## Community Banking Bulletin

Highlight: Earnings support dividends and moderate the declining leverage ratio trend at community banks

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Higher earnings in 2021 have supported continued dividend payouts and capital growth to moderate the downward pressure of deposit-fueled asset growth on community bank leverage ratios.

Dividends, Retained Earnings, and Leverage Capital
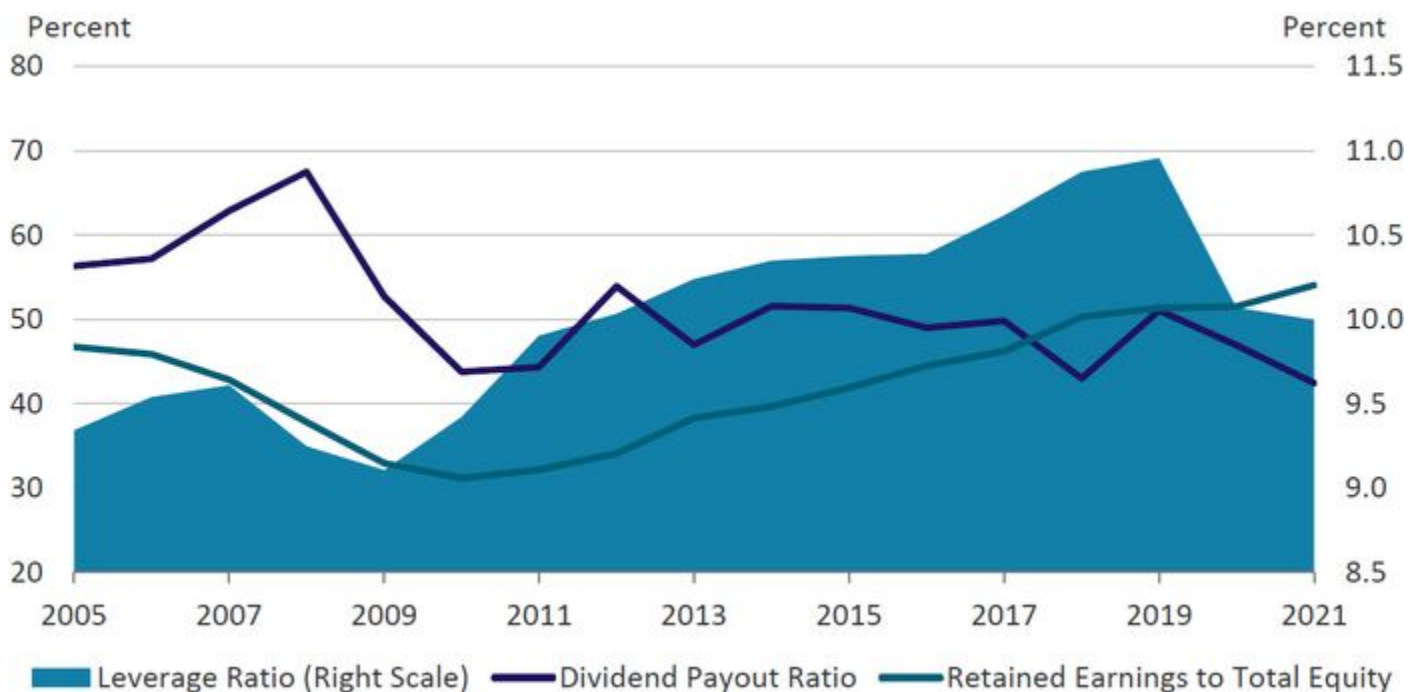
Notes: Dividend payout ratio is calculated as dividends as a percent of net income for banks reporting positive net income. Leverage ratio is equal to tier 1 capital as a percent of average assets.
Source: Reports of Condition and Income.

- Prior to the onset of the pandemic, the aggregate community banking organization[1] (CBO) leverage ratio was trending upward and reached an all-time high of 11 percent at year-end 2019. The leverage ratio then fell suddenly in early 2020 as deposit-fueled asset growth spiked, bringing the ratio down to 10 percent at year-end 2021.

- During the previous financial crisis, leverage ratios declined due to significant credit losses experienced by banks. CBOs initially offset leverage pressure with external capital injections and lower dividend payouts, then subsequently relied on the

internal generation of capital through retained earnings.

- CBOs responded to the steep drop in capital ratios during the pandemic by pulling back dividend payments throughout 2020 and into early 2021. As earnings rebounded in the latter half of 2021, total dividend distribution levels increased towards historical norms, though higher earnings resulted in a relatively lower dividend payout ratio of 43 percent at year-end 2021. Accordingly, retained earnings as a percent of total equity increased to a historical high of 54 percent at year-end 2021, mitigating some balance sheet pressure on leverage ratios.

Questions or comments? Please contact KC.SRM.SRA.CommunityBankingBulletin@kc.frb.org.

Endnotes

[1] Community banking organizations are defined as having $10 billion or less in total assets.