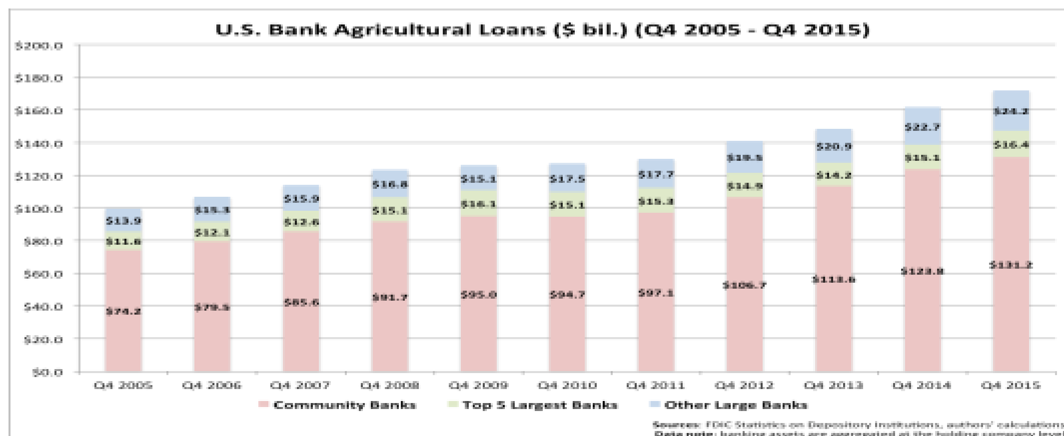
Nothing but the Facts: Community Banking in the United States

This Nothing but the Facts statement by the Committee on Capital Markets Regulation aims to provide policymakers with relevant facts related to the role of community banks in the United States economy and how access to these financial institutions has changed in recent years.[1] Throughout this statement we rely on the Federal Reserve's definition of a community bank as a banking organization with total assets of less than $10 billion.[2]

We find that in recent years there has been a significant decline in the share of U.S. banking assets held by community banks and the number of community banks. More specifically, community banks' share of U.S. banking assets was 30 percent in the early 2000s, 21 percent in 2010 and is now stands at just 18 percent.[3] Similarly, in the early 2000s there were over 8,000 community banks, in 2010 there were 7,000 community banks and there are now just 5,600 community banks in the United States.[4]

But, why should this be a concern for the U.S. economy? The facts demonstrate that there are several reasons. First, according to a recent study by the Federal Deposit Insurance Corporation ("FDIC"), community banks are the only source of physical banking offices in one in five U.S. counties and hold the majority of deposits in rural counties.[5] By enabling access to basic bank accounts in rural counties, community banks in turn facilitate access to traditional credit products that are critical to the economic health of American households. Figure 1 further demonstrates the importance of community banks to rural communities, showing that community banks account for 76 percent of bank agricultural loans.

Figure 1



[1] This Nothing But the Facts Statement is based on "The State and Fate of Community Banking," by Marshall Lux & Robert Greene, published by the Mossavar-Rahmani Center for Business & Government at Harvard University's John F. Kennedy School of Government in February 2015. *See* Marshall Lux & Robert Greene, *The State and Date of Community Banking* (2015), *available at* https://www.hks.harvard.edu/content/download/74695/1687293/version/1/file/Final_State_and_Fate_Lux_Greene.pdf.
[2] Board of Governors of the Federal Reserve System, *Supervisory Policy and Guidance Topics: Community Banking*, https://www.federalreserve.gov/bankinforeg/topics/community_banking.htm (last visited May 2016).
[3] Federal Desposit Insurance Corporation, *All SDI data*, https://www5.fdic.gov/sdi/download_large_list_outside.asp [hereinafter FDIC, *All SDI Data*] (as calculated by Marshall Lux & Robert Greene).
[4] *Id.*
[5] Federal Deposit Inusrance Corporation, Community Banking Study 3-4 (2012), *available at* https://www.fdic.gov/regulations/resources/cbi/report/cbi-full.pdf.

Second, the U.S. Government Accountability Office, Federal Reserve, and FDIC all find that community banks' ability to leverage interpersonal relationships allows them to serve small businesses particularly well.[6] As Federal Reserve Governor Daniel Tarullo noted in 2014, "credit extension to smaller firms is an area in which the relationship-lending model of community banks retains a comparative advantage. It means that community banks are of special significance to local economies." [7] This is demonstrated by Figure 2, which shows that community banks account for 49 percent of small business loans.[8] However, Figure 2 also demonstrates that relative to mid-2010, there has been an 11 percent decline in small business lending by community banks.[9]

Figure 2

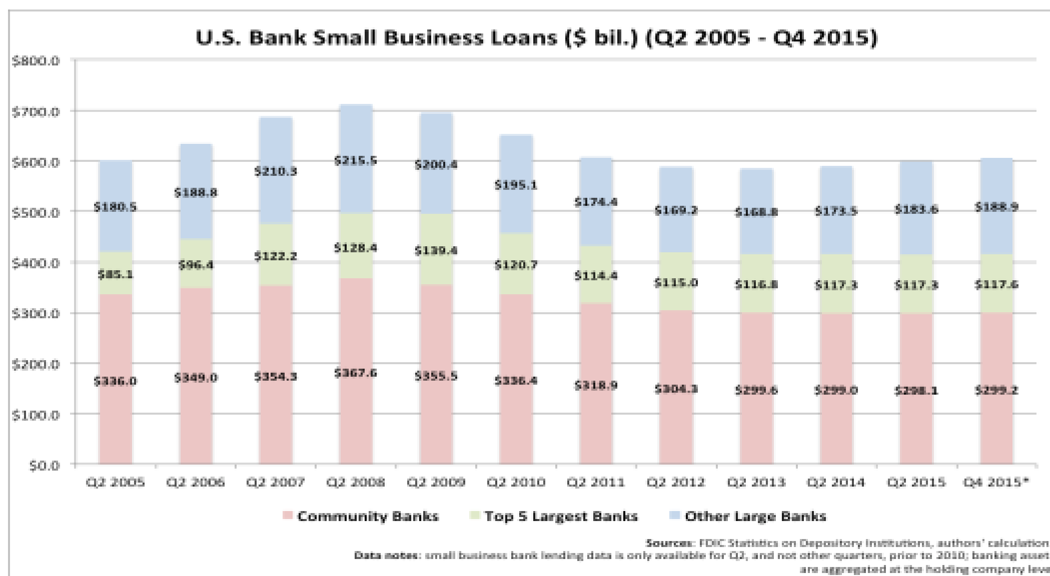


Figure 3 and Figure 4 demonstrate that the significant reduction in the share of total U.S. banking assets held by community banks coincided with the implementation of the Riegle Neal Interstate Banking Act in 1994 and the Dodd-Frank Act in 2010. The Riegle Neal Interstate Banking Act facilitated consolidation of assets among banks because it removed many of the restrictions on opening bank branches across state lines. After consolidation, many banks would be too large to continue to qualify as community banks.

On the other hand, the link between Dodd-Frank and community banks has more to do with regulatory costs. For example, a 2013 survey by the Mercatus Center at George Mason University found that due to Dodd-Frank one-quarter of community banks were planning to hire compliance staff within a year, one-third had hired staff to meet CFPB regulations, and 83

[6] *See* Lux & Greene, *supra* note 1, at 5 (citing U.S. Government Accountability Office, GAO-12-881, Impact of the Dodd-Frank Act Depends Largely on Future Rule Makings 1 (2012)).
[7] Daniel Tarullo, Governor, Board of Governors of the Federal Reserve System, Rethinking the Aims of Prudential Regulation (May 8, 2014), *available at* https://www.federalreserve.gov/newsevents/speech/tarullo20140508a.htm.
[8] FDIC, *All SDI data*, *supra* note 4 (as calculated by Marshall Lux & Robert Greene).
[9] *Id.* (as calculated by Marshall Lux & Robert Greene).

percent experienced compliance cost increases.[10] Other analyses suggest that the increase in regulatory costs are a major factor behind community bank consolidation in recent years.[11] Additionally, recent Federal Reserve Bank of Richmond research finds that a major driver behind the lack of new bank formations is also driven in part by regulatory trends, noting that "banking scholars have found that new entries are more likely when there are fewer regulatory restrictions."[12]

Figure 3

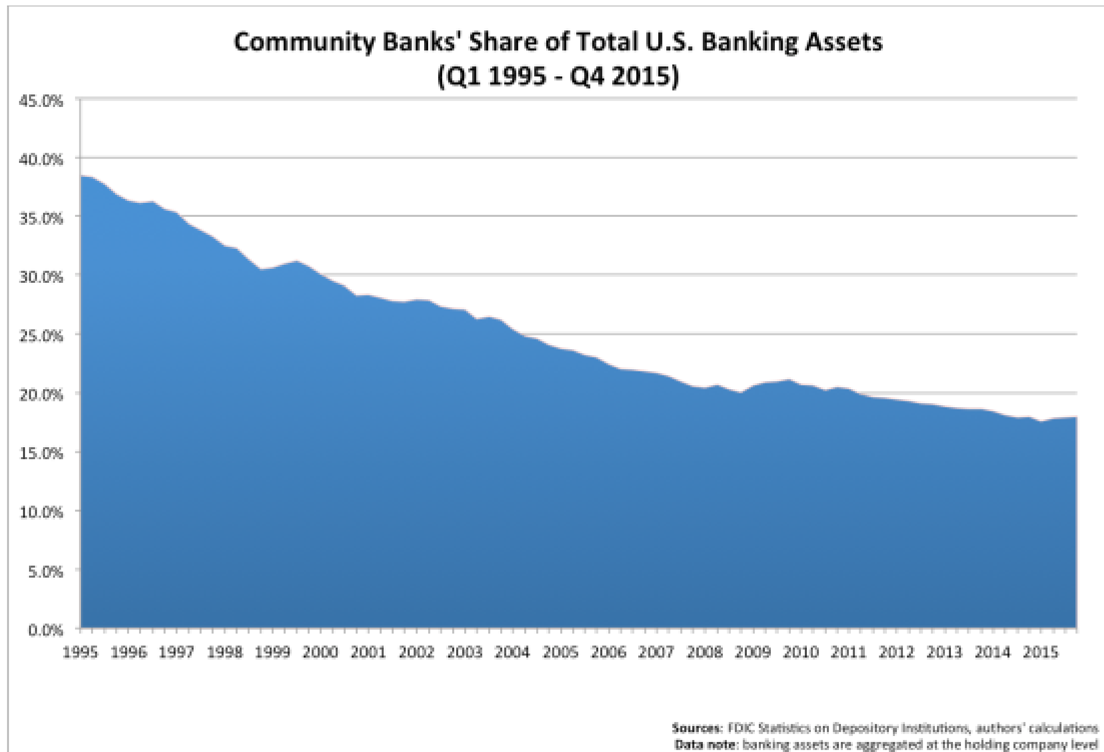


Figure 4

		22 Quarters after the Riegle Neal Interstate Banking Act			22 Quarters after the Dodd-Frank Act
		Q3 1994 - Q1 2000	Q1 2000 - Q3 2006	Q4 2004 - Q2 2010	Q2 2010 - Q4 2015
Number of Comm. Banks	Beginning Quarter	10167	8263	7682	6937
	End Quarter	8263	7481	6937	5673
% Change in Number of Comm. Banks		-18.7%	-9.5%	-9.7%	-18.2%

Source: FDIC Statistics on Depostiory Instituions

[10] Hester Peirce et al., *How Are Small Banks Faring under Dodd-Frank?* (The Mercatus Center at George Mason University, Working Paper 14-05, 2014), *available at* http://mercatus.org/sites/default/files/Peirce_SmallBankSurvey_v1.pdf. *See also* U.S. Government Accountability Office, GAO-16-169, Impacts on Community Banks, Credit Unions and Systemically Important Institutions (2015).
[11] *See* Lux & Greene, *supra* note 1, at 25 (for an overview of several analyses); Tanya D. Marsh & Joseph W. Norman, *The Impact of Dodd-Frank on Community Banks* 5-7, 38 (Wake Forest Univ. Legal Studies Paper No. 2302392, 2013).
[12] Roisin McCord et al., *Explaining the Decline in the Number of Banks since the Great Recession* 4 (The Federal Reserve Bank of Richmond, Economic Brief 15-03, 2015).

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Should you have any questions or concerns, please do not hesitate to contact the Committee's Director, Prof. Hal S. Scott (hscott@law.harvard.edu), or its Executive Director of Research, John Gulliver (jgulliver@capmktsreg.org), at your convenience.