OVERVIEW

• Motivation & Methodology
• Our findings
• What factors are driving consolidation?
• What if we do nothing?
• What should we do?
MOTIVATION & METHODOLOGY

• Motivation
  • Anecdotal evidence of Dodd-Frank & Basel III regulatory pressures on community banks
  • Wanted to understand and quantify the role community banks play in our economy and how that role has changed in recent years
MOTIVATION & METHODOLOGY

• Methodology
  • Used FDIC call report data
  • Defined community banks as $10 billion or less in assets
    • Aggregated assets at the holding company level
    • Results in 98 percent of banks being community banks
  • Conducted thorough literature review
OUR FINDINGS

Almost One-Quarter of Bank Lending Is by Community Banks:
Total Loans and Leases by Bank Type (Q2 2014) ($8.1 Trillion Total)

- **Top 5 Largest Banks**: $3.3 Trillion (41%)
- **Other Large Banks**: $3.0 Trillion (37%)
- **Community Banks (Under $10 Bil)**: $1.8 Trillion (22%)

Source: FDIC Statistics on Depository Institutions
Our Findings

Takeaways:
- Comm. banks hold 51% of bank small bus. loans, down from 55% in Q2 2010
- 10% decline in bank small business loans since mid-2010; 17% decline at small comm. banks while near-constant at larger comm. banks
- Mid-2003 to mid-2007: 25% growth in small bus. loans; +15% at comm. banks
Takeaways: • Comm. banks make up 77% of bank ag. loans; was 75% in mid-2010
• Comm. bank ag. loans up 23% since mid-2010; down 9.5% at large banks
• Ag. loans ($150.3 billion) are 2% of overall bank loans
## OUR FINDINGS

### Number of Banks

<table>
<thead>
<tr>
<th></th>
<th>Community Banks</th>
<th>Large Banks</th>
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<tbody>
<tr>
<td><strong>Q2 1994</strong></td>
<td>10167</td>
<td>73</td>
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<tr>
<td><strong>Q2 2002</strong></td>
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<td>86</td>
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<td><strong>Q2 2006</strong></td>
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<td><strong>Q2 2010</strong></td>
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<td><strong>Q2 2014</strong></td>
<td>6094</td>
<td>100</td>
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**Q2 1994- Q2 2014 bank number change**
- Community banks: **-40%**
- Large banks: **+37%**

**Q2 2010- Q2 2014 bank number change**
- Community banks: **-12%**
- Large banks: **+5%**
OUR FINDINGS

Community Banks’ Share of U.S. Banking Sector Is Falling:
Share of U.S. Depository Institution Assets by Bank Type (Q2 1994 to Q2 2014)

Q2 1994 - Q2 2014 market share change
Community banks: -56% (41% to 18%)
Other large banks: -12% (41% to 36%)
Top 5 largest banks: +155% (18% to 46%)

Source: FDIC Statistics on Depository Institutions
WHAT IS DRIVING CONSOLIDATION?

• Technology
• Changing demographics
• Customer demands
• Economies-of-scale
• Mergers

REGULATION

• Dodd-Frank is estimated to increase regulatory restrictions 32 percent
• GAO and numerous government officials have expressed worry about unintended impacts of growing regulatory complexity
HOW REGULATION DRIVES CONSOLIDATION


Dodd-Frank
- 5,362 finalized (2010–2012)
- 11,181 not yet finalized (projected)
- 16,543 restrictions

Pre-Dodd-Frank
- 10,830 restrictions

Data note: Restrictions computed using the RegData methodology. RegData is only able to calculate regulatory restrictions for 1997 and subsequent years because electronic copies of the complete, annual CFR are publicly available from the Government Printing Office for only that time period. Produced by Patrick A. McLaughlin, Robert Greene, and Rizqi Rachmat, Mercatus Center at George Mason University.

HOW REGULATION DRIVES CONSOLIDATION

• Disproportionately high compliance costs
  • Intuitively a higher as a percentage of asset base
  • Personnel strains:
    • 25% of community banks say they plan to hire new compliance personnel (Peirce et al., Mercatus Center)
    • Two additional personnel reduces the smallest community banks’ median profitability by 45 basis points, resulting in 1/3 of these banks becoming unprofitable (Feldman & Schreck, Minneapolis Fed)
• It impacts mergers and product lines
• Banking scholars: “new entries are more likely when there are fewer regulatory restrictions” (McCord et al., Richmond Fed)
WHAT IF WE DO NOTHING?

• Technology & non-banks will fill in some of the gaps (Mills & McCarthy, Harvard Business School)

• Rural communities and small businesses will likely be disproportionately impacted (FDIC, 2011)

• Concentrated banking systems don’t necessarily serve small and medium enterprises well (Wilmarth; Hasan et al.)

• Community banks – a source of banking system stability (GAO) – could whither for the wrong reasons
SOLUTIONS

• Reform the regulatory process to mitigate unintended consequences
  • Cost-benefit analysis
  • OIRA-review

• Heightened regulatory coordination
  • Bipartisan commission to streamline regulations
  • FSOC should leverage its position as a multi-regulator council to improve regulatory coordination

• Exemptions
  • From: Volcker rule, certain capital requirements, compensation requirements, & some quarterly call reports
  • But be careful: exemptions often fail to exempt
CONCLUSION

• Our research shows:
  1. Consolidation is a long-term trend, but has accelerated once again since the passage of Dodd-Frank
  2. Community banks play a vital and unique role in specific US bank lending markets
• Multiple factors impact consolidation, but intuitively and empirically regulation is a factor
• Regulation is the factor that policy-makers have the most flexibility to adjust (as opposed to consumer preferences)
• We have outlined several bipartisan solutions for them to do just that
SOURCES

Federal Deposit Insurance Corporation (FDIC), FDIC Community Banking Study, December 2012


Roisin McCord, Edward Simpson Prescott & Tim Sablik “Explaining the Decline in the Number of Banks since the Great Recession” (Economic Brief 15-03, The Federal Reserve Bank of Richmond, Mar. 2015)


U.S. Government Accountability Office, Community Banks and Credit Unions: Impact of the Dodd-Frank Act Depends Largely on Future Rulemakings, GAO-12-881, September 2012,