Survival of the Biggest? How Community Banks Can Survive Without Deregulation

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I. INTRODUCTION

The banking industry has experienced several significant changes in regulation in the past three decades. The most recent change stemmed from the Economic Growth, Regulatory Relief, and Consumer Protection Act (Growth Act) passed in 2018. This Act included some rollback of the provisions included in the Dodd-Frank Act passed in 2010.[1] After the financial crisis, Congress passed the Dodd-Frank legislation, and it passed the Growth Act after recovery from this crisis when smaller community banks were showing struggles sometimes attributed to Dodd-Frank compliance costs. The Growth Act introduces new issues for the balance between consumer protection and keeping compliance costs down.[2] This Note will discuss the issues surrounding the deregulation of the Growth Act, the problems facing community banks today, and will recommend how

1. *See infra* Section II.C (discussing the differences between Dodd-Frank and the Growth Act).
2. *See infra* Section III.C (discussing the balance of consumer protection and keeping compliance costs affordable).

community banks can maintain profitability through shifts in business models instead of deregulation.

Part II discusses the history of the banking industry, banking regulation in America, and the issues community banks face to stay profitable. Part III analyzes how the changes made in the Growth Act will affect community banks in various ways. Part IV recommends that Congress and regulatory agencies not further deregulate the banking industry, and community banks should make changes in their technology and business models to stay competitive.

II. BACKGROUND

A. The History of Banking Regulation

The banking industry is an essential aspect of the U.S. economy. At the United States' formation, citizens generally still banked through Great Britain's Banking system.[3] In fact, American banks did not exist until 1781, when the Bank of North America was founded.[4] Shortly after that, the country's first national bank was chartered: the Bank of the United States (BUS).[5] The creation of a national bank spurred state-chartered banks' opening across the nation, eventually leading to a booming bank industry.[6] The BUS was eventually closed when Congress did not renew its charter.[7] Five years later, a second BUS was chartered, but that bank met the same fate when its charter was up for renewal in 1836 and was not renewed.[8]

Originally, banks were an invention of the legislature.[9] This lent itself to a highly politicized industry.[10] State-chartered banks were only created for those backing certain political parties or legislators.[11] To curtail this issue, states started to pass "free banking laws," allowing people to start banks without a charter or permission from the government.[12] One who wanted to open a bank simply had to follow the incorporation laws just like any other business.[13] This practice rid the process of some politicization and increased access to banks for many Americans, but it introduced other problems.[14]

Throughout the 1800s, the banking industry was extremely unstable.[15] There was little oversight and regulation, resulting in several bank crises, which in turn stunted business

3. Richard Sylla, *The US Banking System: Origin, Development, and Regulation*, GILDER LEHRMAN INST. OF AM. HIST. (2009), https://ap.gilderlehrman.org/history-by-era/economics/essays/us-banking-system-origin-development-and-regulation [https://perma.cc/TG6L-JKNC].

4. *Id.*

5. *Id.*

6. *Id.*

7. Jerry W. Markham, *Banking Regulation: Its History and Future*, 4 N.C. BANKING INST. 221, 224 (2000).

8. Sylla, *supra* note 3.

9. *Id.*

10. *Id.*

11. *Id.*

12. Daniel Sanches, *The Free-Banking Era: A Lesson for Today?*, ECON. INSIGHTS, Third Quarter 2016, at 9.

13. *Id.*

14. *Id.*

15. Sylla, *supra* note 3.

growth in America.[16] During the Civil War, the Lincoln administration created a solution to the instability—a national currency backed by government bonds.[17] The hope was this would eliminate the instability of state bank notes and encourage state banks to switch to a national charter, creating consistency and stability in the nation's financial system.[18] The banking industry in America continued to grow, but the industry was still routinely unstable without a national bank.[19] There were several more bank crises before the Federal Reserve was established as the national bank in 1913.[20] Since the Federal Reserve's creation, there have only been two banking crises (excluding the savings and loan crisis in the 1980s).[21] The first crisis happened in the early 1930s and was a large contributing factor to the Great Depression.[22] As a result of this infamous crisis, Congress passed the Glass-Steagall Act.[23] This legislation created deposit insurance and the Financial Deposit Insurance Corporation, and separated commercial banking from investment banking.[24]

The next shift in banking regulations happened throughout 1980 to 2000 when deregulation began.[25] Throughout this period, Congress softened restrictions placed on banks during and after the Great Depression.[26] Interest rate ceilings were being phased out, deposit insurances were rising, and the separation between commercial and investment banking was relaxed.[27] Eventually, in 1999, the Gramm-Leech-Bliley Act repealed the Glass Steagall Act, effectively ending the separation of commercial and investment banking.[28] After this, banking regulations did not see a significant change until the financial crisis of 2008. Shortly after the 2008 crisis, the Dodd-Frank Act was passed in hopes of regaining stability of the banking industry and protecting consumers.[29]

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16. *Id.* For a general discussion on the history of banking crises, bank panics, and recessions in America, see Jeffery Rogers Hummel, *The History of U.S. Recessions and Banking Crises*, ALT-M (Oct. 22, 2015), https://www.alt-m.org/2015/10/22/the-history-of-u-s-recessions-and-banking-crises/ [https://perma.cc/LS2Y-PZ4C].

17. Sylla, *supra* note 3.

18. *Id.*

19. *Id.*

20. *Id.*

21. *Id.*

22. Sylla, *supra* note 3.

23. The Banking Act of 1933, Pub. L. No. 73-66, 48 Stat. 162 (1933); *see generally* Julia Maues, *Banking Act of 1933 (Glass-Steagall)*, FED. RSRV. HIST. (Nov. 29, 2013), https://www.federalreservehistory.org/essays/glass-steagall-act (describing the lead-up to the Glass-Steagall Act).

24. Markham, *supra* note 7, at 236.

25. Matthew Sherman, *A Short History of Financial Deregulation in the United States*, CTR. FOR ECON. & POL'Y RSCH. (July 2009), http://cepr.net/documents/publications/dereg-timeline-2009-07.pdf [https://perma.cc/84HQ-7SZ3].

26. *Id.*

27. *Id.*

28. *Id.*; Gramm-Leach-Bliley Act, Pub. L. No. 106-102, 113 Stat. 1338 (1999).

29. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203 (2010); *see also* David S. Huntington et al., *Summary of Dodd-Frank Financial Regulation Legislation*, HARV. L. SCH. F. ON CORP. GOVERNANCE (July 7, 2010), https://corpgov.law.harvard.edu/2010/07/07/summary-of-dodd-frank-financial-regulation-legislation/ [https://perma.cc/T52H-SSNY].

B. Dodd-Frank Wall Street Reform and Consumer Protection Act

The increasing complexity of financial instruments and financial institutions, the housing bubble, and numerous other factors led to the most recent banking and financial crisis.[30] Financial institutions making risky investments to collect the high mortgage origination fees from customers largely caused the financial crisis.[31] To keep collecting these fees, larger financial institutions repackaged these sub-prime mortgages into mortgage-backed securities and collateralized debt obligations.[32] Banks were heavily invested in these financial instruments, and when they started defaulting, the banks were not adequately capitalized to cover the losses.[33]

Congress decided a solution was needed and passed the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) in 2010.[34] This Act was a comprehensive reform of banking regulation. The stated purpose for this legislation is "[t]o promote the financial stability of the United States by improving accountability and transparency in the financial system, to end 'too big to fail,' to protect the American taxpayer by ending bailouts, to protect consumers from abusive financial services practices, and for other purposes."[35]

The Act is extensive, but this Note will focus on reciprocal deposits, the Volcker Rule, capitalization requirements, oversight implementations, and how the legislation affects community banks. The Dodd-Frank Act included a change in the way banks were capitalized, namely how much capital they had to have.[36] Dodd-Frank raised the minimum capital requirements for banks, requiring them to have a higher minimum risk-weighted assets capital ratio.[37] The FDIC Rules and Regulations have established banks are "adequately capitalized" if they have at least an eight percent risk-weighted assets capital ratio.[38] This requirement is imposed on all banks regardless of asset size.[39]

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30. Erin Coghlan et al., *What Really Caused the Great Recession?*, INST. FOR RSCH. ON LAB. & EMP. (Sept. 19, 2018), https://irle.berkeley.edu/what-really-caused-the-great-recession/ [https://perma.cc/DZ88-2Z9R].

31. *Id.*

32. *Id.*

33. *Id.*

34. *Id.*; Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010).

35. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010).

36. *Dodd-Frank Act: Minimum Capital Requirements*, MOODY'S ANALYTICS (2011), https://www.moodysanalytics.com/-/media/article/2011/11-01-03-dodd-frank-act-regulations-minimum-capital-requirements.pdf [https://perma.cc/VY45-TVMX].

37. Dodd-Frank Wall Street Reform and Consumer Protection Act, 12 U.S.C. § 5371.

38. FDIC, RISK MANAGEMENT MANUAL OF EXAMINATION POLICIES 2.1-8 (2015), https://www.fdic.gov/regulations/safety/manual/section2-1.pdf [https://perma.cc/SR25-XJNT. In order to have a more accurate representation of a bank's risk profile, banks are required to calculate their capital ratios using a weighted-assets total. This number is calculated by weighting the assets according to their inherent risk to the bank. Assets that carry more risk are weighted heavier because they have more of a chance to cause a loss to the bank that would be covered by a decrease in capital. Using a weighted-assets total in calculating the capital ratio allows banks and bank examiners to have a more accurate picture of the bank's ability to cover losses with their capital. *Risk-Weighted Assets*, CORP. FIN. INST., https://corporatefinanceinstitute.com/resources/knowledge/finance/risk-weighted-assets/ [https://perma.cc/QBS3-JY93].

39. FDIC, *supra* note 38.

Another aspect of the Dodd-Frank Act imposed the Volcker Rule, restricting banks from proprietary trading and investing in or sponsoring private equity funds and hedge funds.[40] This was implemented in an effort to go back to the Glass-Steagall Act, which required the separation of investment and commercial banks.[41] This rule was passed with the Dodd-Frank Act in 2010, but the restriction on banks was not imposed until 2015 due to the delay in regulators determining what transactions would violate the rule and what exceptions there would need to be.[42] The rule does not completely prohibit these transactions as there are some limited exceptions.[43] This rule was argued against by many financial institutions, which also contributed to the delay in imposing the rule.

Additionally, banks were no longer allowed to participate in brokered or reciprocal deposits if they were below the "well-capitalized" threshold.[44] Reciprocal deposits are deposits a bank receives from a network of banks in exchange for placing an equal deposit in that network.[45] This practice protects depositors who are over the deposit insurance limit, but these funds are quickly and frequently moved from bank to bank making them volatile.[46]

The Dodd-Frank Act also imposed a significant increase in oversight of the banking industry.[47] It created the Financial Stability Oversight Council to oversee U.S. financial markets to identify potential financial system risks.[48] It also created the Consumer Financial Protection Bureau to serve as a regulator and oversee financial institutions' consumer practices.[49] The Dodd-Frank Act also required banks to perform additional internal oversight.[50] Banks must perform stress tests and report them to regulatory agencies to show they can maintain financial services if there is a downturn in the market.[51] All of the changes resulting from Dodd-Frank were meant to stabilize the financial industry. However, the Volcker Rule, stress tests, the prohibition on reciprocal deposits, and the

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40. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376, 1620 (2010).

41. Yalman Onaran, *The Volcker Rule*, BLOOMBERG (Aug. 20, 2019, 1:15 PM), https://www.bloomberg.com/quicktake/the-volcker-rule [https://perma.cc/4NQ8-DTWM].

42. *Id.* Proprietary trading is "when a bank or firm trades stocks, derivatives, bonds, commodities, or other financial instruments in its own account, using its own money instead of using clients' money." *Proprietary Trading*, CORP. FIN. INST., https://corporatefinanceinstitute.com/resources/knowledge/trading-investing/proprietary-trading/ [https://perma.cc/BH5P-V8PY].

43. 17 C.F.R. § 255 (2014).

44. Debra Cope, *S.2155 Improves Treatment of Reciprocal Deposits*, ABA BANKING J. (July 6, 2018), https://bankingjournal.aba.com/2018/07/s-2155-improves-treatment-of-reciprocal-deposits/ [https://perma.cc/U2UN-JT2E].

45. PROMONTORY INTERFINANCIAL NETWORK, WHAT ARE RECIPROCAL DEPOSITS AND WHY DO THEY MATTER? 1, https://www.promnetwork.com/media/249249/what-are-reciprocal-deposits.pdf [https://perma.cc/2EW6-4EPJ].

46. *Id.*

47. Kimberly Amadeo, *What Is the Dodd-Frank Wall Street Reform Act?*, THE BALANCE (Oct. 30, 2020), https://www.thebalance.com/dodd-frank-wall-street-reform-act-3305688 [https://perma.cc/76V6-F7LN].

48. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376, 1392 (2010).

49. *Id.* § 1011.

50. Amadeo, *supra* note 47.

51. Joel Anderson, *Trump Is Deregulating Banks: Here's What That Means for You*, NASDAQ (Feb. 12, 2019), https://www.nasdaq.com/articles/trump-deregulating-banks-heres-what-means-you-2019-02-12 [https://perma.cc/L3Q7-8KJ8].

capital requirements were all recently changed under the latest action in banking regulation, the Economic Growth, Regulatory Relief, and Consumer Protection Act.[52]

C. Economic Growth, Regulatory Relief, and Consumer Protection Act

Following the passage of the Dodd-Frank Act,[53] there were many critics in the banking industry claiming the legislation was too restrictive. Now the argument, however, is some provisions are no longer needed or should be softened due to the recovered state of the economy.[54] This resulted in the Growth Act being passed in 2018.[55] This Act rolled back some of the restrictions imposed upon banks by the Dodd-Frank Act.[56]

The Growth Act relieves banks with under $10 billion in assets from complying with the Volcker Rule.[57] This allows smaller banks to engage in speculative investing.[58] It also blurs the distinction once again between a bank being an investment bank or a commercial bank.[59] The Growth Act also softens the capital requirements for banks with under $10 billion in total assets.[60] The new minimum ratio is called the "Community Bank Leverage Ratio."[61] It creates the option for smaller institutions to show a leverage ratio of eight to ten percent and satisfy both the leverage ratio requirements and the risk-based requirements.[62]

Another change under the Growth Act allows banks to perform reciprocal deposits again.[63] Reciprocal deposits were considered brokered deposits and therefore banned under the Dodd-Frank Act, but reciprocal deposits will no longer be considered brokered deposits.[64] There are some limitations to this. Namely, banks can only have reciprocal deposits up to the lesser of $5 billion or 20% of their total liabilities, and the bank must be considered well-capitalized under statutory standards.[65]

Lastly, the Growth Act eliminated stress tests for banks with under $250 billion in total assets.[66] This leaves thirteen banks subject to the internal stress tests implemented

52. Economic Growth, Regulatory Relief, and Consumer Protection Act, Pub. L. No. 115-174, 132 Stat. 1296 (2018).

53. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010).

54. Anderson, *supra* note 51.

55. *Id.*

56. *Id.*

57. Economic Growth, Regulatory Relief, and Consumer Protection Act, Pub. L. No. 115-174, 132 Stat. 1296, 1309 (2018).

58. Anderson, *supra* note 51.

59. *Id.*

60. Economic Growth, Regulatory Relief, and Consumer Protection Act, Pub. L. No. 115-174, 132 Stat. 1296, 1306 (2018).

61. *Id.*

62. *Id.* at 1307.

63. *Id.*

64. Samuel R. Woodall III et al., *"Economic Growth, Regulatory Relief, and Consumer Protection Act" Is Enacted*, PROGRAM ON CORP. COMPLIANCE & ENF'T (June 5, 2018), https://wp.nyu.edu/compliance_enforcement/2018/06/05/economic-growth-regulatory-relief-and-consumer-protection-act-is-enacted/ [https://perma.cc/9G5Y-5TQL].

65. *Id.*

66. *Id.*

under the Dodd-Frank Act.[67] This rule was effective immediately for bank holding companies with under $100 billion in assets.[68] This rule became effective for other financial institutions with the correct asset amount after an eighteen-month period following the passing of the bill.[69]

The Growth Act is new, and some of its provisions are not yet in effect. The banking regulatory agencies are formulating rules and guidance on how they will enforce and implement these changes. It is difficult to see at this stage the precise effect it will have on the banking industry. However, it seems there could be potential repercussions from the more relaxed consumer protection provisions.

D. Modern Banking Practices and Issues Currently Facing Community Banks

When discussing the banking industry, the focus is usually on larger national banks, but another important facet of the industry is community banks. There is no exact definition of "community banks" that is agreed upon by the entire industry. Some define it purely by asset size, while others, namely the FDIC, take a multistep approach that factors in asset size, community relations, types of assets, source of assets, etc.[70] The compliance costs of keeping up with the current regulatory framework is a commonly stated reason for community bank failures.[71] Community banks are failing at an alarming rate: from 2008–2015, one in four community banks failed.[72] Some failed by way of the FDIC closing them and paying out depositors, and others closed by larger competitors buying them out.[73] In the wake of the financial crisis, the government provided assistance to the banks deemed "too big to fail."[74] This assistance was not provided to smaller financial institutions and encouraged the consolidation mindset, leading to more and more larger banks buying out smaller ones.[75] The Growth Act is a step toward providing the regulatory relief smaller financial institutions are asking for.

The United States Government Accountability Office conducted a study to see the reasons behind the significant bank failures following the financial crisis.[76] The study found smaller and medium-sized banks that failed were highly concentrated in commercial

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67. *US Banks with Total Assets of at Least $250 Billion in 2018*, ATLAS (2018), https://www.theatlas.com/charts/SJbYNPX1Q [https://perma.cc/9TWK-6J7A] (listing JP Morgan Chase, Bank of America, Citigroup, Wells Fargo, Goldman Sachs Group, Morgan Stanley, US Bancorp, TD Group, PNC Financial Services Group, Bank of New York Mellon, Capital One Financial, HSBC North America Holdings, and State Street).

68. Economic Growth, Regulatory Relief, and Consumer Protection Act § 401(d)(2).

69. Woodall III et al., *supra* note 64.

70. *See Defining the Community Bank*, FDIC, 1, 2 (Dec. 2012), https://www.fdic.gov/regulations/resources/cbi/report/cbsi-1.pdf [https://perma.cc/EM8X-X6T5] (noting various ways community banks are defined and outlining the FDIC's definition of the community bank).

71. Stacy Mitchell, *One in Four Local Banks Has Vanished Since 2008. Here's What's Causing the Decline and Why We Should Treat It as a National Crisis*, INST. FOR LOCAL SELF-RELIANCE (May 5, 2015), https://ilsr.org/vanishing-community-banks-national-crisis/ [https://perma.cc/RP73-MMN6].

72. *Id.*

73. *Id.*

74. *Id.*

75. *Id.*

76. U.S. GOV'T ACCOUNTABILITY OFF., GAO-13-704T, FINANCIAL INSTITUTIONS: CAUSES AND CONSEQUENCES OF RECENT COMMUNITY BANK FAILURES (2013), https://www.gao.gov/assets/660/655193.pdf [https://perma.cc/9EXK-HLGN].

real estate loans.[77] From 2008–2011, 414 banks failed, and of those, 248 of them had significantly increased their lending concentration in commercial real estate loans in the time preceding the financial crisis.[78] These loans defaulted during the crisis, and the banks were not adequately capitalized or prepared to compensate for the loss.[79] The study also indicated the banks that failed "pursued aggressive growth strategies using nontraditional and riskier funding sources such as brokered deposits."[80]

Smaller banks are also struggling to compete with larger banks in terms of geography and technology.[81] Small community banks are generally located in smaller cities and rural areas.[82] Several of these communities are struggling economically, and those that are not are still facing the issue of decreasing populations.[83] Additionally, with improving technology, the location of banks is becoming less relevant.[84] Banking no longer needs to be done at an institution; it can be done from a phone or computer.[85] The competitive advantage community banks have over larger banks is the relationships they establish with their consumers, and that advantage is becoming increasingly obsolete.[86]

III. ANALYSIS

Congress passed the Growth Act in 2018, highlighting issues of deregulation in the banking industry and how the shift in regulations will affect community banks as they find ways to stay profitable as consumer needs and preferences shift. This Part will discuss the current policy arguments and issues facing community banks today, the current status of banking regulations, how these regulations interact with the issues community banks face, and how to strike a balance between compliance costs and consumer protection.

A. Policy Arguments for Community Banks

Community banks play a vital part in the United States' financial system. When determining how best to help support these banks, it is important to discuss why they need to be supported in the first place. Community banks are one of the main sources of funding for loans to farms and small businesses.[87] Community banks also fund mortgages and support small-town public projects.[88] The services and consumer relationships community banks offer could not be easily replaced by large national banks.

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77. *Id.*
78. *Id.*
79. *Id.*
80. *Id.*
81. Ron Shevlin, *The Problem for Small Town Banks: Technology Has Redefined Community*, FORBES, (Mar. 18, 2019, 5:00 A.M.), https://www.forbes.com/sites/ronshevlin/2019/03/18/the-problem-for-small-town-banks-technology-has-redefined-community/#2f46c9bd168b [https://perma.cc/V8JG-AH4F].
82. *Id.*
83. *Id.*
84. *Id.*
85. *Id.*
86. Shevlin, *supra* note 81.
87. John Depman, *Why Community Banks Matter, and Will Survive*, BANK DIR. (Feb. 2, 2015), https://www.bankdirector.com/issues/strategy/why-community-banks-matter-and-will-survive/ [https://perma.cc/N6SN-RUZW].
88. *Id.*

While arguably all banks have the same high-level business model, community banks thrive by building their business model around customer relationships.[89] This model serves as a competitive advantage over larger national banks that do not have the capacity to offer personalized financial services to all of their consumers.[90] One issue facing community banks today is their consumer base's needs and preferences are changing.[91] Today's consumers want their banks to be easily accessible via smartphone applications and online.[92] There is less of a demand for the actual brick and mortar building of a bank. As consumers shift to this more impersonal way of banking (i.e., banking electronically), the competitive advantage community banks enjoy by creating personal relationships with their consumers will no longer be sustainable.[93] This shift is somewhat assuaged by the fact small business owners and some individuals prefer or require a bank offering the flexibility community banks can.[94]

Community banks are also resorting to merging with other community banks or selling out to large national banks to escape or minimize the burden of compliance costs.[95] Community banks are too small to support the additional regulatory costs by themselves. To survive, community banks are merging with other community banks or selling to large banks in order to achieve the scale they need to remain profitable.[96] Consolidation in the banking industry may continue to increase even after deregulation.[97] Under the Growth Act, banks with assets of $50 billion are no longer subject to the additional standards of systemically important financial institutions (SIFIs).[98] Now, that designation does not apply until banks reach $250 billion in assets.[99] This change encourages those banks—who might have shied away from merger agreements because it would push them over the asset floor and subject them to increased compliance issues—to engage in mergers. They would no longer have to factor in these additional costs to their decisions.

More consolidation of community banks affects another issue community banks help to solve—underbanked and unbanked households.[100] The FDIC does a survey every two

89. Ellen Brown, *Regulation Is Killing Community Banks—Public Banks Can Revive Them*, COMMON DREAMS (Oct. 30, 2017), https://www.commondreams.org/views/2017/10/30/regulation-killing-community-banks-public-banks-can-revive-them [https://perma.cc/F8J8-HXRX].

90. *Id.*

91. Shevlin, *supra* note 81.

92. *Id.*

93. Depman, *supra* note 87.

94. Mark Pearce et al., *Why Community Banks Matter: Consumer Perspectives*, FDIC (Feb. 16, 2012), https://www.fdic.gov/news/events/communitybanking/group3.pdf [https://perma.cc/JYG7-8VFK].

95. Brown, *supra* note 89.

96. Jay Jenkins, *The Simple Reason Your Community Bank Just Sold Out to a Big Bank*, MOTLEY FOOL (June 10, 2015, 12:41 PM), https://www.fool.com/investing/general/2015/06/10/the-simple-reason-your-community-bank-just-sold-ou.aspx [https://perma.cc/L5T7-LH24].

97. Gregory J. Hudson & Joseph E. Silvia, *Recent Legislation Encourages Bank M&A Activity*, BUS. L. TODAY (Dec. 18, 2018), https://businesslawtoday.org/2018/12/recent-legislation-encourages-bank-ma-activity/ [https://perma.cc/LQ69-69S8].

98. *Id.* Systemically important financial institutions are a creation of the Dodd-Frank Act denoting institutions that are above a certain asset size that are subject to stricter regulations. For a general discussion of SIFIs, see Emily Liner, *Understanding SIFIs: What Makes an Institution Systemically Important?*, THIRD WAY (Oct. 3, 2017), https://www.thirdway.org/report/understanding-sifis-what-makes-an-institution-systemically-important [https://perma.cc/3FTV-EKLY].

99. Hudson & Silvia, *supra* note 97.

100. Unbanked households are those where no one in the household has a checking or savings account.

years to determine the number of households underbanked or unbanked in the US.[101] In 2017, 6.5% of households were unbanked, and 18.7% of households were underbanked.[102] When asked for a reason for being unbanked, over 30% of the unbanked households listed a distrust of banks as a reason.[103] This is where the competitive advantage of community banks' personal relationships with consumers proves useful. Community banks are in a significantly better position to gain the trust of these households than larger banks, and as community banks continue to consolidate or sell out, they will not be able to provide the personalized, flexible financial services that would help these households.[104]

Community banks play an important role in the financial system by tailoring their services to best help their customers, but they may not be able to keep up with all of the services larger banks can offer, which could lead to their customers leaving.[105] Consumers want to be able to bank from anywhere, but offering these new services can prove too costly for smaller banks.[106] This, in turn, leads to consumers leaving to start accounts at large national banks equipped to offer these extra services while remaining profitable.[107] Consumer preference has led community banks to lose out on market share to large national banks.[108] Around thirty years ago, community banks held around 31% of all bank assets. Now they hold just over 6.5%.[109]

Community banks, being conveniently located, traditionally had the advantage over large banks.[110] This statement is proving to be less true as technology increases.[111] Community banks are generally located in small towns with a limited amount of economic activity, especially since small towns today are facing economic decline and decreasing populations.[112] With their consumer base moving away, community banks in these small towns cannot compete with large national banks,[113] especially because younger

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Underbanked households are those where someone in the household has a checking or savings account, but they obtain additional financial products or services outside of banks. FDIC, 2017 FDIC NATIONAL SURVEY OF UNBANKED AND UNDERBANKED HOUSEHOLDS 1 (2017), https://www.fdic.gov/householdsurvey/2017/2017execsumm.pdf [https://perma.cc/G5SM-FFJU].

101. *Id.*

102. *Id.*

103. *Id.*

104. *See* Justin Prichard, *Benefits of Local Banks vs. Big Banks*, BALANCE (July 26, 2020), https://www.thebalance.com/benefits-of-local-banks-vs-big-banks-4177411 [https://perma.cc/S94H-VVHE] (outlining the benefits of community banks).

105. *See* Rachel Louise Ensign & Coulter Jones, *The Problem for Small-Town Banks: People Want High-Tech Services*, WALL ST. J. (Mar. 2, 2019), https://www.wsj.com/articles/the-problem-for-small-town-banks-people-want-high-tech-services-11551502885 [https://perma.cc/AZ6Z-H8T7] (discussing a community bank in upstate New York that had several customers angry about their technology).

106. *Id.*

107. *Id.*

108. *Id.*

109. *Id.*

110. Prichard, *supra* note 104.

111. *See* Brian Alexander, *What America Is Losing as Its Small Towns Struggle*, ATLANTIC (Oct. 18, 2017), https://www.theatlantic.com/business/archive/2017/10/small-town-economies-culture/543138/ [https://perma.cc/L8A7-UH59] (discussing the current issues facing America's small towns).

112. *Id.*

113. Kevin Tynan, *How Community Institutions are Losing the War Against Megabanks*, FIN. BRAND (Aug. 10, 2017), https://thefinancialbrand.com/66800/community-banks-credit-unions-competition-strategy/ [https://perma.cc/8P4J-5X3R].

consumers—those who are increasingly moving away from small towns—represent a high demand for financial products.[114] Technology also poses a threat to community banks because deposits are now more mobile, making location (and therefore community) less relevant to consumers.[115] This trend is seen in a variety of ways, such as merchant apps, person-to-person payment apps, health savings accounts, and more.[116] People no longer deposit all of their money in their local community bank; it is being spread to other areas.[117]

Disruption of customer base, lack of technology, lack of scale, and other issues community banks are facing pose a threat to the vital role they play in our financial system. The myriad of issues also shows deregulation, while beneficial in some respects to community banks, still may not save them.

B. Status of Community Bank Regulation

The additional costs of complying with the regulatory framework adopted after the financial crisis are sometimes listed as a reason community banks are failing.[118] Compliance costs are a significant part of any bank's operating budget,[119] and while it does present a burden to community banks, the purpose of regulations cannot be pushed aside in the name of saving costs.

An argument circulating for exempting community banks from certain regulations passed after the financial crisis is they are not the systemically important financial institutions that arguably caused the crisis and, therefore, this new regulatory scheme should not apply to them.[120] This overlooks the fact that reducing systemic risk is only one of the reasons behind regulation, some other reasons being consumer protection and prudential regulation.[121] While small community banks might not have been the underlying reasons behind the financial crisis, there were still hundreds of community banks that failed during and after the crisis, showing the prudential regulation of community banks before the crisis was not sufficient.[122]

It is difficult to calculate accurate empirical evidence on exactly how much each regulation costs for each individual bank. This makes it easy for community banks to argue they should be deregulated because the regulation is costing them disproportionately more money than the banks who caused the systemic risk. However, even if consumer protection or prudential regulations are costing community banks significant money, they are still

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114. Shevlin, *supra* note 81.

115. *Id.*

116. *Id.*

117. *Id.*

118. *See generally* Brown, *supra* note 89 (discussing the additional compliance costs harming community banks).

119. Sarah Chacko, *Compliance Costs Rise for Community Banks*, WALL ST. J. PRO CENT. BANKING (Oct. 16, 2017, 12:57 PM), https://www.wsj.com/articles/compliance-costs-rise-for-community-banks-1508173065 [https://perma.cc/S48L-92VT].

120. Hester Peirce, *Regulatory Burdens: The Impact of Dodd-Frank on Community Banking*, MERCATUS CTR. GEO. MASON U. (July 18, 2013), https://www.mercatus.org/publications/financial-markets/regulatory-burdens-impact-dodd-frank-community-banking [https://perma.cc/2KGQ-VXDT] (describing testimony before the House Committee on Oversight and Government Reform).

121. *See* CONG. RSCH. SERV., BANKING POLICY ISSUES IN THE 116TH CONGRESS 19 (2019), https://fas.org/sgp/crs/misc/R45518.pdf [https://perma.cc/UCB9-336C] (listing reasons for the legislation).

122. *Id.*

needed regardless of asset size.[123]

While there is certainly evidence compliance costs are climbing, [124] it is not entirely accurate to allocate those costs to the regulations passed since the financial crisis. A survey administered by the Federal Reserve and the Conference of State Bank Supervisors revealed community banks spent a combined $5.4 billion in compliance costs in 2016.[125] The highest compliance costs were associated with the Bank Secrecy Act, accounting for 22% of community banks' total compliance expenses.[126] Congress enacted the Bank Secrecy Act to "detect money laundering, terrorist financing and other criminal acts and the misuse of our nation's financial institutions."[127] Congress passed this legislation in 1970, and it is an example of essential regulation, despite being costly.[128] Conversely, the capital requirements regulation affected by the Growth Act only accounts for four percent of total compliance costs.[129] Clearly, regulations not affected by the Growth Act may be responsible for rising compliance costs. Additionally, since Congress only passed the Growth Act in 2018, and some of its provisions did not go into effect until 2019, there is no real evidence yet as to cost savings after the deregulation.

Some of the issues leading to the financial crisis in 2008 are still pervasive in the banking industry.[130] They have the potential to come back with the relaxed regulations in the Growth Act. While community banks were not generally participating in the complex financial instruments that large national banks were during this time, they were still affected by the crisis as the originator of these riskier mortgages.[131] Affected community banks did not have enough capital to cover the losses, and therefore, many of them failed during and after the crisis.[132] The Growth Act's weakening of capital requirements may lead to community banks being under-capitalized again.

The problem of community banks being inadequately capitalized is exacerbated by the exemption of community banks from the Volcker Rule. The transactions prohibited by the Volcker Rule are proprietary trading and transactions with hedge funds and private equity funds.[133] Proprietary trading is when banks use their own capital for investment activities instead of customer capital.[134] Losses from these transactions will have a direct

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123. *Id.*

124. Chacko, *supra* note 119.

125. FED. RSRV. & CONF. OF STATE BANK SUPERVISORS, COMMUNITY BANKING IN THE 21ST CENTURY 9 (2017), https://www.communitybanking.org/~/media/files/cb21pub_2017_book_web.pdf?mod=article_inline [https://perma.cc/P22Z-2MX8].

126. Chacko, *supra* note 119.

127. *Bank Secrecy Act*, OFF. OF THE COMPTROLLER OF THE CURRENCY, https://www.occ.treas.gov/topics/supervision-and-examination/bsa/index-bsa.html [https://perma.cc/ZG2D-8UXB] (last visited Feb. 2, 2021).

128. *Bank Secrecy Act*, IRS (Sept. 23, 2020), https://www.irs.gov/businesses/small-businesses-self-employed/bank-secrecy-act [https://perma.cc/R4PF-V3TX].

129. FED. RSRV. & CONF. OF STATE BANK SUPERVISORS, *supra* note 125, at 22.

130. Mark H. Kawa & Steven VanBever, *The Impact of the Financial Crisis on Community Banks: A Conference Summary*, FED. RSRV. BANK OF CHI. (March 2010), https://www.chicagofed.org/publications/chicago-fed-letter/2010/march-272a [https://perma.cc/76K7-4MFF].

131. *Id.*

132. *Id.*

133. Gregory Butz, Comment, *Treating Apples Like Oranges: The Benefits of Exempting Community Banks from the Volcker Rule*, 6 TEX. A&M L. REV. 453, 459 (2019).

134. *Id.*

hit on the bank's capital. While these transactions certainly have the potential to be beneficial to community banks, the risks accompanying them could prove harmful to the banks.

Proponents of deregulation argue community banks generally do not engage in transactions prohibited by the Volcker Rule, so exempting them would only help them reduce compliance costs.[135] This assumes the community banks will continue this trend of not engaging in these transactions in the face of changing consumer demands and the increased difficulty to earn profits. Ultimately, the deregulation provided to community banks by the Growth Act is in some of the same areas that made banks vulnerable during and after the crisis.[136] The combination of loosening restrictions on banks' required capital and allowing them to engage in riskier transactions leaves them vulnerable to possible losses from which they cannot recover.[137]

C. Balancing Deregulation of Community Banks and Consumer Protection

History shows deregulation is almost always followed by a financial crisis.[138] The passing of the Gramm-Leach-Bliley Act in 1999 in some respects set up the most recent crisis by repealing the Glass-Steagall Act.[139] Congress passed the Glass-Steagall Act in reaction to the financial crisis of the Great Depression.[140] The balance between supporting community banks to ensure their survival and ensuring consumer protection is important. A large issue with finding this balance is the lack of data prepared, such as a cost-benefit analysis.[141] There is no formal statute requiring financial regulators to conduct a cost-benefit analysis before adopting new legislation.[142] There is a lack of data on exactly how much Dodd-Frank compliance costs, and there is a lack of data regarding how much cost savings the Growth Act will provide.[143] The lack of empirical data makes it difficult to determine when exactly regulation has gone too far or when deregulation is harming consumers.

Community banks are disproportionately burdened by these costs because the fixed costs are too high for their asset size. While certain regulations only apply to banks once they reach a certain asset size, some regulations apply to all banks regardless of size.[144] Regulations imposed on all banks affect community banks differently than large banks.[145] Community banks do not have the same capacity as large national banks to hire additional

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135. *Id.* at 454.

136. Coghlan et al., *supra* note 30.

137. *Id.*

138. *See generally* Sherman, *supra* note 25.

139. *Id.*

140. Kimberly Amadeo, *Glass Steagall Act of 1933, Its Purpose and Repeal*, THE BALANCE (Nov. 11, 2020), https://www.thebalance.com/glass-steagall-act-definition-purpose-and-repeal-3305850 [https://perma.cc/UNU6-4C9C].

141. Merric R. Kaufman, Note, *Too Small to Succeed?: An Analysis of the Minimal Undue Regulatory Burdens Facing Community Banks in the Post Dodd-Frank Regulatory Environment, and How to Further Minimize Their Burden*, 37 REV. BANKING & FIN. L. 445, 470 (2017).

142. *Id.* at 472.

143. *Id.* at 473–74.

144. *See id.* at 478 (describing the regulations).

145. *See* Peirce, *supra* note 120 (discussing the disproportionate effects the Dodd-Frank Act has on community banks).

personnel to account for the additional regulation.[146] Adding new complex regulations hits community banks harder because their compliance staff is generally less equipped to interpret and comply with new regulations.[147] While these regulations may hit community banks disproportionately in relation to large national banks, it does not detract from their importance.

Proponents of the Growth Act list decreasing compliance costs as a real way to save community banks, but recently community banks have stated that it is deposit growth, not compliance costs, they are most worried about regarding the future.[148] In a survey administered by the Conference of State Bank Supervisors, the number one listed factor influencing future profitability is the cost of funds, with 35% of respondents listing this reason.[149] Only four percent of respondents stated regulatory costs compared to 60% listing regulatory costs as the top concern in 2016.[150] While decreasing compliance costs certainly could help future profitability, this new research shows that it might not be the saving grace for community banks. There is increased competition for traditional deposits among community banks, and shifting their focus to ensure they gather the deposits needed to fund their business model could be a better answer than decreasing costs.

Compliance costs are a very real issue for community banks, and the Growth Act could potentially give them a break in this area. However, it is vital to stay vigilant not to sacrifice the stability of these banks. History shows deregulation does not result in a healthy financial system. Going forward, there should be other options to assist community banks and ensure their profitability and stability that do not involve increased deregulation.

IV. RECOMMENDATION

It is evident community banks' survival is vital to the financial health of the United States and assisting them is certainly advisable. However, assisting community banks should not come at the expense of consumer protection through deregulation. Ultimately, the Growth Act has gone too far in deregulation in the hopes of assisting community banks. This new Act leaves community banks and, by association, their customers, insufficiently protected in the event of another economic downturn similar to the financial crash of 2008. There are several approaches to address this issue, but two courses of action that would work best are: (1) stopping deregulation of the banking industry as it stands and (2) community banks taking other actions to change their business model and consumer relationship practices to increase or sustain their profits, even with the necessary compliance costs.

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146. *Id.*

147. *Id.*

148. CMTY. BANKING RSCH. & POL'Y CONF., COMMUNITY BANKING IN THE 21ST CENTURY 25 (Oct. 2019), https://www.communitybanking.org/~/media/files/publication/cb21publication_2019.pdf [https://perma.cc/6DCQ-CCVP].

149. *Id.* at 24.

150. *Id.* at 21.

A. No Further Repeal of the Dodd-Frank Act

Regulatory compliance is a significant aspect of the banking industry,[151] and the Dodd-Frank Act certainly changed the landscape of it. Now, the Growth Act has the potential to do the same. The Growth Act would be, going forward, the least restrictive piece of legislation passed regarding the regulation of the banking industry. This deregulation, however, leaves consumers vulnerable. Growth Act provisions, including the community and smaller banks exemption from capital requirements, the Volcker Rule, the prohibition on reciprocal deposits, and the stress tests should be reevaluated to ensure protection for consumers.

The potential cost savings provided to community banks and smaller banks by the changes implemented in the Growth Act do not justify the protections they are giving up. Currently, complying with the capital requirements accounts for only four percent of community banks' reported compliance costs.[152] This cost could be decreased under the Growth Act capital requirements but not completely eliminated. Therefore, the cost savings from implementing the less restrictive "Community Banking Leverage Ratio" only results in very minimal cost savings with the potential for improperly capitalized banks. A proper solution is for banks to maintain the capital requirements they were complying with under Dodd-Frank instead of shifting to only complying with the new "Community Bank Leverage Ratio."[153] The new ratio requirement is less restrictive and, in turn, provides less assurance a bank is well-capitalized.

Community banks should also continue to comply with the risk-weighted asset standards implemented by the regulatory agencies after Dodd-Frank was passed as opposed to the new risk-weighting standards under the Growth Act.[154] Basel III laid out the requirements for weighting assets for the capital ratio, and while it is not perfect, it provides a more nuanced response to ensuring banks' capital ratios are more reflective of their actual risk.[155] Weighting riskier assets higher reflects a more accurate picture of the health of a bank's capital and how much they would need in order to stay well-capitalized. Giving riskier assets a lower weight will show a face value calculation of how well-capitalized the bank is, which is not indicative of the bank's ability to cover losses.

151. *See supra* Section III.A (discussing banking regulation in relation to policy).

152. FED. RSRV. & CONF. OF STATE BANK SUPERVISORS, *supra* note 125.

153. *See generally Community Bank Leverage Ratio Framework*, BD. OF GOVERNORS OF THE FED. RSRV. SYS., FDIC, & OCC (Oct. 2019), https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20191029a3.pdf [https://perma.cc/C8ZD-FQDZ] (describing the Community Bank Leverage Ratio).

154. Rule proposals regarding the Growth Act currently show that the regulatory agencies are planning on simplifying the risk-weighting calculation in regard to certain assets such as high volatility commercial real estate loans. *See* Regulatory Capital Rule: Simplifications to the Capital Rule Pursuant to the Economic Growth and Regulatory Paperwork Reduction Act of 1996, 84 Fed. Reg. 35,234 (July 22, 2019) (to be codified at 12 C.F.R. pts. 3, 217, 324) (discussing future rule proposals in regard to the Growth Act).

155. *See generally What is Basel III?*, CORP. FIN. INST., https://corporatefinanceinstitute.com/resources/knowledge/finance/basel-iii/ [https://perma.cc/QZM9-5MJ4] (giving an overview of Basel III, its impact, and its criticisms).

B. Community Banks Should Implement Business Changes Instead of the Government Implementing Regulatory Changes

One of the purposes behind the Growth Act was to help community banks save on regulatory compliance costs to stay profitable in today's market when the number of these banks is rapidly decreasing.[156] This purpose can be achieved by means other than deregulation in ways that will still provide for the financial stability of banks while protecting consumers.

Community banks and larger national banks thrive on different business models, and this difference is a benefit to community banks when attracting customers.[157] Community banks can offer personal relationships between bankers and customers. This benefit is not as desirable to today's consumers, forcing community banks to turn to other avenues to remain competitive.[158]

One of the areas community banks can improve on is technology. National banks can provide their customers with more ATMs than community banks. With their resources, national banks are able to offer apps that are more user-friendly and practical than community banks can. While most community banks are trying to keep up in the technology area, improving the technological options they provide to their customers can only help increase their customer retention.

Community banks can improve their technology in two ways. The first is through collecting more data from their current customers to see why they are making the banking decisions they are. Collecting data is essential, and banks could do this by investing in more comprehensive customer relationship management systems, allowing them to keep personal relationships with customers. Banks could use this data collected about their customers to make shifts in product or service options or in business practices to ensure they are fulfilling those customers' needs.

The second is by improving the features offered on their banking applications (or offering one if they do not already have one). Improving community banks' applications can contribute significantly to keeping up with larger banks. Consumers today want to be able to complete all of their banking activities without having to go to a brick-and-mortar structure. Providing apps with more features will provide this service to customers and will, in turn, give them fewer reasons to leave community banks for large national banks. This can also help community banks retain customers that may have opened their accounts when they lived in the community the bank serves but now no longer live there. Younger customers are moving into cities and away from the community banks they used before they were adults, but community banks can encourage those customers to stay with them by offering these online banking options.

It is no longer enough to provide only for transfers, mobile deposits, and access to the amounts in customers' accounts. This is where collecting more data on customers' needs and wants can interact to improve upon the features offered on the app. Having more data informing the banks of what the customers want in an app will help them tailor their apps specifically to their targeted customer base. This is better than the deregulation in the Growth Act. It allows banks to get a more accurate picture of what their consumers want,

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156. *See supra* Section II.D.
157. *See supra* Section II.C.
158. *See supra* Section III.A.

and tailoring their business to that would increase revenues. Tailoring a business to what the customer wants and needs is vital to any business, and banks should be doing this anyway. In light of the current landscape, however, it could provide banks with an option to keep them profitable while still putting up the costs for complying with regulations protecting consumers.

The FDIC recently updated its study on community banks first conducted in 2012.[159] When researching the effects of technology for community banks, the FDIC split these banks into three categories—low adopting, medium adopting, and high adopting—based on their rates of adopting new technologies.[160] High-adopting banks saw an increase in assets and deposits at a faster rate compared to medium and low adopting banks.[161] This shows that adopting new technologies can help banks increase their deposits, which in turn increases their potential for profitability.

To focus on the profitability of small banks, implementing this sort of technology can certainly be expensive, and there are several ways to cut down on these initial costs. As technology continues to advance, the costs of implementing apps and websites decrease, but this will not completely eliminate the cost barrier. One solution presented to assist smaller banks in implementing new technology is to form a technology cooperative of small banks.[162] One of the large issues facing community banks is they do not have the scale to support the costs of more advanced technology. To combat this, community banks in the same geographic region can go in together—on a sort of utility functioning as a data collection and processing service. Each bank would pay a portion of the capital for this utility, keeping it affordable enough while allowing these banks to use data to their advantage in ways they previously could not. This could also be a small solution to the issue of small community banks merging more frequently. Banks would no longer need to merge to survive, so they can stay open in communities needing them to be there while remaining profitable. The upfront costs to implement new technology options to consumers presents a barrier to community banks, but it will provide long-term returns for their business.

Recent evidence suggests that community banks believe costs of funds to be more of an influential factor in future profitability than regulatory costs. This shows the increased need for community banks to focus on retaining and gaining customers in order to ensure they maintain or grow their traditional funding sources. Decreasing regulatory costs does not help if the funding for revenue streams is not maintained. Community banks should focus on retaining and growing their customer base through new technology and by capitalizing on the products and services they can offer that cannot be matched by large national banks.

Shifting business practices to increase earnings and provide for customers' shifting needs and wants is a better long-term solution than what is provided through deregulation. While deregulation may ultimately result in cost savings in the short term, it does not

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159. *FDIC Community Banking Study*, FDIC (Dec. 2020), https://www.fdic.gov/resources/community-banking/report/2020/2020-cbi-study-full.pdf [https://perma.cc/FT7F-KHNE].

160. *Id.*

161. *Id.* at 6–13.

162. Clifford Rossi, *How Community Banks Can Save Themselves*, AM. BANKER (Jan. 6, 2014, 3:00 PM), https://www.americanbanker.com/opinion/how-community-banks-can-save-themselves [https://perma.cc/22UD-MJDF].

provide the surety and control to community banks that adapting their business would. Community banks are not in control of the congressional legislation decisions and the regulatory agencies, but they can control how they conduct their business. Shifting the focus to ensuring they are able to adapt to changes in consumers' needs and wants provides a much more stable solution for community bank's survival.

V. CONCLUSION

This Note recommends community banks shift their business model to accommodate the shift in consumers' needs and preferences by updating their technology and using the new technology to collect data to help better serve their customers. This Note also outlines some of the issues that could come from the looser regulatory framework in the Growth Act, namely the changing of the capital rules for smaller banks, the release from prohibition on reciprocal deposits, and the exemption from the Volcker Rule. This could leave consumers and banks alike vulnerable in the event of another financial crisis. Community banks are vital to the financial landscape of America, and ensuring their survival is of utmost importance. It is critical to include in the discussion of assisting community banks the interests of consumer protection and to ensure any solutions provided do not sacrifice consumers' interests.