

## S&B Top 15<sup>th</sup> Percentile of Community Banks in Review

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The 2013 Seifried & Brew (S&B) Top 15<sup>th</sup> Percentile of Community Banks has been released. Utilizing the S&B Total Risk/Return Composite Ranking, nearly 1,000 community banks have made the cut. It is with a balance of risk and reward that banks can achieve a spot on the list. Of the Top 15<sup>th</sup> Percentile of Community Banks, 660 were designated non-sub S and 327 were designated Sub S. In order to rank the banks in a statistically sound manner, two groups of rankings were created based on whether or not a bank filed under a Sub Chapter S Election (Sub S).

Part of the composite score is created through the Seifried & Brew Total Risk Index (S&B Risk Index). The S&B Risk Index is an independent method of risk assessment that has as its foundation the critical elements used by the regulators to evaluate the health of a financial institution. Credit risk, earnings at risk, liquidity risk, capital risk and economic risk are the foundations of the S&B Risk Index. The following analyses use a comparison of the Top 15<sup>th</sup> group to a national community benchmark; this benchmark excludes the Top 15<sup>th</sup> Percentile of Community Banks.

### **The Non-Sub S Review**

2013 proved to be a year of improvement for the community banking industry as a whole. The national benchmark not designated Sub S showed a 1.04 increase in their mean composite score to 44.91, while the Top 15<sup>th</sup> Percentile of Community Banks saw their mean composite score decrease 0.43 to 65.29. The decrease from 2012 was mostly a result of slightly lower earnings within the Top 15<sup>th</sup> group. It is important to keep in mind the Top 15<sup>th</sup> group is not static, so there is a possibility of a high earner from last year dropping out of the group.

Maintaining a position in the Top 15<sup>th</sup> Percentile of Community Banks is achieved through traditional/conservative banking practices. This year, risk is being mitigated within the Top 15<sup>th</sup> group average as it has dropped to a score of 37.90 from 37.98 in 2012. The national benchmark saw significant improvement with respect to risk score decreasing from 48.93 in 2012 to 47.05 in 2013. The reward scores paint a similar picture for the national benchmark but not to the extent of the improvement in risk.

As with the national benchmark, the Top 15<sup>th</sup> Percentile of Community Banks has run into issues of margin compression; however, the Top 15<sup>th</sup> group has seen a slower rate in the reduction of net interest margin. Net overhead, the difference between noninterest expense and noninterest income, improved modestly for the Top 15<sup>th</sup> group (5 bps), and improvements were similar for the national benchmark (2 bps). However, net overhead for the Top 15<sup>th</sup> group is at a level of 1.63% versus 2.47% for the national benchmark. Capital ratios continue to strengthen significantly for the Top 15<sup>th</sup> banks; leverage ratio was up 64 bps to 12.29%, while the national benchmark is only up 27 bps to 10.79%.

## The Sub S Review

We divided out community banks that are designated Sub S in order to ensure meaningful statistical analysis. Sub S institutions maintain a different tax structure, creating a disproportionate reward score for banks that are not designated Sub S.

The national benchmark for community banks that are designated Sub S showed a 0.36 decrease in their mean composite score to 55.96, while the Top 15<sup>th</sup> Percentile of Community Banks saw their mean composite score decrease 1.16 to 76.14. The Top 15<sup>th</sup> Sub S group's falling mean composite score was a result of their risk increasing while their mean reward score remained relatively stable. The opposite was true for the banks not making the Top 15<sup>th</sup>: They saw a reduction in overall risk, but their average reward score fell from 58.13 to 57.35.

The mean risk score for the national benchmark of the Sub S group was reduced to 46.15 from 46.46 in 2012. This is a result of the national benchmark group having significant room for improvement in both capital and credit risk areas. The national benchmark mean for leverage ratio was up 18 basis points to 10.32%, while the Top 15<sup>th</sup> group's mean fell 5 basis points to 11.03% in 2013. With respect to credit risk, the national benchmark mean for nonperforming assets to total assets ratio was down 44 basis points to 2.00%; the Top 15<sup>th</sup> group's mean increased 7 basis points to 0.86% in 2013. While the ratios represented in the Top 15<sup>th</sup> group are high performing, they are unable to improve at the rate of the other Sub S community banks.

Similar to the other community banks in the nation, the Sub S national benchmark group experienced margin compression. The national benchmark mean for net interest margin fell by 16 basis points to 3.65%. However, the mean net interest margin for Top 15<sup>th</sup> banks was 4.14%, unchanged from 2012.

Net overhead was a major concern for the Top 15<sup>th</sup> Percentile of Community Banks. The group saw significant reduction in noninterest income with less of a reduction in noninterest expense; this increased the mean net overhead ratio from 1.49% in 2012 to 1.71% in 2013. The national benchmark mean for Sub S community banks improved, reducing net overhead by 4 basis points to 2.25%.

## The Takeaway

Being in the Top 15<sup>th</sup> Percentile of Community Banks is typically not an anomaly. The analysis takes into account the last four quarters of composite scores. For example, this removes banks that may have large one-time gains, or conversely, it may include a bank that had charged off a loan that was later recovered. 655 of the 987 banks that made the Top 15<sup>th</sup> group also were in the Top 15<sup>th</sup> group last year.

From a geographic standpoint, Texas claims 12.36% of the Top 15<sup>th</sup> group, while Iowa is at 7.70% and South Dakota and Missouri each claim 5.98% of the group. However, Iowa's claim dropped from its 2012 level of 9.20%. Illinois saw a significant drop to 5.27% of the group, from 6.78% in 2012. The top three states that most improved were Georgia, Louisiana and Missouri.



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While the majority of banks in the nation continue to improve, Top 15<sup>th</sup> performers may have hit their stride. Conservative and traditional banking is what makes a Top 15<sup>th</sup> bank what it is. These banks represent a well-balanced risk and reward profile. Although the gap between Top 15<sup>th</sup> banks and the national benchmark has narrowed since 2012, Top 15<sup>th</sup> still represent strongholds of the community bank industry.