How Are Small Banks Faring Under Dodd-Frank?

Hester Peirce
Senior Research Fellow
Mercatus Center, George Mason University
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.
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.”

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

<table>
<thead>
<tr>
<th>Title I</th>
<th>Title III</th>
</tr>
</thead>
<tbody>
<tr>
<td>Risk Committees</td>
<td>OTS</td>
</tr>
<tr>
<td>SIFIs</td>
<td>Deposit Insurance</td>
</tr>
<tr>
<td>Capital</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Title VI</th>
<th>Title VII</th>
</tr>
</thead>
<tbody>
<tr>
<td>Interstate branching</td>
<td>New rules for OTC derivatives markets</td>
</tr>
<tr>
<td>Volcker Rule</td>
<td>Position limits</td>
</tr>
<tr>
<td>Commercial interest-bearing checking</td>
<td></td>
</tr>
</tbody>
</table>
# Relevant Provisions of Dodd-Frank

<table>
<thead>
<tr>
<th>Title IX</th>
<th>Title X</th>
</tr>
</thead>
<tbody>
<tr>
<td>Municipal Advisors</td>
<td>CFPB</td>
</tr>
<tr>
<td>Qualified Residential Mortgages/Risk Retention</td>
<td>Mortgage Disclosure</td>
</tr>
<tr>
<td>Executive Compensation</td>
<td>Small business/mortgage data collection</td>
</tr>
<tr>
<td>Incentive Pay</td>
<td>Durbin Amendment</td>
</tr>
<tr>
<td>Internal Control Audit Relief</td>
<td>Remittances</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Title XIV</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Ability to Repay/Qualified Mortgage</td>
<td></td>
</tr>
<tr>
<td>Mortgage Origination &amp; Servicing</td>
<td></td>
</tr>
<tr>
<td>Appraisals</td>
<td></td>
</tr>
<tr>
<td>Escrow Accounts</td>
<td></td>
</tr>
</tbody>
</table>

- [Mercatus Center](https://www.mercatus.org)
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?"

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 10-40 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.
- The 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 windows 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

Mareia Poltero, 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
<table>
<thead>
<tr>
<th>Survey section</th>
<th>Number of respondents (N)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>222</td>
</tr>
<tr>
<td>2</td>
<td>190</td>
</tr>
<tr>
<td>3</td>
<td>172</td>
</tr>
<tr>
<td>4</td>
<td>162</td>
</tr>
<tr>
<td>Mean</td>
<td>187</td>
</tr>
</tbody>
</table>
Geographic Distribution of Responding Banks

States in which participating banks have their headquarters

States in which no participating banks have headquarters

MERCATUS CENTER
George Mason University
<table>
<thead>
<tr>
<th></th>
<th>Survey sample</th>
<th>Small bank population</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Assets</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Mean</td>
<td>$510,926,326</td>
<td>$435,025,837</td>
</tr>
<tr>
<td>Median</td>
<td>$221,000,000</td>
<td>$173,405,000</td>
</tr>
<tr>
<td><strong>FTE employees</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Mean</td>
<td>120</td>
<td>96</td>
</tr>
<tr>
<td>Median</td>
<td>52</td>
<td>41</td>
</tr>
</tbody>
</table>
Distribution of Survey Sample vs. Distribution of Small Bank Population

- Less than $10 million: 0.9% of Sample, 0% of Population
- $10 million to $100 million: 22.7% of Sample, 20% of Population
- $100 million to $1 billion: 29.6% of Sample, 40% of Population
- $1 billion to $10 billion: 65.0% of Sample, 61.3% of Population
- $10 billion to $100 billion: 11.4% of Sample, 8.8% of Population

MERCATUS CENTER
George Mason University
Engagement in Advocacy Efforts

Before the passage of the Dodd-Frank Act in July 2010
After the passage of the Dodd-Frank Act in July 2010

Percentage of Respondents

Met with an elected official to discuss regulatory policy issues
Discussed regulatory issues with regulators (not including routine contacts with examiners)
Submitted public comments in connection with proposed regulations, including through a representative organization or outside law firm
Held a membership in a representative organization that engages in advocacy on regulatory issues
Engaged in other public advocacy such as letters to the editor, op-ed pieces, open letters, or blog articles
None of the above

Sample Size N = 190

MERCATUS CENTER
George Mason University
Charter Type

<table>
<thead>
<tr>
<th>Charter Type</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bank</td>
<td>85.7%</td>
</tr>
<tr>
<td>Thrift</td>
<td>14.3%</td>
</tr>
</tbody>
</table>

Sample Size $N = 222$ with 217 valid responses

Bank

Thrift
(including savings association, savings bank, savings and loan association, or mutual)
Primary Federal Regulator

- Federal Deposit Insurance Corporation: 58.9%
- Office of the Comptroller of the Currency: 25.1%
- Federal Reserve: 16.0%

Sample size $N = 190$ with 175 valid responses
Which of the Following Best Describes Your Bank?

Sample Size $N = 222$ with 221 valid responses

- Local: 84.6%
- National: 10.9%
- Statewide: 2.3%
- Interstate-Regional: 1.4%
- Intrastate-Regional: 0.9%
Organizational Structure

Sample Size $N = 222$ with 221 valid responses

- 55.2% Subsidiary of a financial holding company
- 41.6% Stand-alone
- 3.2% Other

MERCATUS CENTER
George Mason University
Ownership Description

- Closely held: 35%
- Family-owned: 34%
- S Corp: 33%
- C Corp: 20%
- Mutual: 11%
- Traded on an exchange: 6%
- Other: 1%

Sample Size N = 222
Market Type(s) Served

<table>
<thead>
<tr>
<th>Geographic Area</th>
<th>Percentage of Respondents</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rural (population less than 50,000)</td>
<td>70%</td>
</tr>
<tr>
<td>Small metropolitan area (population greater than 50,000 and less than 500,000)</td>
<td>20%</td>
</tr>
<tr>
<td>Large metropolitan area (population greater than 500,000)</td>
<td>10%</td>
</tr>
</tbody>
</table>

Sample Size $N = 222$
Income Market(s) Served

<table>
<thead>
<tr>
<th>Market Income Type</th>
<th>Percentage of Respondents</th>
</tr>
</thead>
<tbody>
<tr>
<td>Low Income</td>
<td>34.7%</td>
</tr>
<tr>
<td>Moderate Income</td>
<td>64.9%</td>
</tr>
<tr>
<td>Middle Income</td>
<td>56.3%</td>
</tr>
<tr>
<td>Upper Income</td>
<td>14.9%</td>
</tr>
</tbody>
</table>

Sample Size N = 222
Changes in the Number of Branches Since 2008

- 57.1% Stayed the same
- 29.7% Increased
- 13.2% Decreased

Sample Size $N = 222$ with 219 valid responses
Change in Annual Compliance Costs Since Dodd-Frank

- Increased by more than 5%: 82.9%
- Increased by less than 5%: 5.3%
- No change: 3.2%
- Decreased by less than 5%: 0.5%
- Decreased by more than 5%: 8.0%

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)

- Substantially more burdensome than the BSA: 65.6%
- Substantially less burdensome than the BSA: 16.4%
- Slightly less burdensome than the BSA: 15.3%
- Slightly more burdensome than the BSA: 2.1%
- As burdensome as the BSA: 0.5%

Sample Size $N = 190$ with 189 valid responses
Business Activities Affected by CFPB?

Yes 71.0%

No 29.0%

Sample Size $N = 172$ with 169 valid responses
Compliance/Legal Staff Added Due to CFPB

Yes 37.3%
No 62.7%

Sample size $N = 172$ with 169 valid responses
Histogram of Personnel Added Due to CFPB

Sample Size $N = 63$
Hiring Additional Compliance Personnel in Next 12 Months

- Yes: 27.4%
- No: 44.6%
- Unsure: 28.0%

Sample Size $N = 190$ with 186 valid responses
In-house compliance personnel: 93.7%

External consultants: 38.4%

External legal counsel: 23.2%

External compliance personnel: 22.6%

In-house legal counsel: 9.5%

Other: 2.1%

Sample Size N = 190
Anticipated Engagement with Outside Consultants for Dodd-Frank

- Yes: 51.1%
- No: 27.7%
- Unsure: 21.3%

Sample Size $N = 190$ with 188 valid responses
Products and Services Offered

Sample size $N = 222$
Products and Services Added in Response to Dodd-Frank

- None/NA: 94.0%
- Other Response: 6.0%

Sample Size $N = 222$ with 133 valid responses
Impact of Dodd-Frank on Products/Services Offered

- Derivatives
- Securities and Investment Products
- Other Commercial Lending
- Commercial Real Estate Lending
- Agricultural Lending
- Small Business Lending (non-SBA)
- Small Business Lending (SBA)
- Debit Cards
- Insurance
- Construction and Development Lending
- Credit Cards
- Remittance Transfers
- Mortgage Servicing
- Overdraft Protection
- Home Equity Lines of Credit
- Residential Mortgages

Sample Size $N = 222$

- Anticipate Discontinuing as a Result of the Dodd-Frank Act
- Discontinued as a Result of the Dodd-Frank Act
Reasons for Alterations to Mortgage Offerings

- In response to bank examiner requests
- In response to demand changes in the secondary market
- For business reasons
- In anticipation of future regulatory changes
- In response to specific regulatory requirements

Percentage of Respondents

Sample Size $N = 172$
Effects on Mortgage Offerings

Percentage of Respondents

0% 20% 40% 60%

- Consumer Financial Protection Bureau
- Definition of “qualified mortgage”
- Definition of “qualified residential mortgage”
- Low-interest rate environment
- Pressure from bank examiners
- Changed underwriting requirements by Fannie Mae and/or Freddie Mac
- Basel III

Sample Size
N = 172
Does Your Bank Anticipate that it Will Make Any Loans That Do Not Meet the Definition of a "Qualified Mortgage"?

- **Yes**: 34.8%
- **No**: 30.5%
- **Unsure**: 32.3%
- **Not Applicable**: 2.4%

Sample Size $N = 172$ with 164 valid responses
Anticipate Changes to the Nature, Mix, and Volume of Mortgage Products in Response to Regulatory Changes

Yes 63.6%
No 14.8%
Unsure 21.6%

Sample size $N = 172$ with $162$ valid responses
Change in Return on Equity since July 2010

- Increased significantly: 8.1%
- Increased slightly: 28.6%
- Decreased slightly: 26.7%
- Decreased significantly: 22.4%
- No change: 14.3%

Sample size $N = 172$ with 161 valid responses
Impact of Policy on Bank Earnings

- Derivatives regulation
- Volcker Rule
- Elimination of the Office of Thrift Supervision
- Municipal advisor regulation
- FDIC insurance coverage
- Incentive-based compensation
- Systemic risk oversight
- New capital requirements
- Debit card interchange fees
- Consumer Financial Protection Bureau
- Changes in mortgage regulation

Significant negative impact
Slight negative impact
Slight positive impact
Significant positive impact

Sample size $N = 172$
Effects of Dodd-Frank on Fees of Product/Service

Sample size $N = 172$
Figures representing "no impact" have been omitted
Changes in Customer Fees since Dodd-Frank

- Remained the same: 39.8%
- Decreased by less than 5%: 24.2%
- Increased by less than 5%: 16.1%
- Increased by more than 5%: 11.2%
- Decreased by more than 5%: 8.7%

Sample size $N = 172$ with 161 valid responses
Has the Durbin Amendment Affected Your Bank?

- Yes: 48.3%
- No: 30.1%
- Unsure: 18.8%
- Not applicable: 2.8%

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
Alterations to Credit Analysis Practices in Response to Dodd-Frank

- Altered the nature of the securities that your bank purchases: 25%
- Contracted with outside firms to conduct credit analysis: 20%
- Hired additional employees to conduct credit analysis: 15%
- Other: 15%

Sample size $N = 162$
Activities Modified in Anticipation of the Volcker Rule

- **No**: 91.3%
- **Yes**: 0.6%
- **Unsure**: 8.1%

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

Sample size $N = 190$ with 172 valid responses
Have the Municipal Advisor Rules Changed the Way You Interact with Municipalities?

- Yes: 4.0%
- No: 67.2%
- Unsure: 12.6%
- Not applicable: 16.1%

Sample size $N = 190$ with 174 valid responses

Note: The survey pre-dated the finalization of the municipal advisor rules.
Effect of Trust-Preferred Securities Phase-out

Sample size $N = 190$ with 157 valid responses
Concern About Current Interest Rate Environment

- Concerned: 37.9%
- Extremely concerned: 40.4%
- Slightly concerned: 18.0%
- Not concerned at all: 3.7%

Sample size $N = 162$ with 161 valid responses
Concern About Future Interest Rate Risk

- Extremely concerned: 35.4%
- Concerned: 36.6%
- Slightly concerned: 23.6%
- Not concerned at all: 4.3%

Sample size $N = 162$ with 161 valid responses
Potential Future Strategies

- Switching from a federal charter to a state charter: 8%
- Discontinuing operations: 4%
- Selling a subsidiary or affiliate: 4%

Sample size $N = 172$
Reasons for Changes in Tier 1 Capital

- **Anticipated changes**
  - Merger/acquisition
  - Other
  - Specific regulatory requirements
  - Recommendation of bank regulators
  - Anticipation of Basel III changes
  - Business reasons

- **Changes since Dodd-Frank**

Percentage of respondents

Sample size $N = 190$
Anticipate Engagement in M&A Activity in the Next Five Years

- Yes: 26.3%
- No: 46.3%
- Unsure: 27.5%

Sample Size $N = 162$ with 160 valid responses
Coordination Among Regulators

Sample size $N = 190$ with 172 valid responses
<table>
<thead>
<tr>
<th>Certainty about Which Law Applies</th>
<th>Count</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Has decreased significantly</td>
<td>21</td>
<td>11.1%</td>
</tr>
<tr>
<td>Has decreased slightly</td>
<td>38</td>
<td>20.0%</td>
</tr>
<tr>
<td>Has not changed</td>
<td>75</td>
<td>39.5%</td>
</tr>
<tr>
<td>Has increased slightly</td>
<td>22</td>
<td>11.6%</td>
</tr>
<tr>
<td>Has increased significantly</td>
<td>17</td>
<td>8.9%</td>
</tr>
</tbody>
</table>

Sample size N = 190 with 173 valid responses
Regulator Contact Regarding Feasibility of Dodd-Frank

- None of the above: 65.8%
- State bank regulators: 22.6%
- Federal Deposit Insurance Corporation: 16.3%
- Federal Reserve: 11.1%
- Office of the Comptroller of the Currency: 8.4%
- Consumer Financial Protection Bureau: 2.1%
- State insurance regulators: 1.1%
- Securities and Exchange Commission: 0.5%

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
Thank you

Hester Peirce
hpeirce@mercatus.gmu.edu
703-993-4941