Native American Banks: Overview and Recent Performance

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Abstract

While minority-owned commercial banks have received some attention in the finance literature, little attention has been directed at a particular sub-category: *Native American* commercial banks. Our paper attempts to fill that void. After covering some background information on Native American banks, we contrast this category's financial performance with peer group institutions—focusing on the period 2005-10. Profitability, as measured by return on assets (ROA), has been a problem for Native American banks. Looking behind ROA, the Native American category has done reasonably well in maintaining net interest margin, while encountering difficulties in controlling overhead expenses and loan losses.

I. Introduction

For a number of years, U.S. commercial bank regulators have encouraged participation of minorities in the commercial banking business. For example, in 2002, the FDIC established a national coordinator for a "minority depository institutions program"—describing the coordinator as one who "will regularly contact the various minority depository institution trade associations to seek feedback on the FDIC's efforts under this program, discuss possible training initiatives, and explore options for preserving and promoting minority ownership of depository institutions" (FDIC, 2002). Formally, minority institutions are those identified by the FDIC as being "operated by a minority board serving an African American, Hispanic, Asian or Pacific Islander, or multi-racial community or majority owned by such minorities."

Another regulator program for the minority bank segment came about in 2008, with the Federal Reserve's launch of its "Partnership for Progress." A Federal Reserve press release described this as "an innovative outreach and technical assistance program for minority-owned and de novo institutions…." (Board of Governors, 2008). The Partnership for Progress website turns out to be a useful source for performance data on minority commercial banks, and in what follows, is used extensively. Data are organized according to minority category: African American, Asian, Hispanic, Native American, and multi-racial.

While minority-owned commercial banks have received some attention in the finance literature, we find very little attention directed to the sub-category of *Native American* commercial banks. Our paper attempts to fill that void. Our goal is to highlight performance characteristics of the Native American banks—especially noting how their performance stacks up relative to peer institutions. But first, in the next two sections, we review some related literature on minority banks, and provide some background on Native American banks.

II. Previous literature on minority banks

A representative article in the minority commercial bank literature was authored by Douglas A. Price, and appeared in the 1990 Federal Reserve Bank of Cleveland *Economic Commentary*. Price compared minority and nonminority institutions, using some basic financial performance measures (Price, 1990). He reported that minority banks tended to be less

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profitable than their nonminority peer institutions, with the disparity being especially pronounced among smaller banks. But Price was not able to offer data on different *sub-categories* of minority banks. As an aside, the Price article can provide a nice source of reference citations for the earlier literature on minority banks—especially in the 1970s and 1980s. We will not attempt to review that literature here; much of it focused on African American banks.

A few years later, in 1996, a Federal Reserve Bank of Chicago article examined minority and women-owned banks, specifically looking at the managerial efficiency of such institutions, compared to their non-minority bank peers. Iftekhar Hasan and William C. Hunter, using data just for the year 1992, found that "the average minority- or women-owned bank was significantly more inefficient than the average nonminority bank" (Hasan and Hunter, 1996, page 27). But, out of a total of 95 minority banks in 1992, just five were Native American banks.

Literature aimed specifically at Native American commercial banks is very slim. One fairly recent example was published by the Federal Reserve Bank of Boston (Swan, 2008). Jon Swan provides a case study of a Colorado-based institution, Native American Bank, NA. The bank was started in 2001, resulting from a purchase of an existing tribal bank. One interesting aspect is the bank's ownership makeup: multiple tribes, from across the United States, came together as investors. According to Swan, the bank appears to have a national focus in its lending endeavors as well.

III. Background on Native American banks

As of June 30, 2010, the Partnership for Progress website reports a total of 21 Native American commercial banks. This compares with 185 banks in the entire *minority* category. Table I lists the Native American institutions, arrayed by average total assets in 2010. The largest, Lumbee Guarantee Bank in North Carolina, has average total assets of about $271 million. Clearly, most Native American banks are small, and would be categorized as "community banks." In terms of chartering, six are *national* banks, having been chartered by the Office of the Comptroller of the Currency. The remaining banks are state-chartered, with most having the FDIC as primary Federal regulator—and as such, they are *not* members of the Federal Reserve System. Not surprisingly, the Native American banks tend to be found in the vicinity of tribal populations. Eleven of the 21 banks are located in Oklahoma.

A review of the websites of the Native American Banks shows a wide variety in how such banks present themselves to the public. Sometimes, a bank's connection with Native Americans is prominently displayed, but not always. Lumbee Guarantee Bank presents a detailed history of its origins at its website, including the following passage:

Lumbee Bank was incorporated under the laws of North Carolina on September 29, 1971, and commenced operations as a North Carolina state-chartered bank on December 20, 1971. This day, what appeared to be an impossible dream became a reality, and history was made because Lumbee Bank was the first Indian owned bank in the United States.

Along the same lines, the website of the Bank of Cherokee County, in Oklahoma, notes the following:

Table I

Bank	**City or town**	**State**	**2010 Avg Tot Assets (000)**	**2010 ROA (%)**	**Primary Federal Regulator**
Lumbee Guarantee Bank	Pembroke	NC	271,251	0.52	FDIC
Canyon National Bank	Palm Springs	CA	236,048	-4.24	OCC
First National Bk. and Trust	Shawnee	OK	200,195	0.35	OCC
Borrego Springs Bank, N.A.	La Mesa	CA	137,583	1.47	OCC
Farmers & Merchants Bank	Crescent	OK	127,173	0.72	FDIC
Woodlands National Bank	Hinckley	MN	125,899	0.39	OCC
Bay Bank	Green Bay	WI	121,700	0.36	FDIC
American Bk. of Baxter Springs	Baxter Springs	KS	117,067	-4.06	Fed. Res.
Bank of Cherokee County	Hulbert	OK	99,452	0.78	Fed. Res.
Bank of Commerce	Stilwell	OK	94,624	1.56	FDIC
Oklahoma State Bank	Vinita	OK	91,300	1.09	FDIC
Native American Bank, N.A.	Denver	CO	89,660	1.46	OCC
Bank2	Oklahoma City	OK	89,644	1.14	Fed. Res.
Peoples Bank of Seneca	Seneca	MO	86,796	1.28	FDIC
F & M Bank, N.A.	Yukon	OK	81,653	0.32	OCC
Fort Gibson State Bank	Fort Gibson	OK	63,879	0.82	FDIC
Peoples Bank	Westville	OK	53,990	1.87	FDIC
First State Bank of Porter	Porter	OK	34,936	2.22	FDIC
AllNations Bank	Calumet	OK	27,749	0.5	Fed. Res.
Eagle Bank	Polson	MT	24,018	0.27	FDIC
Turtle Mountain State Bank	Belcourt	ND	17,018	-0.81	FDIC

The bank was founded in 1907, the year Indian Territory and Oklahoma Territory united as the State of Oklahoma, by a group of prominent members of the Cherokee tribe. In 1996 the ownership of the bank changed only for the fourth time in its history when another group of prominent members of the Cherokee tribe headed by Gary D. Chapman acquired the bank.

In stark contrast, the website of Bay Bank, in Green Bay, Wisconsin, displays absolutely nothing about its tribal ownership.

In passing, we acknowledge a disputed issue of exactly *when* the *first* Native American bank appeared on the scene. The quotations above—from Lumbee Bank and Bank of Cherokee County—seem to be at odds with each other, at least on the surface. Adding even more to the mystery, an article published by the Federal Reserve Bank of Boston in 2008 makes reference to "the first tribal bank, founded in 1987"—that being identified as "Blackfeet National Bank of Browning, Montana" (Swan, 2008, page 22).

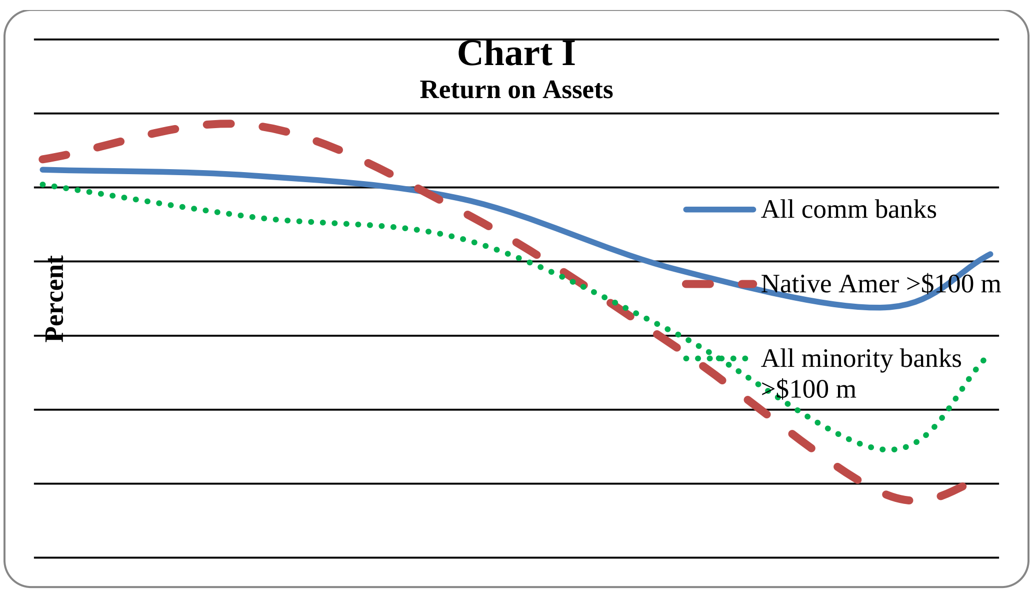
IV. Financial performance of Native American banks

In what follows, we rely on the Partnership for Progress website for minority bank data. For general bank comparative statistics, we employ data from the Federal Financial Institutions Examination Council (FFIEC). The Partnership for Progress presents quarterly data, and reports the data for *two* size categories: (1) banks under $100 million in total assets, and (2) banks of at least $100 million in assets. In what follows, we present just the "over-$100 million" bank data—since statistics in the small-bank Native American group appear to be dramatically influenced by some newly-chartered banks. Our performance data are based on the *fourth-quarter* results for years 2005 through 2009, and the *second-quarter* results for 2010 (the fourth quarter 2010 data were not yet available.)

We have divided our performance coverage into four areas: (a) profitability, (b) loan quality, (c) liquidity, and (d) bank capital. And we compare Native American results with *two* peer groups: (1) minority banks having at least $100 million in assets, and (2) all U.S. commercial banks. At year-end 2005, there were 117 banks in the minority category, with eight identified as Native American. By June, 2010, the minority group had grown to 128, with nine identified as Native American. By comparison, the total number of insured commercial banks fell from 7,471 at year-end 2005 to 6,636 in June, 2010.

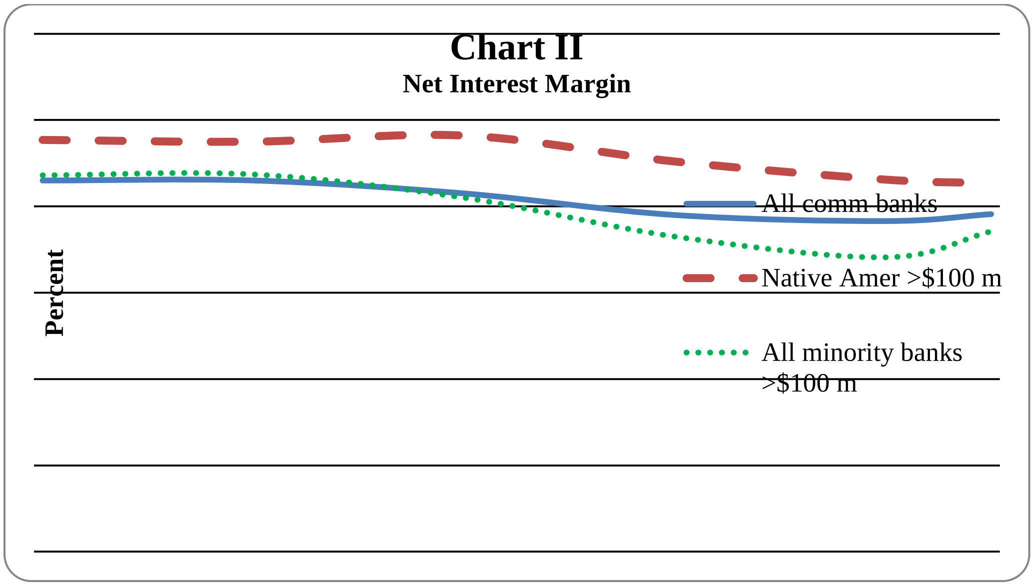
a) Profitability

In Chart I, we see that minority bank return on assets (ROA) suffered dramatically as the 2007-09 recession became apparent. And Native American banks were particularly challenged.

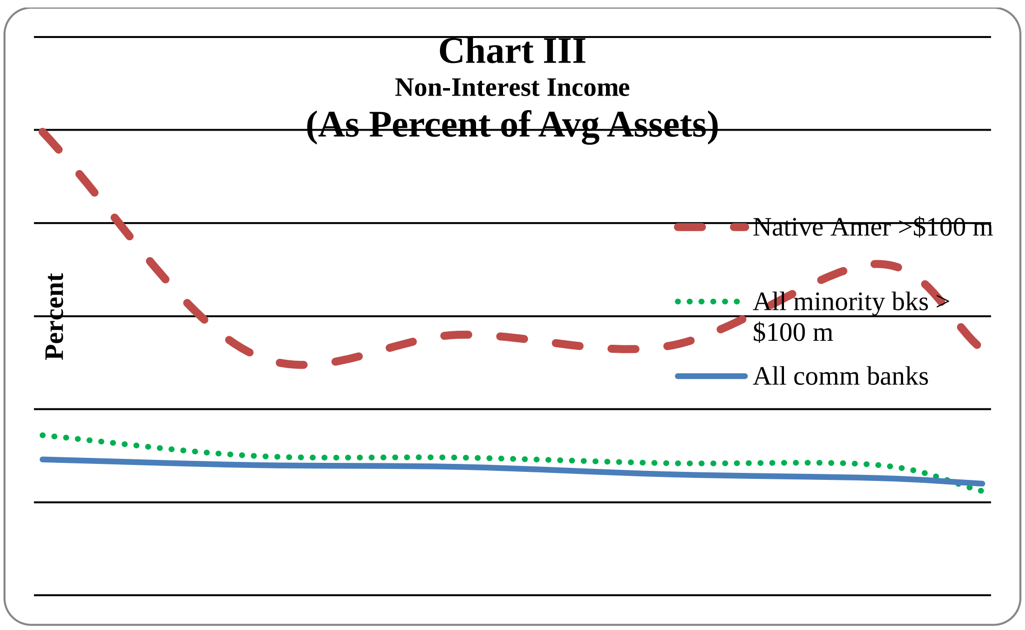


To dig a bit deeper, the next set of charts addresses important *sources* of bank profitability—in essence, the *drivers* behind Chart I.

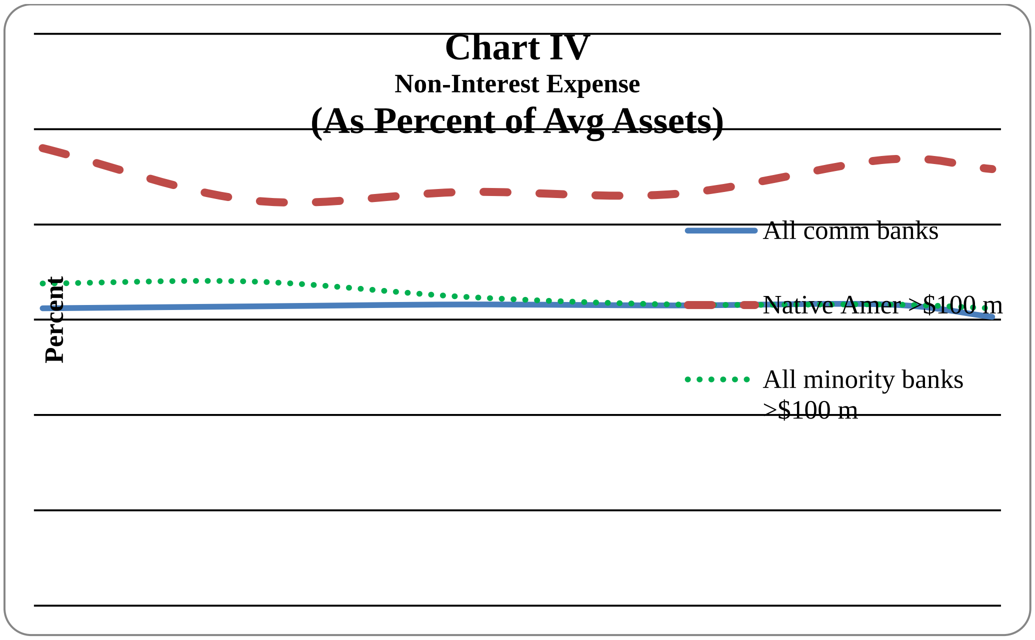
Although Native American banks had their problems with ROA, they displayed comparatively *good* results on net interest margin (NIM), which is plotted in Chart II. NIM is simply interest income less interest expense, divided by earning assets. As such, it is sensitive to the bank's pricing—on both the asset and liability sides of the balance sheet.



Two additional measures get at remaining major parts of the income statement. First, Chart III presents non-interest income (as a percent of average assets). This part of the income statement will reflect the bank's success in generating fee income. And the Native American banks show relatively good performance here.

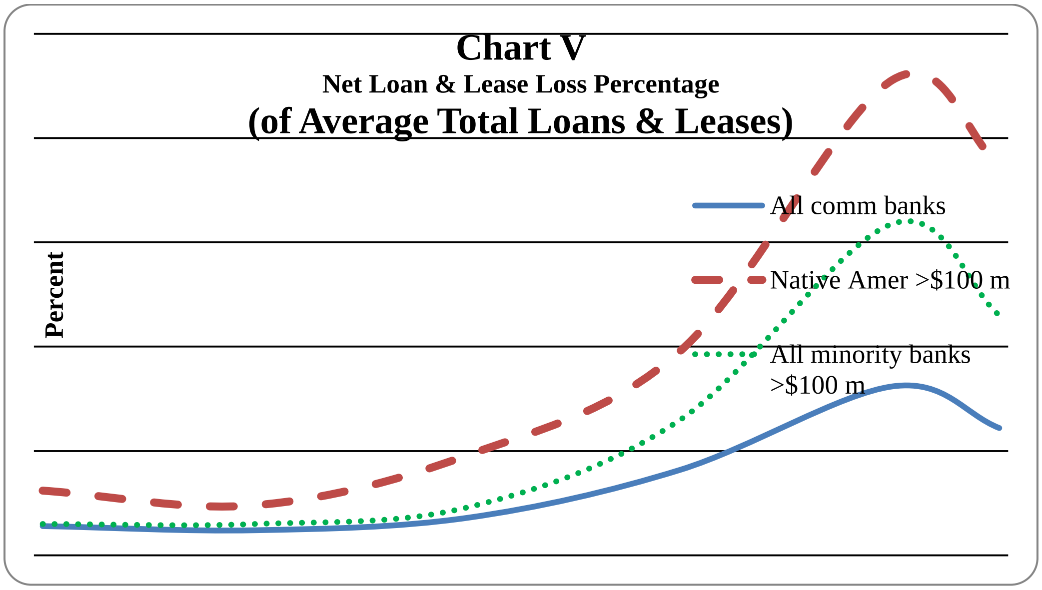


Obviously, Charts II and III tell some "good news" for the Native American category—and seem at odds with the poor ROA results displayed in Chart I. The answer to the apparent contradiction appears in "non-interest expense"—essentially, *overhead*. This is where personnel and occupancy expenses are captured. Clearly, as displayed in Chart IV, the Native American banks have *not* fared well on this metric.



b) Loan quality

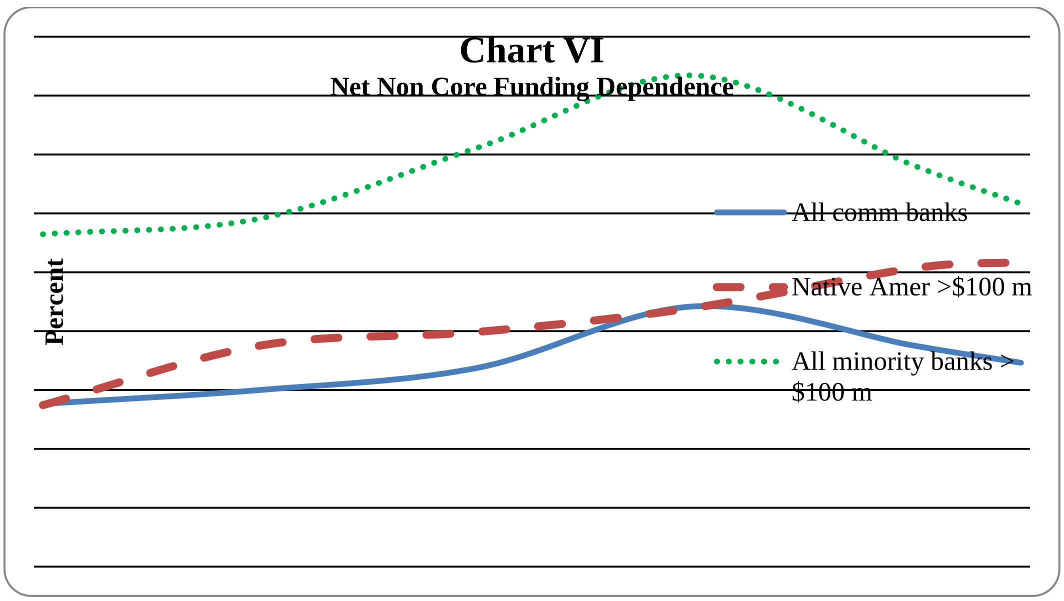
In banking, it's one thing to book a "nice fat margin." But it's quite another to build a *quality* loan portfolio. To capture loan quality, we've chosen to look at loan losses. Formally, Chart V presents the "net loan and lease loss percentage." It appears that problems in the loan portfolio—particularly as the economy fell into recession—were especially pronounced for Native American banks.



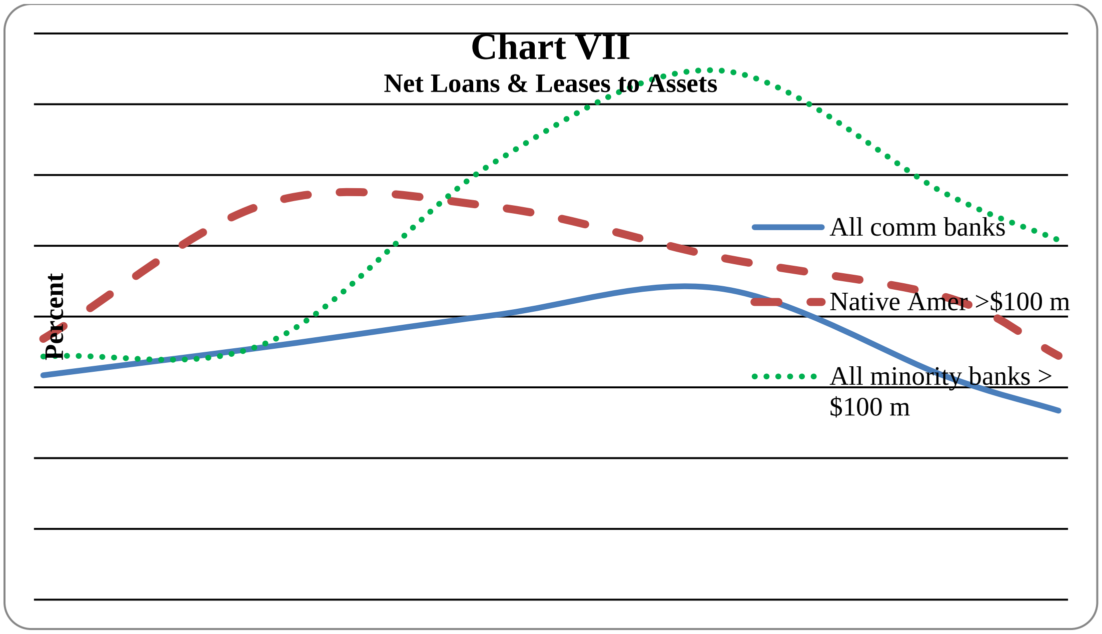
c) Liquidity

Liquidity risk in banking can be rooted in different parts of the balance sheet. One source of liquidity risk is associated with a bank's reliance on *non-core* deposits. Non-core funding is basically large-denomination, *money market* funding. It comes from suppliers who are highly sensitive to interest rate movements. Non-core funding tends to be more expensive than core deposit funding—but also, it tends to have a *less predictable* cost, and hence, present *more* liquidity risk. In Chart VI, we show "non-core funding dependence" for our different bank categories.

The Native American category was somewhat more heavily dependent on non-core funding than all commercial banks. But Native American non-core deposit usage did suggest a *lower* risk profile, when compared to *all* minority banks. In addition, it's also interesting to note that the Native American banks were *increasing* their usage of non-core funding, at a time when our peer bank categories were reducing their use of such funding.



A second indicator of bank liquidity relates to the bank's *asset* structure. How much of a bank's total assets is tied up in items having limited liquidity? One traditional measure of this is the "loan to assets" ratio, captured here in Chart VII.

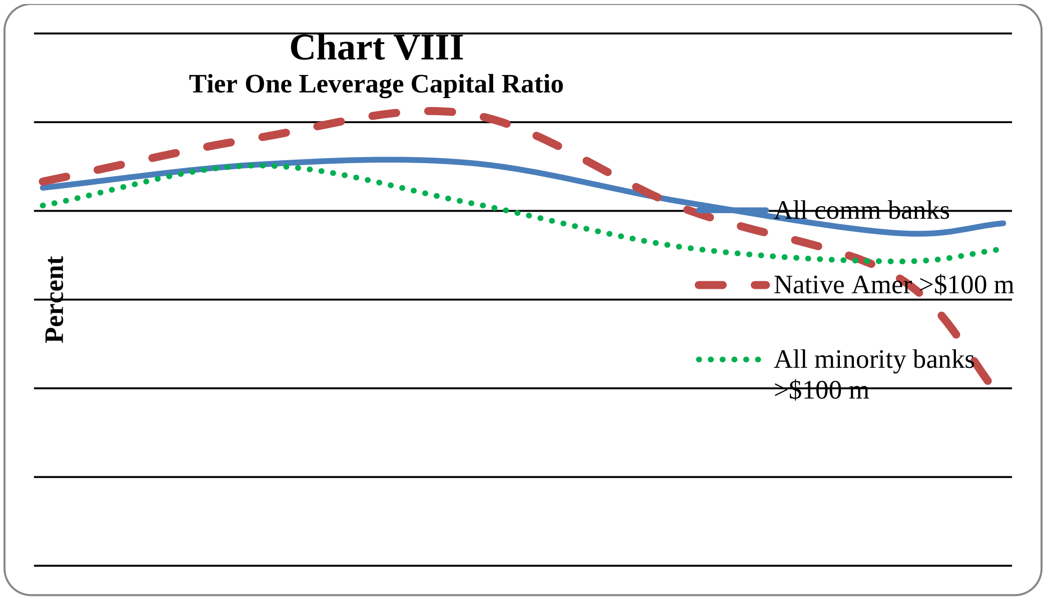


All of our peer categories were showing declines in this measure by 2009. The ratio for Native American banks started to decline even earlier. But also note that, in 2005 and 2006—the Native American banks had *relatively heavier* holdings of loans.

d) Bank capital

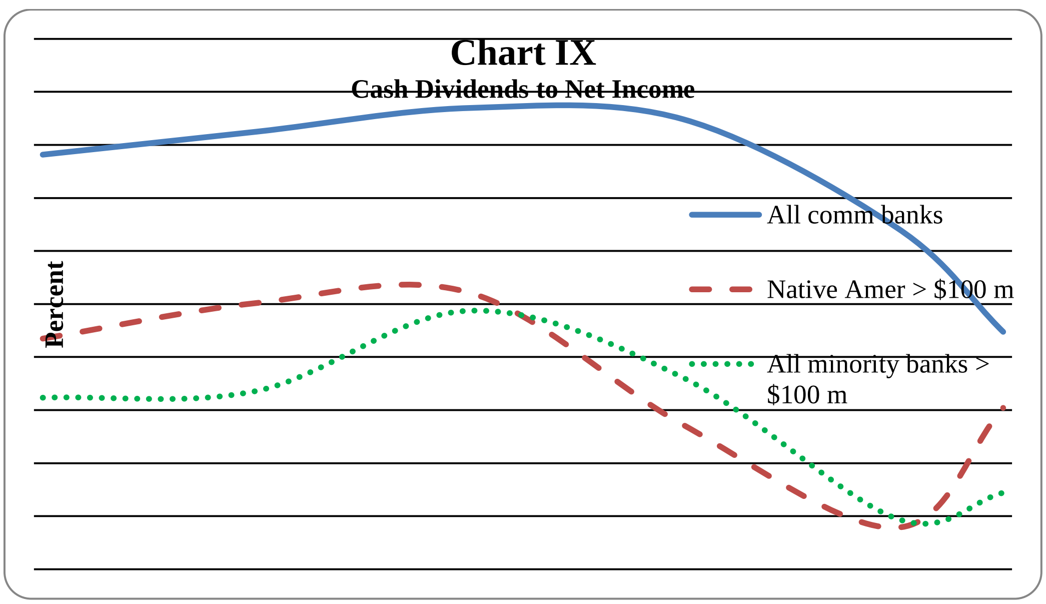
Finally, we turn to bank capital. Capitalization has been a major concern to bank regulators in recent years—particularly for large banks, which have often been treated as "too big to fail" candidates.

Chart VIII presents the "Tier I leverage" ratio—in essence, the capital-to-assets ratio. And for the banking industry as a whole, we observe a fall-off during the recession. But once again—as in the case of both ROA and loan losses—the Native American category has shown a *more dramatic* decline.



Another capital-related issue is how the contributors of bank *equity* capital have been *paid* over recent years. Chart IX presents readings for "cash dividends to net income," or the dividend payout ratio. Both Native American banks and the larger, minority bank cohort have paid out smaller fractions of net income, compared to all U.S. banks. And clearly, the recession has had an impact—in the logical direction—on dividend payout ratios.

Perhaps one puzzling shred of information is the slight *increase* in payout ratios of minority (and Native American) banks as of mid-2010. You might say that minority institutions wasted little time in responding to a *slightly* improved profitablity picture in 2010 (as noted by the ROA movement, displayed back in Chart I).



V. Conclusion

We have presented an overview of Native American commercial banks. Our overview included performance comparisons for the years 2005 through mid-2010. We showed performance results for those Native American banks having at least $100 million in total assets, and compared the results with: (1) all minority banks having at least $100 million in total assets, and (2) all U.S. commercial banks.

Native American banks have been particularly challenged in the recent recessionary period. Profitability, as measured by ROA, has shown a more dramatic movement during the 2005-10 period. Looking *behind* the ROA figures, Native American banks have done reasonably well in maintaining *net interest margin*, but have had a difficult time keeping overhead expenses under control. And loan losses have been a significant problem. Measures of liquidity risk did not appear especially notable for the Native American banks, on the whole. But it was interesting that the Native American banks were increasing their *non-core* deposit usage in very recent years—when our two peer groups were showing a decline in such usage. Finally, Native American bank profitability problems have no doubt contributed to a declining Tier I leverage ratio.

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