From Myths to Opportunities:
Uncovering Value in the Community Banking Sector

A data-driven approach to understanding the risk, return, and impact.

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"Certainly, community banks have a critical role in keeping their local economies vibrant and growing by lending to creditworthy borrowers in their regions. They often respond with greater agility to lending requests than their national competitors because of their detailed knowledge of the needs of their customers and their close ties to the communities they serve. Such lending helps foster the economy by allowing businesses to buy new equipment, add workers, or sign contracts for increased trade or services. Those effects are felt at a local level and may appear at first glance to be fairly modest, but when you multiply these effects across the thousands of community banks in the United States, you really see how the lending decisions they make help the broader national economy."

Ben Bernanke | ***Former Chairman, Board of Governors of the Federal Reserve System***[1]

EXECUTIVE SUMMARY

This white paper analyzes the risks, returns, and impact of the often-overlooked **community banking sector**, comprising community banks as defined by the Federal Deposit Insurance Corporation (FDIC) and all credit unions insured by the National Credit Union Administration (NCUA). These institutions, typically smaller in size, focus on localized markets, offering tailored financial products and services that address the specific needs of their communities. By examining the sector's longer-term financial performance, including during the Great Financial Crisis (2007-2009), and emphasizing its economic and social contributions, the paper provides insights for treasury managers, investors, and financial professionals on the value of utilizing community banks and credit unions.

Despite their demonstrated strengths, community banks and credit unions often face misconceptions among financial professionals. These misconceptions include the belief that these institutions carry higher-risk loans, maintain less stable balance sheets, and/or offer below market deposit rates, leading many treasury managers and financial professionals to overlook their potential[2] as viable components of a cash portfolio. This white paper challenges these myths, providing data-driven insights to highlight the lower credit risk, competitive deposit rates, and well-capitalized balance sheets of the community banking sector that drive critical economic development and social impact.

The Community Banking Sector

This white paper defines the **community banking sector** as consisting of FDIC-defined community banks[3] and all NCUA-insured credit unions. These institutions are generally smaller in size, with most holding less than $10 billion in assets, and focus on serving localized markets or defined membership groups. Community banks are for-profit institutions, while credit unions are not-for-profit cooperatives focused on serving the financial needs of a specific membership group.[4] Despite differences in ownership structure, both community banks and credit unions operate with a business model centered on traditional banking activities, such as deposit-taking and lending, which is tailored to the specific needs of their target markets.

In contrast, larger regional or international banks operate across large geographies and engage in a wider range of activities, including investment banking, securities trading, wealth management, and international operations. Non-community banks have historically reported noninterest income at more than double the rate of community banks.[5] While these activities can drive higher earnings, they also introduce heightened sensitivity to global markets and economic trends.

The Size and Importance of the Community Banking Sector

Though composed of smaller individual institutions, the community banking sector as a whole plays a disproportionately large role in supporting local economies, small businesses, farms, and families.

Together, community banking institutions account for 8,637 entities[6]—95% of all regulated financial institutions in the U.S.—and hold about 20% of total industry assets.[7] Between 2018 and 2023, community banks grew their branch count by 1.5%, while non-community banks closed branches at a much higher rate of 17.5%. During the same period credit unions lost 0.1% of their branches. The loss of bank branches has been most prominent in rural areas, where non-community banks have closed 21.1% of branches, while community banks have closed just 0.1% of branches.[8]

In addition to its continued branch presence in communities across the nation, the community banking sector has played a significant role in providing credit to the U.S. economy. The community banking sector provides a significant amount of loans for commercial real estate, small business, and farms. This underscores community banking's critical role in providing access to capital, supporting both

The Size and Importance of the Community Banking Sector (cont.)

local and national economies.[9] While it has become common to believe the very largest banks are "too big to fail," the community banking sector is **"too big to ignore**."

Earnings

When compared to non-community banks, the community banking sector has historically exhibited a lower yet more stable return on assets (ROA), reflecting a more conservative business model. From 1984 to June 2024, community banks averaged a pre-tax ROA of 1.14 compared to 1.53 for non-community banks. However, non-community banks' higher profitability has come with increased volatility. During the Great Financial Crisis (2007–2009), community banks saw their pre-tax ROA drop to a low of -0.76. By comparison, during the same period non-community banks reached a low of -1.65, more than double that of community banks. The higher historical average ROA for non-community banks has been paired with higher volatility, exhibiting higher returns in time of economic expansion and larger losses in times of economic stress. More recently, for the quarter ending June 30, 2024, credit unions reported an average ROA of 0.69%, while community banks posted a pre-tax ROA of 1.14% and non-community banks achieved a higher pre-tax ROA of 1.53%.[10,11]

Credit Risk

The average net charge-off rate has historically been lower for community banks (0.37%) when compared to larger banks (0.89%) during the period of January 1984 to June 2024. During the Great Financial Crisis, net charge-off rates peaked at 1.15% for credit unions,[12] 1.36% for community banks, and 2.89% for all other banks.[13] The long-term average net-charge off rates and noncurrent loan rates underscore strength and resilience of the community banking sector's loan portfolios, and highlights community banks' effectiveness in managing credit during even the most challenging economic conditions.

Capitalization

Community banks and credit unions also maintain higher levels of core capital or net assets on their balance sheets, providing a larger buffer against financial shocks. During the Great Financial Crisis, community banks reported an average core capital ratio of 10.5%, compared to 8.1% for all other banks. This trend has continued; as of June 2024, credit unions held a net worth ratio of 11.07%, and community banks reported a core capital ratio of 10.84%, both exceeding the 9.11% ratio of larger banks.[14,15] While the non-community bank average is considered well-capitalized by regulatory standards, the lower core capital ratios reflect a higher risk tolerance and greater use of leverage. In contrast, the capitalization of community banks and credit unions reflects a more conservative approach with less complex balance sheets.

In addition to higher equity ratios, the community banking sector has also relied more on insured deposit liabilities, supporting its conservative balance sheet management. As of June 2024, credit unions funded 84% of their operations through deposits, followed by community banks at 83% and non-community banks at 78%. Credit unions also have the highest level of insured deposits, with 91% of deposits insured, compared to 70% for community banks and 60% for non-community banks. This conservative funding approach aligns with higher equity levels, reflecting the sector's overall conservative balance sheet management.

Interest Paid on Deposits

The community banking sector has historically provided competitive deposit rates, making them effective options for cash investments. Credit unions emphasize their member-owned structure, which allows them to often return higher deposit rates directly to their members (depositors) rather than distributing profits to shareholders.[16] For banks, historical data from January 1984 to June 2024 show that the average cost of interest-bearing deposits for community banks was 3.42%, higher than the 3.31% average reported by non-community

Interest Paid on Deposits (cont.)

banks.[17] While the rates offered by individual institutions—and even to individual customers—can vary, the data underscore the community banking sector's ability to provide competitive cash deposit returns.

Interest Charged to Borrowers

The community banking sector offers borrowers lower average interest rates, enabling access to affordable credit for small businesses, farms, and families. Total loan yields are the interest income earned by financial institutions and paid by borrowers. As of June 30, 2024, credit unions reported the lowest average total loan yields (5.70%),[18] followed by community banks at 6.14% and larger banks at 7.07%. In consumer lending, community banks provide significantly lower loan rates to borrowers compared to all other banks, with an average loan rate of 8.46% versus 11.59% at non-community banks.[19] Total loan yields cannot be directly compared across institutions, as they are influenced by the composition of loan portfolios. Factors such as loan types, collateral, tenure, and loan sizes all affect overall interest rates. Nonetheless, total loan yield data combined with historical credit risk data show that the community banking sector effectively serves local communities by maintaining affordable capital costs for customers, without taking on increased credit risk.

Social & Economic Impact

In addition to offering lower credit risk, higher capitalization, and competitive deposit rates, the community banking sector provides depositors with two significant advantages: increased impact and greater choice.

The community banking sector has an outsized impact, with its market share of small business and agriculture loans far exceeding its share of deposits.[20] More of the funds placed in community banks and credit unions are lent to the people, businesses, and communities that need them most, amplifying the impact of every deposit. By choosing a community-based institution, depositors can support stronger communities while aligning their money with the geographies, issues and values that matter most to them.

In addition, the localized operations of community banks and credit unions result in a diverse range of institutions, each uniquely positioned to address the distinct needs of its own community. Unlike large banks, which operate on more standardized models, community-based institutions tailor their products and services to align with the priorities of their local markets or membership groups. This gives depositors greater control over where, how, and to whom their money is lent, offering a level of transparency and alignment often absent in larger financial institutions. For depositors, this provides the opportunity to know *"where your cash spends a night"*[21] and enables the creation of customized impact within cash portfolios.

INTRODUCTION

This white paper analyzes the risks, returns, and impact of the often-overlooked **community banking sector**, comprising community banks as defined by the Federal Deposit Insurance Corporation (FDIC) and all credit unions insured by the National Credit Union Administration (NCUA).

Through a data-driven approach, this paper challenges common myths and assumptions that may discourage the inclusion of community-based financial institutions in cash portfolios. While individual institutions may diverge from sector averages, the data illustrate the overall capacity of the community banking sector to deliver meaningful risk-adjusted financial and social returns. Aggregated data from the FDIC Quarterly Banking Profile (1984 to June 2024) and NCUA Financial Call Reports reveal that these institutions maintain high credit quality and conservative balance sheets, and are well capitalized. The sector has been able to deliver prudent financial management while providing competitive deposit rates and affordable loans to local communities, playing a key part of our local and national economy.

INTRODUCTION (cont.)

Community banks and credit unions play a critical role in fostering local economic growth and resilience. By prioritizing lending[22] to small businesses, farms, and families[23], they channel capital to underserved areas, supporting job creation, community development, and economic stability. Their relationship-driven models align financial products and services with the unique needs of their customers or members, amplifying their local impact.

This paper does not aim to identify specific institutions based on metrics of risk, return, or impact. Nor does it define criteria to establish an investable universe within the community banking sector. The responsibility of building cash portfolios that meet risk, return, and impact objectives lies with depositors or their investment managers and advisors. Instead, the paper seeks to provide an overview of this lesser-known segment of the financial system, highlight its collective importance, and uncover its value in achieving both financial and social goals

DEFINING THE COMMUNITY BANKING SECTOR

The community banking sector, as defined in this white paper, includes FDIC-designated community banks and all NCUA-insured credit unions. These two categories were chosen for their reliable, publicly available data from trusted regulatory sources—the FDIC and NCUA—and for their shared emphasis on smaller-scale, relationship-based, and specialized banking services. Both groups are regulated at the state or federal level and are examined for safety and soundness using the CAMEL rating system, which assesses an institution's Capital adequacy, Asset quality, Management, Earnings, and Liquidity (CAMEL). These ratings are a critical tool for identifying problem banks and credit unions often well before failures occur, providing regulators and bank management time to rectify the institution's safety and soundness or prepare for a sale, merger, or other corrective action.

Both community banks and credit unions focus on serving localized markets or defined membership groups, prioritizing relationship-driven banking through core activities of deposit-taking and lending. Their presence within the communities they serve allows them to develop local knowledge and deep personal relationships, which enhance product design, risk management, and underwriting. These characteristics, rooted in their direct engagement with community members, are difficult to replicate in larger banking models, which are often more removed from the specific needs of local communities.

Together, community banks and credit unions account for approximately 95% of all insured deposit-taking institutions in the United States, underscoring their significant role in the financial system. As of June 2024, there were 4,533 credit unions and 4,104 community banks. By contrast, there were just 435 regional, national, or international banks operating across the United States.

Number of Insured Deposit Institutions

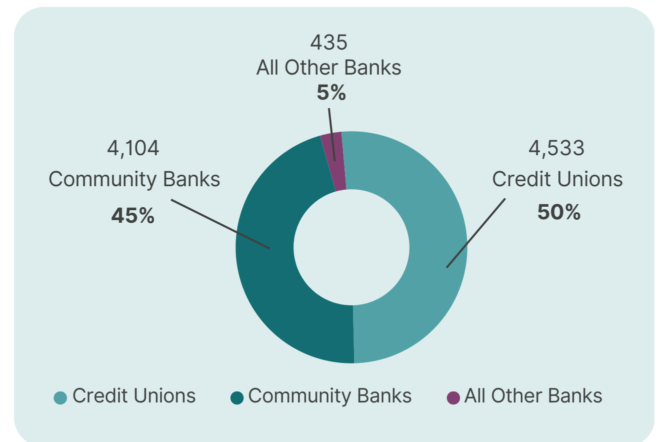


FIGURE 1 – NUMBER OF INSURED INSTITUTIONS SOURCE: FDIC & NCUA AS OF JUNE 2024

Community Banks

Community banks are defined by the FDIC based on their size, geographic focus, and business model. These institutions typically hold less than $10 billion in assets, serve specific geographic areas, and focus on core banking activities. The FDIC's definition excludes institutions that allocate most of their assets to non-core activities, such as credit card lending, or those with a significant foreign presence or that are foreign subsidiaries. Community banks with larger asset sizes (greater than $2 billion) must operate in no more than three states and two metropolitan statistical areas (MSAs).[24]

The community banking sector differs from regional and international banking in scale, geographic reach, and product focus. Regional banks typically have assets exceeding $10 billion, operate across multiple states with hundreds or thousands of branches, and offer a larger set of non-lending products and services. For example, Manufacturers and Traders Trust Company (M&T Bank) has $200 billion in assets and over 1,000 branches, operates in 12 states, maintains foreign offices, and offers a range of products and subsidiaries, including wealth management, trust administration, and investment banking.[25] The largest international banks surpass regional banks in size. For example, JPMorgan Chase has more than $3 trillion in assets, thousands of branches worldwide, and operations in numerous countries. The largest banks are heavily involved in high-volume transactional banking and global services like investment banking, securities trading, derivatives, commodities and foreign exchange, reflecting their scale and complexity.

In contrast, the community banking sector remains predominantly localized, prioritizing personalized services and core banking activities. While some larger community banks and credit unions may offer non-lending products like financial planning or wealth management, their operations are generally less complex. Their focus on community-driven solutions sets them apart from larger institutions.

Credit Unions

Credit unions are not-for-profit financial cooperatives that are regulated by federal or state agencies and insured by the National Credit Union Administration (NCUA). Every depositor or borrower is not just a customer but a member-owner—a shareholder with participation in the credit union's governance. Credit union members open a *share account*, the equivalent of a savings account, to establish their membership. Unlike for-profit banks, credit unions reinvest their profits into benefits for members—such as lower fees, better rates, and enhanced services—rather than distributing profits to outside shareholders. Like community banks, credit unions' accounts are insured up to $250,000 by the full faith and credit of the federal government (up to $500,000 for a joint account) and are regularly examined by state or federal regulators, ensuring transparency, soundness, and stability.

Membership eligibility in a credit union is defined by a common bond, which may be based on geography (e.g., residents of a specific area), employment (e.g., employees of a company or industry), association membership, or family ties. This structure fosters a sense of community and shared financial goals while also limiting eligibility. Each depositor will be eligible to join a specific set of credit unions that meet their common membership criteria. However, some credit unions, such as those with a low-income designation, can accept deposits from non-members to advance their mission of promoting financial inclusion and serving underserved populations.[26]

While almost all credit unions hold less than $10 billion in assets, the 20 largest credit unions exceed this threshold, representing about 0.4% of all credit unions. Despite their size, these larger credit unions remain part of the community banking sector due to their nonprofit mission, common membership bond, and democratic governance structure.

COMMUNITY BANKING SECTOR: TOO BIG TO IGNORE

In the wake of multiple financial crises over the past two decades, including the Great Financial Crisis and the recent crises of larger regional banks like Silicon Valley Bank, Signature Bank, and First Republic Bank, confidence in the banking sector has been tested. To provide stability, governments and regulators have intervened during crises, providing access to capital, special asset purchase programs, systemic risk exceptions and additional efforts to reduce fear and stabilize the financial system. For many, these actions have reinforced the perception that large banks are "too big to fail," creating the impression that only the largest banks are truly safe. This, in turn, has overshadowed smaller financial institutions that may not benefit from such implicit guarantees.

It can be common to simplify complex realities into corollaries, leading to assumptions like: if the largest banks are the safest, then the smallest banks must be the riskiest. Yet the truth is far more nuanced. Each financial institution carries its own risks and strengths, and as demonstrated by the crises of Silicon Valley Bank, Signature Bank, and First Republic, which were all regional banks with assets exceeding $100 billion, risk assessments based on size alone are misguided.[27]

While no single community bank or credit union may be deemed "too big to fail," the community banking sector is **"too big to ignore."** These institutions play a vital role in supporting local economies, small businesses, farms, and families across the nation.

COMPARATIVE FINANCIAL ANALYSIS

A comparison of financial metrics between community banks and non-community banks from January 1984 to June 2024 reveals significant differences in these institutions' financial management and risk profiles. By analyzing key financial ratios over this extended period—particularly during times of economic stress, such as the Great Financial Crisis—a clearer understanding emerges of how these institutions manage risk, generate income, and deliver value to depositors and borrowers.

Community banks excel at delivering core banking services with higher credit quality, conservative balance sheets, and competitive rates. These strengths contribute to their stability, even during periods of economic turbulence. Their relationship-driven approach and localized focus encourage prudent lending practices and resilience in volatile markets.

Analysis of aggregated data from the NCUA, while not always directly comparable to FDIC data due to differences in reporting methodologies, supports similar conclusions. Credit unions, as cooperative, not-for-profit entities, return surplus earnings to members (depositors and borrowers) in the form of higher deposit rates, lower loan rates, reduced fees, or dividends. Like community banks, credit unions generally report lower returns on assets but exhibit higher credit quality and more conservative balance sheets than non-community banks.

In contrast, non-community banks have achieved higher, albeit more volatile, earnings driven by economies of scale, riskier loan portfolios, greater leverage, and diversified income streams from non-lending activities. While these factors boost profitability, they also increase exposure to economic cycles, leading to larger spikes in charge-offs and drops in earnings during financial downturns.

INCOME STATEMENT

Earnings

Earnings performance is a key indicator of a financial institution's profitability and long-term sustainability. Historically, both community banks and credit unions have exhibited lower, yet more stable, returns on assets (ROA) and returns on equity (ROE), as compared to larger, non-community banks. The community banking

Earnings (cont.)

sector, with its focus on traditional deposit and lending services, and credit unions, which operate on a not-for-profit model focused on serving membership groups, have maintained more consistent earnings over time. While their returns may be lower on average, they tend to experience less dramatic swings during periods of economic stress.

As of the quarter ending June 30, 2024, credit unions had an average ROA of 0.69%,[28] while community banks posted an average pre-tax ROA of 1.14%. In contrast, larger, non-community banks reported a higher average pre-tax ROA of 1.53%,[29] demonstrating their greater earnings power. The data suggest these higher earnings are driven by more leverage on the balance sheet, higher risk loan portfolios, greater non-interest income from market linked activities such as investment banking and trading, and increased operating efficiency from scale. These higher returns, however, often come with increased volatility.

An example of this can be observed during the Great Financial Crisis. During this period, non-community banks saw earnings drop more sharply and recover more slowly compared to community banks. The complexity of non-community banks' operations and exposure to higher-risk assets led to increased credit losses and greater earnings volatility. In contrast, community banks, which generally hold more conservative loan portfolios and utilize less leverage on their balance sheets, experienced less severe declines in earnings and were able to recover more quickly as economic conditions improved.

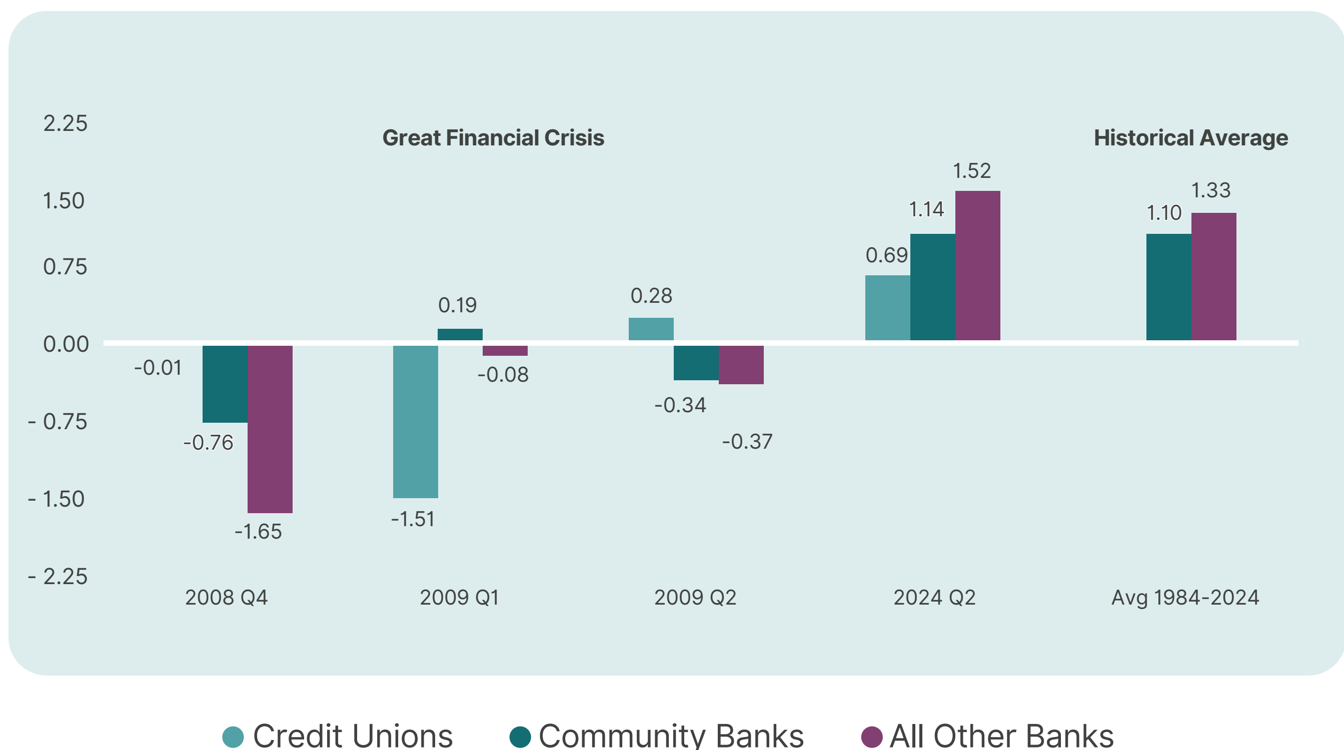


FIGURE 2 – RETURN ON ASSETS | SOURCE: FDIC & NCUA

Noninterest Income

One significant factor contributing to the higher earnings of non-community banks is their involvement in non-lending activities such as trading securities and derivatives, investment banking, wealth management, brokerage services, and other fee-based services. These activities can generate substantial revenue streams that supplement traditional lending income. Historically, average noninterest income for larger banks has been more than double that of community banks, with non-community banks earning an average of 1.90% as percentage of assets from noninterest income, while community banks have earned 0.86%.[30]

For example, in the second quarter of 2024, Wells Fargo reported total noninterest income of $8.8 billion which represents 42% of its total quarterly income of $20.7 billion. The noninterest income includes $3 billion from wealth management and brokerage commissions and $1.4 billion from gains on trading activities. Total noninterest income grew 19% year over year, which correlates to a similar increase in public equity markets, with the representative S&P 500 index up 23% over the same time.[31]

While these non-lending activities can significantly boost earnings, they also introduce more volatility into earnings, as they are often tied to financial markets, business cycles, and global geopolitics. In contrast, community banks and credit unions typically operate with simpler business models that focus primarily on core deposit-taking and lending activities. These institutions tend to have fewer non-lending revenue streams and, therefore, do not experience the same level of earnings growth as larger banks when markets perform well. However, this simplicity also provides a buffer against the volatility seen in larger institutions that are more exposed to macroeconomic and market-driven activities. During the Great Financial Crisis, non-community banks saw a 35% drop in noninterest income as a percentage of average assets, followed by a rebound of 77%, while community banks saw a change of less than 10%.[32]

Noninterest Income as % of Assets

FIGURE 3 – NONINTEREST INCOME | SOURCE: FDIC

Net Interest Margins

With the community banking sector's reduced reliance on noninterest income, net interest margin (NIM) stands as a key indicator of the sector's business model. NIM measures the difference between interest earned on loans and securities and the interest paid on deposits and borrowings, expressed as a percentage of average earning assets.

The community bank revenue model has been driven by higher NIM, combined with higher credit quality and lower defaults, to generate stable revenue from core lending operations. From 1984 through June 2024, community banks achieved an average NIM of 3.72%, surpassing the 3.46% average for non-community banks. As of June 2024, credit unions recorded a NIM of 3.05%, compared to 3.30% for community banks and 3.15% for non-community banks.

In contrast, credit unions, structured as not-for-profit cooperatives, typically exhibit lower net interest margins (NIMs). Unlike banks, which generate excess income to distribute to external shareholders, credit unions aim to create value for their members by intentionally reducing NIM and offering higher deposit rates and lower borrowing costs. Like community banks, credit unions rely on strong credit portfolios and low default rates to generate stable earnings from core lending activities, ensuring financial stability while prioritizing member benefits.

Net Interest Margin as % (NIM)

Credit Unions · Community Banks · All Other Banks

FIGURE 4 – NET INTEREST MARGIN | SOURCE: FDIC & NCUA

BALANCE SHEET

Banks and credit unions are capitalized through a combination of equity, deposit liabilities, and non-deposit liabilities. Effective capitalization strategies require balancing these components to find an appropriate mix of risk and profitability, while meeting regulatory requirements. A financial institution with a well-structured capital base can better weather economic shocks, maintain depositor confidence, and support long-term growth.

Equity

All banks and credit unions are required to maintain minimum levels of equity or net assets. These requirements ensure institutions have enough capital to absorb losses. However, while operating within regulations, banks and credit unions make strategic and operational decisions about their capitalization structures, which influence their risk and return profiles.

Equity ratios measure the proportion of an institution's assets funded by equity rather than liabilities. The FDIC provides a core capital (leverage) ratio that divides a bank's Tier 1 Capital by its average total assets. The NCUA provides a net worth ratio, which divides a credit union's net worth by average total assets. These metrics were chosen as a simple and direct method to measure the equity and leverage levels of financial institutions across various sizes and complexity. The FDIC and NCUA also mandate additional risk weighted equity ratios to best evaluate capital adequacy based on the size and complexity of an institution's assets. The risk weighted formulas used by credit unions, community banks, and all other banks can vary, making it more difficult to draw direct comparisons. For example, the Federal Reserve estimated in 2020 that 87% of community banks did not maintain large, complex, or risky balance sheets and qualified for a simplified ratio amply named the community bank leverage ratio (CBLR).[33]

A higher equity ratio reduces financial risk by providing a larger buffer to absorb losses and maintain stability during economic downturns. However, banks holding excess equity can dilute returns for shareholders. On the other hand, institutions with lower equity ratios rely more on leverage, funding a larger portion of their assets through liabilities such as deposits or borrowing. Leverage can increase returns on equity by enabling institutions to generate income from a smaller equity base, but it also heightens financial risk. More highly leveraged institutions are more vulnerable to financial shocks, with smaller equity reserves available to absorb losses.

Historically, from January 1984 – June 2024, community banks have held more equity and used less leverage than all other banks. Community banks' core capital ratio averaged 9.46% over that time, while all other banks averaged a ratio of 7.65%. With more recent increases in regulatory requirements, the current equity ratios are above their historic averages. As of June 2024, credit unions had an average net worth ratio of 11.07%, while community banks' average core capital ratio was 10.84%, and non-community banks had a ratio of 9.11%. The FDIC considers banks with a core capital ratio of greater than 5 as well-capitalized while the NCUA considers credit unions with a net worth ratio of greater than 7 as well-capitalized.

Core Capital Ratio (FDIC) / Net Worth Ratio as % (NCUA)

● Credit Unions ● Community Banks ● All Other Banks

FIGURE 5 – CORE CAPITAL RATIO | SOURCE: FDIC & NCUA

Liabilities

Liabilities are the primary funding source for banks and credit unions, encompassing financial obligations to depositors and other creditors. These liabilities, including both deposit-based and non-deposit sources, are essential to the operations of financial institutions. Effective management of liabilities is critical for maintaining liquidity, financial stability, and sustainable growth.

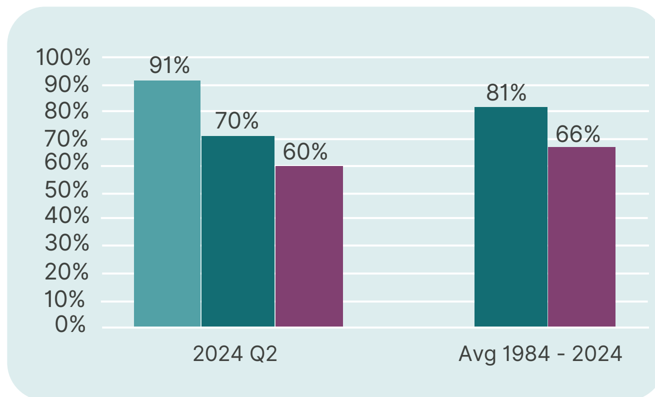
Deposit liabilities—such as checking accounts, savings accounts, money market accounts, and certificates of deposit—are the main funding source for most institutions. Deposits are generally lower-cost and stable, allowing banks and credit unions to fund loans and investments efficiently. The composition of deposits—including maturity profiles and the balance between insured and uninsured deposits—affects risk, particularly during financial stress. Insured deposits offer a stable, lower-cost, and conservative source of capital, reducing exposure to market volatility.

Non-deposit liabilities supplement funding needs through borrowings from bonds, interbank loans, corporate credit unions, the Federal Reserve, Federal Home Loan Bank, repurchase agreements, and private credit markets. These sources can provide flexibility, speed, and access to large amounts of capital—advantages that are difficult to achieve through deposit growth alone. However, non-deposit liabilities often involve higher costs and added complexity, such as covenants, variable rates, and terms that affect rates, maturities, and repayment conditions. Overreliance on these sources can increase leverage and risk, especially during economic or market instability.

The community banking sector has historically relied more on deposit liabilities, with a higher proportion of insured deposits contributing to its conservative balance sheet management. As of June 2024, credit unions led with 84% of funding from deposits, followed by community banks at 83% and non-community banks at 78%. Historically, community banks have averaged 78% of assets funded by deposits, compared to 70% for non-community banks. Credit unions maintain the highest percentage of insured deposits (91%), compared to 70% for community banks and 60% for non-community banks.

In recent years, new technology has been developed to increase efficiency and help connect institutions and individuals to banking networks.

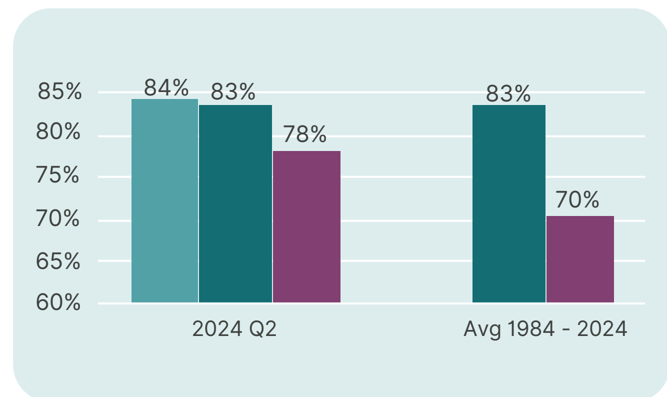
Insured Deposits as % of Total Deposits



Credit Unions Community Banks All Other Banks

FIGURE 6 – INSURED DEPOSITS
SOURCE: FDIC & NCUA

Total Deposits as % of Total Assets



Credit Unions Community Banks All Other Banks

FIGURE 7 – DEPOSITS AS % OF ASSETS
SOURCE: FDIC & NCUA

Funding their balance sheets with a higher percentage of insured deposits has been a key source of financial stability for community banks. Insured deposits generally carry a lower cost of capital than non-deposit liabilities, helping to keep their overall cost of capital lower than peers that rely on non-deposit liabilities. With a larger portion of insured deposits, the community banking sector has been able to deliver on a business model that balances strong NIM while still paying higher interest to depositors and charging borrowers a lower average rate on loans. This unique business model may seem counterintuitive, and a common misconception is that the community banking sector must either pay lower interest on its deposits or charge customers higher loan rates. However, historical data from January 1984 to June 2024 show that the average cost of interest-bearing deposits for community banks was 3.42%, higher than the 3.31% average reported by non-community banks.[34] Credit unions emphasize their member-owned structure, which allows them to often return higher deposit rates directly to their members (depositors) rather than distributing profits to shareholders.[35] While the rates offered by individual institutions—and even to individual customers—can vary, these data underscore the community banking sector's ability to provide competitive cash deposit returns. The community banking sector also offers borrowers lower average interest rates, enabling access to affordable credit for small businesses, farms, and families. As of June 30, 2024, credit unions reported the lowest average total loan yields—representing the interest income earned by financial institutions and paid by borrowers—at 5.70%,[36] followed by community banks at 6.14%, while larger banks reported higher yields of 7.07%. In consumer lending, community banks provide significantly lower loan rate to borrowers compared to all other banks, with an average loan rate of 8.46% versus 11.59% at non-community banks.[37] Total loan yields cannot be directly compared across institutions, as they are influenced by the composition of loan portfolios; factors such as loan types, collateral, tenure, and loan sizes all affect overall interest rates. Nonetheless, total loan yield data combined with historical credit risk data shows that the community banking sector effectively serves local communities by maintaining affordable capital costs.

Assets

A bank or credit union's balance sheet is funded through a combination of liabilities (e.g., deposits and borrowings) and equity. Management then decides how to deploy these funds into assets, such as loans, investments, and cash reserves. These deployment decisions carry varying levels of risk, as loans involve credit risks tied to borrowers' repayment ability,

Assets (cont.)

while investments range from low-risk securities to higher-risk instruments. Balancing these risks with liquidity and profitability is essential to meeting the institution's goals—whether maximizing shareholder value in banks or prioritizing member benefits in credit unions.

One key metric for evaluating asset deployment is the percentage of loans to total assets, which indicates how much of an institution's resources are loaned out to customers or members. Community banks and credit unions allocate a larger portion of their assets to loans compared to larger banks, reflecting their localized focus. As of June 2024, credit unions lent out 70.45% of their assets, community banks 68.79%, and non-community banks just 49%. This is consistent with the historical trend of community-focused institutions playing a significant role in direct lending.

Carrying a higher percentage of loans makes the credit quality of those loans critically important. The community banking sector has effectively paired its elevated loan deployment with prudent risk management, consistently demonstrating superior credit quality. The community banking sector's low net charge-off rate, which measures the percentage of loans written off as losses, highlights this strength. Historically, community banks have reported

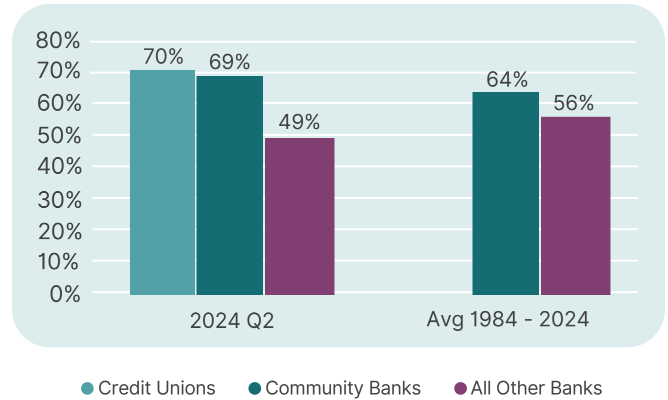
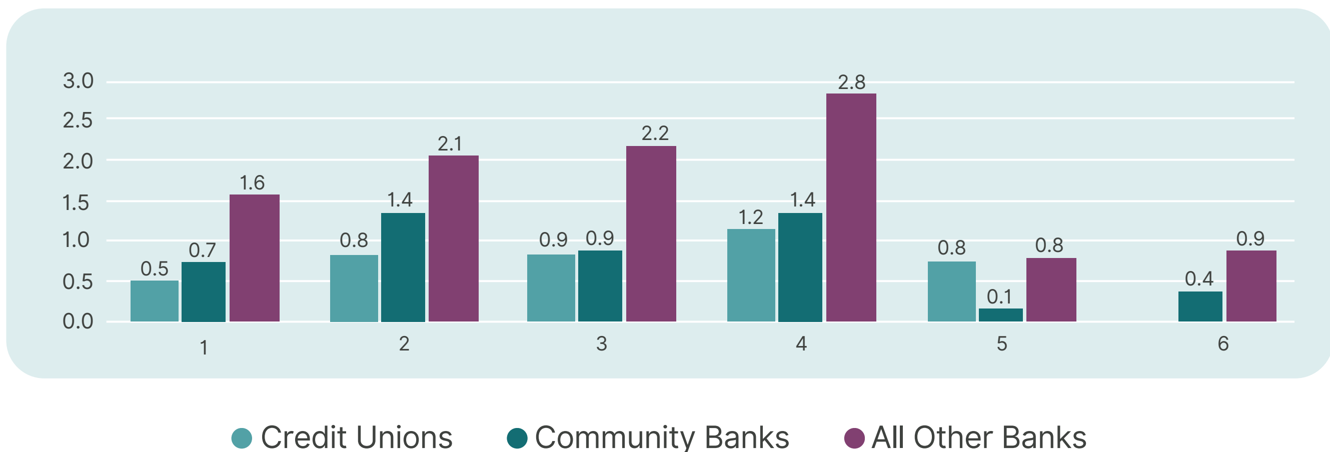


FIGURE 8 – LOANS TO ASSETS / SOURCE: FDIC & NCUA

significantly lower net charge-off rates (0.37%) than other banks (0.89%). As of June 2024, these rates were 0.14% for community banks, 0.75% for credit unions, and 0.78% for non-community banks. Similarly, the noncurrent loan rate, which tracks loans overdue by 90 days or more or in nonaccrual status, underscores this trend. As of June 2024, credit unions reported a delinquency rate of 0.59%, while community banks had a noncurrent loan and lease rate of 0.63%, compared to non-community banks at 1.05%.[38, 39] These metrics reflect the disciplined underwriting practices and localized expertise of community-focused institutions, enabling them to maintain strong credit quality while prioritizing lending to their communities and members.

Quarterly Net Charge-Off Rate as %



Credit Unions | Community Banks | All Other Banks

FIGURE 9 – QUARTERLY NET CHARGE-OFF RATE | SOURCE: FDIC & NCUA

ECONOMIC & SOCIAL IMPACT

The social and economic impact of the community banking sector can be evaluated by examining three key areas: the geographic regions where these institutions operate, the customer groups they serve, and the reach of their products and services to address the unique needs of both their communities and the national economy.

Geography

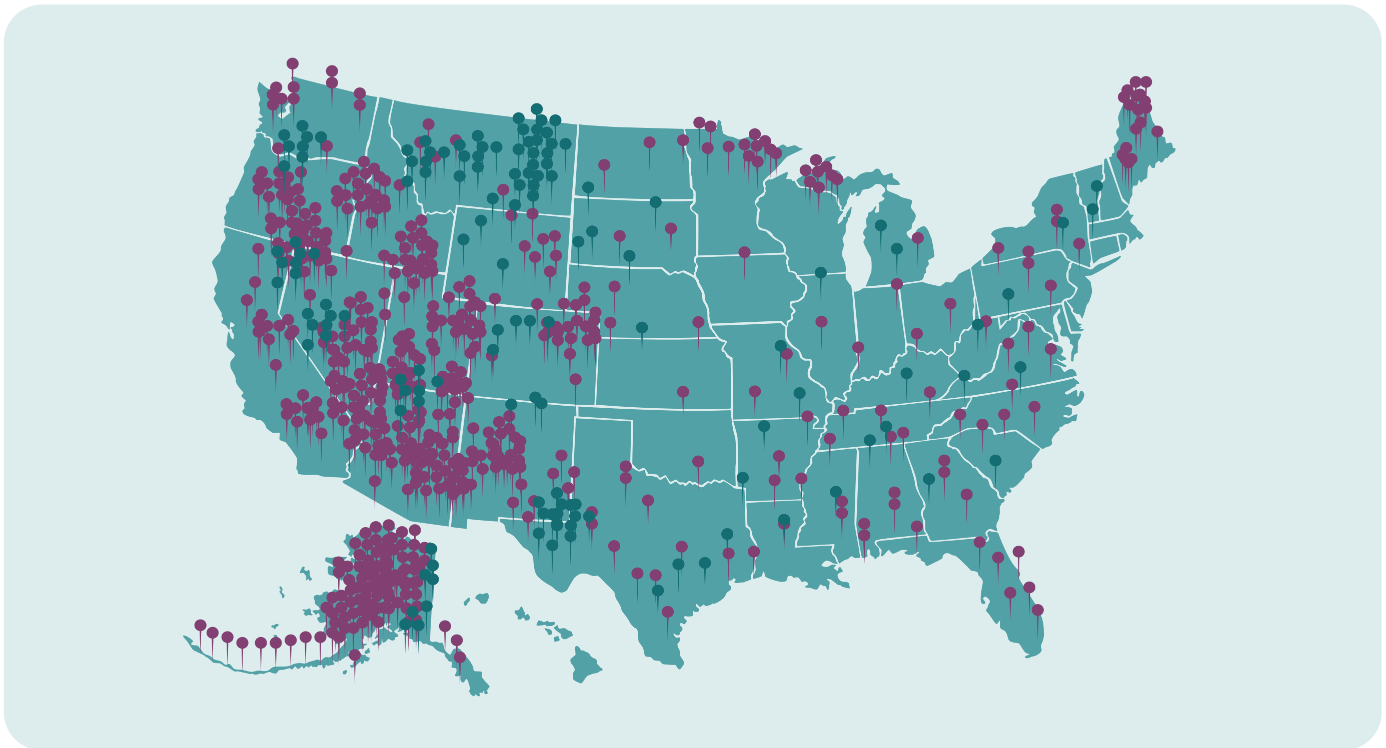
Physical bank branches remain vital for many communities, especially for lower-income, rural, older, and disabled populations who face barriers to online banking. For this reason, the economic impact of branch closures can be high for the most underserved populations. These groups often rely on in-person services for financial guidance, loan applications, fraud prevention, and cash-based transactions. A closer proximity to branches is associated with more mortgage approvals and better loan terms for individual households.[40] Losing access to physical branches can reduce access to homeownership, reduce opportunities for wealth building and increasing the cost of both borrowing and basic transactions that are replaced by costly alternatives like payday lenders and check-cashing services. The impacts of branch closures are amplified by demographic factors like income, race, digital connectivity, and the prevalence of older and disabled residents.[41]

Access to branches and personal relationships with bankers are also particularly valuable for small businesses and farms. Relationship based lending—where credit decisions are based at least in part on personal, localized knowledge of the borrower and its market—is a vital part of the national economy. Small businesses are key drivers of job creation and economic growth, and farms provide the food that feed our nation. These entities rely heavily on relationship-based lending, especially in rural areas, where localized knowledge is paramount to understanding credit risk and making informed credit decisions. In the absence of relationship-based knowledge, larger non-community banks often do not lend in these markets.[42,43]

Despite the benefits of physical bank branches, the number of total bank and credit union branches in the United States has been declining since the Great Financial Crisis, and the decline has accelerated since the start of the COVID-19 pandemic.[44] Between 2017 and 2021, 9% of all U.S. bank branches closed, with more than 4,000 closures occurring from March 2020 to October 2021—nearly double the pre-pandemic rate. This followed a decline from 92,394 branches in 2009 to under 78,000 in 2023.[45]

The continuing decline in the number of branches has created an increasing number of banking deserts, which are areas with no bank or credit union branches within a defined radius from population centers, or within a whole census tract. As of 2023, over 12 million Americans live in one of the 3,618 banking deserts in the United States. Since the onset of the COVID-19 pandemic, over 760,000 people have lost access to a bank branch within their community. In the areas that gained access to branches and were therefore no longer considered banking deserts, 45% were served by a community bank branch and 36% by a credit union branch.[46]

Since 2018, the closure of bank branches has been disproportionally driven by non-community banks. Between 2018 and 2023, community banks grew their branch count by 1.5% and credit unions lost 0.1% of branches.[47] In contrast, non-community banks closed branches at a much higher rate of 17.5%. The loss of branches can be most prominent in rural areas, where non-community banks closed 21.1% of branches, while community banks closed just 0.1% of branches. Community bank branches represent over 71% of all bank branches in rural areas and hold nearly two-thirds of all deposits in rural areas.[48]



● Banking Desert ● Potential Desert ● 2+ Branches

FIGURE 10 – BANKING DESERTS | SOURCE: FED COMMUNITIES BANKING DESERT DASHBOARD (2023)

Customers

The community banking sector serves customers and members representative of the diverse geographic and economic makeup of the United States. The community banking sector is present in affluent suburbs and rural agriculture communities. The sector serves large corporations and single-parent households. One strength of the sector is its ability and willingness to serve everyone, even those traditionally underserved by the largest banks. The most recent 2023 survey by the FDIC estimates that there are 5.6 million households that remain unbanked, meaning that they do not have at least one checking account or savings account. While the overall rate of unbanked households is declining, financial access is not proportionally available to all Americans.

Some community banks and credit unions operate under specific designations that reflect their missions and the populations they serve. These designations—such as Community Development Financial Institution (CDFI), Minority Depository Institution (MDI), Low-Income Credit Union (LICU), and Women's Depository Institution (WDI)—highlight the role these institutions play in promoting financial inclusion and serving underserved communities. While these designations provide valuable insights into the missions and target markets of these institutions, it is important to recognize that they are not all-encompassing, and many impactful financial institutions operate without formal designations.

Community Development Financial Institution (CDFI)

A CDFI is a financial institution certified by the U.S. Department of the Treasury that focuses on providing financial services to low-income, distressed, and underserved communities. CDFIs can be banks, credit unions, loan funds, or venture capital funds. The primary goal of a CDFI is to support economic development by

Community Development Financial Institution (CDFI) (cont.)

offering affordable loans, technical assistance, and other financial services that promote entrepreneurship, affordable housing, and community development. It is important to note that CDFIs are not limited to regulated, deposit-taking institutions—many CDFIs are non-regulated and provide alternative financing options. CDFIs play a critical role in expanding access to capital in communities where traditional banks may be reluctant to lend.

Minority Depository Institution (MDI)

An MDI is a designation given to banks and credit unions in which either more than 50% of the institution's ownership is held by minority individuals, or the board of directors and the community served is predominantly composed of minority populations. They advance financial inclusion and racial disparities in access to financial services. By serving minority communities, MDIs help foster economic opportunities, promote homeownership, and support minority-owned businesses.

Low-Income Credit Union (LICU)

The Low-Income Credit Union (LICU) designation is given to credit unions that serve low-income populations, defined as members who earn less than 80% of the median family income for the area. LICUs are empowered to expand services to financially underserved populations by offering products such as low-cost loans, financial education, and credit-building programs. Importantly, LICUs have greater regulatory flexibility, including the ability to accept secondary capital, offer non-member deposits, and access special government programs to support their mission. This designation allows LICUs to focus on reducing poverty and promoting economic empowerment in low-income areas.

Women's Depository Institution (WDI)

A Women's Depository Institution (WDI) focuses on serving women, particularly in underserved or marginalized communities. These institutions, which may be banks, credit unions, or other financial entities, are dedicated to supporting the financial needs of women through products and services designed to enhance their economic independence. WDIs offer financial education, business loans for women entrepreneurs, and savings programs that specifically target the unique challenges women face in accessing capital. By prioritizing women's financial empowerment,[42] WDIs contribute to gender equity in the financial system and promote broader economic inclusion.

Products & Services

The product and services offered by community banks and credit unions play a pivotal role in the communities they serve, and when aggregated together, are vital to health and growth of the national economy.[49] The community banking sector particularly excels in making commercial and industrial (C&I), commercial real estate (CRE), and farm and farmland loans. The importance of these sectors cannot be overstated; small businesses and family farms represent a core part of the U.S. economy and are vital for economic growth, job creation and strong communities.

Small businesses employ 59 million workers, making up 45.9% of all private sector employees and representing 43.5% of U.S. gross domestic product (GDP). From 1995 to June 2023, small business outpaced large business in net new job creation, creating 20.2 million net new jobs which represents 61% of all net new jobs.[50] Despite their smaller asset size and total market share, community banks play an outsized role in financing the commercial CRE and C&I loans for the nation's small businesses. Small businesses often need smaller loan amounts that are too small for the largest banks or have unique needs that can be difficult to underwrite without localized, personal knowledge of the business and its

Products & Services (cont.)

market. In 2020, community banks made 32% of all CRE loans. The sector holds an even larger market share of smaller dollar loans, with over 60% of CRE loans under $1 million dollars. For C&I loans sized $250,000 - $1 million, community banks made 41.6% of nation's small business commercial loans.[51]

With the advantage of local market knowledge and personal relationships, community banks and credit unions have been shown to not only provide an outsized share of lending in key sectors, but also to continue lending during times of economic stress. By providing access to credit during difficult economic times, the community banking sector can help reduce economic volatility and adverse impacts on small firms and employers. The responsiveness of the community banking sector to local needs can also be seen in the deployment of The Paycheck Protection Program (PPP) during COVID-19. Community based lenders were able to more quickly help their customers access funds, with more than half of PPP loans issued by community banks.

In addition to small business lending, the community banking sector, enabled by its rural branch presence, provides a majority of the credit issued to farms by commercial banks in the U.S. In 2020, of all agricultural lending by commercial banks, community banks provided 81% of farm real estate debt and 74% of operating debt. The scale and importance of agricultural credit provided by community banks is even more prevalent in smaller loan sizes, and community banks provided close to 90% of all commercial bank farmland loans with amounts less than $500,000.[52] Small and midsize farms make up almost 95% of all farms in the U.S. and produce 42.6% of agricultural output. These family run farms rely heavily on the community banking sector and its specialized products and services.

In addition to their focus on small businesses and agriculture, community banks and credit unions both provide essential lending for residential real estate, consumer financing, and other personal financial services. Community banks offer mortgage and commercial real estate loans that support local development, while credit unions excel in providing consumer loans for everyday needs, such as financing vehicles and home purchases. Due to their not-for-profit structure, credit unions often offer consumers lower interest rates and fewer fees, helping underserved populations improve their credit and achieve financial stability.

Together, the community banking sector contributes to the financial well-being of communities by supporting businesses, farms, and households in ways that larger banks may not prioritize. These institutions provide indispensable services to both rural and urban communities, and their emphasis on relationship-based lending and localized knowledge allows them to cater to the specific needs of their customers. By offering essential financial products that foster both personal and business growth, community banks and credit unions remain key contributors to the resilience and vitality of the U.S. economy.

CONCLUSION

The community banking sector is strong, stable, and responsive. It has maintained conservative balance sheets and stable earnings through a business model that focuses on serving its local community by attracting deposits to fund its balance sheets, providing competitive rates on deposits and loans, and ensuring strong credit quality. Community banks and credit unions provide banking services to millions of Americans, especially those in rural or underserved areas, with each institution playing a vital role in its own community. Collectively, the sector is an important part of our financial system and national economy. Despite its strength and importance, the community banking sector is often characterized by myths and misconceptions. This paper provides data-driven analysis for treasury managers and financial professionals to uncover the financial and social value in the sector to improve risk adjusted returns and achieve positive social and environmental impact.

Appendices

Appendix A – FDIC Research Definition of Community Banking Organizations [53]

The determination of which insured institutions are considered community banks is based on five steps.

The first step in defining a community bank is to aggregate all charter-level data reported under each holding company into a single banking organization. This aggregation applies both to balance-sheet measures and the number and location of banking offices. Under the FDIC definition, if the banking organization is designated as a community bank, every charter reporting under that organization is also considered a community bank when working with data at the charter level.

The second step is to exclude any banking organization where more than 50% of total assets are held in certain specialty banking charters, including: credit card specialists, consumer nonbank banks, industrial loan companies, trust companies, bankers' banks, and banks holding 10% or more of total assets in foreign offices.

Once the specialty organizations are removed, the third step involves including organizations that engage in basic banking activities as measured by the total loans-to assets ratio (greater than 33%) and the ratio of core deposits to assets (greater than 50%). Core deposits are defined as non-brokered deposits in domestic offices. Analysis of the underlying data shows that these thresholds establish meaningful levels of basic lending and deposit gathering and still allow for a degree of diversity in how individual banks construct their balance sheets.

The fourth step includes organizations that operate within a limited geographic scope. This limitation of scope is used as a proxy measure for a bank's relationship approach to banking. Banks that operate within a limited market area have more ease in managing relationships at a personal level. Under this step, four criteria are applied to each banking organization. They include both a minimum and maximum number of total banking offices, a maximum level of deposits for any one office, and location-based criteria. The limits on the number of and deposits per office are adjusted upward quarterly. For banking offices, banks must have more than one office, and the maximum number of offices is 40 in 1985 and reached 107 in 2024. The maximum level of deposits for any one office is $1.25 billion in deposits in 1985 and reached $10.87 billion in deposits in 2024. The remaining geographic limitations are also based on maximums for the number of states (fixed at three) and large metropolitan areas (fixed at two) in which the organization maintains offices. Branch office data are based on the most recent data from the annual June 30 Summary of Deposits Survey that are available at the time of publication.

Finally, the definition establishes an asset-size limit, also adjusted upward quarterly and below which the limits on banking activities and geographic scope are waived. The asset-size limit is $250 million in 1985 and reached $2.17 billion in 2024. This final step acknowledges the fact that most of those small banks that are not excluded as specialty banks meet the requirements for banking activities and geographic limits in any event.

Summary:

Community banks are designated at the level of the banking charter. All charters under designated holding companies are considered community banking charters.

Appendices (cont.)

Exclude any organization with:

1) No loans or no core deposits

2) Assets held in foreign branches > 10% of total assets

3) More than 50% of assets in certain specialty banks, including:

   a) credit card specialists
   b) consumer nonbank banks

      i) Consumer nonbank banks are financial institutions with limited charters that can make commercial loans or take deposits, but not both.

   c) industrial loan companies
   d) trust companies
   e) bankers' banks

Include all remaining banking organizations with:

1) Total assets < indexed size threshold

   a) Asset size threshold indexed to equal $250 million in 1985 and $2.17 billion in 2024

2) Total assets ≥ indexed size threshold, where:

   a) Loan to assets > 33%
   b) Core deposits to assets > 50%
   c) More than 1 office but no more than the indexed maximum number of offices

      i) Maximum number of offices indexed to equal 40 in 1985 and 107 in 2024

   d) Number of large MSAs with offices ≤ 2
   e) Number of states with offices ≤ 3
   f) No single office with deposits > indexed maximum branch deposit size.

      i) Maximum branch deposit size indexed to equal $1.25 billion in 1985 and $10.87 billion in 2024.

Appendix B – Examples of Impact Deposits by Corporations

1. **Patagonia**
   Patagonia, demonstrating a strong commitment to combating climate change, has deposited $15 million into institutions actively involved in carbon reduction and energy efficiency lending.[54] These institutions focus on underserved communities disproportionately affected by climate change. Patagonia's actions demonstrate how financial practices can align with sustainability and values that contribute to the global energy transition. Their deposits supported Locus Bank's CDFI Loan Fund, which in turn funded Flywheel Development. Flywheel Development, a small business founded in 2014, focuses on making renewable energy accessible to low-income families in Washington, DC. With this support, Flywheel participates in the "Solar for All" program, aiming to provide clean energy to 100,000 low- and moderate-income households and helping families save up to 50% on electricity bills. Patagonia's impact-aligned deposits highlight their dedication to using all their corporate resources to address climate change.

2. **NerdWallet**
   In November 2022, NerdWallet released its inaugural Environmental, Social, and Governance (ESG) Report, highlighting its commitment to financial inclusion.[55] As part of its Financial Equality Project, NerdWallet deposited $2 million into Self-Help Federal Credit Union, a Community Development Credit Union (CDCU) that provides economic opportunities for underserved communities. This deposit supports personal, mortgage, and commercial loans for members, demonstrating NerdWallet's dedication to promoting financial equity.

3. **Mastercard**
   Mastercard is committed to driving positive change through its focus on People, Prosperity, and Planet.[56] The company demonstrates this commitment through its Center for Inclusive Growth and corporate initiatives aimed at promoting financial inclusion and supporting underserved communities. Mastercard recognizes the vital role that small businesses play in driving economic growth and generating wealth. It has made commitments to support these businesses, offering them business growth solutions and access to safe and affordable financing. For example, Mastercard's deposits program supports Optus Bank, which provides crucial small business financing to low-income communities. Additionally, sMastercard is dedicated to environmental sustainability and invests in catalyzing climate-smart financial solutions. By aligning its financial practices with sustainable and inclusive goals, Mastercard is actively working to create a positive impact.

Appendix C – Examples of Community Banks and Credit Unions

1. **Hope Credit Union (Jackson, Mississippi)**
   Hope Credit Union (HOPE) is a pivotal financial institution based in Jackson, Mississippi, that serves low-income communities across the Deep South. The credit union is committed to providing affordable financial services and loans to individuals and families, homebuyers, and small businesses in underserved areas. Hope Credit Union's work focuses on community development, including affordable housing, small business support, and economic mobility for low-income individuals. With assets of nearly $700 million, the credit union serves thousands of members in Alabama, Arkansas, Louisiana, Mississippi, and Tennessee. HOPE's deposit-driven funding model enables it to provide crucial financial resources where they are needed most, contributing to long-term economic stability in these communities.

   Learn more at: https://hopecu.org/

2. **Self-Help Federal Credit Union (Oakland, California)**
   Headquartered in Oakland, California, Self-Help Federal Credit Union (SHFCU) is a leading CDFI that focuses on providing financial services to underserved communities. With over $2 billion in assets and serving more than 129,000 members in 38 branches – 22 in California, nine in Illinois, five in Washington, and two in Wisconsin, Self-Help Federal is one of the fastest-growing community development-designated financial institutions in the country. The credit union is dedicated to promoting economic justice through access to affordable loans and financial services, particularly for low-income families, immigrants, and small businesses. SHFCU's impact focus includes affordable housing, financial education, and supporting community development. It leverages deposit-driven capital to offer lower-interest loans and help build financial stability in neighborhoods that are typically excluded from traditional banking systems. This commitment to financial inclusion is at the heart of Self-Help's operations and mission.

   Learn more at: https://www.self-helpfcu.org/

3. **Optus Bank (Columbia, South Carolina)**
   Optus Bank is a Black-owned community bank based in Columbia, South Carolina, that serves underbanked communities in the Southeast United States. The bank focuses on promoting economic inclusion through providing affordable loans, financial education, and business development support, particularly for Black and minority communities. Optus Bank has received significant support from corporate and institutional investors, including a $50 million deposit from PayPal, to increase its lending capacity. With a strong commitment to closing the racial wealth gap, Optus Bank uses its deposits to offer loans for affordable housing, small businesses, and community development. Its assets are rapidly growing, helping to fund sustainable economic growth and financial empowerment in underserved areas.

   Learn more at: https://optus.bank/

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