Changes in the banking industry

Finance

Changes in the Banking Industry

The report analyzes the banking structure based on Federal Deposit Insurance Corporation’s (FDIC) Quarterly Banking Profile released for the third quarter i. e. September 2010. This report captures the key indicators of a sound banking structure, analyzes the possible reasons for the observed changes and changes in competition and structure of the banking industry over the last few years.

Key Indicators

The banks’ return on assets has increased to 0. 56% after the meltdown in 2008 which was as low as 0. 03%. The core capital has also shown similar pattern, which has increased from 7. 47% in 2008 to 8. 99% in 2010. The capital ratio stands at 11. 39% in 2010 when compared to 8% in 2006. The number of institutions reporting to the FDIC has decreased from 8833 institutions in the year 2005 to 7760 institutions in 2010. The number of problem institutions has increased drastically on a year on year basis from 552 in 2009 to 860 in 2010. The number of failed institutions has also increased to 127 institutions in 2010 from just 3 institutions in the year 2007.

Possible reasons for the observed changes in the banking industry

Bank’s return on assets which refers to net income as a percentage of total assets, increased which suggests that the banking industry is able to garner more interest income with rise in demand for loans with reducing cost of funds, therefore sustaining revenues and improving asset quality. In relation with the core capital ratio, Tier 1 capital can absorb losses without a bank being required to cease its functioning. Therefore increase in core capital ratio indicates the health of the banking industry is improving considerably.

The banking industry is giving prime importance to strengthen the Tier 1 level of capital. Credit growth has been strong due to which the net interest margin is indicating an upward trend with a 291. 33% increase in net operating income of banks. Despite this relatively good news, the number of problem institutions has increased primarily because of financial, operational or managerial weaknesses that might lead to increased number of failed institutions in the last quarter of 2010. The trend of number of institutions reporting to FDIC reducing is largely explained by the acquisition of smaller institutions by bigger institutions to prevent banks from failing and also because of increasing number of failed institutions.

Changes in competition and structure of banking industry

The number of problem institutions continues to increase but the aggregate assets of these problem institutions continued to decline suggests that this are smaller institutions in nature. This might have led to merger or acquisition of these problem institutions with bigger and efficient institutions. This would have led to decrease in the contribution of assets of these failed institutions and create a more robust structure in the banking industry. After this process of consolidation, there could be a new round of growth as institutions would compete for deposits to fund new lending activity. However, the figures stated by the FDIC in the quarterly bank profile might not be the true picture of the banking industry as large number of financial institutions do not have balance sheet which are marked to market, i. e. hidden notional amount of derivatives, thereby creating a vulnerable banking structure which might be victim of high leverage factor of banks leading to further economical turmoil.

References

Federal Deposit Insurance Corporation, Quarterly Banking Profile, 30 September 2010, Web site: http://www2. fdic. gov/qbp/.