ago.

Fed Gov. Bowman Argues for More Banks

The latest to weigh in on this debate is Federal Reserve Gov. Michelle W. Bowman, who, [in a recent speech](#), said the US has an unmet need for new banks. In her view, the current number of banks in the US — 4,706 in 2022, down from 9,354 in 2002 — is too few to meet the financial needs of the US. "Should we be concerned about the decline in the number of banks in the US banking system? In my view, we should," she said.

While banking consolidation continues to decrease the number of banks, new bank formation (de novo banks) is anemic at best. These two trends combined spell a lack of competition for customers in smaller communities, which can have consequences, like less funding for new or growing businesses. The risk to rural communities is that if consolidation picks up, some may lose access to their CFI's branches entirely, or will have their accounts moved to a faraway financial institution that doesn't understand their community.

To make matters more serious, there is little incentive for those who want to try to start a new bank in the US. In fact, Bowman argues, current regulations are so difficult to navigate that they work as a disincentive.

The Rise of Charter Strip Acquisitions

Investors who may be interested in starting a bank, but find themselves discouraged by the red tape required to do so have lately turned to a hybrid process called charter strip acquisitions. Instead of seeking a de novo charter, these financial investors of operations prefer to take over an existing bank, then change leadership and focus. The resulting bank is like a newly chartered one, except it uses an existing charter, thus avoiding the lengthy and costly process of getting approval for a new charter.

That process has been a favorite of fintech companies trying to break into banking. For example, fintech company SoFi did a charter strip [acquisition of Golden Pacific Bank](#).

Taking a Leaf from the UK’s Book

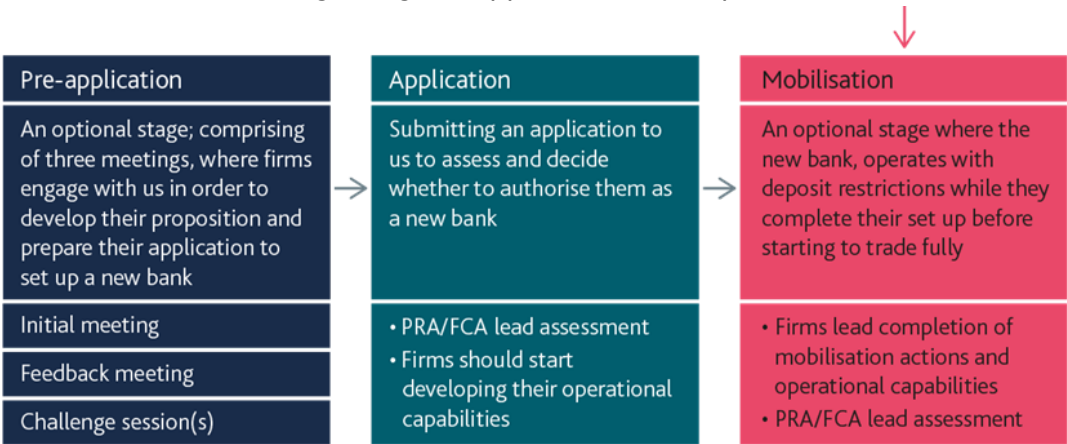
Bowman suggests that regulators and Congress need to review existing rules for new bank charters to see where the process could be streamlined and improved without undercutting protections. One place to look for innovative ideas might be the United Kingdom, she suggested, as their new process increases transparency.

The UK’s Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA) [have distinct roles in the de novo process](#). The PRA’s role is to promote sound practices while encouraging competition between institutions. The FCA’s role is more focused on protecting consumers and enhancing the integrity of the Bank of England. Together, the FCA and PRA have adopted the New Bank Start-up Unit initiative, which Bowman says, “provides transparent, single-stop resources about the life cycle of de novo bank formation, including planning, applying, early-stage operation, and eventually moving into a mature, steady state as a viable banking operation.”

Here are other ways that the New Bank Start-up Unit initiative makes the UK’s de novo process more streamlined and thoughtful:

- 1. **Comprehensive timeline and process.** The New Bank Start-up Unit realizes that the de novo process is a multi-year venture that encompasses more than just the application process. The UK’s approach recognizes the planning stages, such as raising capital, creating a business plan, developing infrastructure, acquiring staff, and making decisions about technology.
- 2. **Philosophy of proportionality.** Bowman noted in her speech that while there are standards for de novo banks, there’s an emphasis on proportionality. Applications are assessed on a case-by-case basis, meaning there’s some flexibility. By contrast, the US process has very stringent guidelines.
- 3. **Resources and support for de novo banks.** The Bank of England’s New Bank Start-up Unit provides de novo institutions with plenty of advice, including encouraging them to have action plans to solve any turbulence as they gain their footing. There are some risks that gathering extra capital can’t help a new institution weather, and the UK aids de novo banks in building plans to address the common pitfalls, such as unsteady growth, loan quality issues, and other weaknesses.

The Bank of England’s new bank application process differs from the US in many ways, but one aspect that might be of interest to US regulators is when new banks can start operating. In the UK, applicants can start operating in a restricted fashion before gaining full approval, under a process called [Mobilization](#).



Source: <https://www.bankofengland.co.uk/>

In the Mobilization stage, a bank has cleared most of the application process and is nearing full authorization. Mobilization gives the bank a head start on raising capital to help complete the authorization process and allows it to start building its technology and other operating systems. Banks can raise up to £50K during this period, but they cannot start full banking operations until gaining final authorization. De novo banks in the UK can remain in the Mobilization stage for up to 12 months. In contrast, de novo banks in the US are not allowed to accept any deposits prior to charter approval.

Bowman pointed to the Bank of England's model as a possible template for our de novo system, if regulators are open to changes in the current process, for the sake of having more banks available.

Does the US need more banks? Some think we do, as mergers and acquisitions continue to shrink the nation's banking landscape and reduce the number of CFIs. The British de novo model might be worth exploring for regulators as a way to provide additional incentive to startups in this country, and make sure de novo banks are more prepared and feel supported by regulators.

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ECONOMY & RATES

Rates As Of: 09/19/2023 12:46PM (GMT-0700)

Treasury	Yields	MTD Chg	YTD Chg
3M	5.55	-0.01	1.13
6M	5.51	0.03	0.75
1Y	5.44	0.08	0.73
2Y	5.09	0.22	0.66
5Y	4.52	0.26	0.51
10Y	4.36	0.25	0.48
30Y	4.43	0.21	0.46
FF Market	FF Disc	IORR	
5.33	5.50	5.40	
SOFR	Prime	QREFR	
5.31	8.50	5.32	

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