Dodd-Frank: Repercussions on Community Banks and Local Lending

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Abstract

The Dodd-Frank Act, in response to the 2008 financial crisis, attempts to subdue systemic risk assumed by financial institutions, but makes the mistake of treating the financial industry through a one-size-fits-all approach. The American financial system is diverse, servicing communities, regions, and small-robust economies throughout the country. Community banks, making up 99 percent of all institutions, are distinct from larger institutions who caused the crisis and are responsible for systemic risk. This report analyzes the secondary and tertiary effects caused by Dodd-Frank on community banks in the financial system.

The first repercussion is in the increase of cost compliance that threatens the community banking model. The disproportionate impact of compliance costs creates an artificial and exaggerated economies of scale that disrupt the service that community banks provide. The second repercussion is in the unintended consequence of isolating certain segments of society from loan eligibility. Lending standards legally prohibit community banks from conducting normal practices that are normal and relatively risk free. Policy reform ought to focus on reflecting the difference between community banks from larger financial institutions by exempting community banks where they are irrelevant.

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Dodd-Frank Act: Repercussions on Community Banks and Local Lending

The goal of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, enacted as a response to the financial crisis of 2008 (hereafter referred to as “the Crisis”), was noble: to protect consumers and prevent a crisis from happening again. The aim was to reduce, if not completely subdue, the systemic risk that banking and financial institutions posed to the entire economic system. Despite these good intentions, Dodd-Frank inappropriately addresses the entire banking industry as a whole through the same lens, creating its unintended consequences that have disrupted multiple layers of the American economy.

The American banking industry is not a monolith. Community banks (state, local, and regional institutions) comprise 99 percent of all banks in the United States, though they hold 20 percent of total bank assets.[1] Their market share, consumer segment, and lending purposes make them incomparable to the concentrated one percent of banks holding 80 percent of all financial assets. The results of Dodd-Frank’s one-size-fits-all approach demonstrates why financial regulation and economic policy must be sensitive to regional and market-based differences throughout the economy. Treating the financial industry as if it is homogenous will result in harming and disrupting the regional and diverse needs that make up the U.S. economy.

This report analyzes the secondary and tertiary effects caused by Dodd-Frank on community banks in the financial system. It examines the current state of community banks, the impact of Dodd-Frank on community banks, and proposals for policy reform. This analysis will provide two conclusions. First, Dodd-Frank has put the banking system’s incentive to grow in a

[1] United States. Government Accountability Office, *Community Banks and Credit Unions: Impact of the Dodd-Frank Act Depends Largely on Future Rule Makings: Report to Congressional Requesters*. GAO 12-881, September 2012. 5.

double bind, threatening the sustainability of its current model. The regulation has created artificial economies of scale,[2] exacerbating the marginalization and decline of community banks while also dis-incentivizing growth. In turn, this creates the risk of an oligopolistic industry that amplifies the systemic risk that larger financial institutions pose. Second, Dodd-Frank intentionally restricts lending practices through Qualified-Mortgage and Ability-To-Repay standards. This set of standards isolates specific segments of society from loan eligibility such as small and medium enterprises, people of low-income, and the recently unemployed/retired.

The analysis herein is founded upon primary and secondary research, references to multiple government reports and studies, academic reviews and journals, along with personal interviews of banking professionals conducted from March 2015 to April 2016. This report's aim is to provide an objective perspective as to the consequences of one of the largest financial reforms in the history of the American economy.

COMMUNITY BANKS POST DODD-FRANK

Consistent with financial industry asset-size category protocols, the definition of a community bank will be a bank whose assets are below $10 billion and whose operations largely exist within the United States economy.[3] Other authorities, such as the Government Accountability Office and the Federal Reserve also use this definition. This includes institutions that service rural areas as well as small local economies.

[2] "Economies of scale" is an economic term used to describe a natural condition of an industry where the cost of operations decline as output grows. In other words, as a banking institution grows in operations, its cost of operations, including cost of compliance with regulation, is more easily handled.

[3] On the feedback provided by bank presidents regarding this definition of community banks, it is worth noting that this is a mere quantitative definition. When looking at other factors, such as operations (as will be discussed), the qualities consistent with community banks also include institutions with assets larger than $10 billion. Nevertheless, for the purpose of this analysis, the definition will be quantitative in order to more easily categorize institutions.

This first section provides a literary review from prior studies. Particularly useful is a study conducted by the Massavar-Rahmani Center for Business and Government [M-RCBG] at the Harvard Kennedy School on the *State and Fate of Community Banking*.

1. Economic Observations

<u>Market Share Decline</u>

From 1985 to 2010, the number of community banks shrunk by 58 percent, from 17,997 to 7,551.[4] The number of banks with assets under $100 million experienced a greater decline of 81 percent.[5] The M-RCBG notes that since 2010, the decline has accelerated. In both commercial and industrial lending, community banks' share of the lending market have dropped from 20.6 percent of all loans to 16 percent. Particularly for those with assets under $1 billion, banks experienced a drop of 36 percent in overall lending.[6] Since 1994, community banks' share of the lending market fell by half from 41 to 22 percent.[7]

<u>Trend of Growing Consolidation</u>

Breaking down the 58 percent of community banks that exited the market, 80 percent of those banks merged and only 16 percent had failed.[8] The rapid consolidation of community banks is due to a number of reasons, as will be discussed. After Dodd-Frank was passed, the rate of community bank consolidation has doubled.[9] The M-RCBG reported that from 2006 to 2010

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[4] Ibid.

[5] United States. Government Accountability Office, *Community Banks and Credit Unions: Impact of the Dodd-Frank Act Depends Largely on Future Rule Makings: Report to Congressional Requesters*. GAO 12-881, September 2012. 8.

[6] Lux, Marshall, and Robert Greene. *The State and Fate of Community Banking*. Harvard Kennedy School. Mossavar-Rahamani Center for Business and Government. February 2015. www.hks.harvard.edu/mrcbg. 18.

[7] Lux, Marshall, and Robert Greene. *The State and Fate of Community Banking*. Harvard Kennedy School. Mossavar-Rahamani Center for Business and Government. February 2015. www.hks.harvard.edu/mrcbg. 14.

[8] United States. Government Accountability Office, *Community Banks and Credit Unions: Impact of the Dodd-Frank Act Depends Largely on Future Rule Makings: Report to Congressional Requesters*. GAO 12-881, September 2012. 8.

[9] Lux, Marshall, and Robert Greene. *The State and Fate of Community Banking*. Harvard Kennedy School. Mossavar-Rahamani Center for Business and Government. February 2015. www.hks.harvard.edu/mrcbg. 19.

the number of community banks fell 6.4 percent; from 2010 to 2014, the amount of community banks fell 12.4 percent. As will be noted in the analysis, this report agrees with the M-RCBG report that this correlation may be also accounted as causation by Dodd-Frank.

Important Lending Segments

There are three market areas in which community bank lending serves a critical role: agriculture, small and medium enterprises (SMEs), and local real estate. Community banks provide 46 percent of all local real estate lending. While agricultural lending comprises only two percent of the lending market, 77 percent of agricultural loans originated in community banks, and particularly from banks with less than $1 billion in assets who provide 55 percent.[10] For community banks, 14 percent of all loans were provided to agriculture, compared to one-percent of larger banks. [11] Especially since 2000, the volume of agriculture lending rose over 75 percent from $80 million in 2000 to over $140 million in 2010.[12] Community banks also originate almost 50 percent of the loans to SMEs. Similar to agriculture lending, 18 percent of total community bank lending is to SMEs, while it only comprises five percent of lending for larger banks.[13] Additionally, larger community banks have experienced strong growth in SME loans since 2002 with 8 percent growth.[14]

As the M-RCBG noted, community banks are essential to local economies. The Federal Reserve Board Governor Daniel Tarullo stated,

[10] Lux, Marshall, and Robert Greene. *The State and Fate of Community Banking*. Harvard Kennedy School. Mossavar-Rahamani Center for Business and Government. February 2015. www.hks.harvard.edu/mrcbg. 9.
[11] United States. Government Accountability Office, *Community Banks and Credit Unions: Impact of the Dodd-Frank Act Depends Largely on Future Rule Makings: Report to Congressional Requesters*. GAO 12-881, September 2012. 15.
[12] Lux, Marshall, and Robert Greene. *The State and Fate of Community Banking*. Harvard Kennedy School. Mossavar-Rahamani Center for Business and Government. February 2015. www.hks.harvard.edu/mrcbg. 10.
[13] United States. Government Accountability Office, *Community Banks and Credit Unions: Impact of the Dodd-Frank Act Depends Largely on Future Rule Makings: Report to Congressional Requesters*. GAO 12-881, September 2012. 14.
[14] United States. Government Accountability Office, *Community Banks and Credit Unions: Impact of the Dodd-Frank Act Depends Largely on Future Rule Makings: Report to Congressional Requesters*. GAO 12-881, September 2012. 17.

> [C]redit 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…. [P]articularly in rural areas, the disappearance of community banks could augur a permanent falloff in this kind of credit, at least a portion of which may not be maintained in the more standardized approach to lending, characteristic of larger banks.[15]

Their client-base, service to local economies, and function is necessarily different from larger institutions. While they maintain a smaller market share, community banks nevertheless remain vitally important to communities and economies throughout the United States.

2. Functional Observations

It is widely noted that community banks operate on relationship-based lending practices. GAO reports, the Federal Reserve, and the Federal Deposit Insurance Corporation each acknowledge the differences in lending behavior with community banks. Contrasted with larger banks, whose decision is more mechanically calculated, community banks include context, familiarity, recommendations, and history as factors involved in making lending decisions.[16] [17]

Additionally, community banks do substantially contribute to systemic risk. While their revenue streams are not as diverse, they are not materially or substantially involved in complex hedging and securitization practices.[18] As evidence, the return on assets for community banks remained positive throughout the Crisis, while larger banks' ROA fell to negative margins.[19]

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[15] Lux, Marshall, and Robert Greene. *The State and Fate of Community Banking*. Harvard Kennedy School. Mossavar-Rahamani Center for Business and Government. February 2015. www.hks.harvard.edu/mrcbg. 5.
[16] Interview with President of XYZ Bank
[17] Gustke, Constance. "Community vs. Big Banks | Bankrate.com." Community vs. Big Banks | Bankrate.com. January 2014. Accessed April 2016. http://www.bankrate.com/finance/savings/community-vs-big-banks.aspx.
[18] Disalvo, James, and Ryan Johnston. "BANKING TRENDS: How Dodd–Frank Affects Small Bank Costs." March 2016. https://www.philadelphiafed.org/-/media/research-and-data/publications/banking-trends/2016/bt-how_dodd_frank_affects_small_bank_costs.pdf?la=en.
[19] Lux, Marshall, and Robert Greene. *The State and Fate of Community Banking*. Harvard Kennedy School. Mossavar-Rahamani Center for Business and Government. February 2015. www.hks.harvard.edu/mrcbg. 6.

3. Geographic Observations

Local economies significantly rely on community banks to access credit, capital, and liquidity. Local economies are also a primary customer of community banks. In 2011, the FDIC conducted a study on community banks and found that "more than 1,200 U.S. counties, encompassing 16.3 million people, would have limited physical access to mainstream banking services without the presence of community banks."[20] Community banks are the primary financial institution for rural areas, representing 58 percent of branches and 49 percent of deposits,[21] while their presence in urban locations composes 24 percent and 14 percent of total branches and deposits.

Appendix I provides a map from the FDIC's study which charts the locations of all community and non-community banks throughout America. In 2011, 82 percent of community banks operated within three or fewer counties, in comparison to non-community banks at 37 percent.[22] The FDIC report also provided the long-term trends since 1987 to find that community banks have stayed within three counties, maintaining a much more concentrated scope, while larger institutions have maintained a much wider reach. The study also found that "community banks are more likely to locate their headquarters and banking offices in nonmetro areas than are noncommunity banks."[23]

[20] United States. Federal Deposit Insurance Corporation. Community Banking Initiative. *FDIC's Community Banking Study*. Ch. 3. December 2012.
[21] United States. Government Accountability Office, *Community Banks and Credit Unions: Impact of the Dodd-Frank Act Depends Largely on Future Rule Makings: Report to Congressional Requesters*. GAO 12-881, September 2012. 15.
[22] United States. Federal Deposit Insurance Corporation. Community Banking Initiative. *FDIC's Community Banking Study*. Ch. 3. December 2012. 3-3.
[23] United States. Federal Deposit Insurance Corporation. Community Banking Initiative. *FDIC's Community Banking Study*. Ch. 3. December 2012. 3-4.

4. Legislative Observations

The 20th century set the foundation for Dodd-Frank. After the United States experienced 23 financial crises,[24] including 15 recessions with an average length of 14 months, thirteen sets of legislative acts were passed by Congress. Each set up different agencies that were assigned responsibility for quelling the turbulence of economic cycles and ensuring transparency.[25] In contrast the 19th century saw only five pieces of legislation, and in the 18th century there were three. The latest legislative response, Dodd-Frank, was the culmination of an incrementally increasing micromanagement policy by federal regulations toward the banking sector. As written by Robert G. Wilmers, Chairman of the Board and CEO of M&T Bank, in a letter written in a 2016 to the shareholders, "[T]oday's banking environment is typified by a relationship between institutions and governing agencies that is less than collaborative – a product, it seems, of a political atmosphere where pressure remains upon banks to prove themselves reformed."[26] Another bank's CEO stated, "The regulators have become our first customer."[27]

REPERCUSSIONS ON COMMUNITY BANKS

Dodd-Frank's 2,300 pages of legislation has resulted in 22,296 pages of regulation have been released.[28] As of the latest report in July 2016, only 77 percent (271) of the 390 rules have been finalized; 15 percent (61) of proposed rules have missed their deadlines, and only half of

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[24] Hummel, Jeffrey R. "The History of U.S. Recessions and Banking Crises - Alt-M." AltM. October 22, 2015. http://www.alt-m.org/2015/10/22/the-history-of-u-s-recessions-and-banking-crises/.
[25] Wallace, William H. *The American Monetary System: An Insider's View of Financial Institutions, Markets and Monetary Policy*. Switzerland: Springer International Publishing, 2013. 9.
[26] M&T Bank. Executive. "2015 Annual Report." News release, 2015. http://ir.mandtbank.com/
[27] This comment was obtained during an interview with a president of a Colorado regional bank who asked that he and the bank he represents remain anonymous.
[28] "Welcome to Davis Polk Regulatory Resources™." Five Years of Dodd Frank. http://www.volckerrule.com/infographic/july2015infographic.html.

those have been proposed.[29] The remaining 30 percent of rules surely be consequential and worthy of further study. However, the rules that have been created thus far provide enough repercussions worth addressing. This report specifically analyzes two significant repercussions.

5. Relevant Sections in Dodd-Frank

Appendix II provides a table listing the titles and sections of Dodd-Frank that are relevant to community banks thus far. The Government Accountability Office (GAO), responsible for providing an annual report on Dodd-Frank, reported at the end of 2012 and 2015 the estimated impact of these relevant sections. Currently, there are seven titles and 33 sections[30] that are expected to impact community banks – dependent "on how agencies implement certain provisions through their rules."[31] Many of these rules are finalized and applicable, but Section 165(a)(2) and Section 1022 of Title X allows the Board of Governors and the Consumer Financial Protection Bureau (CFPB) to tailor its rules based upon a variety of factors. Despite this allowance, several rules and principles are comprehensively applied to all banking institutions.[32]

6. Double-Bind in Scaling

Economies of scale exist within the financial industry. A banking institution's marginal profitability increases its operational efficiencies with growth. For any industry, economies of scale is both an incentive to grow and an indicator that the market is more effectively served by

[29] Davis Polk Report. Dodd-Frank Progress Report. July 2016. https://www.davispolk.com/sites/default/files/2016-dodd-frank-six-year-anniversary-report.pdf
[30] Peirce, Hester, Ian C. Robinson, and Thomas Stratmann. "How Are Small Banks Faring Under Dodd-Frank?" *SSRN Electronic Journal SSRN Journal* 14, no. 05 (February 2014). doi:10.2139/ssrn.2435206.
[31] United States. Government Accountability Office, *Dodd-Frank Regulations*: *Impact on Community banks, Credit Unions and Systemically Important Financial Institutions: Report to Congressional Requesters*. GAO 16-169, December 2015. 19.
[32] United States. Government Accountability Office, *Dodd-Frank Regulations*: *Impact on Community banks, Credit Unions and Systemically Important Financial Institutions: Report to Congressional Requesters*. GAO 16-169, December 2015. 12.

larger institutions. Banks with assets over $10 billion consistently earn higher rates of return than community banks.[33] An FDIC study in 2004 found that "smaller institutions tend to have higher equity capital ratios than large banks, which also leads to lower returns on equity at a given level of earnings."[34] They also have fewer productive assets than larger banks, with a capitalization ratio at 10.5 percent in 2014.[35] Furthermore, in 2011 larger banks earned $1.71 for every dollar spent on operating costs. Community banks earned $1.09.[36] This difference in functional performance has been attributed to be the cause of consolidation over the past 50 years along with recent deregulation that has allowed for inter-state mergers.[37]

However, the acceleration in consolidations since 2010 has been due to the increased cost of compliance with Dodd Frank creating the artificial and exaggerated economies of scale. In turn, smaller banks are unsustainable and are forced to either merge or fail. In this way, Dodd-Frank has altered the behavior and shape of the financial industry. Most banks, 61 percent, hold less than $250 million in assets.[38] Supported by single-source revenue streams and interest-income, these financial institutions operate on small margins. These small margins are further slashed by regulatory compliance that costs more per loan and per customer for smaller institutions than for larger banks. Janet Yellen openly recognized this reality, stating that the cost

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[33] United States. Government Accountability Office, *Community Banks and Credit Unions: Impact of the Dodd-Frank Act Depends Largely on Future Rule Makings: Report to Congressional Requesters*. GAO 12-881, September 2012. 10.
[34] United States. Government Accountability Office, *Community Banks and Credit Unions: Impact of the Dodd-Frank Act Depends Largely on Future Rule Makings: Report to Congressional Requesters*. GAO 12-881, September 2012. 11.
[35] Lux, Marshall, and Robert Greene. *The State and Fate of Community Banking*. Harvard Kennedy School. Mossavar-Rahamani Center for Business and Government. February 2015. www.hks.harvard.edu/mrcbg. 5.
[36] United States. Government Accountability Office, *Community Banks and Credit Unions: Impact of the Dodd-Frank Act Depends Largely on Future Rule Makings: Report to Congressional Requesters*. GAO 12-881, September 2012. 12.
[37] United States. Government Accountability Office, *Community Banks and Credit Unions: Impact of the Dodd-Frank Act Depends Largely on Future Rule Makings: Report to Congressional Requesters*. GAO 12-881, September 2012. 8.
[38] United States. Government Accountability Office, *Dodd-Frank Regulations*: *Impact on Community banks, Credit Unions and Systemically Important Financial Institutions: Report to Congressional Requesters*. GAO 16-169, December 2015. 12.

of compliance will have a disproportionate impact on smaller banks.[39] Due to the limited staff, smaller banks are not able to absorb the cost of complying with regulation in a way that curbs its impact on the institution's profitability.

Even though the CFPB has exempted community banks from some legislative mandates, community banks still face significant regulatory costs in the requirements to avoid restricted practices and create systems that prove to regulators that there are no violations. For example, Section 619, known as the "Volcker Rule," prohibits proprietary trading by banking institutions. Only one percent of community banks would be affected by this mandate, as community banks do not primarily engage in this activity. Yet, "[u]nder the proposed rules, banks that do not engage in any covered trading or fund activities must ensure that their existing investment policies and procedures include [proof of] measures that are designed to prevent them from becoming engaged in prohibited activities"[40] (brackets added for emphasis). Another example of unnecessary cost-adding is Section 1073, which requires all financial institutions to provide remittance transfer services. The rule also extends the requirement to include disclosures, receipts, and the ability to cancel 30 minutes after the transaction. However, the GOA study reports that only 10 percent of institutions have this capability, imposing additional costs on the 90 percent of community banks who do not poses this capability.[41] Another example is section

[39] Disalvo, James, and Ryan Johnston. "BANKING TRENDS: How Dodd–Frank Affects Small Bank Costs." March 2016. https://www.philadelphiafed.org/-/media/research-and-data/publications/banking-trends/2016/bt-how_dodd_frank_affects_small_bank_costs.pdf?la=en.

[40] United States. Government Accountability Office, *Community Banks and Credit Unions: Impact of the Dodd-Frank Act Depends Largely on Future Rule Makings: Report to Congressional Requesters*. GAO 12-881, September 2012. 51-52.

[41] United States. Government Accountability Office, *Community Banks and Credit Unions: Impact of the Dodd-Frank Act Depends Largely on Future Rule Makings: Report to Congressional Requesters*. GAO 12-881, September 2012. 59.

723 in Title VII that requires registration and regulation of swap dealers and swap participants.[42] However, as of 2011, only 15 percent of community banks held derivatives, making it a sunk cost for the majority of community banks. Especially with the possibility of requiring community banks to clear swaps through a clearing-house institution, procedural costs irrelevant to community banks would still be incurred.

Tracking the cost of compliance is difficult for community banks as compliance costs are classified as direct costs and part of operations. [43] Due to the nature of community bank accounting, the procedural costs, time, and staff required to distinguish compliance costs from normal operations are not worth the value of the information created.[44] Thus, other data must be gathered. Providing anecdotal evidence, a regional director of a bank stated that since Dodd-Frank was instituted, his compliance staff increased from four to ten full-time employees. The average full-time employee costs more than $65,000 along with $95,000 in additional training.

Some economists have been able to create methods of calculating ROA cost of compliance. The Minneapolis Federal Reserve developed a calculation that concluded "40 basis points is the minimum return on assets that investors require of a small bank…. Nearly 18 percent of banks with less than $50 million in assets would fall below this minimum return if they had to hire an additional full-time employee."[45] Though, in an interview with a bank

[42] United States. Government Accountability Office, *Community Banks and Credit Unions: Impact of the Dodd-Frank Act Depends Largely on Future Rule Makings: Report to Congressional Requesters*. GAO 12-881, September 2012. 54.

[43] United States. Government Accountability Office, *Dodd-Frank Regulations*: *Impact on Community banks, Credit Unions and Systemically Important Financial Institutions: Report to Congressional Requesters*. GAO 16-169, December 2015.

[44] Disalvo, James, and Ryan Johnston. "BANKING TRENDS: How Dodd–Frank Affects Small Bank Costs." March 2016. https://www.philadelphiafed.org/-/media/research-and-data/publications/banking-trends/2016/bt-how_dodd_frank_affects_small_bank_costs.pdf?la=en.

[45] Disalvo, James, and Ryan Johnston. "BANKING TRENDS: How Dodd–Frank Affects Small Bank Costs." March 2016. https://www.philadelphiafed.org/-/media/research-and-data/publications/banking-trends/2016/bt-how_dodd_frank_affects_small_bank_costs.pdf?la=en.

president stated that calculation to be extremely conservative. Furthermore, a 2014 study by the Mercatus Center (George Mason University) found that 90 percent of banks had an increase of cost compliance since Dodd-Frank, and 82 percent had an increase to more than five percent.[46]

The "cost center" of compliance is the first element of the double bind facing community banks. Community banks are faced with two options: grow or merge. Growth is unlikely for the majority of banks servicing rural economies due to the trend of stagnant growth. Economic output and potential is higher in metro areas than in rural communities.[47] Larger banks have recognized this trend, and since 1987 the share of non-community banks' offices and deposits in metro areas has increased by 18 percent and 21 percent, respectively. Larger institutions are migrating toward the fastest-growing metro areas.[48] Nor do larger banks have any incentive to merge into slowly-developing local and rural economies. The second option is to grow; however, since community banks are the primary financial service provider for these economies, the slower rate of community growth limits the bank opportunities available.[49] Consequently, even if most of the smaller institutions would be able to absorb the costs without failing, the very least consequence will be a significant number of smaller banks that will exit the market. In turn, this would severely damage the rural economy in America, seeing that "[m]any nonmetro areas tend to rely much more heavily on community banks as their lifeline to mainstream financial services."[50] Furthermore, in 2012 an estimated 40 percent of low population rural counties, and 43 percent of low population rural counties next to a metro area, do not have a financial

[46] Peirce, Hester, Ian C. Robinson, and Thomas Stratmann. "How Are Small Banks Faring Under Dodd-Frank?" *SSRN Electronic Journal SSRN Journal* 14, no. 05 (February 2014). doi:10.2139/ssrn.2435206.
[47] United States. Federal Deposit Insurance Corporation. Community Banking Initiative. *FDIC's Community Banking Study*. Ch. 3. December 2012. 3-6.
[48] United States. Federal Deposit Insurance Corporation. Community Banking Initiative. *FDIC's Community Banking Study*. Ch. 3. December 2012. 3-7.
[49] United States. Federal Deposit Insurance Corporation. Community Banking Initiative. *FDIC's Community Banking Study*. Ch. 3. December 2012. 3-9.
[50] United States. Federal Deposit Insurance Corporation. Community Banking Initiative. *FDIC's Community Banking Study*. Ch. 3. December 2012. 3-5.

institution office or branch present in the county.[51] Due to the increase in consolidation of community banks since Dodd-Frank, that gap continues to grow.

A secondary impact is in the removal of community banks' relationship-based lending. As previously noted, the process by which community banks make lending decisions is both specific and essential to how local economies operate. Without this relationship-based connection to financial intermediaries, the transfer of capital and credit flow becomes severely restricted.[52] Therefore, even if it was conceded that community banks would be able to survive, the influence of regulatory compliance, at the minimum, is disruptive of the local economy.

The other side of this double bind is a dis-incentive to grow. Exceptions for smaller institutions exist in Dodd-Frank, which is defined by an asset threshold of less than $10 billion. Thus, the brunt of burdening regulation falls on institutions larger than $10 billion. An example is Section 1075 which mandates a decrease of interchange transaction fees, from 44 cents per transaction to 22 cents.[53] This significant reduction threatens one of the most important non-interest income streams for community banks, which is integral to community bank earnings.[54] As another example, Section 334 increases capital ratio requirements[55] to 1.35 percent of

[51] Ellinger, Paul. "Bank Branch Expansion in Rural Areas." Farmdoc Daily. May 25, 2012. http://farmdocdaily.illinois.edu/2012/05/bank-branch-expansion-in-rural.html. University of Illinois at Urbana-Champaign

[52] Skeel, David Arthur, JD. "Five Years after Dodd-Frank: Unintended Consequences and Room for Improvement." *University of Pennsylvania Public Policy Initiative* 3, no. 10 (December 2015): 1-7. publicpolicy.wharton.upenn.edu.

[53] Disalvo, James, and Ryan Johnston. "BANKING TRENDS: How Dodd–Frank Affects Small Bank Costs." March 2016. https://www.philadelphiafed.org/-/media/research-and-data/publications/banking-trends/2016/bt-how_dodd_frank_affects_small_bank_costs.pdf?la=en.

[54] Ibid.

[55] "Federal Deposit Insurance Corporation." FDIC: FDIC Initiatives under the Dodd-Frank Wall Street Reform and Consumer Protection Act. February 2016. https://www.fdic.gov/regulations/reform/initiatives.html.

uninsured deposits.[56] An increase in capital requirements means less productive assets available for lending. This translates into fewer profits.

As a result, according to a regional community bank president[57] some banks just over $10 billion are seeking to drop below the threshold line and those near the threshold line are attempting to restrict their growth. For financial institutions already larger than $10 billion, the cost of compliance spurs an increased assumption of risk in order to compensate for the lowered margins. In turn, this compounds the systemic risk which Dodd-Frank originally sought to avoid. William H. Wallace wrote in *The American Monetary System*, “Banks, generally, have not been the leaders in the process of change; they have reacted to change.”[58] Ultimately, the incentives and structure of the financial industry has been changed by the mandates from Dodd-Frank. Smaller institutions are more susceptible to fail, harming local economies.

7. Limited Lending Policy – Excluding Market Segments

Beyond the impact to community banks themselves, Dodd-Frank also poses repercussions on a socio-economic level. Dodd-Frank intentionally restricts lending practices in Subtitle B of Title XIV through Qualified Mortgage and Ability-to-Repay standards. The aim was to prohibit the loose underwriting practices that caused the Crisis.[59] The Consumer Financial Protection Bureau (CFPB) is responsible for this mandate and has created a criterion to define and identify irresponsible loans. Community banks do not pose systemic risk in any significant degree; by definition community banks have a small minority of assets in the lending market.

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[56] U.S. Congress. *Dodd-Frank Wall Street Reform and Consumer Protection Act*. 111th Cong., 2d sess. Cong. H.R. 4173. Washington, D.C.: U.S. G.P.O., 2010. (Sec. 334).

[57] This comment was obtained during an interview with a president of a Colorado regional bank who asked that he and the bank he represents remain anonymous.

[58] Wallace, William H. *The American Monetary System: An Insider’s View of Financial Institutions, Market and Monetary Policy*. Switzerland: Springer International Publishing, 2013. 26.

[59] United States. Consumer Financial Protection Bureau. *Ability-to-Repay and Qualified Mortgage Rule*. Title XIV Mortgage-related Rules. 2016. http://www.consumerfinance.gov/policy-compliance/guidance/implementation-guidance/title-xiv-mortgage-rules/. 18.

Moreover, customer segments such as small and medium enterprises (SMEs) and low-income populations are incorrectly ineligible for loans based upon these standards. The consequence is an exclusionary system that derails the purpose of financial intermediaries.

Qualified Mortgages (QM)

Section 1412 defines a qualified mortgage (QM) to be mortgages "for which the regular periodic payments for the loan may not result in an increase of the principal balance or allow the consumer to defer repayment of principal."[60] Based upon the CFPB rules adopted in June 2014, QMs serve as a bright-line for liability assumed by banks providing mortgage liens. The four types of QMs (General, Temporary, Small-Creditor, and Balloon-Payments) are based upon where they can be originated. For each type of QM, different standards apply.[61] QMs shield a banking institution from liability in case the debtor decides to sue in default or foreclosure situations. As the Federal Reserve Bank of Philadelphia Research Department found, QMs apply to smaller banks disproportionately in comparison to larger ones, as smaller banks are more heavily involved in the local real estate market.[62] Because of the risk, many banks, and especially community banks, have decided not to provide non-QM loans in order to avoid the exposure to liability. In a 2015 survey of community banks, only one-third (974) said they would provide non-QMs on an exceptional basis.[63] QM criteria also requires abidance by ATR standards.

Ability-to-Repay (ATR)

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[60] U.S. Congress. *Dodd-Frank Wall Street Reform and Consumer Protection Act*. 111th Cong., 2d sess. Cong. H.R. 4173. Washington, D.C.: U.S. G.P.O., 2010. (Sec. 1412).

[61] United States. Consumer Financial Protection Bureau. *Ability-to-Repay and Qualified Mortgage Rule*. Title XIV Mortgage-related Rules. 2016. http://www.consumerfinance.gov/policy-compliance/guidance/implementation-guidance/title-xiv-mortgage-rules/. 18.

[62] Disalvo, James, and Ryan Johnston. "BANKING TRENDS: How Dodd–Frank Affects Small Bank Costs." March 2016. https://www.philadelphiafed.org/-/media/research-and-data/publications/banking-trends/2016/bt-how_dodd_frank_affects_small_bank_costs.pdf?la=en.

[63] United States. Government Accountability Office, *Dodd-Frank Regulations*: *Impact on Community banks, Credit Unions and Systemically Important Financial Institutions: Report to Congressional Requesters*. GAO 16-169, December 2015. 27.

Section 1411 prohibits financial institutions from making a mortgage loan without meeting the requirements of proof that the customer has the ability to repay the loan based upon verified and documented information.[64] Eight items are required for loan eligibility:

[64] United States. Government Accountability Office, *Community Banks and Credit Unions: Impact of the Dodd-Frank Act Depends Largely on Future Rule Makings: Report to Congressional Requesters*. GAO 12-881, September 2012. 37.

1. Current or reasonably expected income or assets (other than the value of the property that secures the loan) that the consumer will rely on to repay the loan

2. Current employment status

3. Monthly mortgage payment

4. Monthly payment on simultaneous loans

5. Monthly payment for property taxes and expenses

6. Debts, Alimony, and child-support

7. Monthly debt-to-income ratio or residual income, that is calculated using the total of all of the mortgage and non-mortgage obligations listed above, as a ratio of gross monthly income

8. Credit History[65]

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[65] United States. Consumer Financial Protection Bureau. *Ability-to-Repay and Qualified Mortgage Rule*. Title XIV Mortgage-related Rules. 2016. http://www.consumerfinance.gov/policy-compliance/guidance/implementation-guidance/title-xiv-mortgage-rules/. 18.

The GAO stated in a 2015 report that this legally required standard of eligibility incurs substantial costs to the potential debtor and restricts the availability of mortgage credit.[66] This conflicts with how community banks operate on a relationship-based process. A bank president stated during an interview that community banks have privity to contextual knowledge, are familiar with the history and environment of the economy, and generally maintain relationships with their customers and recommendations. Decisions are not *solely* dependent upon mechanical calculations. Removing this function of community banks removes a critical element of the community bank's role in the local economy.[67]

As a result, segments of the market become ineligible for such loans, by law and without exceptions. The President of the Colorado Banker's Association mentioned that the group most directly affected by this restriction are those in low-income or recently unemployed/retired.[68] Due to the legal requirement to prove credit history, the profiles of those in low-income situations inherently look insolvent on its face. Recently unemployed or retired individuals do not often have proof of income. In fact, these criterion calculations (particularly item #7 above) actually misconstrue situations that render it unnecessarily difficult for customers to be eligible. Debt-ratio calculations from all debt sources must be combined in assessing the individual's profile. This particularly affects small business owners and sole proprietors whose company's assets and liability are recognized as their own. Ratios that would look and be prudent standing alone are ignored. In turn, low-income individuals have an unnecessarily difficult time in

[66] United States. Government Accountability Office, *Dodd-Frank Regulations*: *Impact on Community banks, Credit Unions and Systemically Important Financial Institutions: Report to Congressional Requesters*. GAO 16-169, December 2015. 25.
[67]*Mars, Shayla.* MyBankTracker. "What to Consider When Deciding on Large vs. Community Bank." The Huffington Post. August 27, 2013. http://www.huffingtonpost.com/mybanktracker/what-to-consider-when-dec_b_3805598.html.
[68] "On Community Banks and Dodd-Frank's Impact." Interview by author. March 22, 2016.

receiving loans, even from institutions intentionally set up to provide services to low-income populations (i.e. Habitat for Humanity). The conversation, context, and relationship-based information that community banks glean from relationship-based processes is eliminated, and responsible people suffer as a result.

For SMEs, community bank lending doubled from 1998-2008. Since 2010, SME lending has fallen by 11 percent.[69] In fact, this consequence may be a factor contributing to the decline in local economies. Due to the requirements, several layers of data gathering, audits (by the bank, the business, and independent parties), and bank analyses extend the timeframe of acquiring a loan and the cost incurred during the process. Ultimately, the mandated process for loan origination prevents community banks from exercising their local knowledge in ways that makes their role as the financial intermediary most effective.

POLICY RECOMMENDATIONS

In turning to the recommendations for changes and reform, it is most important to note at the outset that community banks were not the cause for the Crisis. The nature of community banks makes the significance of their contribution to systemic risk almost irrelevant. Asset structure, operations, capitalization, and past failure tests, point out that community banks do not pose a significant threat to the country's financial stability. A well-regulated financial system ought to reflect that reality. In the most recent Congressional Session (114), several initiatives were created to address Dodd-Frank.[70] H.R. 4894 seeks to repeal all of Title II in Dodd-Frank.[71]

[69] Lux, Marshall, and Robert Greene. *The State and Fate of Community Banking*. Harvard Kennedy School. Mossavar-Rahamani Center for Business and Government. February 2015. www.hks.harvard.edu/mrcbg. 11.
[70] http://financialservices.house.gov/dodd-frank/
[71] U.S. Congress. *To repeal title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act*. 114th Cong., 2nd sess. Cong. H.R. 4894. Washington, D.C.: U.S. G.P.O., 2015. https://www.congress.gov/bill/114th-congress/house-bill/4894?resultIndex=11

H.R. 3340 attempts to reform the Financial Services Oversight Council.[72] A U.S. District Court ruled against the FSOC in classifying MetLife as a SIFI.[73] This analysis will not comment on those initiatives but points out that Dodd-Frank is experiencing more review and inspection.

8. Policy Recommendation

A simple way of easing the issue of an unnecessary compliance burden is to exempt community banks. Specifically, this study proposes: amending Dodd-Frank to exempt all banks with assets under $10 billion from QM and ATR standards if the bank holds 100 percent of the loan; furthermore, exempting all community banks from legislative requirements (as mentioned), rather than requiring proof of innocence. For financial stability, this proposal solves the issue of systemic risk and excluding market segments from loan-eligibility. For community banks, it would eliminate the unnecessary mandates that threatens sustainability and solvency.

Second, there must be an effort to narrow the scope of agency mandates and limit the federal agency's discretionary authority. Title X created the CFPB and empowered it with discretionary authority to interpret mandates and issue rules that create the compliance regulations. The Board of Governors, CFPB, SEC, FDIC, and FSOC each have the discretionary power by Dodd-Frank to interpret and apply regulation. The role of administrative authority limits the accountability and oversight of implementation; in turn, this contradicts the rule of law. Legal provisions and expectations of compliance have become more vague.[74] Limiting the scope of authority may bolster the effectiveness of mandates as issued by Congress. Third, Ben

[72] U.S. Congress. *Financial Stability Oversight Council Reform Act.* 114th Cong., 2nd sess. Cong. H.R. 3340. Washington, D.C.: U.S. G.P.O., 2015. https://www.congress.gov/bill/114th-congress/house-bill/3340?resultIndex=9
[73] Person, and Ryan Tracy. "MetLife Wins Bid to Shed 'Systemically Important' Label." WSJ. March 2016. http://www.wsj.com/articles/federal-judge-rescinds-federal-government-determination-that-metlife-is-systemically-important-1459349828.
[74] Skeel, David Arthur, JD. "Five Years after Dodd-Frank: Unintended Consequences and Room for Improvement." *University of Pennsylvania Public Policy Initiative* 3, no. 10 (December 2015): 1-7. publicpolicy.wharton.upenn.edu.

Bernanke commended Dodd-Frank's attempt to "level the playing field." [75] Before the Crisis, not all institutions were supervised, which was one of the primary reasons for the Crisis.[76] Nevertheless, intervening in such a way that levels the playing field of competition, by overregulating a different sector, does not help free-market competition. An attempt must be made to orient the mandates in a way that ensures equitable treatment, according to banking categorizations not as any form of overreacting correction.

9. Current Amendment – H.R. 2896

H.R. 2896, the TAILOR ACT, is an example of legislation that is currently being considered in Congress. Proposed by Scott Tipton (R-CO) in October 2015, the TAILOR ACT would require "federal financial institutions regulatory agencies to take risk profiles and business models of institutions into account when taking regulatory actions."[77] The provisions include cost-benefit analyses, increased supervision before House Committees, and a requirement that agencies apply the action "in a manner that limits the regulatory compliance impact, cost, liability risk, and other burdens."[78] In an October hearing, Americans for Financial Reform (AFR) argued that this regulation is unnecessary, since Section 165(a) (2) already provides this allowance: "taking into consideration their capital structure, riskiness, complexity, financial activities… size, and any other risk related factors."[79] The flaw in AFR's argument is that rules *have been made* to smaller institutions based upon what is "best practices" for larger institutions,

[75] United States. Government Accountability Office, *Community Banks and Credit Unions: Impact of the Dodd-Frank Act Depends Largely on Future Rule Makings: Report to Congressional Requesters*. GAO 12-881, September 2012.
[76] Bernanke, Ben S. *The Courage to Act: A Memoir of a Crisis and Its Aftermath*. New York, London: W.W. Norton & Company, 2015. 95.
[77] U.S. Congress. *Taking Account of Institutions with Low Operating Risk Act of 2015.* 114th Cong., 1st sess. Cong. H.R. 2896. Washington, D.C.: U.S. G.P.O., 2015.
[78] U.S. Congress. *Taking Account of Institutions with Low Operating Risk Act of 2015.* 114th Cong., 1st sess. Cong. H.R. 2896. Washington, D.C.: U.S. G.P.O., 2015.
[79] U.S. Congress. *Dodd-Frank Wall Street Reform and Consumer Protection Act*. 111th Cong., 2d sess. Cong. H.R. 4173. Washington, D.C.: U.S. G.P.O., 2010. (Sec. 165)

regardless of the differences. Furthermore, financial regulators are exempt from E.O. 12,866 which requires cost-benefit analyses and regulatory alternatives, Section 165 leaves it open to discretion. As, Dr. Paul Kupiec, a resident scholar at the American Enterprise Institute, argued in the same hearing, the TAILOR ACT would explicitly require relevance in a pertinent manner.[80] H.R. 2896 may in time successfully ensure appropriate application.

10. Timeless Principles

It is possible that the recommended legislation could be instituted, or amended in such a way that renders the large extent of this analysis moot. With that possibility, this report will conclude with an observation that will be germane beyond the changing of Dodd-Frank.

As mentioned previously, the banking system of the United States is not a monolith. The banking industry has been diverse, deep, and split between larger and more community-based institutions.[81] This bifurcated structure is healthy and allows for the economy to be served as it needs. The diversity, uniqueness, and tailored service that different financial intermediaries provide to the United States economy on all levels is a fundamental reason for the economy's progress, and has been a hallmark of America's financial economy as a whole. The banking system is critical to the stability of the economy. An attempt to micro-manage the financial system and its institutions will compromise growth and the diversity of the United States' economy.

[80] Retrieval of Congressional Hearing records through ProQuest LLC. Accessed March 25, 2016 (Committee Majority Staff, October 19, 2015, Subcommittee on Financial Institutions and Consumer Credit).
[81] United States. Kansas City Federal Reserve. Economic Research Department. *The Role of Community Banks in the U.S. Economy*. 2003. https://www.kansascityfed.org/PUBLICAT/ECONREV/PDF/2q03keet.pdf

CONCLUSION

The past century has experienced a pendulum swing in economic regulation, attempting to find a balance between control and freedom. After 2008, Dodd-Frank swung to one side regulating banks that did not cause the Crisis. While Dodd-Frank maintains certain provisions that are needed and appropriate, it fails to accurately address the reality of America's diverse financial system. The effect on community banks is more than an inconvenience; the sustainability of community banks is threatened. In turn, the sustainability of local economies, which heavily rely upon community banks for their credit and capital flow, are put at risk. Consequentially, the trend of bank consolidation will continue to accelerate due to artificially exaggerated economies of scale, local economies, small businesses, and low-income groups are isolated. Ultimately, economic policy must be regionally appropriate in order to maximize the potential that financial intermediaries provide to the economy.

FOR FUTURE STUDIES AND RESEARCH

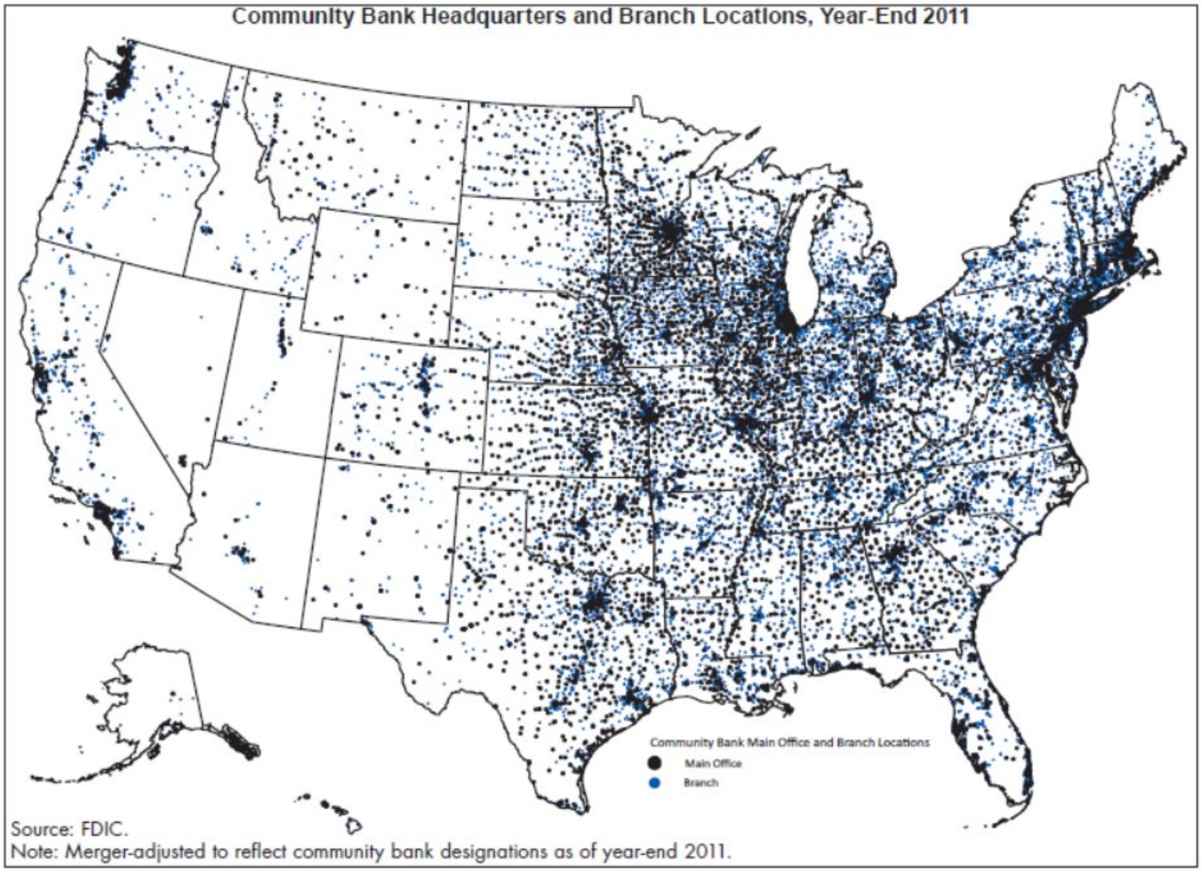
In pursuing additional studies similar and relevant to this analysis, the following topics may serve to provide greater insight and depth:

- The Return on Assets of community banks, what are primary drivers and how sensitive is it to economic turbulence in the adjacent economy.
- The role of local knowledge and what standards do community banks find most fitting.
- A cost-benefit analysis of capital requirements on community banks in comparison to larger institutions.
- The Savings and Loans Crisis in the 1980s, its primary cause and if the current system will create a similar crisis to reoccur.
- Factors that drive ROE ratios for community banks, and how sensitive they are to the cost of compliance.
- Capital-Ratio levels and if it incentives greater risk taking for larger community banks.

APPENDIX I

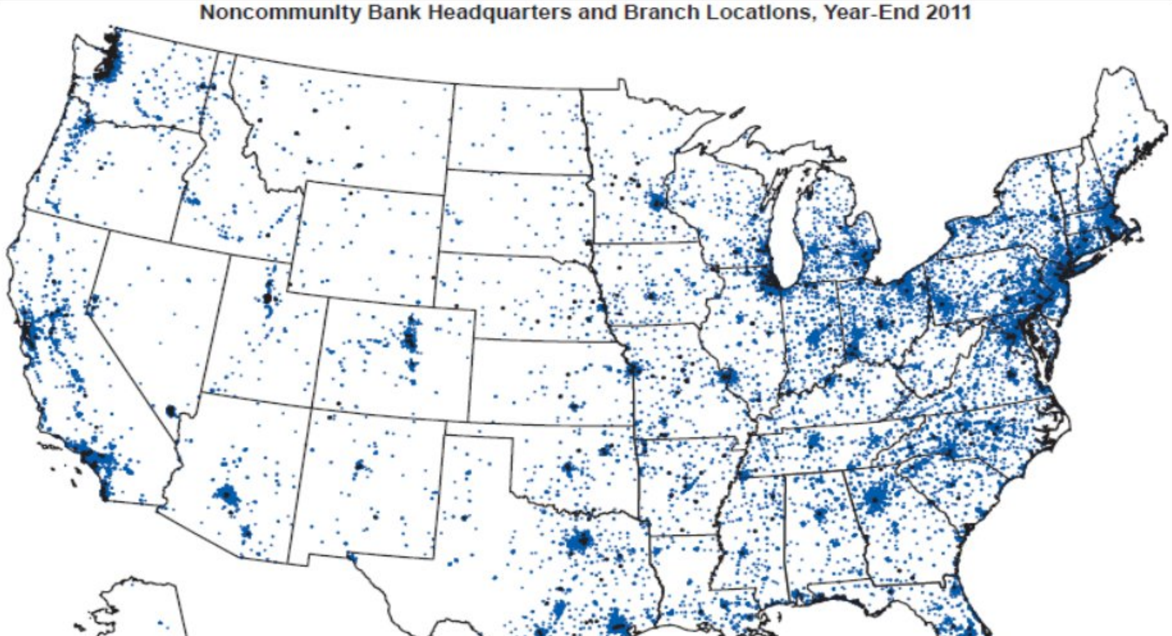
Geography of Community Banks v Non-Community Banks

Source: FDIC Study in 2011



(*FDIC Community Banking Study)*

Noncommunity Bank Headquarters and Branch Locations, Year-End 2011



Source: FDIC.
Note: Merger-adjusted to reflect community bank designations as of year-end 2011.

APPENDIX II

Dodd-Frank Provisions – Relevant to Community Banks

Source: GAO Report – September 2012
(Community Banks and Credit Unions: Impact of Dodd-Frank Act Depends Largely on Future Rule Makings)

Table 6: Dodd-Frank Act Provisions Expected by Federal Regulators, State Regulatory Associations, and Industry Associations to Impact Community Banks and Credit Unions

Title and subtitle	Provisions expected to impact community banks and credit unions
Title I—Financial Stability	
Subtitle C—Additional Board of Governors Authority for Certain Nonbank Financial Companies and Bank Holding Companies	Section 165, Enhanced supervision and prudential standards for nonbank financial companies supervised by the Board of Governors of the Federal Reserve System (Federal Reserve) and certain bank holding companies. Section 165(h)(2)(B) permits the Federal Reserve to require publicly traded bank holding companies with less than $10 billion in assets to establish a risk committee.
	Section 171, Leverage and risk-based capital requirements. This section requires federal banking agencies to establish minimum leverage and risk-based capital requirements on a consolidated basis for insured depository institutions, depository institution holding companies, and systemically important nonbanks. Section 171(b)(4)(C) exempts from capital deductions otherwise required by this section debt or equity instruments issued before May 19, 2010, by bank holding companies with less than $15 billion in assets and mutual holding companies. Moreover, section 171(b)(5)(C) exempts from section 171 bank holding companies subject to the Federal Reserve's Small Bank Holding Company Policy Statement in effect on May 19, 2010.
Title II—Orderly Liquidation Authority	
Title III—Transfer of Powers to the Comptroller of the Currency, the Corporation, and Board of Governors	
Subtitle A—Transfer of Powers and Duties	Subtitle A of Title III abolishes the Office of Thrift Supervision and provides for the transfer of its functions and authorities to the Office of the Comptroller of the Currency (OCC), Federal Deposit Insurance Corporation (FDIC), and Federal Reserve.
Subtitle C—Federal Deposit Insurance Corporation	Subtitle C of Title III contains provisions that make changes to the federal deposit insurance regime, including (1) redefining the assessment base against which deposit insurance premiums are calculated (section 331) and increasing the standard maximum deposit and share insurance amount from $100,000 to $250,000 (section 335).
	Section 334, Transition reserve ratio requirements to reflect new assessment base. This provision exempts banks with less than $10 billion in assets from the increase in the minimum reserve ratio.
Subtitle D—Other Matters	Section 341, Branching. Section 341 permits any thrift that converts to a bank charter to continue to operate branches and agency offices in existence prior to the charter conversion.
	Section 343, Insurance of transaction accounts. Section 343 provided temporary unlimited deposit and share insurance coverage for non-interest-bearing transaction accounts from December 31, 2010, through December 31, 2012.
Title IV—Regulation of Advisers to Hedge Funds and Others	
Title V—Insurance	
Title VI—Improvements to Regulation of Bank and Savings Association Holding Companies and Depository Institutions	
	Section 613, De novo branching into states. Section 613 expands the de novo interstate branching authority of national and state banks by eliminating the requirement that a state expressly opt-in to de novo branching.
	Section 619, Prohibitions on proprietary trading and certain relationships with hedge funds and private equity funds. This section prohibits banking entities from engaging in proprietary trading and private fund management activities, subject to certain exemptions.
	Section 627 Interest-bearing transaction accounts authorized. This section eliminates the prohibition against the payment of interest on demand deposits (e.g., commercial checking accounts).

Title and subtitle	Provisions expected to impact community banks and credit unions
Title VII—Wall Street Transparency and Accountability	
	Title VII contains provisions that authorize Commodity Futures Trading Commission (CFTC) and Securities and Exchange Commission (SEC) to regulate the OTC derivative markets and subject various market participants to capital, margin, business conduct, and other requirements.
Subtitle A—Regulation of Over-the-Counter Swaps Markets	Section 721, Definitions. Section 721 amends the Commodity Exchange Act to require CFTC to exempt an entity that engages in de minimis derivatives from the swap dealer definition.
	Section 723, Clearing. This section provides CFTC with the authority to exempt from the mandatory clearing requirement community banks and credit unions with less than $10 billion in assets.
	Section 737, Position limits. This section provides CFTC with the discretionary authority to exempt community banks or credit unions, among other entities and transactions, from the position limits.
Subtitle B—Regulation of Security-Based Swap Markets	Section 761, Definitions under the Securities Exchange Act of 1934. Section 761 amends the 1934 act to require SEC to exempt an entity that engages in de minimis quantity of security-based swap dealing from the swap dealer definition.
	Section 763, Amendments to the Securities Exchange Act of 1934. This section amends the 1934 act to authorize SEC to exempt from the mandatory clearing requirement community banks and credit unions with less than $10 billion in assets. The amendment also provides SEC with the discretionary authority to exempt entities from position limits.
Title VIII—Payment, Clearing, and Settlement Supervisor	
Title IX—Investor Protections and Improvements to the Regulation of Securities	
Subtitle C—Improvements to the Regulation of Credit Rating Agencies	Section 939A, Review of reliance on ratings. Section 939A requires federal banking and other agencies to review their regulations requiring the use of credit ratings with a goal of modifying those regulations by substituting for such use the standard of creditworthiness they deem appropriate.
Subtitle D—Improvements to the Asset-Backed Securitization Process	Subtitle D of Title IX contains provisions that require federal agencies to jointly issue rules requiring a securitizer of an asset-backed security (other than a residential mortgage-backed security) to retain at least 5 percent of the credit risk in any asset that the securitizer, through the issuance of an asset-backed security, transfers, sells, or conveys to a third party.
	Section 941, Regulation of credit risk retention. This section includes language providing regulators with the discretionary authority to exempt entities from the risk retention requirements.
Subtitle E—Accountability and Executive Compensation	Subtitle E of Title XI contains provisions that require additional executive compensation-related disclosures by public companies, including requiring such companies to hold a non-binding vote to approve the compensation of certain executives (Section 951).
	Section 956, Enhanced compensation structure reporting. This section requires financial institutions to report incentive compensation to their regulator and prohibits incentive compensation that is “excessive” or “could lead to material financial loss” at an institution. Financial institutions with less than $1 billion in assets are exempted from this provision.
Subtitle G—Strengthening Corporate Governance	Section 971, Proxy access. Subsection 971(c) provides SEC with the authority to exempt certain issuers from the proxy access requirement.
Subtitle H—Municipal Securities	Section 975, Regulation of municipal securities and changes to the board of the Municipal Securities Rulemaking Board. Section 975 amends section 15B of the Securities Exchange Act, 15 U.S.C. § 78o-4, to require municipal advisors, who were largely unregulated, to register with SEC like other financial advisors.
Subtitle I—Public Company Accounting Oversight Board, Portfolio Margining, and Other Matters	Section 989G, Exemption for nonaccelerated filers. Section 989G exempts smaller issuers from section 404(b) of the Sarbanes-Oxley Act, 15 U.S.C. § 7262(b).

Title and subtitle	Provisions expected to impact community banks and credit unions
Title X—Bureau of Consumer Financial Protection	
Subtitle A—Bureau of Consumer Financial Protection	Subtitle A of Title X contains provisions that create CFPB to regulate financial products or services provided by insured depository institutions, finance companies, mortgage lenders, and a broad range of nontraditional financial services entities, and provides CFPB with the authority to prevent covered institutions from engaging in unfair, deceptive, or abusive acts or practices in the provision of consumer financial products and services.
Subtitle B—General Powers of the Bureau	Subtitle B of Title X contains provisions that provide CFPB the authority to prescribe rules and issue orders and guidance, as may be necessary or appropriate to enable the Bureau to administer federal consumer financial laws.
	Section 1022, Rule-making authority. Section 1022(b)(3) grants CFPB broad authority to exempt entities from the provisions of Title X or any rule under Title X. This could include community banks and credit unions.
	Section 1024, Supervision of nondepository covered persons. Provides CFPB with supervisory and enforcement authority for federal consumer financial protection laws for certain nonbank institutions such as nonbank institutions that provide origination, brokerage, or servicing of residential real estate loans.
	Section 1025. Supervision of very large banks, savings associations, and credit unions. This provision generally excludes banks and credit unions with $10 billion or less in assets (other than affiliates of large banks) from CFPB supervision.
	Section 1026, Other banks, savings associations, and credit unions. This section provides CFPB with certain authority over small banks and credit unions with less than $10 billion in assets. This authority allows CFPB to require reports, as necessary, from small banks and credit unions and CFPB, at its discretion, may include its examiners on a sampling basis in small banks and credit union examinations conducted by their prudential regulator.
Subtitle C—Specific Bureau Authorities	Subtitle C of Title X contains sections that provide CFPB with the authority to prescribe rules identifying as unlawful, unfair, deceptive, or abusive acts or practices for a consumer financial product or service and to ensure that the features of any consumer financial product or service are fully, accurately, and effectively disclosed to consumers. In addition, it requires the CFPB to establish reasonable procedures to provide a timely response to consumers to complaints against or inquiries concerning a financial institution.
	Section 1032, Disclosures. This section includes a provision (section 1032(f)) that requires CFPB to combine disclosures required under the Truth in Lending Act (TILA) and sections 4 and 5 of the Real Estate Settlement Procedures Act of 1974 into a single disclosure.
Subtitle G—Regulatory Improvements	Section 1071 Small business loan data collection. This section requires that lenders collect and report to CFPB certain women-owned, minority-owned, and small business loan data. In addition, this provision provides CFPB with the discretionary authority to exempt any financial institution from the data collection and reporting requirements.
	Section 1073 Remittance transfers. This section requires disclosures to consumers that send money remittance transfers in accordance with rules to be prescribed by CFPB.
	Section 1075 Reasonable fees and rules for payment card transactions. This section requires the Federal Reserve to prescribe regulations regarding any interchange transaction fee that an issuer may receive or charge for an electronic debit transaction. This provision includes an exemption for institutions with less than $10 billion in assets from the cap on debit card interchange fees.
Subtitle H—Conforming Amendments	Section 1094 Amendments to the Home Mortgage Disclosure Act of 1975 (HMDA). This section amends HMDA to expand the scope of information relating to mortgage loans to add a number of new data elements.

Title and subtitle	Provisions expected to impact community banks and credit unions
	Section 1098 Amendments to the Real Estate Settlement Procedures Act of 1974. This section requires CFPB to issue rules that combine two different mortgage loan disclosures, one required by the TILA and the other by the Real Estate Settlement Act.
Title XI—Federal Reserve System Provisions	
Title XII—Improving Access to Mainstream Financial Institutions	
Title XIII—Pay it Back Act	
Title XIV—Mortgage Reform and Anti-Predatory Lending Act	
Subtitle A—Residential Mortgage Loan Origination Standards	Subtitle A of Title XIV contains provisions that establish certain origination standards to be applied by lenders in the underwriting of residential mortgage loans, including registration and licensing requirements for mortgage originators and a prohibition on steering and certain mortgage originator compensation.
	Section 1405. Regulations. CFPB may, by rule, exempt from or modify disclosure requirements, in whole or in part, for any class of residential mortgage loans for which it determines that such exemption or modification is in the interest of consumers and in the public interest.
Subtitle B—Minimum Standards For Mortgages	Subtitle B of Title XIV contains provisions that establish minimum standards for mortgage loans.
	Section 1411, Ability to Repay. This section amends the TILA to provide that no creditor may make a residential mortgage loan unless the creditor makes a reasonable and good faith determination based on verified and documented information that the consumer has the reasonable ability to repay the loan at the time the loan is consummated.
	Section 1412, Safe Harbor and Rebuttable Presumption. This section provides the "qualified mortgage" criteria under which a creditor or assignee may presume the ability-to-repay requirements have been met. It also provides regulators with the authority to consider certain loans as qualified mortgages as long as they meet certain criteria, including balloon loans being extended by a lender that operates in a predominantly rural or underserved area.
	Section 1422, State attorney general enforcement authority. This section provides state attorneys general with increased enforcement authority for certain provisions of TILA including steering prohibitions; ability to repay; minimum standards for residential mortgage loans; appraisal independence; prompt crediting of mortgage payments; requests for payoff amounts; and property appraisal requirements.
Subtitle C—High-Cost Mortgages	Subtitle C of Title XIV contains provisions that expand the definition of high-cost mortgage, enhance existing protections regarding prepayment penalties and balloon payments, and prohibit certain practices.
Subtitle E—Mortgage Servicing	Subtitle E of Title XIV contains provisions that require the establishment of escrow or impound accounts for the payment of taxes and insurance in connection with certain first lien mortgage loans.
	Section 1461, Escrow and impound accounts relating to certain consumer credit transactions. This section includes a provision authorizing CFPB to exempt from the escrow requirements entities that operate in predominantly rural or underserved areas; have total annual mortgage loan originations that do not exceed a certain limit; retain their mortgage loan originations in portfolio; or meet any asset-size threshold and any other criteria established by CFPB.
	Section 1462, Disclosure notice for consumers who waive escrow services. This section amends TILA to add a requirement that creditors provide specified disclosures to consumers who waive escrow services.
Subtitle F—Appraisal Activities	Subtitle F of Title XIV contains provisions regarding appraisals in connection with residential mortgage loans.

Title and subtitle	Provisions expected to impact community banks and credit unions
	Section 1471, Property appraisal requirements. This section provides regulators with discretionary authority to exempt, by rule, a class of loans from the appraisal requirements in this section if they determine that the exemption is in the public interest and promotes the safety and soundness of creditors.
	Section 1472, Appraisal Independence Requirements. This section amends TILA by adding appraisal independence requirements. These requirements include, among other things, a description of acts or practices that violate appraisal independence, a list of actions that an appraiser can take at the request of an interested party but do not violate independence, and mandatory reporting of appraisers that do not comply with Uniform Standards of Professional Appraisal Practice to state appraiser certifying and licensing agencies.
Title XV—Miscellaneous Provisions	
Title XVI—Section 1256 Contracts	

Source: GAO analysis of information collected from federal regulators (the Federal Deposit Insurance Corporation, the Federal Reserve, National Credit Union Administration, Office of the Comptroller of the Currency, and the Bureau of Consumer Financial Protection); state regulatory associations (Conference of State Bank Supervisors and National Association of State Credit Union Supervisors); and industry associations, including the American Bankers Association, Independent Community Bankers of America, Credit Union National Association, and National Association of Federal Credit Union.