

Community Banking
in the 21st Century



How Are Small Banks Faring Under Dodd-Frank?

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This presentation is based on a paper prepared with my colleagues Ian Robinson and Thomas Stratmann, which is available at <http://mercatus.org/publication/how-are-small-banks-faring-under-dodd-frank>.

Today's Agenda

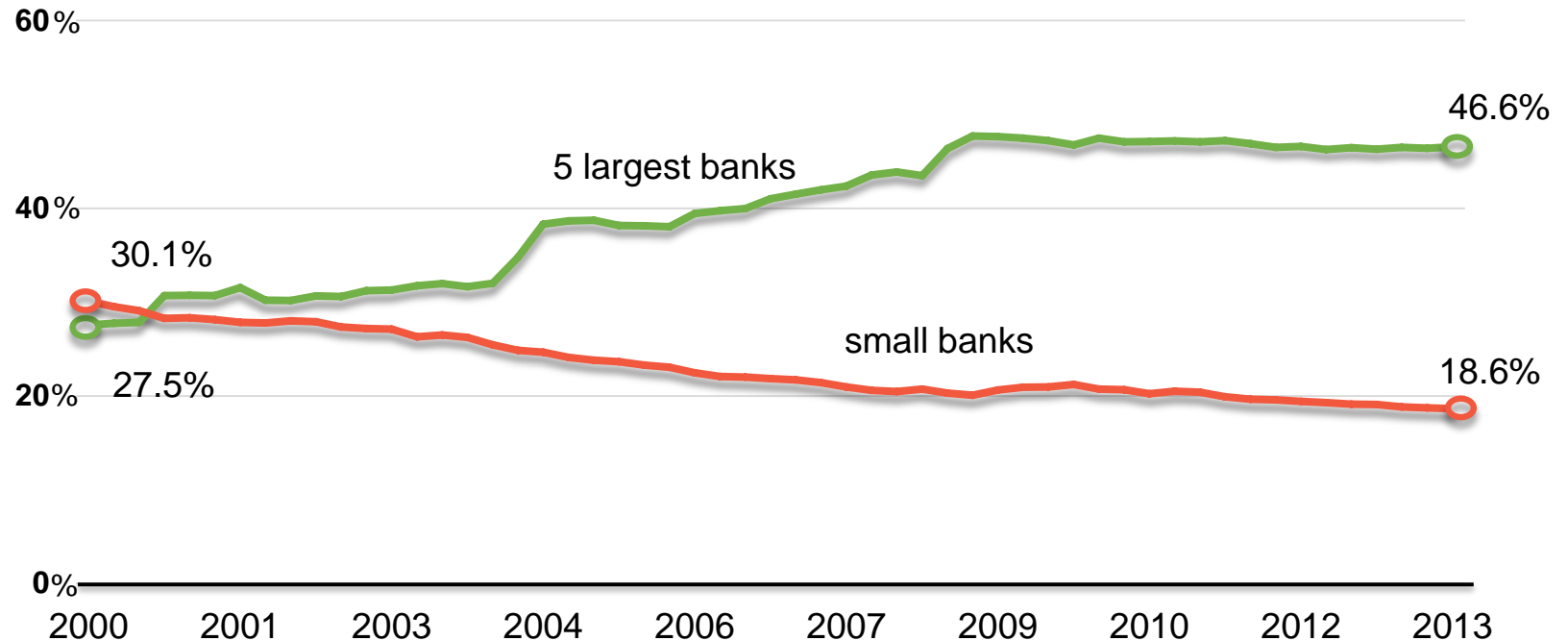
- Why we did the survey
- Methodology and survey population
- Results
- Recommendations

How Small Is Small?

- We used a \$10 billion cut off:
 - Same cut-off that some regulators use, e.g., CSBS & Fed surveys.
 - Same cut-off used for some purposes in Dodd-Frank.
- But we acknowledge:
 - Life for very small banks is different than life for banks at top of range.
 - Our definition is not as nuanced as FDIC's new definition of community bank.

Big banks have been bulking up

Share of Total US Banking Assets Held by 5 Largest Banks vs. Small Banks



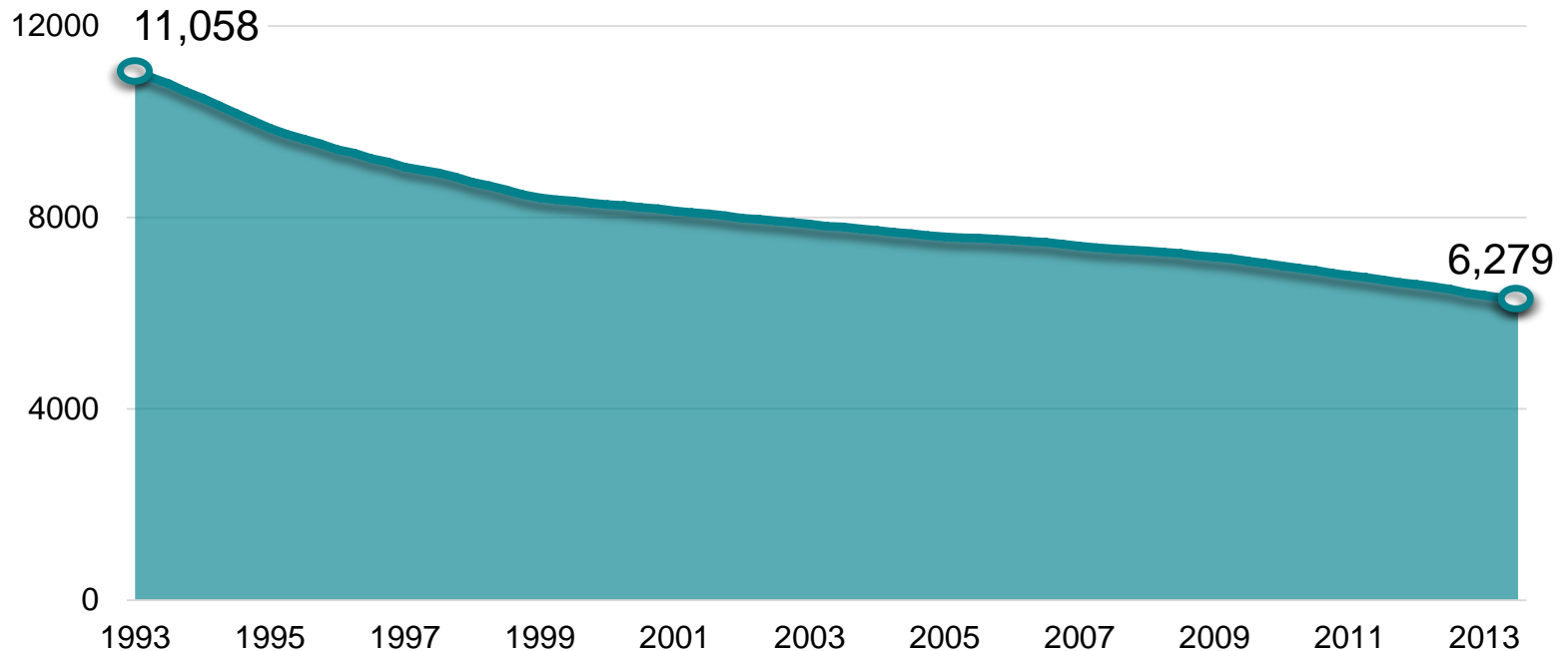
Source: *Statistics on Depository Institutions*, Federal Deposit Insurance Corporation.

Data note: Banks are ranked by asset size. Small banks are defined as U.S. banks with \$10 billion or less in assets.

For purposes of this chart, banks were aggregated under their bank holding companies. Available data did not permit thrifts to be aggregated under their holding companies. Produced by Hester Peirce, Robert Greene & Rizqi Rachmat, Mercatus Center at George Mason University

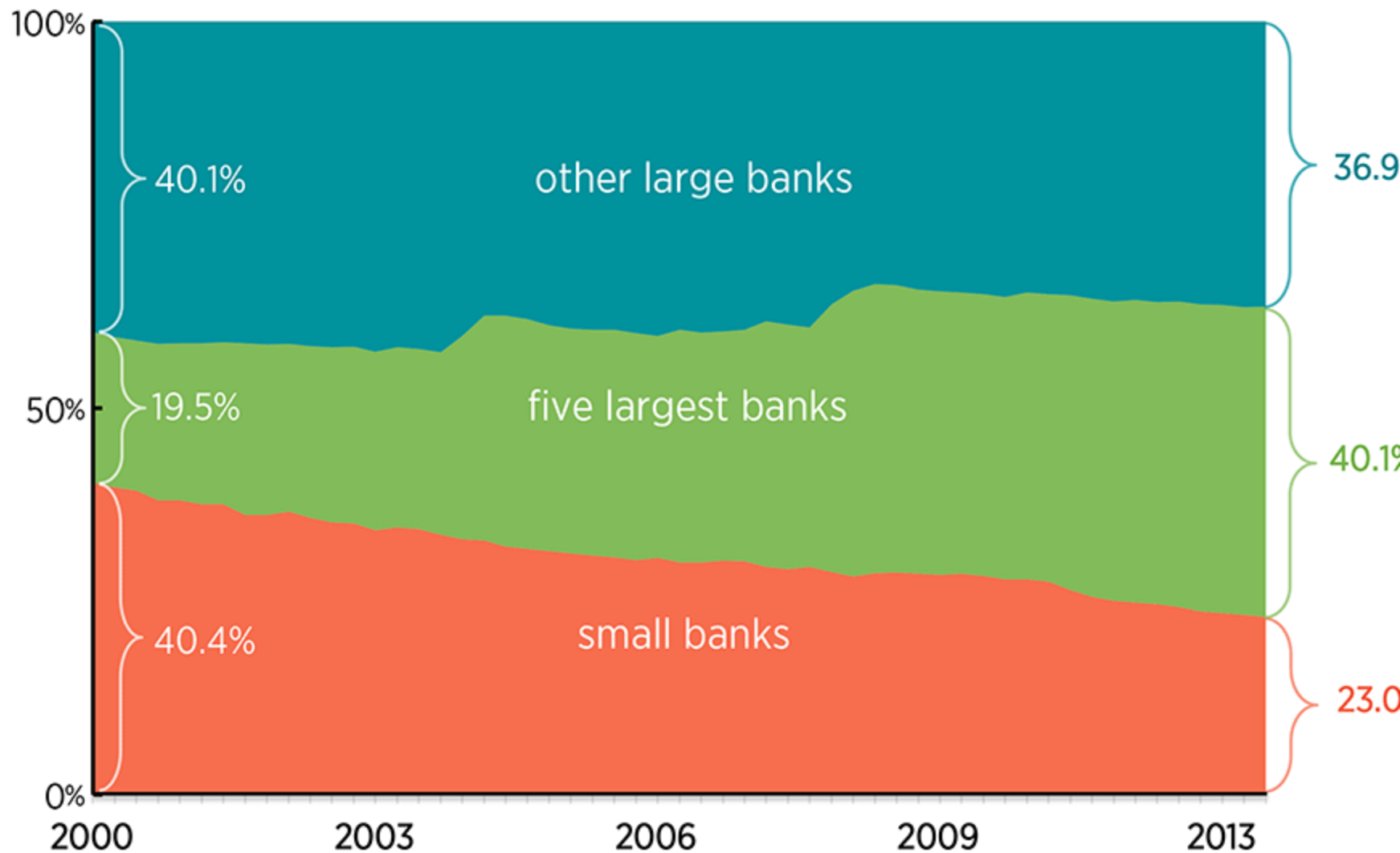
The ranks of small banks have been thinning

**Figure 1. Number of Banks with \$10 Billion or Less in Assets
(Quarterly Data, 1993–2013)**



Source: Statistics on Depository Institutions, Federal Deposit Insurance Corporation.
Data notes: Bank holding companies were used to group organizations. Thrift holding companies were not used to group organizations, because complete data on thrift holding companies was not available.

Share of Total Domestic Deposits Held by Small Banks vs. Large Banks, 2000-2013



Source: *Statistics on Depository Institutions*, Federal Deposit Insurance Corporation
Data note: Banks are ranked by asset size. Small banks are defined as US banks with \$10 billion or less in assets.
For purposes of this chart, banks were aggregated under their bank holding companies.
Available data did not permit thrifts to be aggregated under their holding companies.
Produced by by Hester Peirce, Robert Greene, and Rizqi Rachmat, Mercatus Center at George Mason University

Important Role of Small Banks

- They fill an important niche for customers who like more personalized service.
- They are not model-bound as the bigger banks of necessity are.
- They are important small business lenders.
- They are important in rural areas.

“Amid the 500 some banks that have failed since 2007, the highest rates of failure were observed among non-community banks and among community banks that departed from the traditional model and tried to grow faster with risky assets often funded by volatile brokered deposits.”

Examining the State of Small Depository Institutions, Hearing Before the Senate Committee on Banking, Housing & Urban Affairs (Sept. 16, 2014) (testimony of Doreen Eberley, Director of Risk Management Supervision Federal Deposit Insurance Corporation), *available at* http://www.banking.senate.gov/public/index.cfm?FuseAction=Files.View&FileStore_id=b25e599c-3f16-4f5e-bb27-ac38c5d7203b.



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Why we did the survey?

- Dodd-Frank's proponents acknowledged that small banks serve an important role in the bank landscape.
- Yet Dodd-Frank seems to be having a trickle-down effect on small banks. We wanted to understand why.
- The marginal costs of Dodd-Frank might hasten the trend of small banks losing ground to big banks.
- When we did the survey, there was little empirical work on community banks' regulatory costs, particularly work specifically focused on Dodd-Frank.

Relevant Provisions of Dodd-Frank

Title I

Risk Committees
SIFIs
Capital

Title III

OTS
Deposit Insurance

Title VI

Interstate branching
Volcker Rule
Commercial interest-bearing checking

Title VII

New rules for OTC derivatives markets
Position limits



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Relevant Provisions of Dodd-Frank

Title IX

Municipal Advisors
**Qualified Residential Mortgages/
Risk Retention**
Executive compensation
Incentive Pay
Internal Control Audit Relief

Title X

CFPB
Mortgage Disclosure
**Small business/mortgage data
collection**
Durbin Amendment
Remittances

Title XIV

Ability to Repay/Qualified Mortgage
Mortgage Origination & Servicing
Appraisals
Escrow Accounts



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Survey Results

Overview of What We Found

- Compliance costs are going up.
- Small banks are particularly concerned about the mortgage rules and the CFPB.
- Banks are considering cuts to products and services and consolidation.
- Banks expect consumers not to benefit from Dodd-Frank.



Small Bank Survey

For the results of the Small Bank Survey, see "[How Are Small Banks Faring Under Dodd-Frank?](#)"

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The Mercatus Center at George Mason University is a not-for-profit research center dedicated to bridging the gap between academic research and public policy challenges. This survey looks at banks with \$10 billion or less in assets to determine how Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) affects them and their customers. Findings from this research will be used to communicate with policymakers, regulators, and the general public about the effects that the Dodd-Frank Act is having on small banks and the potential economic and competitive implications.

The survey touches on a range of topics related to regulatory developments and banks' responses to those developments, including changes in product and service offerings and effects on strategic planning and staffing. Although the survey asks for information about your bank in order to better understand how different types of banks are being affected, the survey is completely anonymous.

Your participation would be greatly appreciated. The survey should take approximately 15-45 minutes of the time of a bank officer or employee who is broadly knowledgeable about your bank.

You can access a PDF copy of the survey questions [here](#).

Please note:

- All references to "your bank" refer to the bank, thrift, or banking entity for which you work, including all its branches.
- All questions are optional.
- When precise information is not readily available to answer a question, an estimate is sufficient.
- This survey is intended to be anonymous and confidential. Please do not include your name or the name of your bank. When we report the results of the survey, your answers generally will be aggregated with answers from other respondents. Although we might quote from your narrative responses for illustrative purposes, we will not reproduce any quotes that could lead to the identification of your bank.
- *Once you begin you will not be able to save your answers and return to complete the survey at a later time; however, your session will remain active as long as your browser window remains open.*
- *Use the "Continue" and "Previous" buttons at the bottom of each survey page to navigate between pages. If you use your internet browser's "Forward" and "Back" buttons all completed responses will be lost.*

Contact

Hester Peirce, Senior Research Fellow at the Mercatus Center at George Mason University and a co-investigator conducting this research, may be reached at: SmallBankSurvey@mercatus.gmu.edu

Informed Consent

Your bank's participation in this survey is voluntary. There are no risks associated with the survey and no direct benefits. Your bank's participation will help to advance research on the effects of the Dodd-Frank Act and help to inform future policy recommendations.



Survey Design

- 96 questions
- July-September 2013
- Pre-survey, telephonic focus groups
- Link to survey distributed by e-mail
 - through certain national and state banking associations
 - mass mailings from self-generated email lists
- Completed by knowledgeable bank employee
- Anonymous respondents



Categories Covered in Survey

- 1. Bank Characteristics, Products and Services**
- 2. Regulatory and Compliance Activities, Capital, FDIC, Durbin Amendment, Municipal Advisors, Regulatory Oversight, Volcker Rule, Compensation**
- 3. Bureau of Consumer Financial Protection, Mortgages, Derivatives, Fees and Revenue**
- 4. Strategy, Credit Ratings, Other Issues**

Survey section	Number of respondents (N)
1	222
2	190
3	172
4	162
Mean	187



The map displays the following distribution:

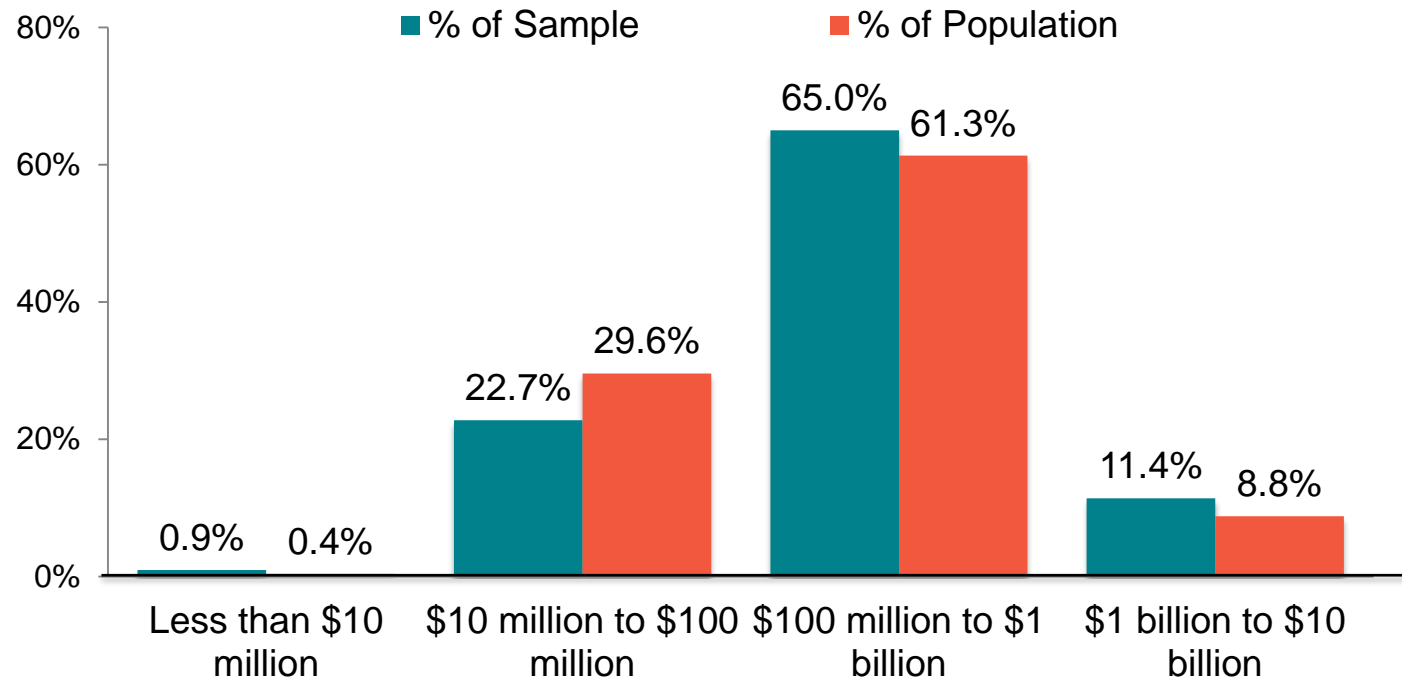
- States in which participating banks have their headquarters (Orange):** California, Oregon, Washington, Idaho, Utah, Arizona, Nevada, Montana, Wyoming, Colorado, New Mexico, Texas, Oklahoma, Kansas, Nebraska, South Dakota, North Dakota, Minnesota, Iowa, Missouri, Arkansas, Louisiana, Mississippi, Alabama, Georgia, Florida, South Carolina, North Carolina, Virginia, West Virginia, Kentucky, Tennessee, Indiana, Michigan, Wisconsin, Illinois, Ohio, Pennsylvania, Maryland, Delaware, New Jersey, Connecticut, Rhode Island, Massachusetts, Vermont, New Hampshire, Maine.
- States in which no participating banks have headquarters (Gray):** Alaska, Hawaii, Nevada, Arizona, New Mexico, Texas, Oklahoma, Kansas, Nebraska, South Dakota, North Dakota, Minnesota, Iowa, Missouri, Arkansas, Louisiana, Mississippi, Alabama, Georgia, Florida, South Carolina, North Carolina, Virginia, West Virginia, Kentucky, Tennessee, Indiana, Michigan, Wisconsin, Illinois, Ohio, Pennsylvania, Maryland, Delaware, New Jersey, Connecticut, Rhode Island, Massachusetts, Vermont, New Hampshire, Maine.

	Survey sample	Small bank population
Assets		
Mean	\$510,926,326	\$435,025,837
Median	\$221,000,000	\$173,405,000
FTE employees		
Mean	120	96
Median	52	41



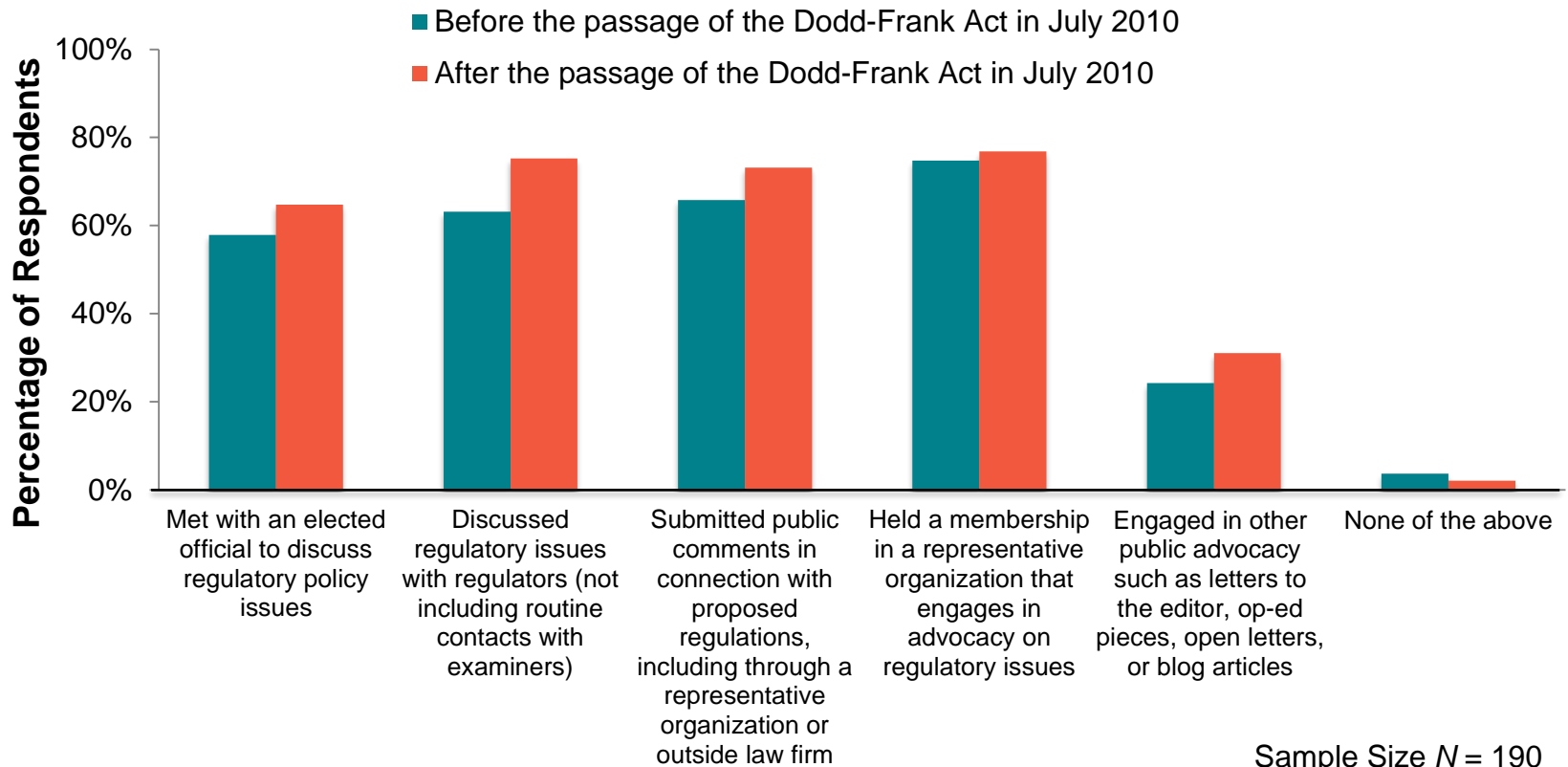
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Distribution of Survey Sample vs. Distribution of Small Bank Population

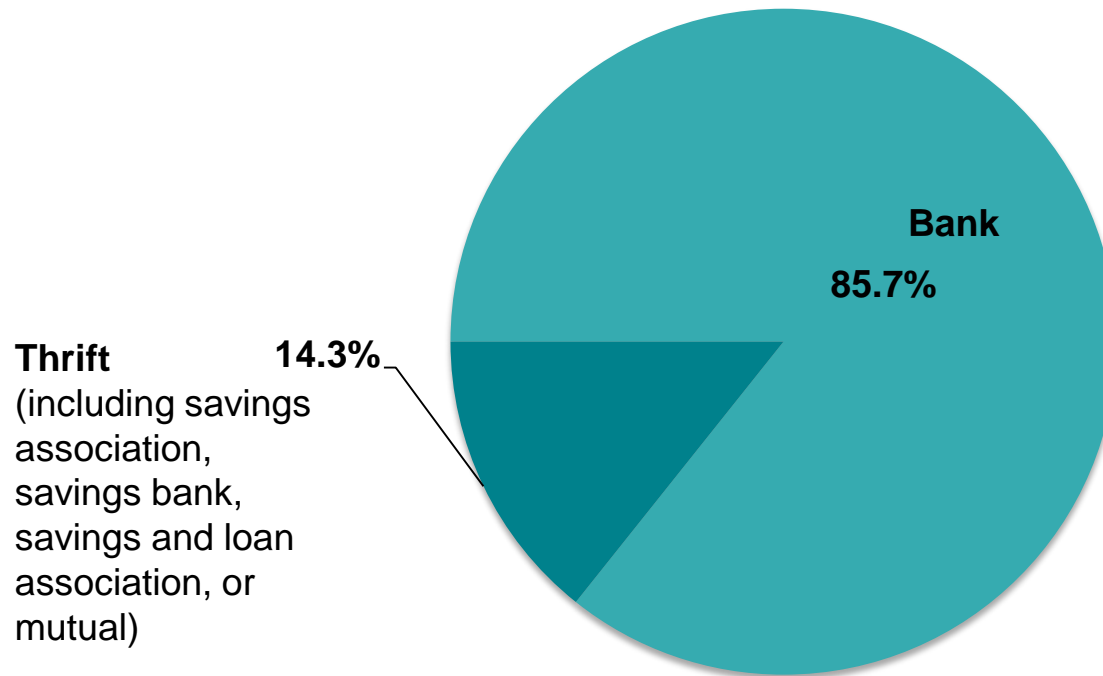


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Engagement in Advocacy Efforts

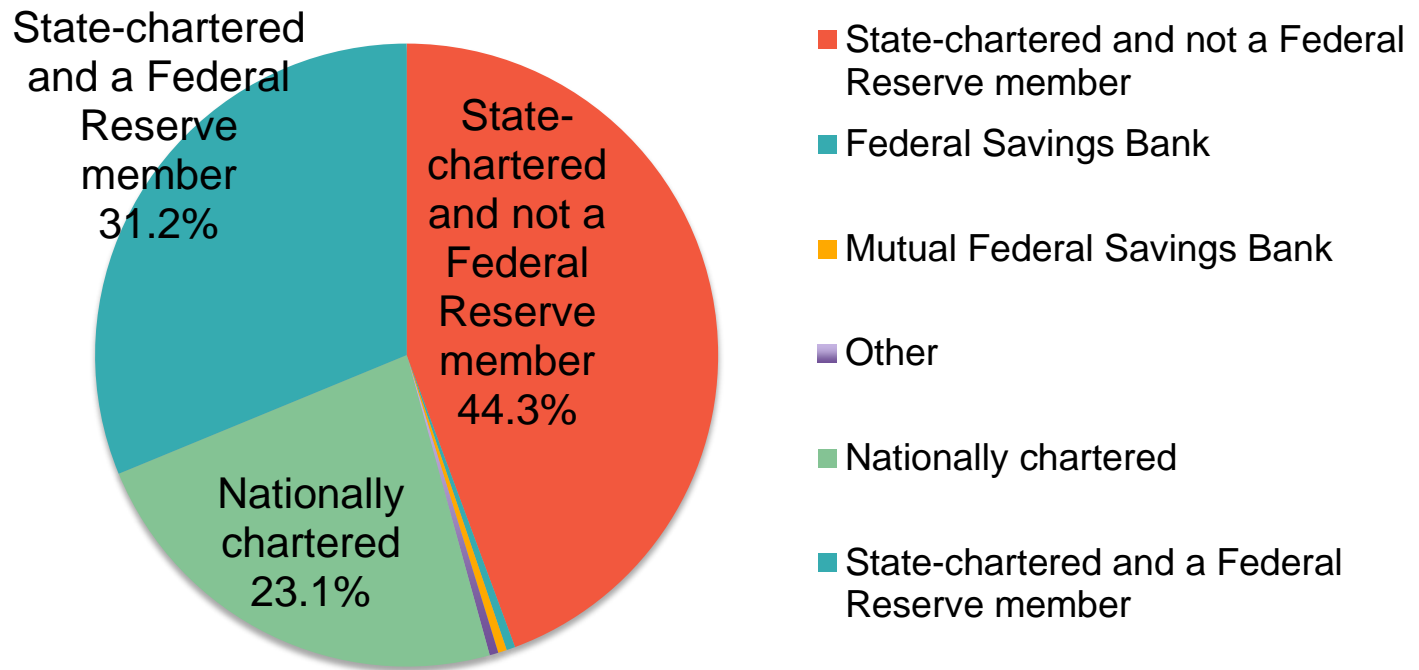


Charter Type



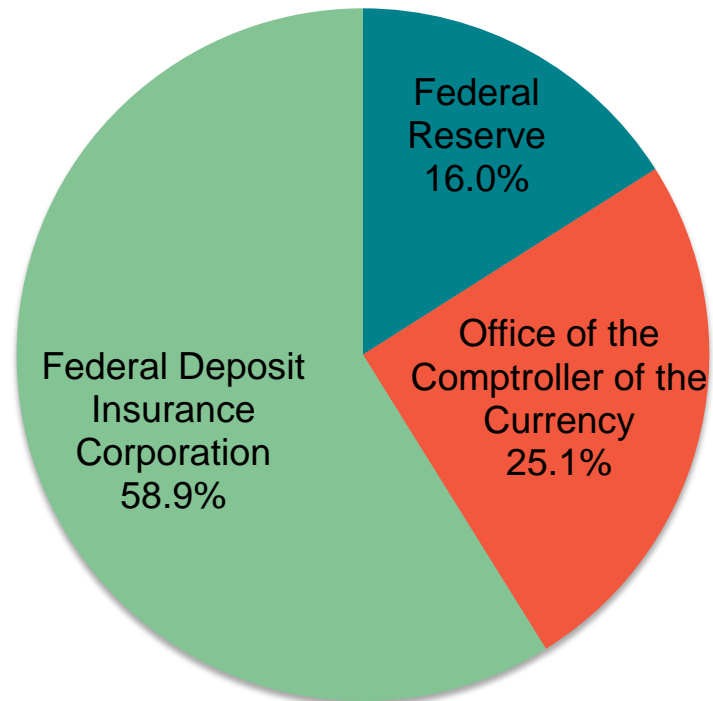
Sample Size $N = 222$ with 217 valid responses

Bank Type



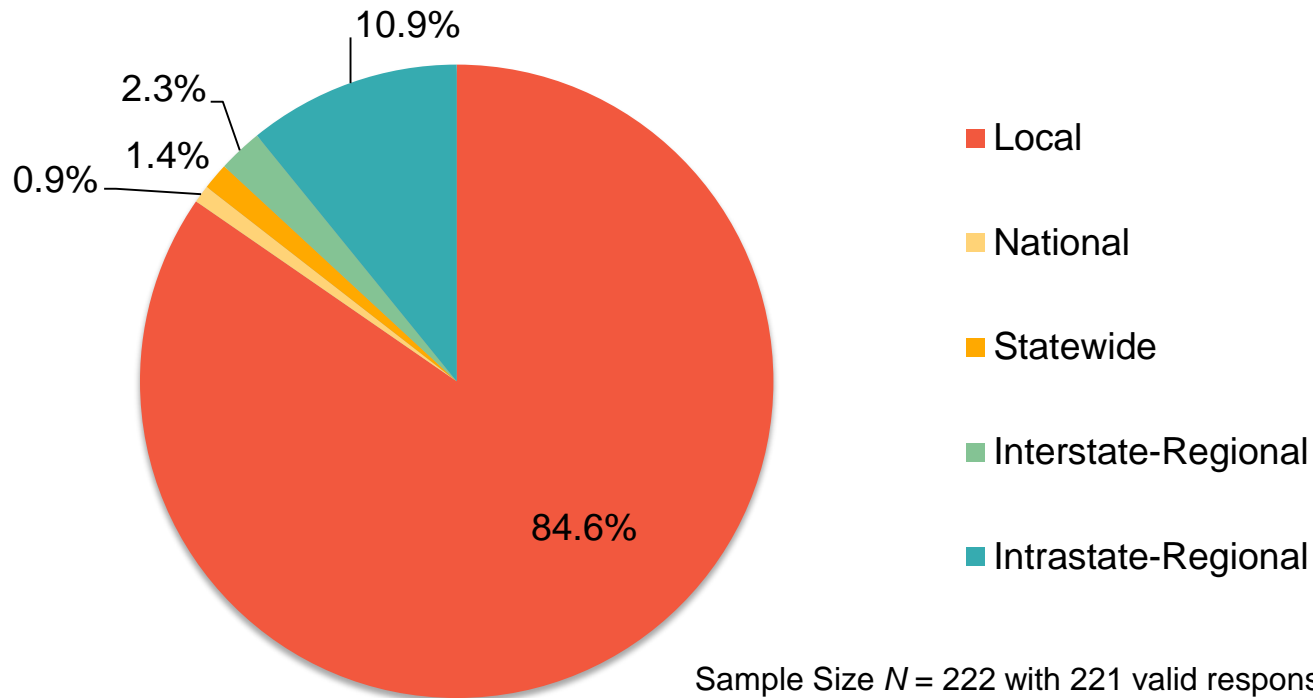
Sample Size $N = 222$ with 220 valid responses

Primary Federal Regulator

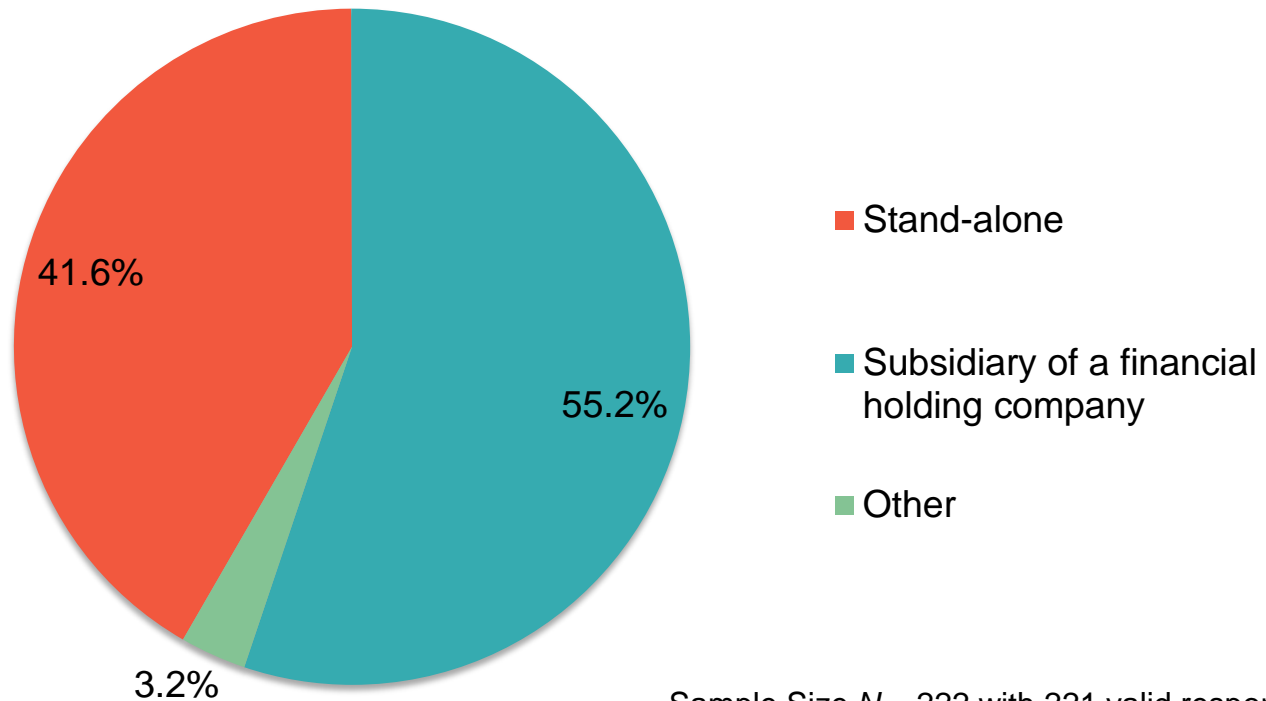


Sample size $N = 190$ with 175 valid responses

Which of the Following Best Describes Your Bank?

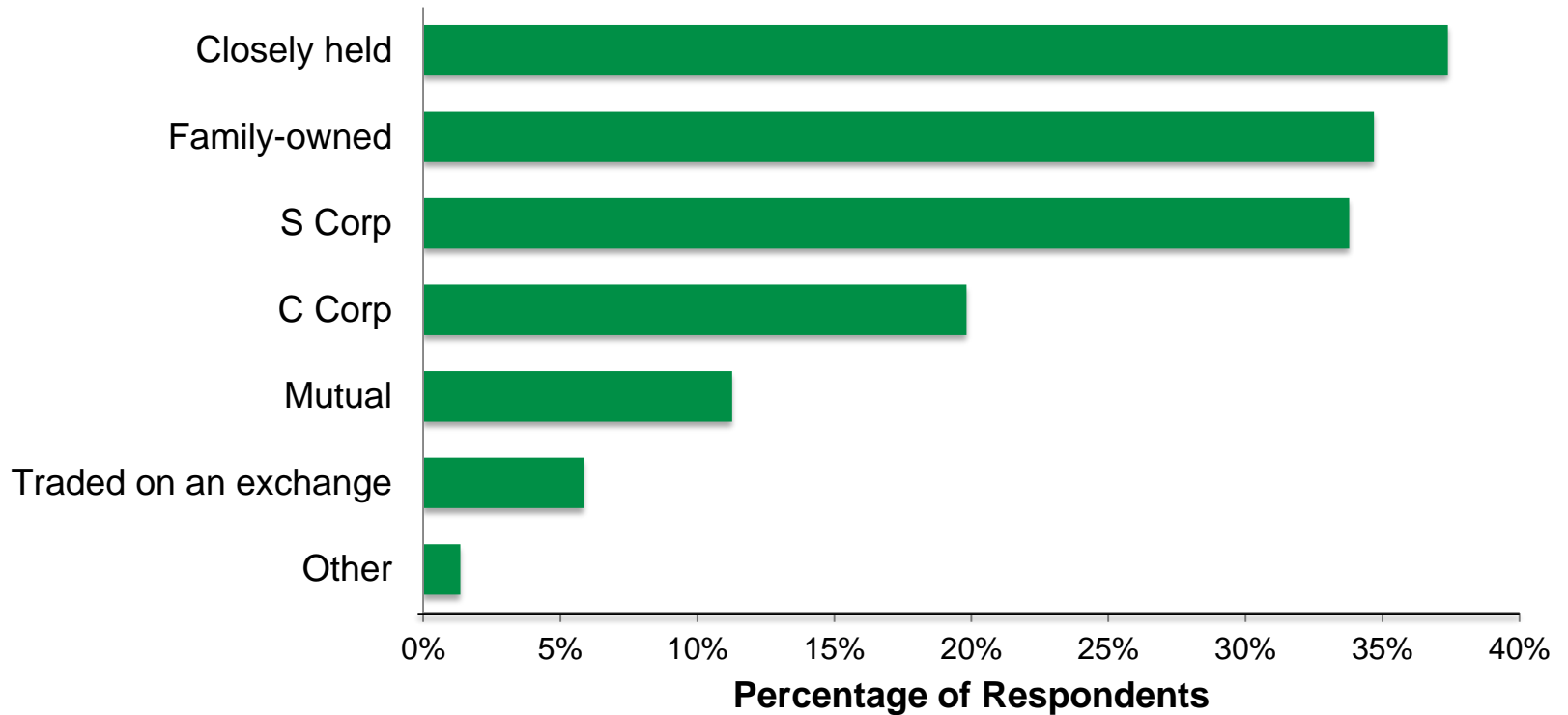


Organizational Structure



Sample Size $N = 222$ with 221 valid responses

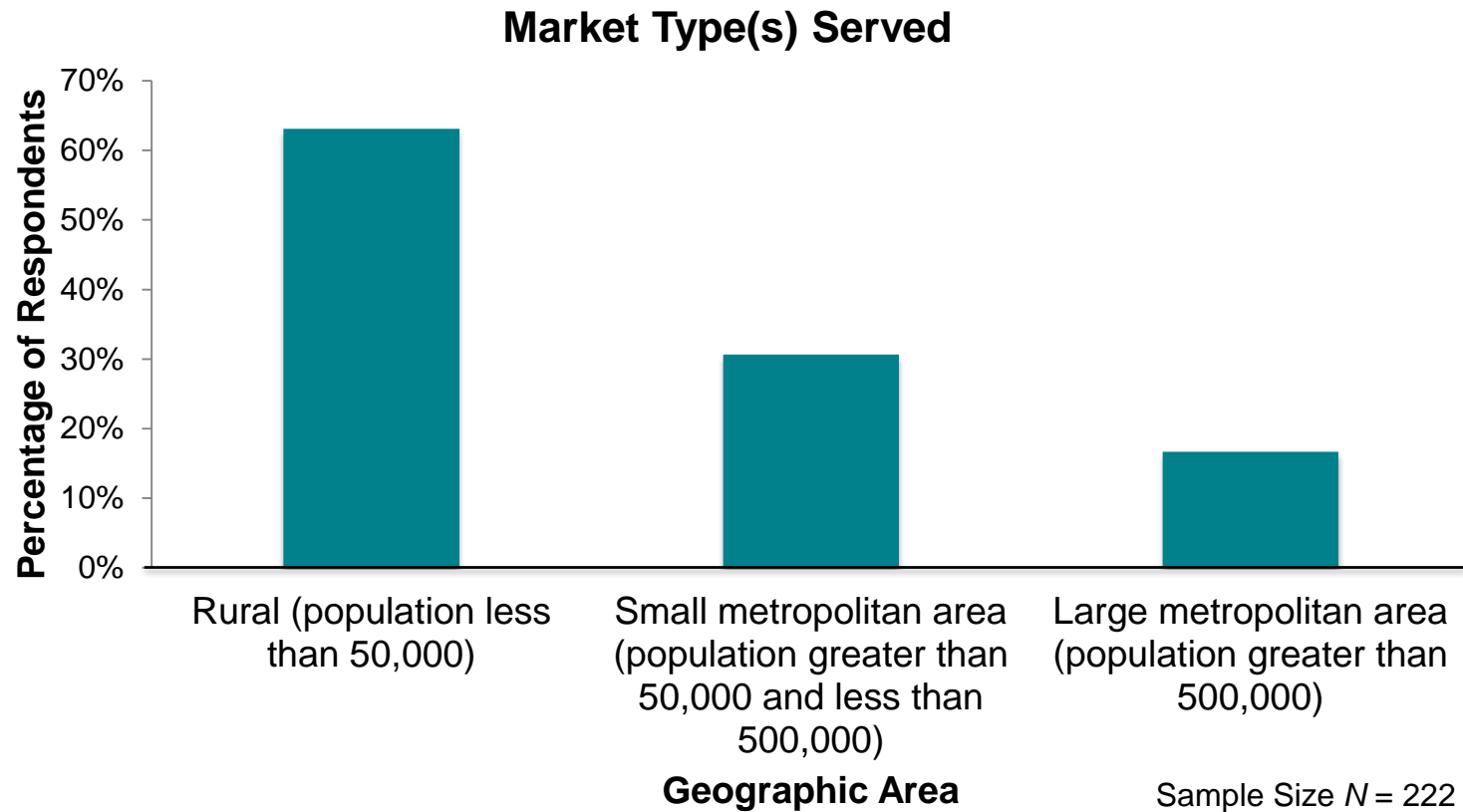
Ownership Description

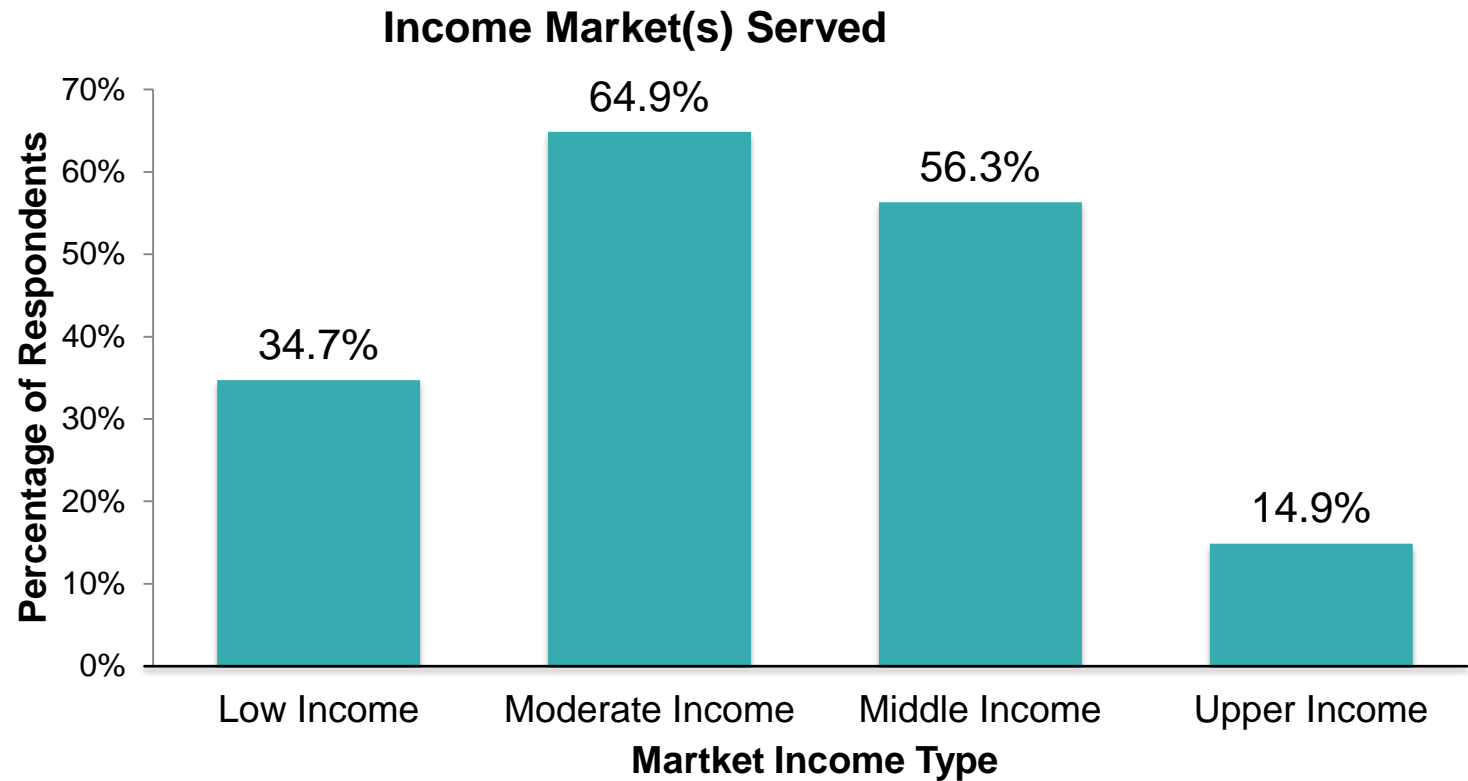


Sample Size $N = 222$



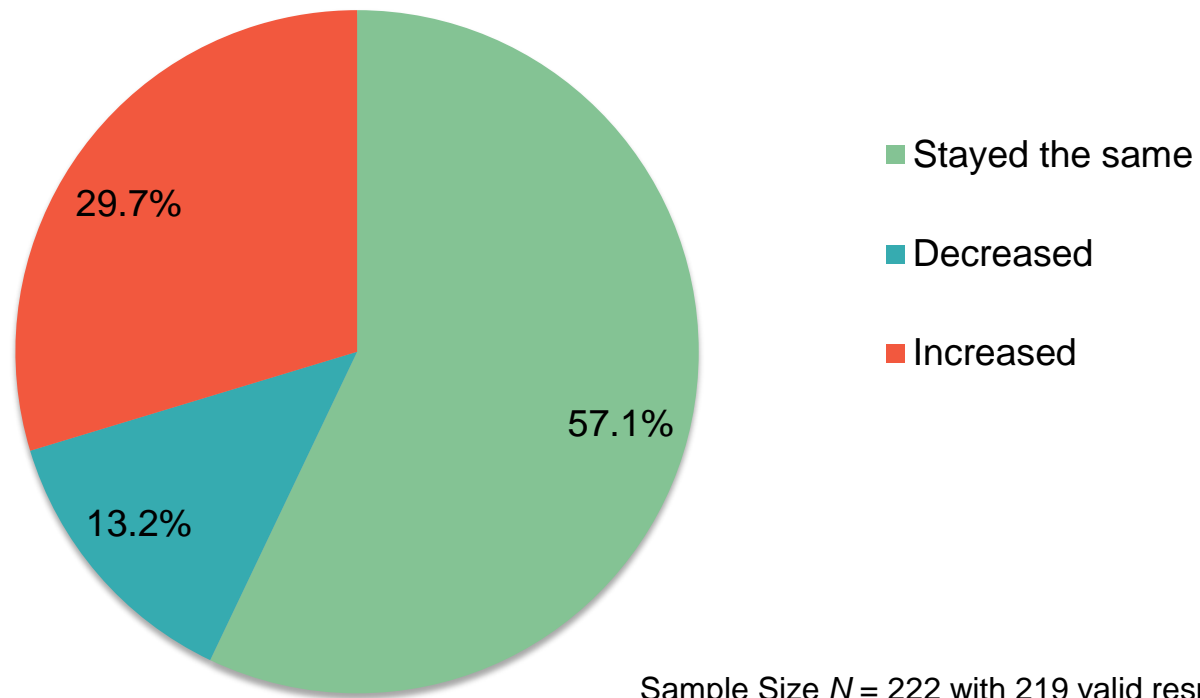
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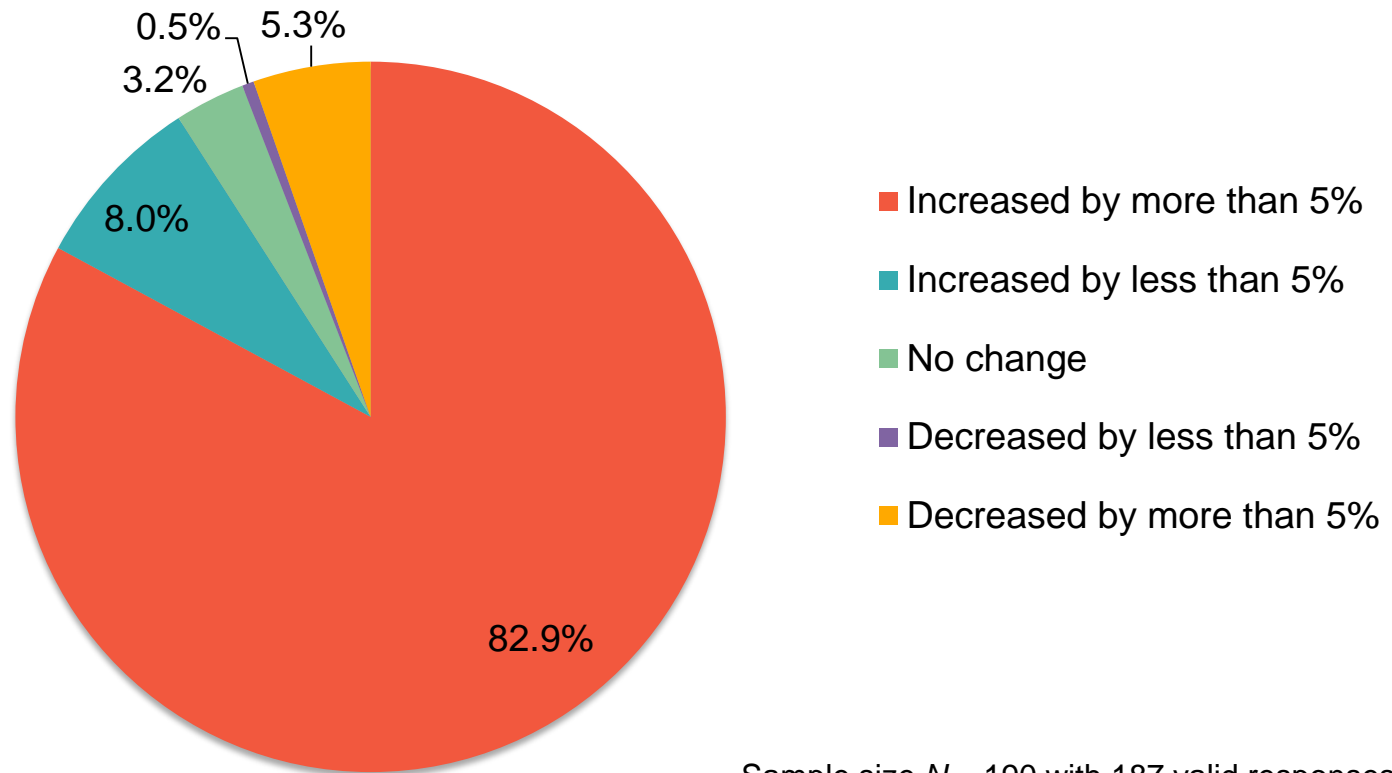
Sample Size $N = 222$

Changes in the Number of Branches Since 2008



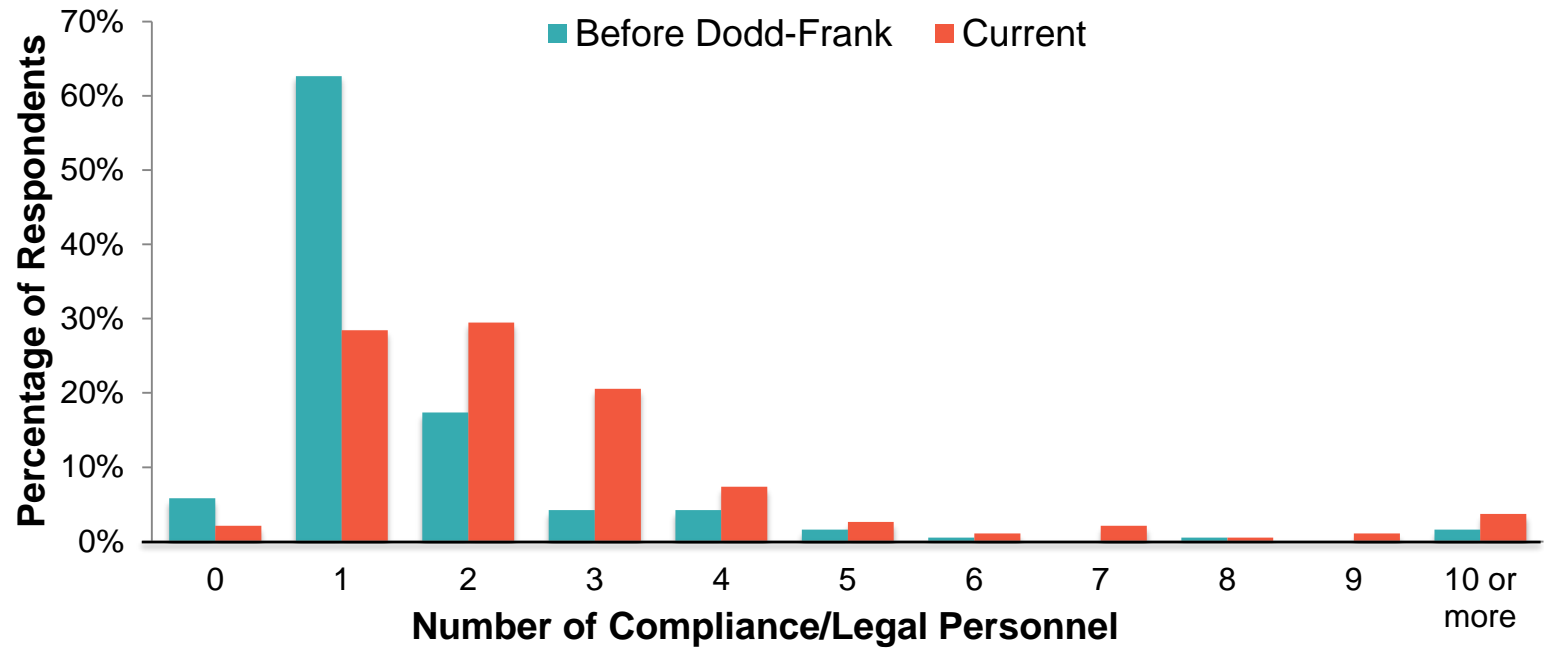
Sample Size $N = 222$ with 219 valid responses

Change in Annual Compliance Costs Since Dodd-Frank



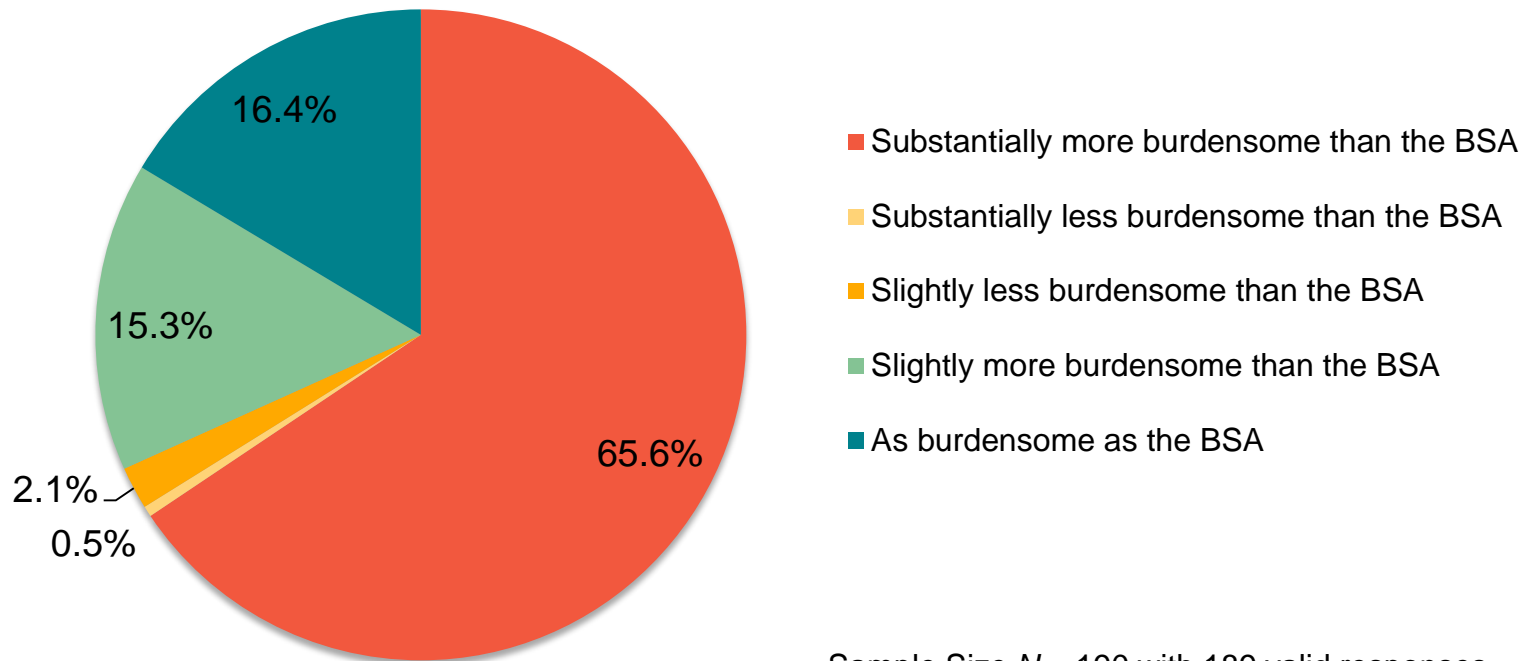
Sample size $N = 190$ with 187 valid responses

Histogram of Compliance/Legal Personnel



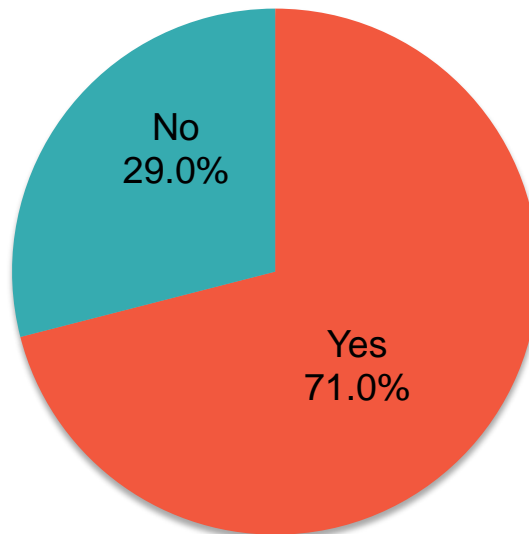
Sample Size $N = 190$

Dodd-Frank Compared to the Bank Secrecy Act (BSA)



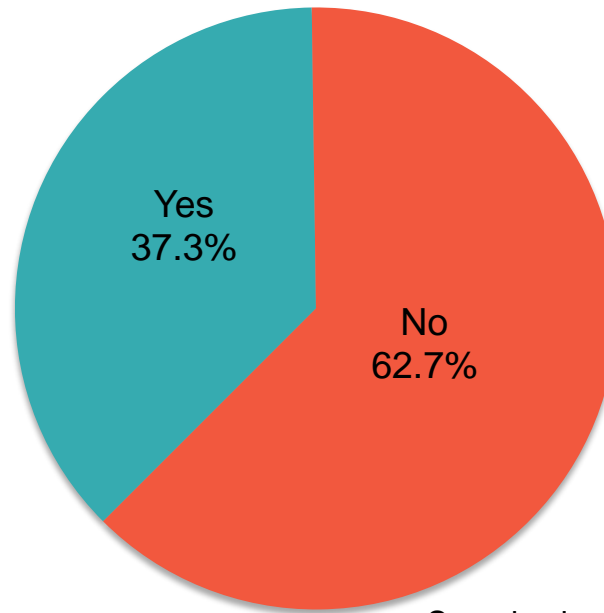
Sample Size $N = 190$ with 189 valid responses

Business Activities Affected by CFPB?



Sample Size $N = 172$ with 169 valid responses

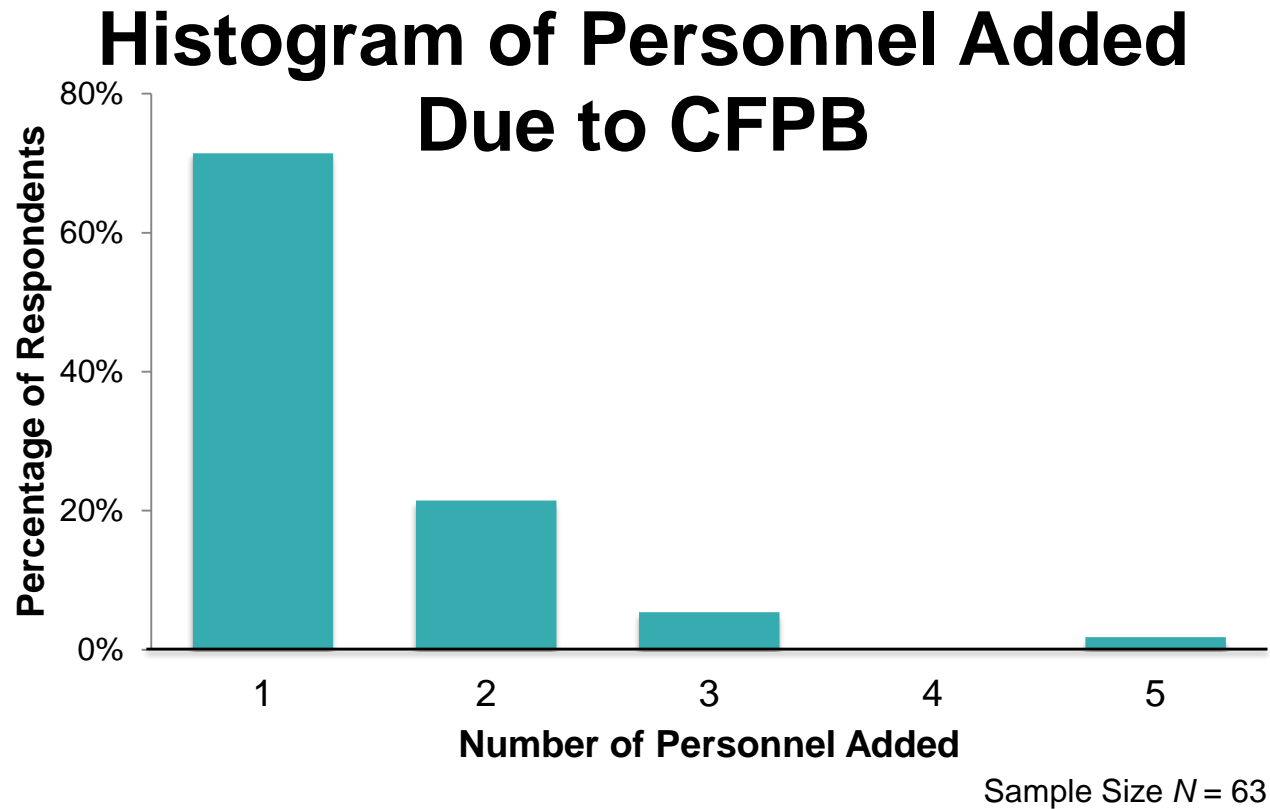
Compliance/Legal Staff Added Due to CFPB



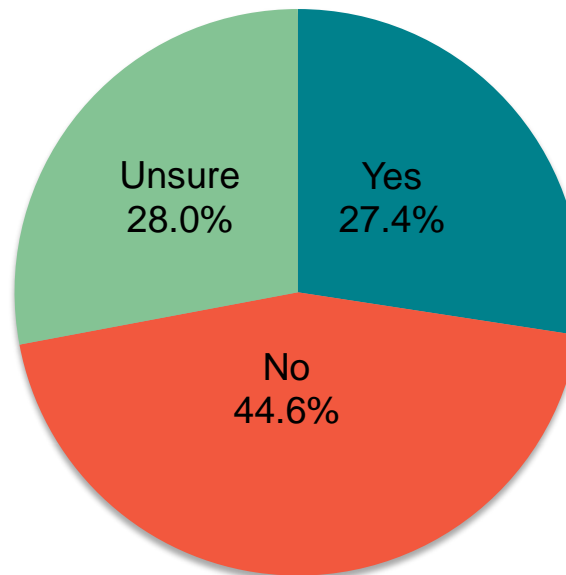
Sample size $N = 172$ with 169 valid responses



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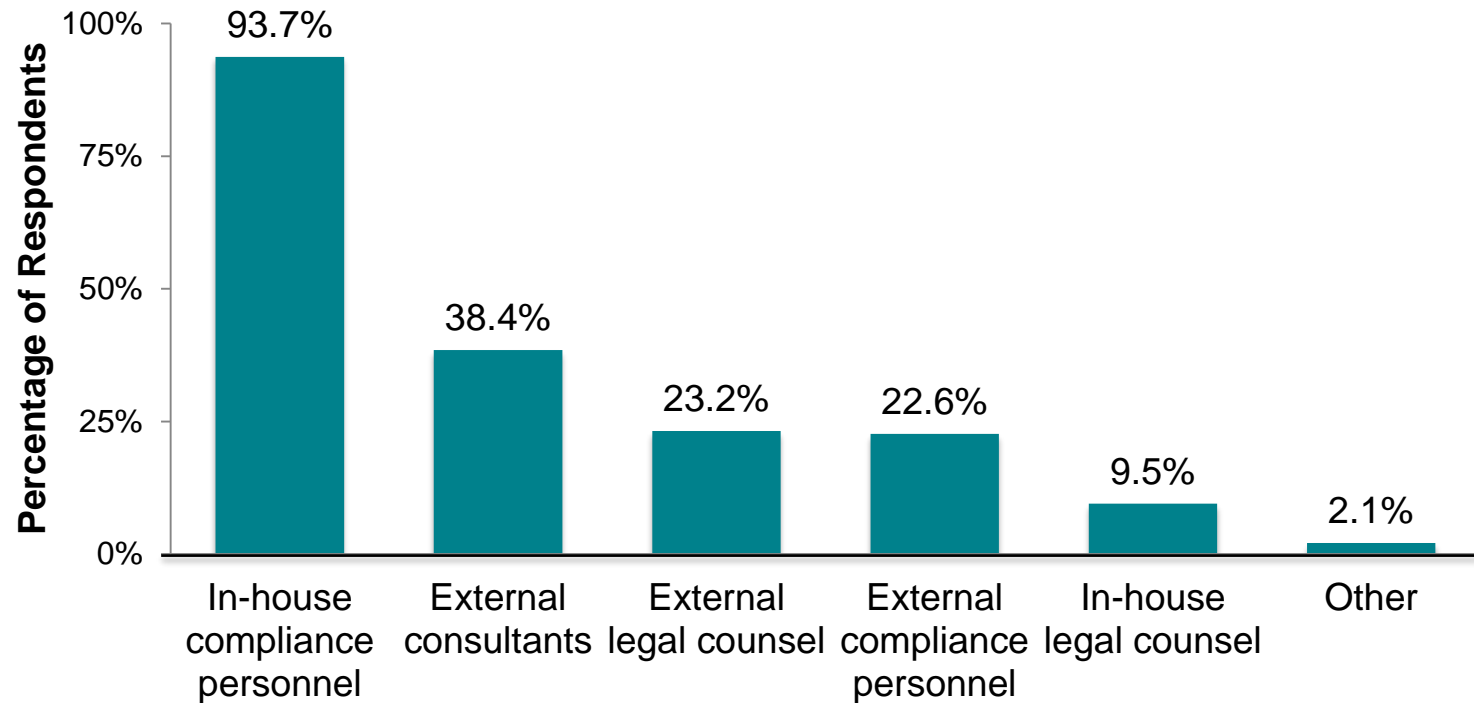


Hiring Additional Compliance Personnel in Next 12 Months



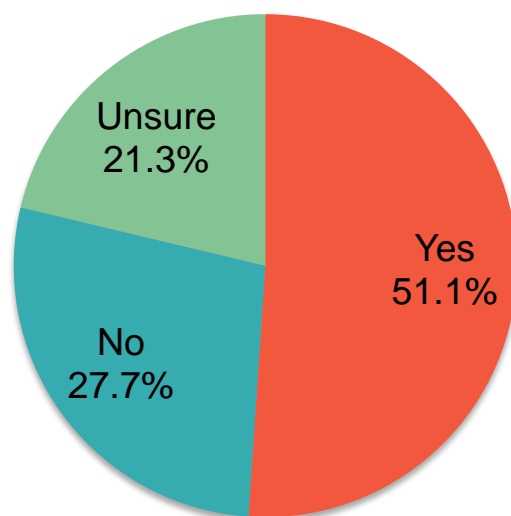
Sample Size $N = 190$ with 186 valid responses

Compliance Responsibility



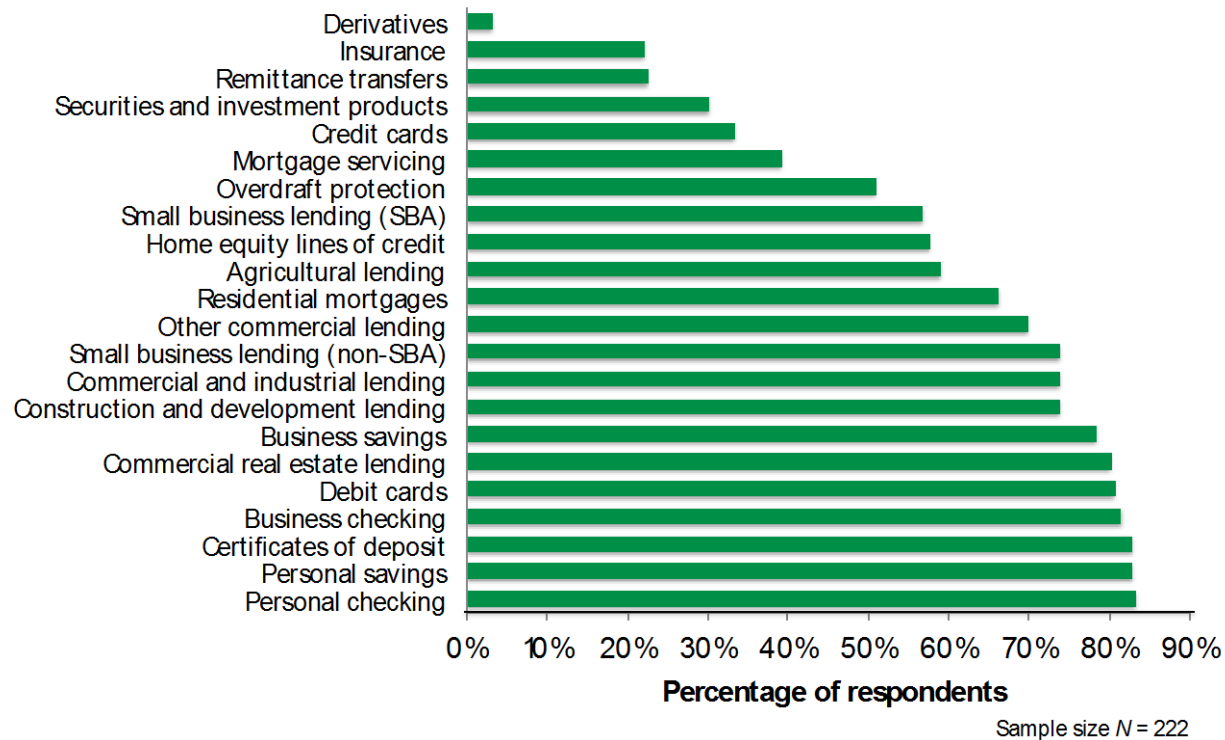
Sample Size $N = 190$

Anticipated Engagement with Outside Consultants for Dodd- Frank

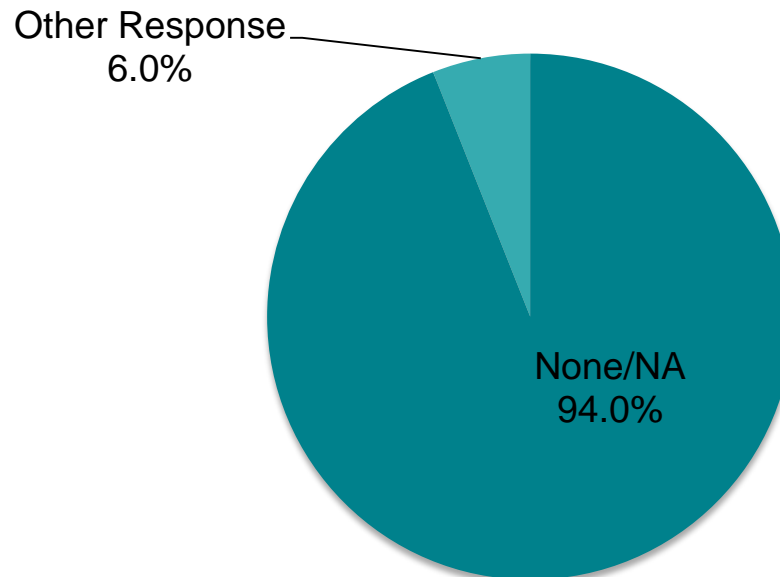


Sample Size $N = 190$ with 188 valid responses

Products and Services Offered

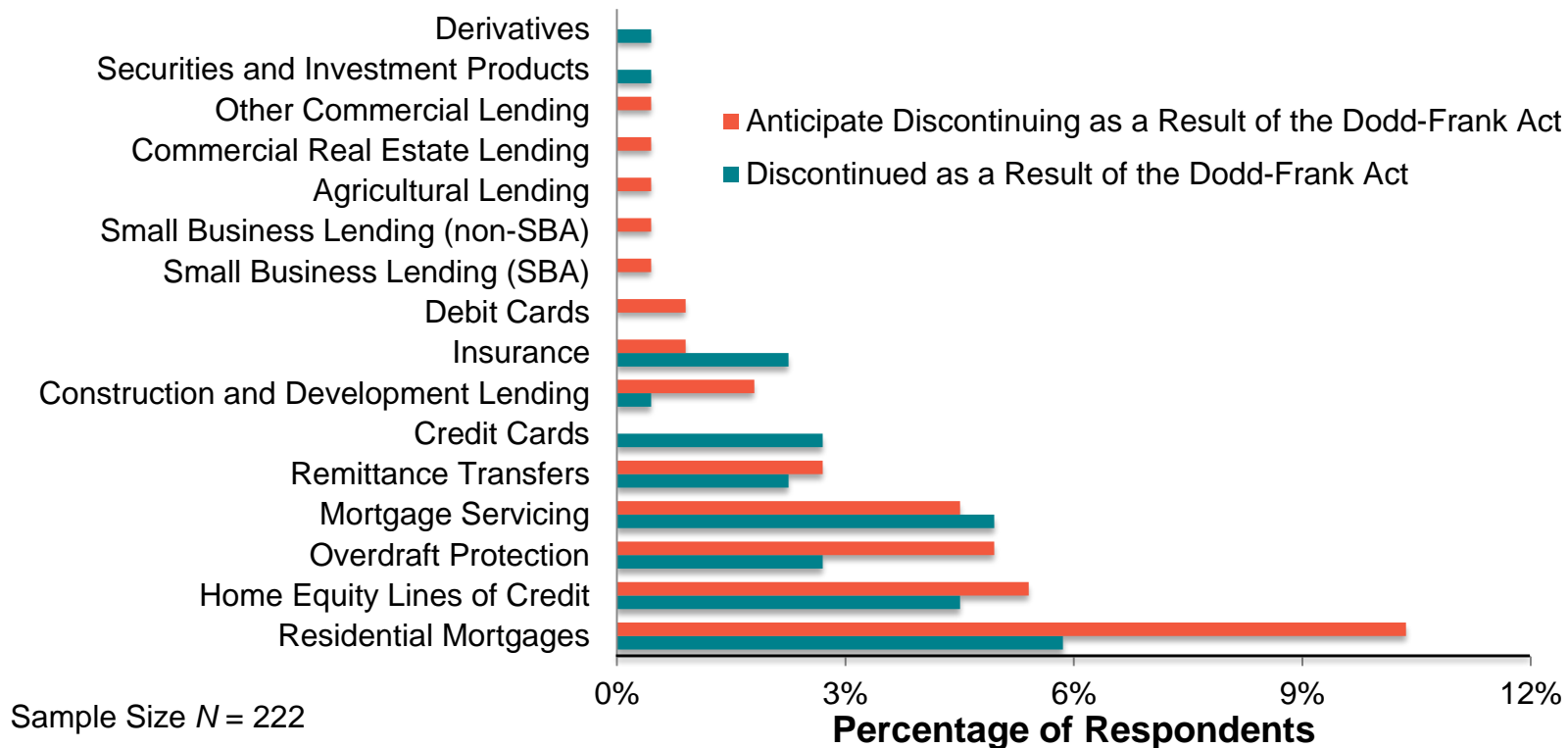


Products and Services Added in Response to Dodd-Frank

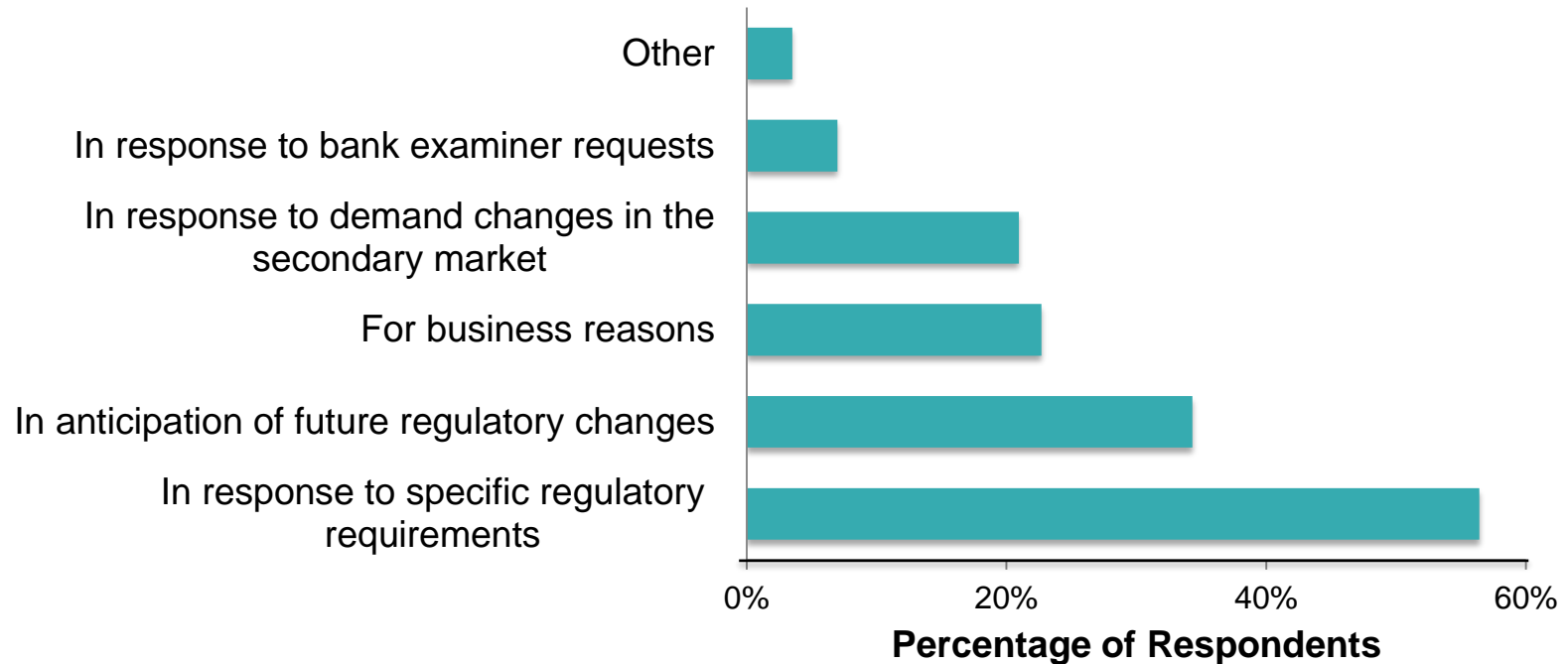


Sample Size $N = 222$ with 133 valid responses

Impact of Dodd-Frank on Products/Services Offered

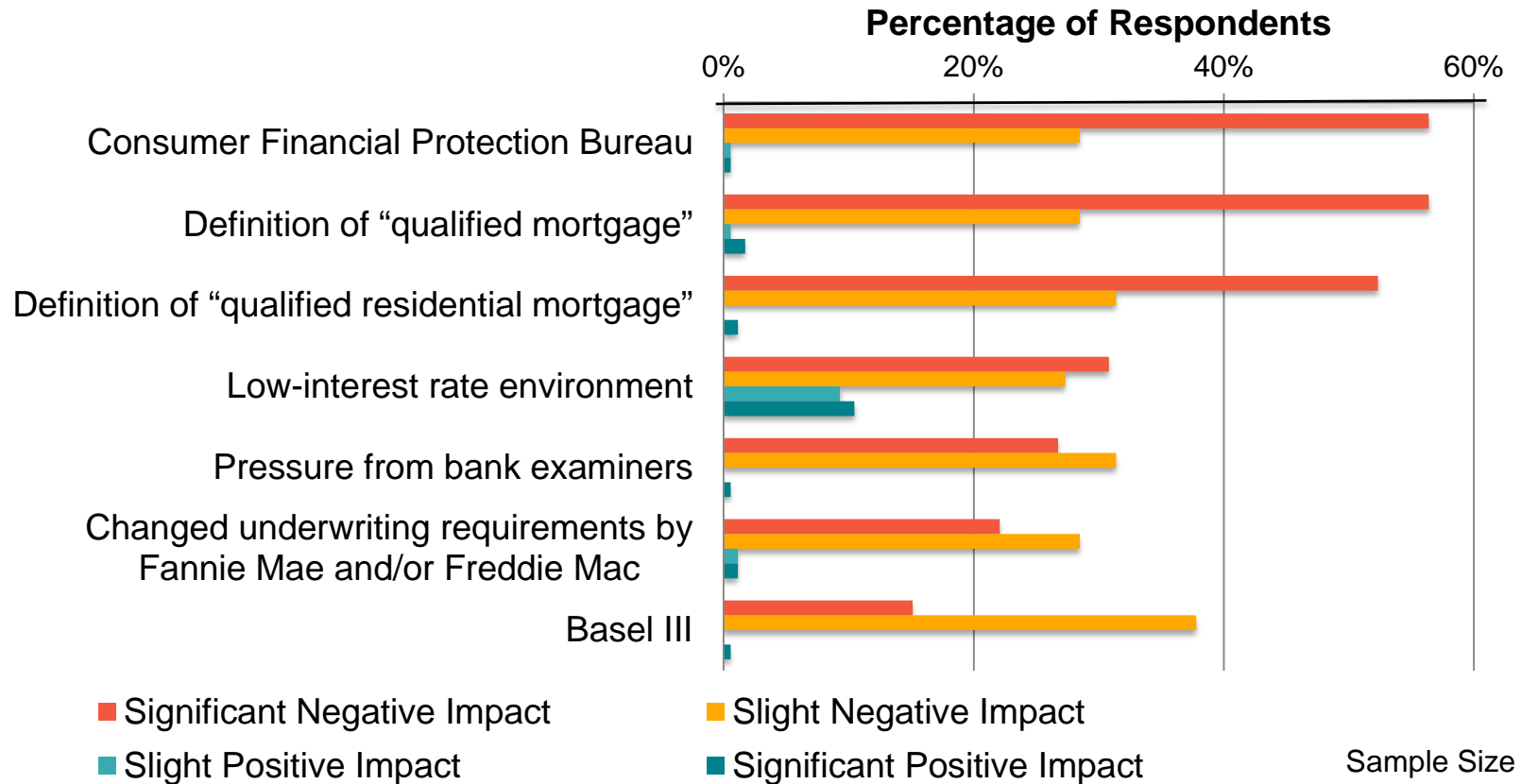


Reasons for Alterations to Mortgage Offerings



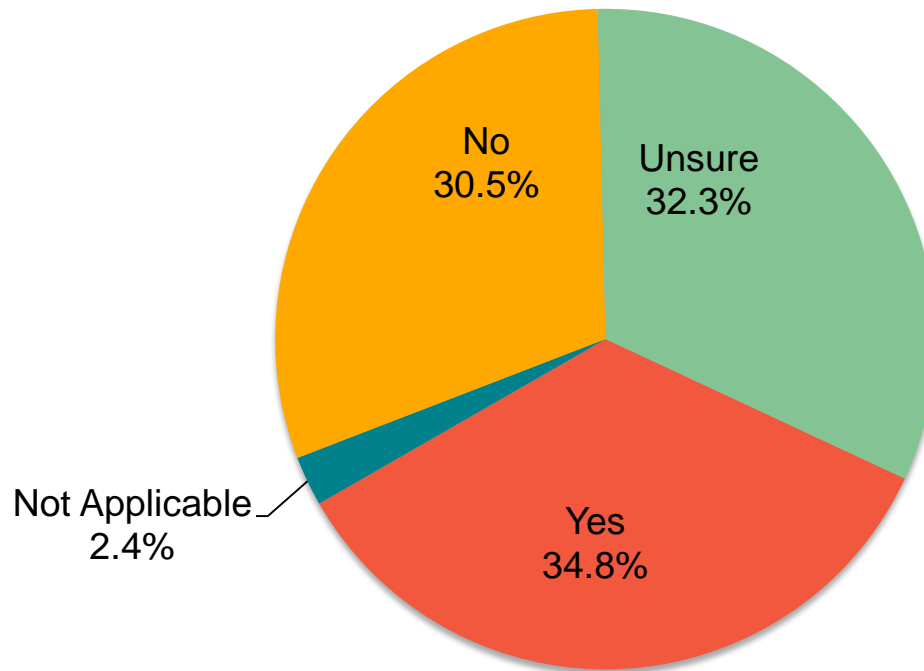
Sample Size $N = 172$

Effects on Mortgage Offerings



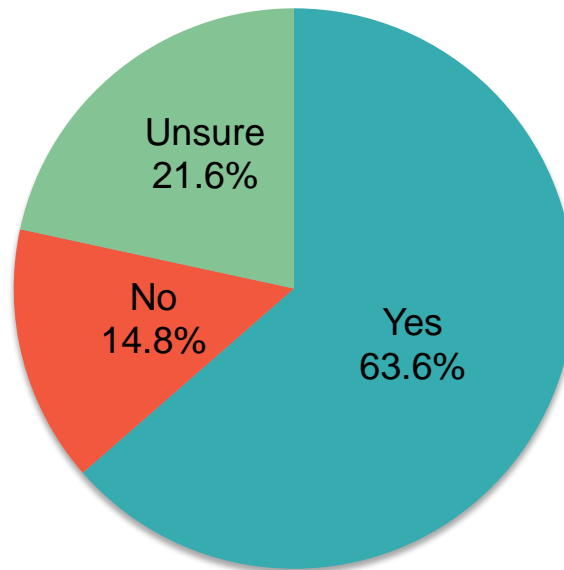
Sample Size
N = 172

Does Your Bank Anticipate that it Will Make Any Loans That Do Not Meet the Definition of a “Qualified Mortgage”?



Sample Size $N = 172$ with 164 valid responses

Anticipate Changes to the Nature, Mix, and Volume of Mortgage Products in Response to Regulatory Changes

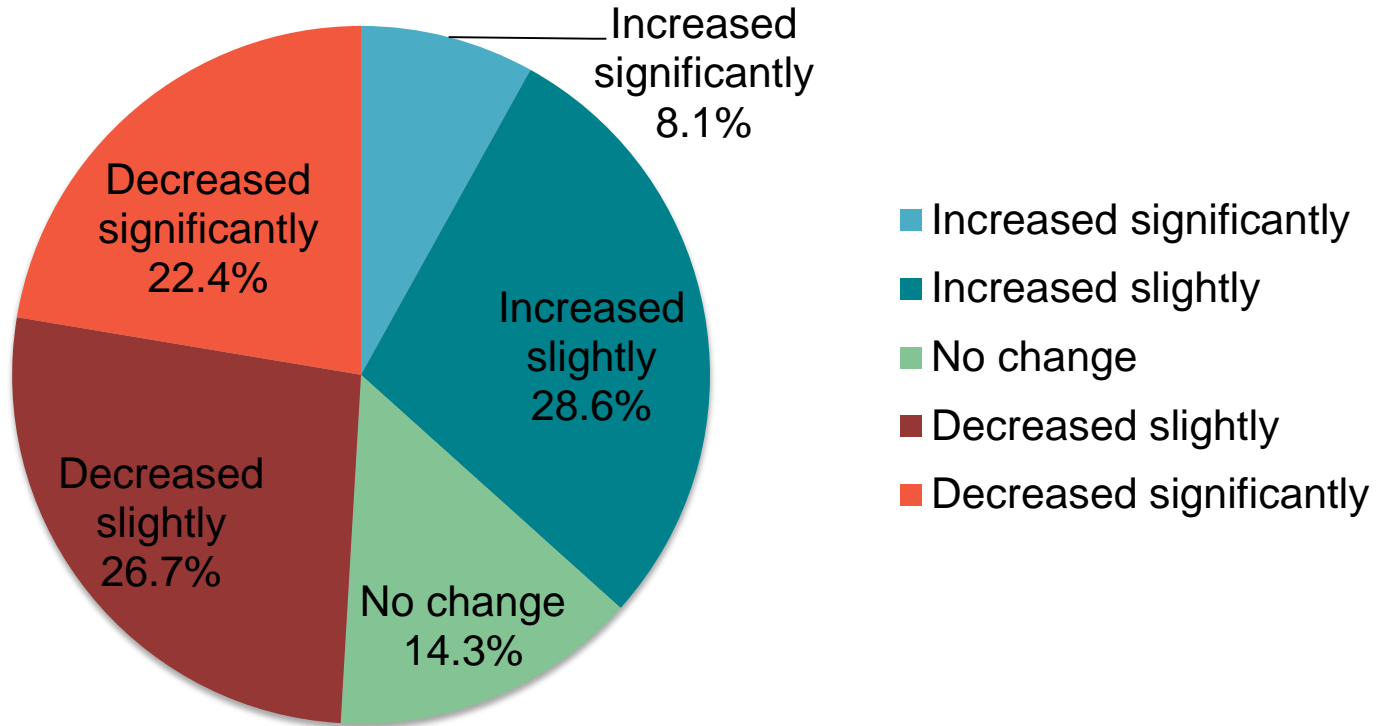


Sample size $N = 172$ with 162 valid responses



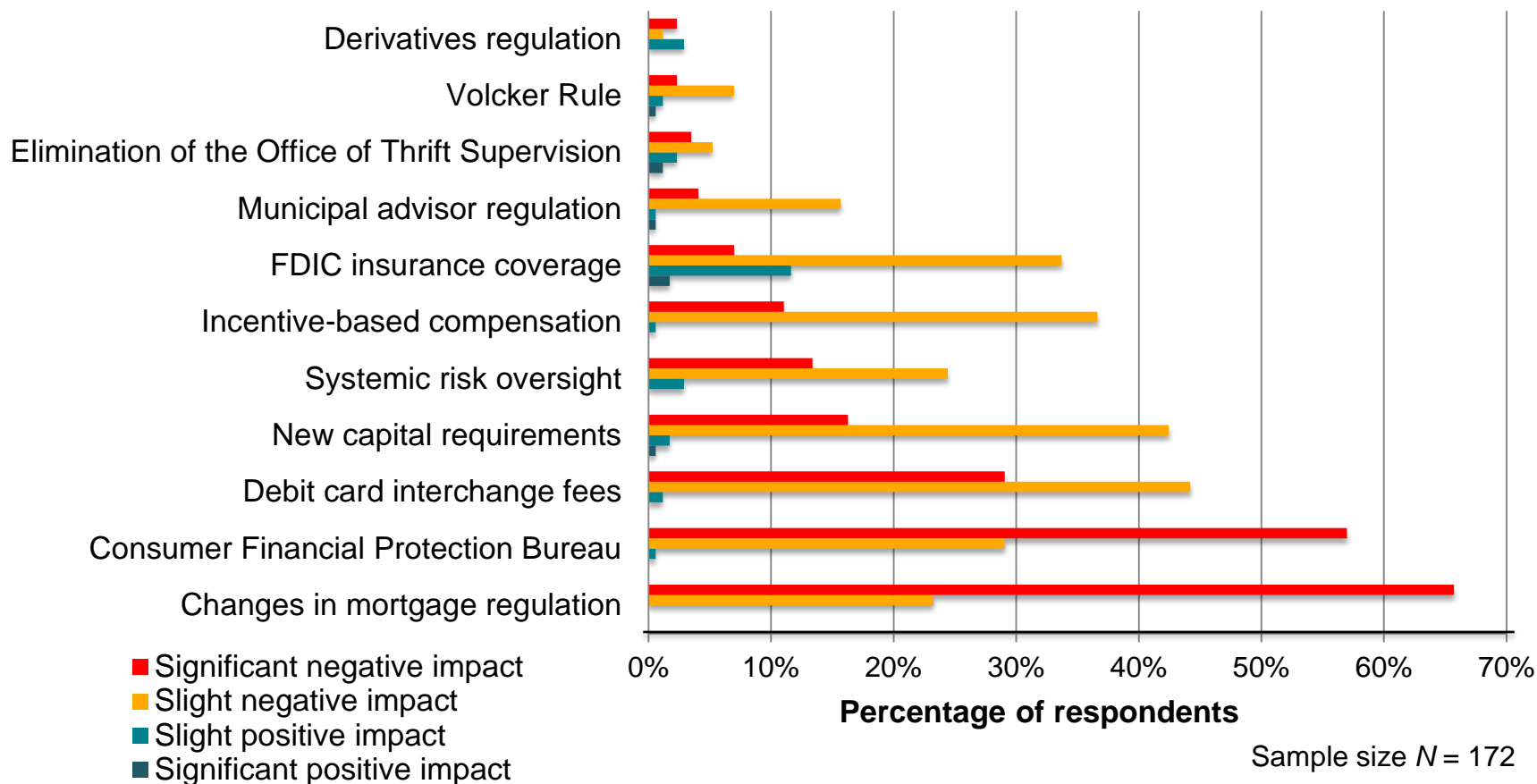
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Change in Return on Equity since July 2010

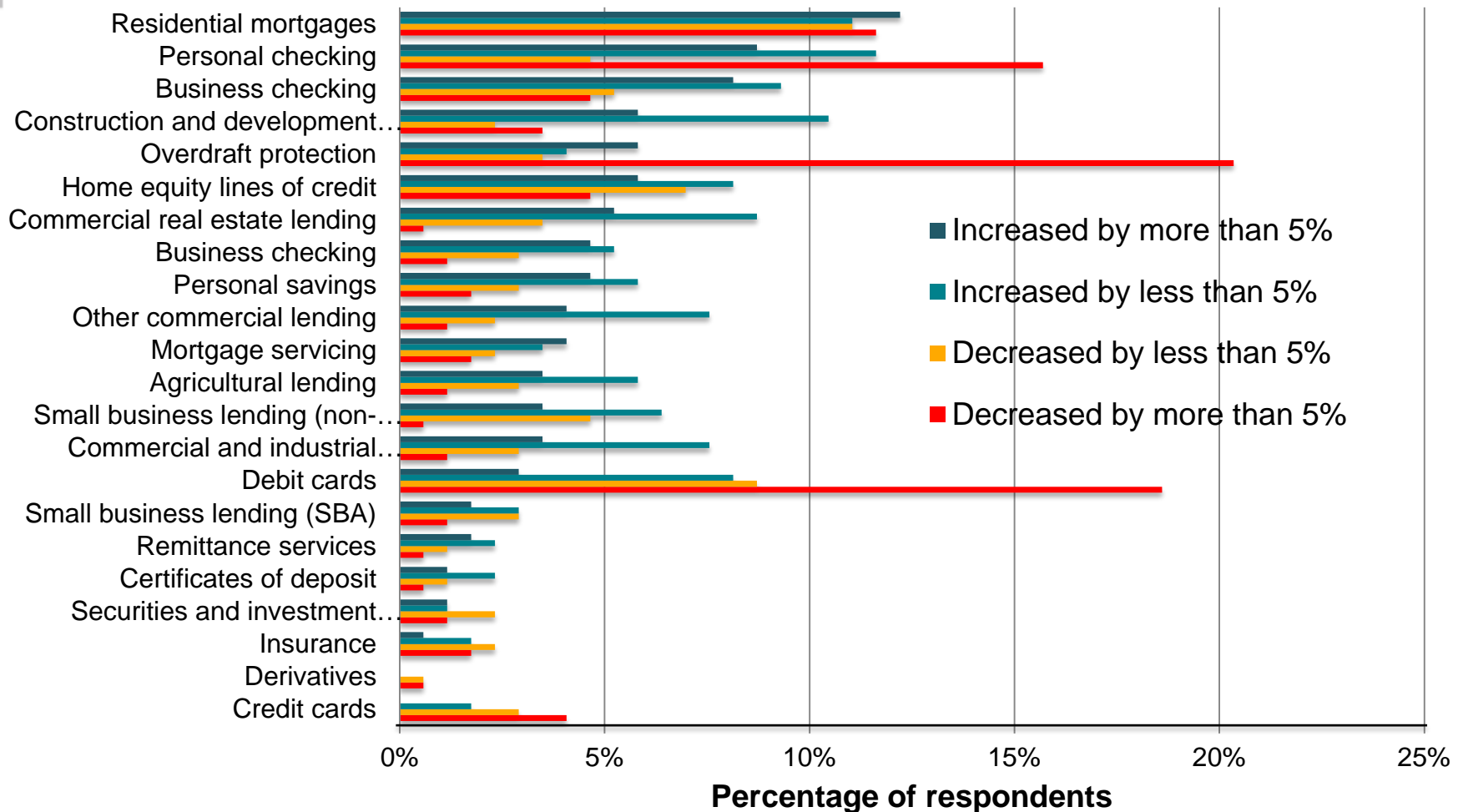


Sample size $N = 172$ with 161 valid responses

Impact of Policy on Bank Earnings



Effects of Dodd-Frank on Fees of Product/Service



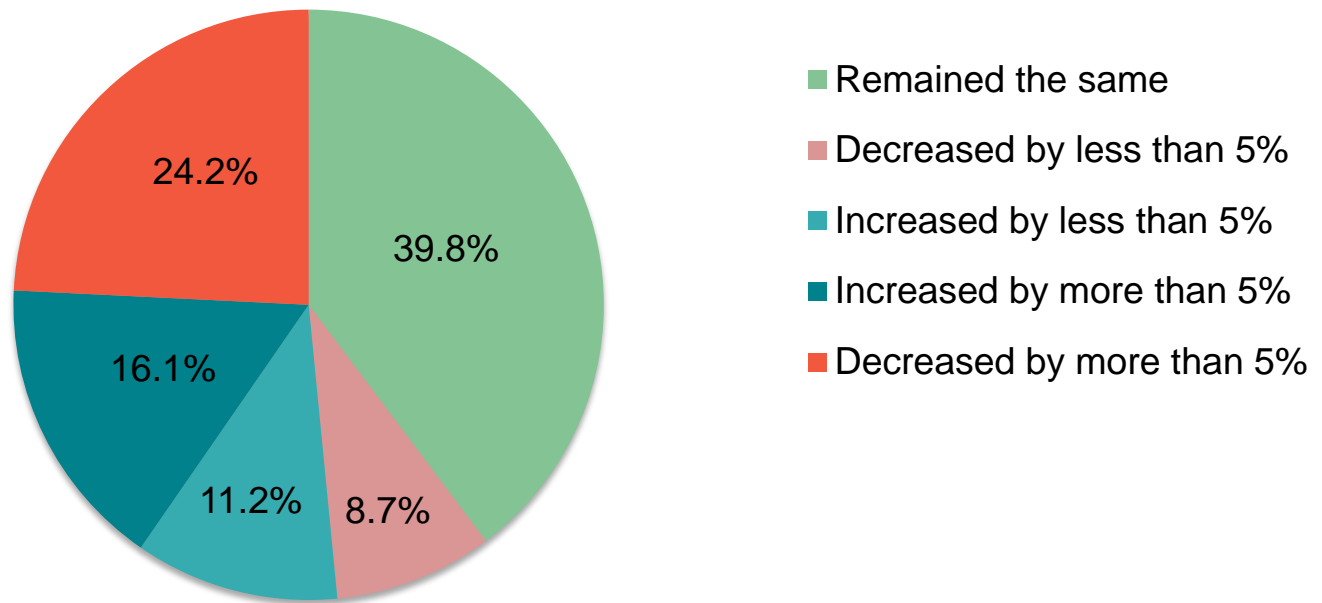
Sample size $N = 172$

Figures representing "no impact" have been omitted



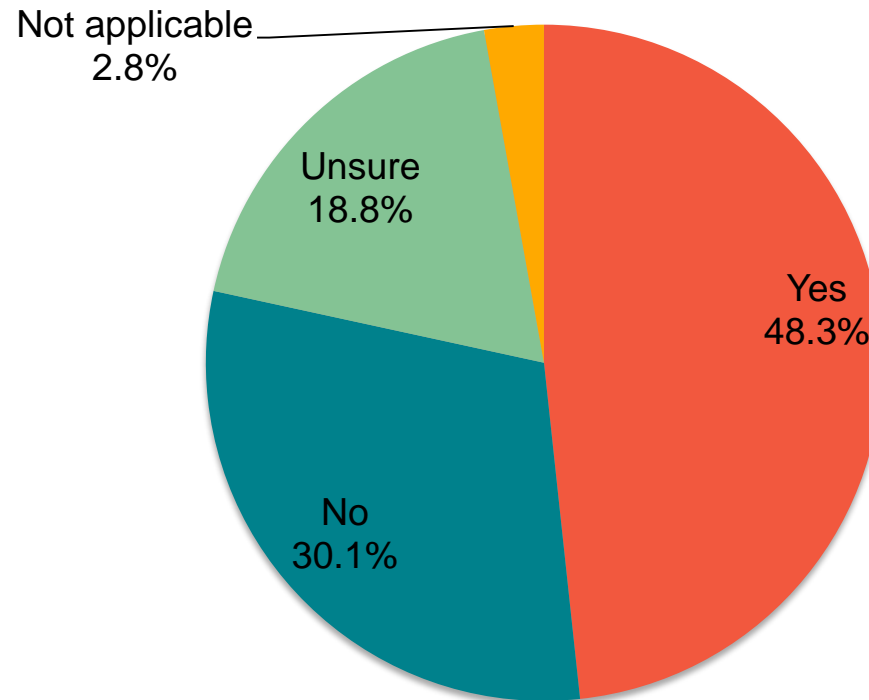
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Changes in Customer Fees since Dodd-Frank



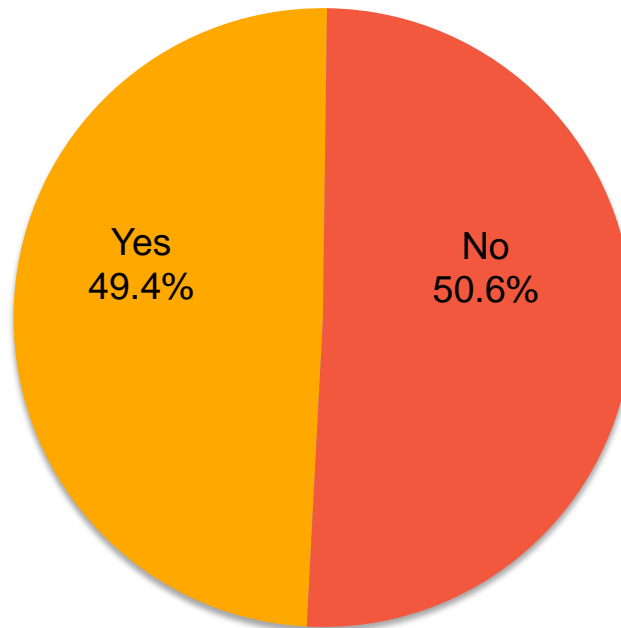
Sample size $N = 172$ with 161 valid responses

Has the Durbin Amendment Affected Your Bank?



Sample size $N = 190$ with 176 valid responses

Alterations to Credit-Analysis Practices in Response to Dodd-Frank

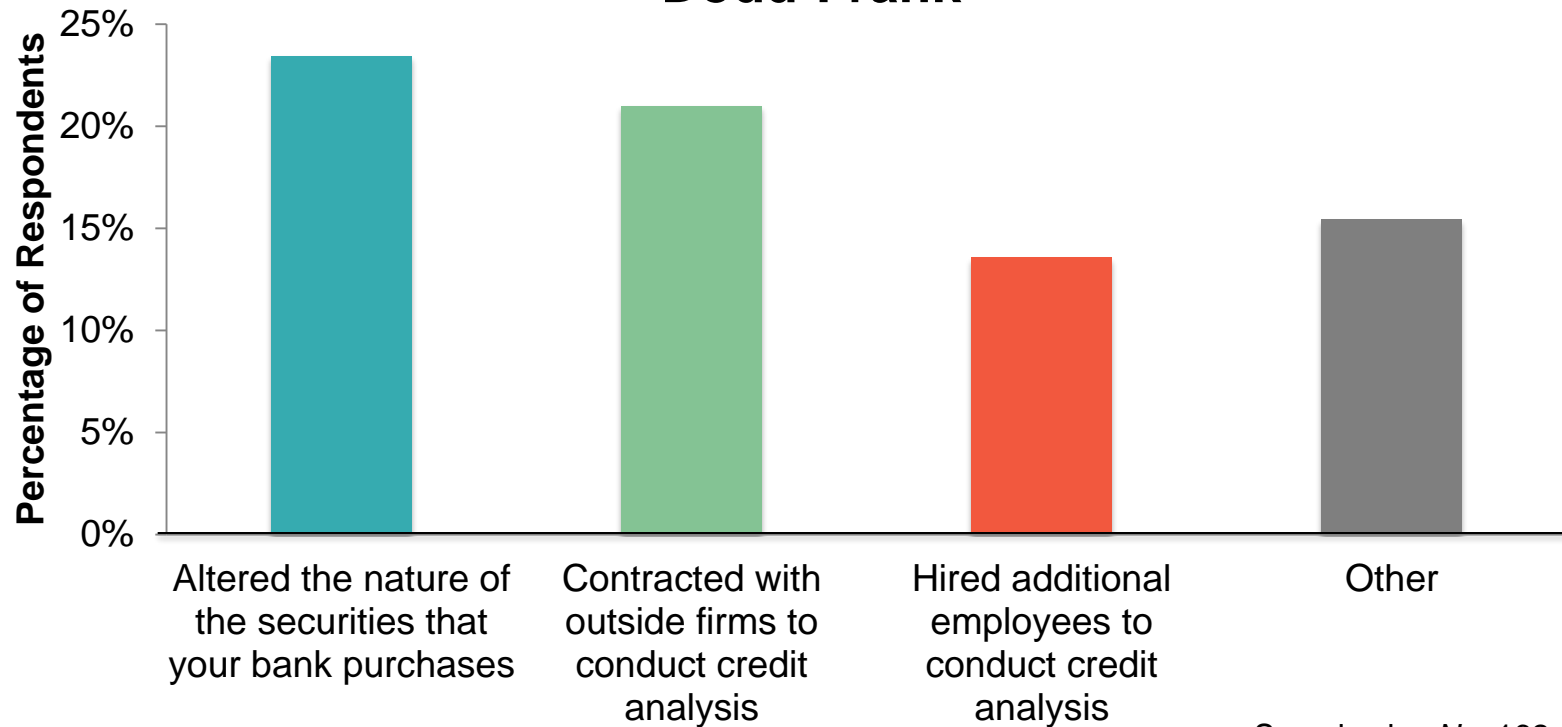


Sample size $N = 162$ with 160 valid responses

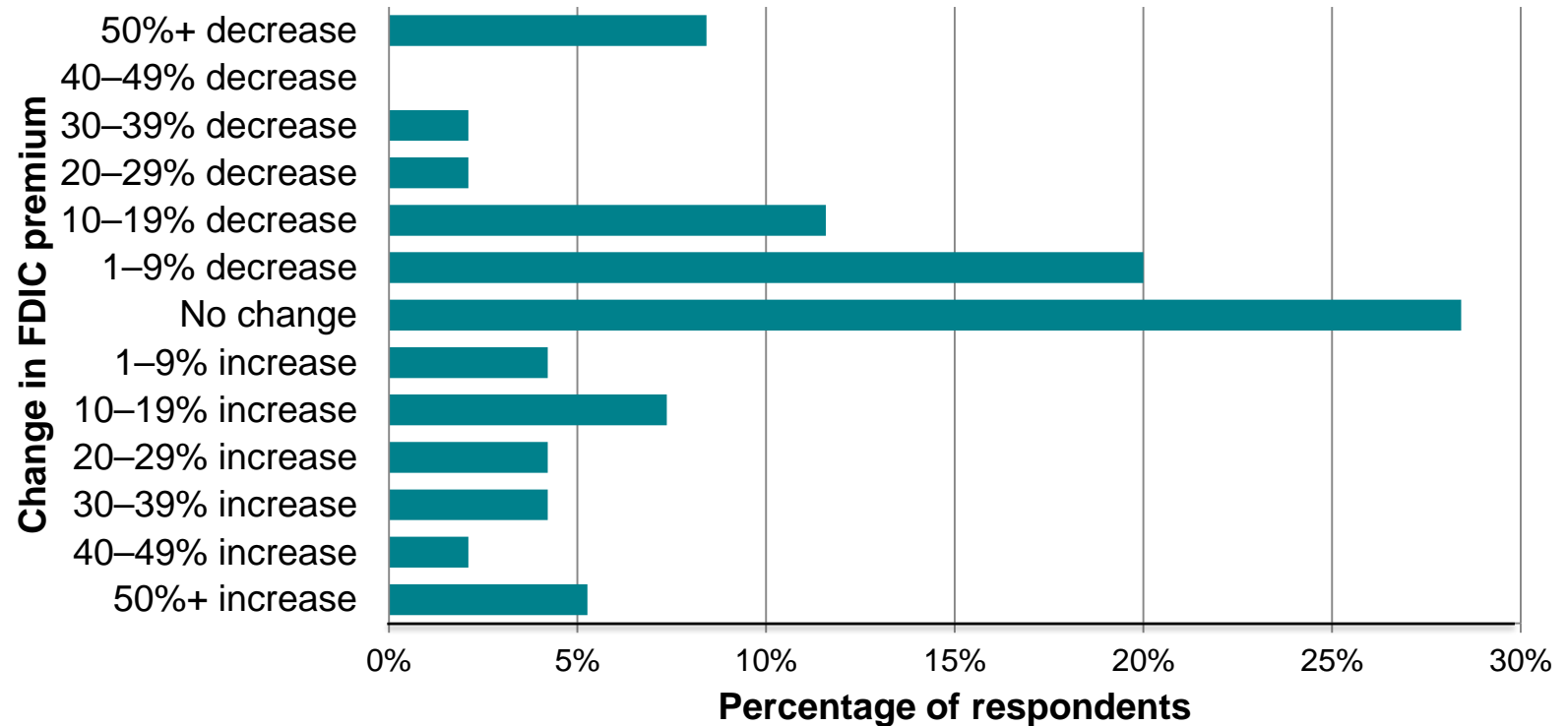


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Alterations to Credit Analysis Practices in Response to Dodd-Frank

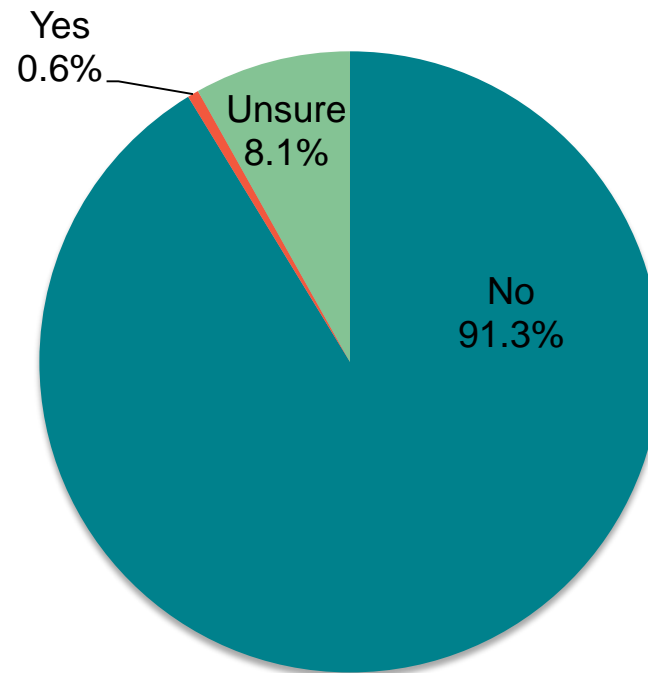


FDIC Premium Changes



Sample size $N = 190$

Activities Modified in Anticipation of the Volcker Rule



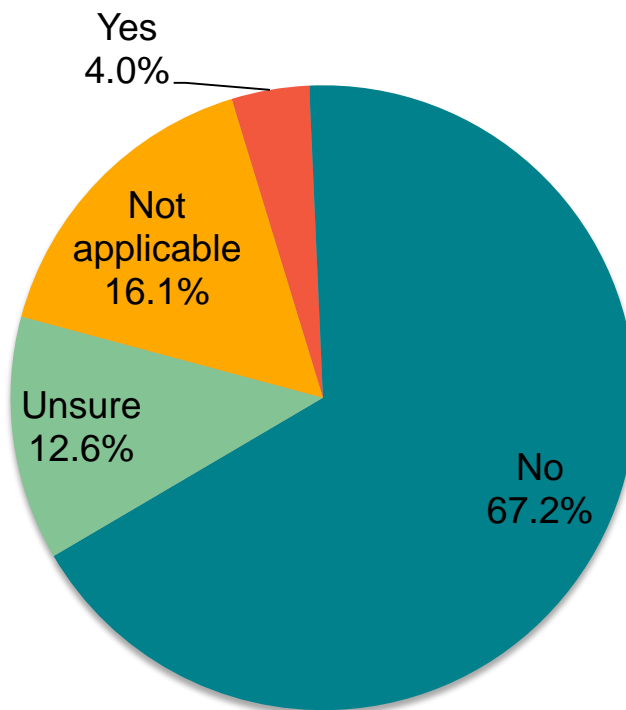
Note:
The survey
pre-dated
the finalization
of the Volcker
Rule.

Sample size $N = 190$ with 172 valid responses



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Have the Municipal Advisor Rules Changed the Way You Interact with Municipalities?



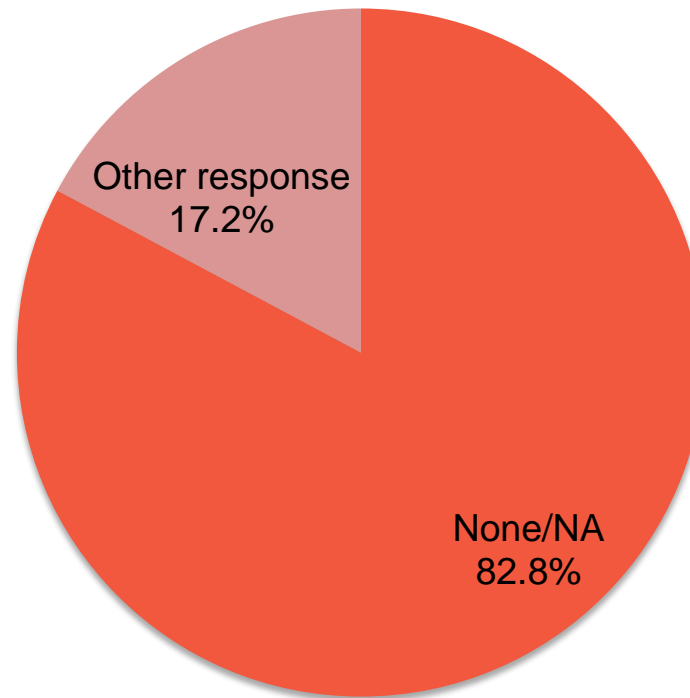
Note:
The survey
pre-dated
the finalization
of the municipal
advisor rules.

Sample size $N = 190$ with 174 valid responses



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Effect of Trust-Preferred Securities Phase-out

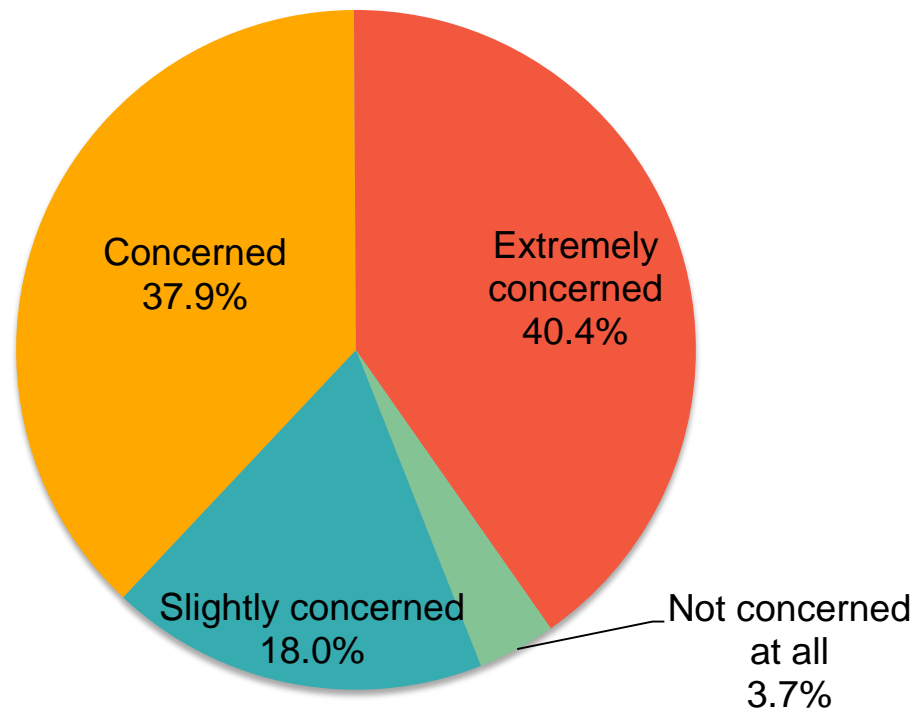


Sample size $N = 190$ with 157 valid responses



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Concern About Current Interest Rate Environment

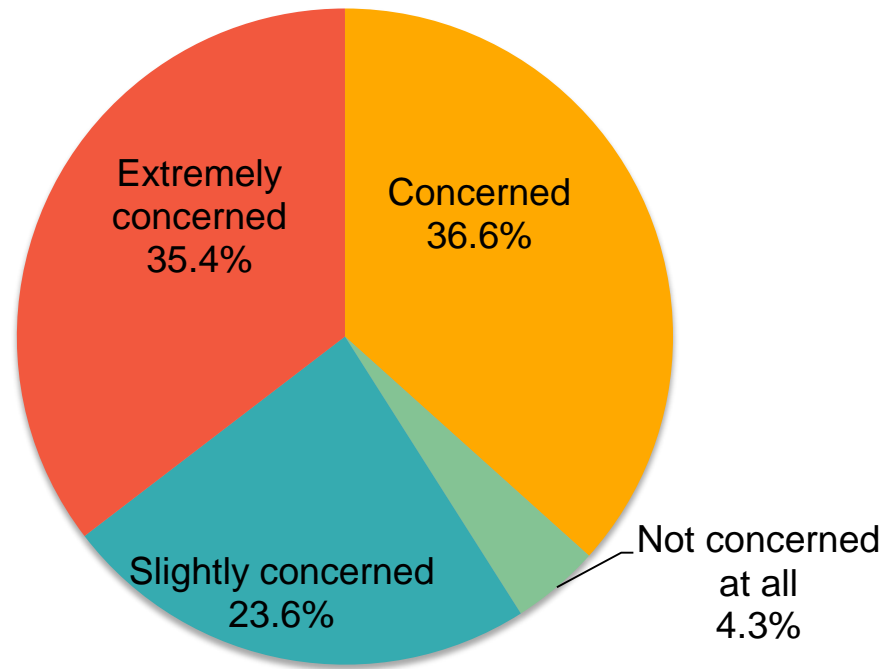


Sample size $N = 162$ with 161 valid responses



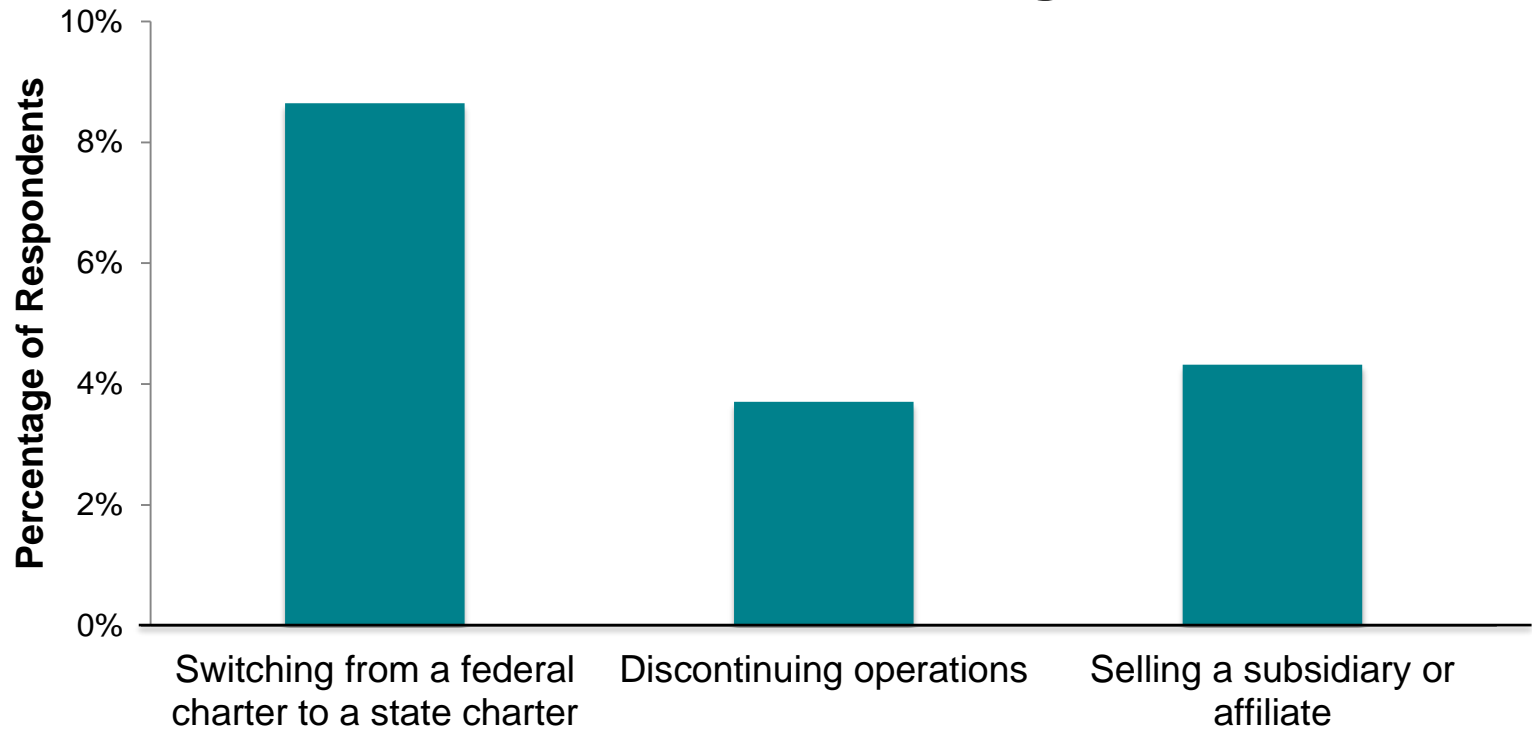
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Concern About Future Interest Rate Risk



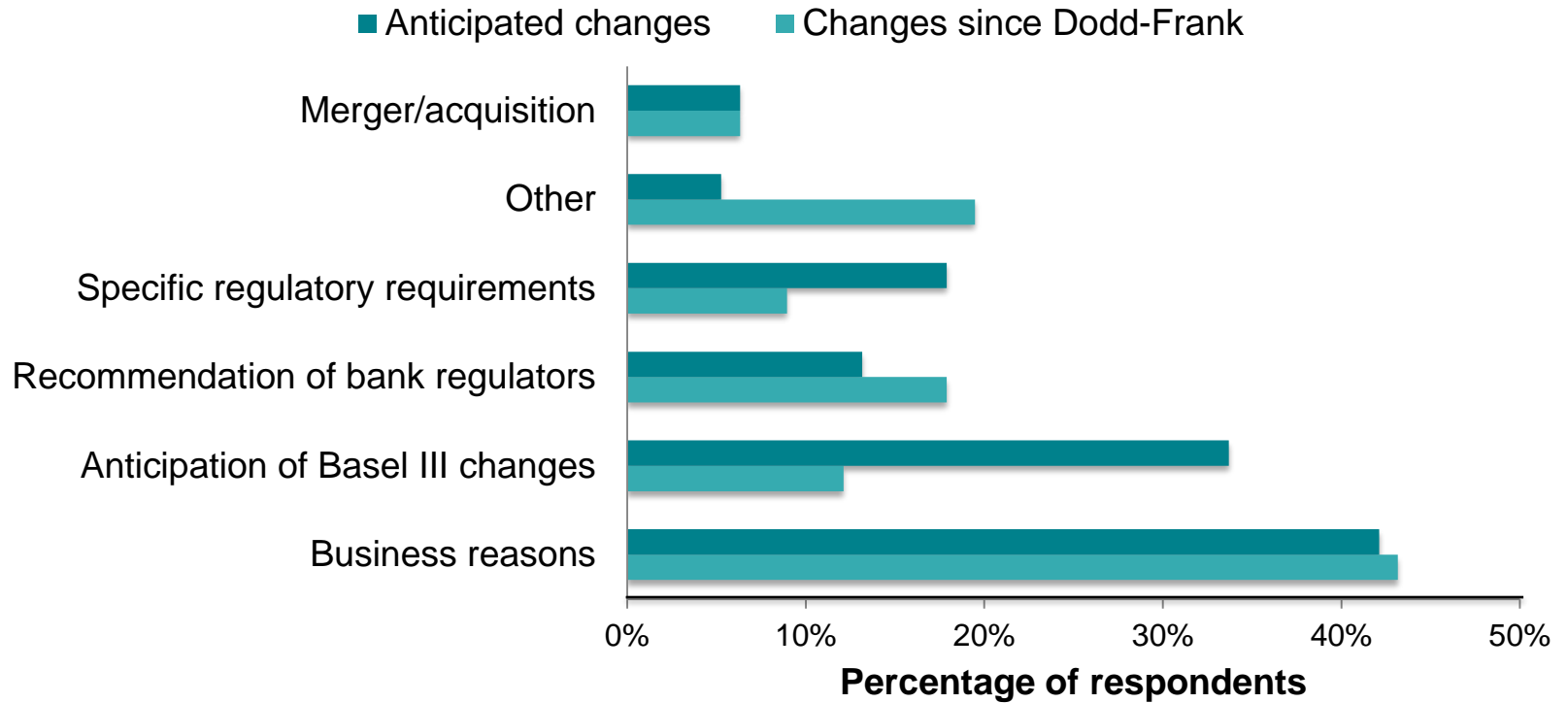
Sample size $N = 162$ with 161 valid responses

Potential Future Strategies



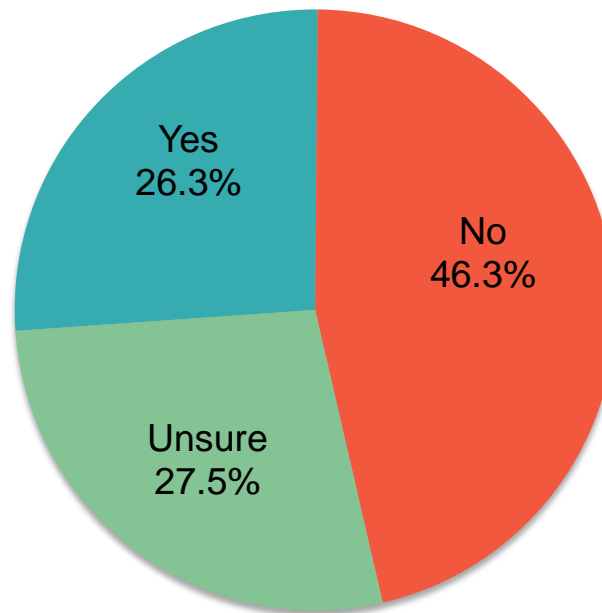
Sample size $N = 172$

Reasons for Changes in Tier 1 Capital



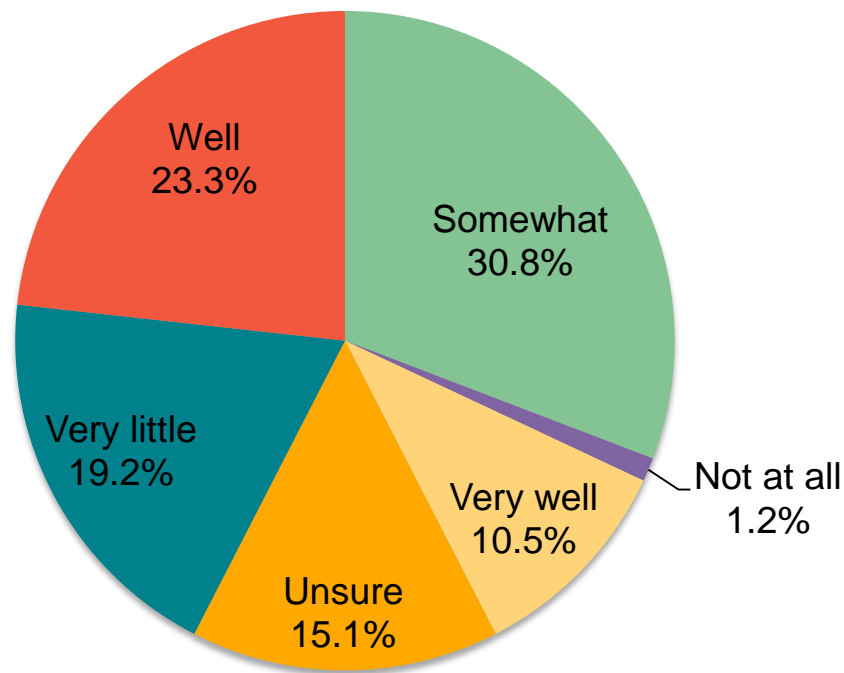
Sample size $N = 190$

Anticipate Engagement in M&A Activity in the Next Five Years



Sample Size $N = 162$ with 160 valid responses

Coordination Among Regulators



Sample size $N = 190$ with 172 valid responses



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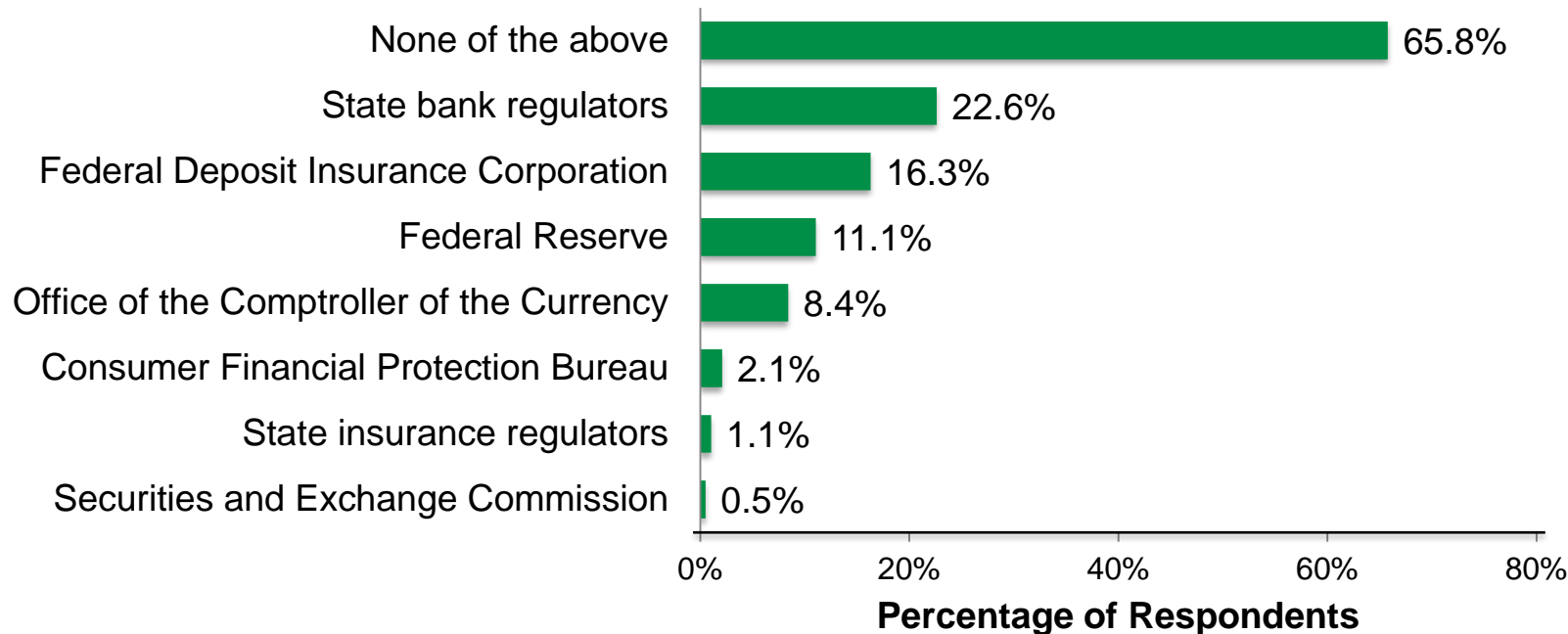
Certainty
about
Which
Law
Applies

Has decreased significantly	21	11.1%
Has decreased slightly	38	20.0%
Has not changed	75	39.5%
Has increased slightly	22	11.6%
Has increased significantly	17	8.9%
Sample size N = 190 with 173 valid responses		



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Regulator Contact Regarding Feasibility of Dodd-Frank



Sample Size $N = 190$

Respondent Commentary

- “We operate with our focus on the regulators - not the customer.”
- “Much more of management's time is spent figuring out what the rules say and what we have to do to comply with them rather than how we can increase customer service, product offerings, etc..”

Recommendations

- Regulators need to listen to small banks—state regulators are ahead of federal regulators on this one.
- Rule-writers should use economic analysis and analysis under the Regulatory Flexibility Act and SBREFA to help identify the consequences and quantify the impact *before* adopting a rule.
- Use the ongoing Economic Growth and Regulatory Paperwork Reduction Act process to eliminate unnecessary regulatory burdens.
- Provide longer implementation periods.

As regulators, we cannot – and should not – regulate the risk out of the industry. Instead, we must create a responsive and agile supervisory structure that enables financial institutions and their customers to be profitable, thereby facilitating economic development and creating jobs in their communities.

CANDACE A. FRANKS
BANK COMMISSIONER, ARKANSAS STATE BANK DEPARTMENT
CHAIRMAN, CONFERENCE OF STATE BANK SUPERVISORS, First National Bankers
Bankshares, Inc. 2014 Annual Summer Conference, Sandestin, Florida, June 17, 2014

Thank you

Hester Peirce

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703-993-4941