NEWS FLASH

BANK OF GEORGE

Founded 2007

August 2010

Dear Shareholders/Customers,

A very informative article, *What Is a Community Bank, Anyway?*, was recently posted on www.huffingtonpost.com. Author Katy Welter is a retired community banker, and she accurately outlines the significance and roles of community banks in our country. We thank you for your commitment to Bank of George, and after reading the article below, you will further understand the importance of supporting community banks.

What Is a Community Bank, Anyway?

The wikipedia entry for "community banks" is four lines long. That's not saying much about one of the most important collections of businesses in our economy. Community bank is one of those phrases, like "all natural," that people use without really knowing what they mean or how others will interpret it. The term conjures up images of *It's a Wonderful Life*, and the First National Bank of ______ that regularly features in cartoon town squares. But community banks are not a fiction. So, what are they?

Regulators, legislators and bankers commonly take "community bank" to mean a bank with "less than $1 billion in assets under management." Roughly speaking, "assets under management" means the number of loans and other similar investments a bank controls (banks account for deposits as liabilities). This $1 billion rule of thumb is an easy metric to identify, but it doesn't tell us much else. As of the first quarter of this year, 7,256 of 7,932 (or 92%) of FDIC-insured financial institutions held $1 billion or fewer in assets. But there's more to these banks than asset size.

Community banks aren't just small. They're local. Your dollar in a small bank will likely underwrite a local home or business or be invested in U.S. government-backed securities. That same dollar in a megabank will fund loans across the country and may well buy foreign currencies or bonds, corporate stock or bonds and various other securities. Community banks tend to obtain deposits from local individuals and businesses and lend them out to local borrowers. Larger banks frequently derive their funding from sources around the country and the world, which are often far more complex than your typical checking account or certificate of deposit.

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Community banks keep it simple, legally speaking. The vast majority are either stand-alone corporations or owned by what is called a bank holding company (BHC). A BHC is just what it sounds like—a corporation designed for the sole purpose of owning a bank. But big banks—the five biggest, in fact—are owned by *financial* holding companies. These corporations, authorized by the Gramm-Leach Bliley Act of 1999, can own subsidiary companies engaged in different types of financial activities, including investment banking, insurance sales, credit cards and stock brokering. Bank of America Corporation for example, owns companies that do all of the above.

Community banks specialize in "relationship banking," as opposed to "transactional banking," which large banks master through economies of scale. The former approach drives profit through long-term, multiple-account relationships and customized service for core customers. The latter makes money on volume—from large numbers of standardized accounts, numerous locations and automated service.

Community banks make money their money from loans. They are far more likely than big banks to rely on traditional sources (e.g., interest from loans) as their main source of income. They earn the difference between the average interest rate they pay on deposits and the rate they charge to lend that money. Community banks can still profit from this simple model largely because their loyal customers' money doesn't leave with each competing bank's promotion. These dependable deposits are called "core deposits"; they are essential to a community bank's success, and are the goal of any relationship banking strategy. Big banks' "non-interest income" amounts to fees associated with accounts, overdrafts, loans, brokerage and securitization of loans.

92% of U.S. banks—those under $1 billion in asset size—compete over just a fraction of the nation's assets. The six largest banks in the United States control 72% or $9.4 trillion of the nation's $13.3 trillion in assets. If small banks are going to stand a chance, then we ought to at least know what they are.

Source: This post relied on *Bank Management*, 7th Edition, by Timothy Koch and Scott MacDonald. ©2010 Huffington Post, August 4, 2010.

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