

August 24, 2016

The Honorable Jason Furman  
 President’s Council of Economic Advisors  
 Eisenhower Executive Office Building  
 Room 360  
 1650 Pennsylvania Ave  
 Washington, DC 20504

Dear Dr. Furman:

First, I appreciate the work of the Council to document the consolidation of the banking industry in your recent report entitled “The Performance of Community Banks Over Time.” This report is long overdue as community banks have been urging the Administration, Congress and regulators to address the rapid decline in the industry. Having thoroughly reviewed the report I must admit to being baffled by your findings. You are correct that community banks are resilient and have endeavored to provide the vital financial services critical to the success of their communities. It is also true that consolidation is not a new phenomenon affecting the banking industry. But the notion that the Dodd-Frank Act—and its 24,000 pages of proposed and final rules—has had no impact on community banks is simply untrue.

The report concludes that the decline in the number of banks since Dodd-Frank was enacted—**1,708 or 22% of the industry**—is not compelling evidence that the Act has had a negative impact. As proof that somehow the loss of a bank every business day since DFA doesn’t matter, the report states that bank branching patterns, lending growth and geographic reach “show that community banks remain strong.”

A conversation with any community banker would dispel this forced conclusion. The thousands of new regulations that have been imposed on community banks is an enormous driver of decisions to sell to a larger bank. The median sized bank in this country has only 42 employees. These are small businesses themselves. There is simply not enough capacity to read and understand what rules apply (especially as rules are modified); implement, train, and test for compliance with those that do; and still have the time and resources to meet with individuals and businesses about their financial needs. According to research by the American Action Forum, “it would take 36,950 employees working full-time (2,000 hours annually) to complete a single year of the law’s paperwork.”



Source: Call Report, Federal Financial Institutions Examination Council

Some banks have stopped offering certain products altogether, such as mortgage and other consumer loans. The October 2015 RESPA/TILA integration rules have raised mortgage costs, delayed closings and have limited access to home loans to many potential new buyers. [TRID Survey Results](#) In April 2016, 72 percent of community banks reported that the 2014 rules on ability to repay and qualified mortgages have restricted their ability to extend credit, even after over two years of adjustment and adaptation. [Mortgage Survey Results](#)

Moreover, the rules intended for the largest banks are too often considered ‘best practices’ for all banks, compounding the hardship for smaller institutions. Arbitrary size thresholds create disincentives for community banks to grow because of the significant regulation that is added as soon as the threshold is crossed. This limits the services they could provide because of arbitrary rules, not business decisions to meet community needs.

Even more troubling is that strong, well-run community banks are telling the ABA that they have no choice but to sell. Just a few weeks ago, a banker in the Northeast wrote to us and said:

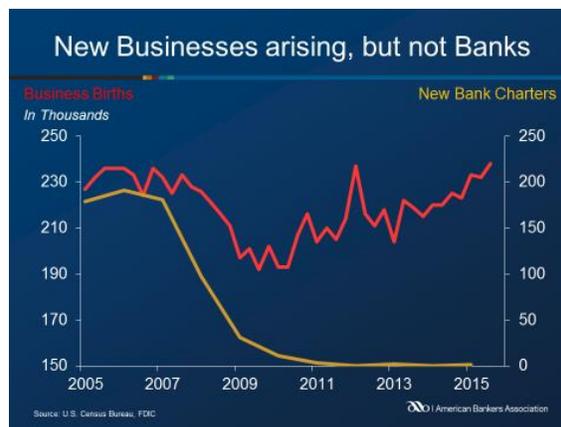
“Unfortunately we became a victim of Dodd-Frank. The effects of Dodd-Frank, including the TILA-RESPA integration, the pending expansion of HMDA, ability to repay, forced-placed hazard insurance requirements, plus other regulatory issues such as the pending overdrafts rules, restrictions on small dollar lending, the military lending rule, the Durbin Amendment, etc... resulted in financial projections showing substantial declines in revenues and increases in compliance costs, reaching the point that in a few short years an otherwise healthy community bank with strong capital and satisfactory earnings could no longer meet a number of financial bench-marks set by the regulators. These conclusions forced the bank to sell now when our shareholders and some of our employees would be less adversely affected.”

In May this bank merged with a much larger bank, resulting in approximately 50% of the employees losing their jobs, all because of the cumulative impact of regulation. Sadly, this is not an isolated case. The Council’s report documents very carefully the fact that community banks are exiting, primarily merging with other community banks. The report shows the decline quite dramatically, particularly among the smallest banks. Does it matter if small banks are merging? The CEA concludes it does not since community banks “remain strong.”

What happens when this trend continues—as it surely will—if nothing is done to stem it? Community bankers are community leaders. They are involved in many local organizations, serve on school and hospital boards, donate thousands of volunteer hours to charities—all in addition to the advice they provide to small businesses, families and individuals, young and old, about their daily financial and banking needs. If this trend continues unabated, there will be fewer financial services in communities and less economic growth. Whether intended or not, the Dodd-Frank Act has added fuel to industry consolidation, reduced flexibility for product offerings, and increased the cost of providing financial services—a cost that is ultimately borne by customers.

The report also suggests that the increased pace in consolidation since 2010 is due to the lack of de novo banks, not a change in “exit dynamics.” It argues that the lack of de novos is a result of low interest rates. The exceptionally low interest rate environment certainly has had a negative impact on all banks and no doubt has had a role in limiting new bank charters. But new banks have been formed in large numbers through many recessionary times. For example, in 1990—the middle of the so-called “S&L Crisis” and the beginning of a recession—there were 193 new banks chartered. ***Over the next 10 years, 1,500 new banks were chartered.***

Contrast that with the latest cycle: it started similarly with 181 new charters in 2007 (the start of the recession) but fell off very quickly over the next two years. Since the Dodd-Frank Act was enacted in 2010, there have only been 7 de novos with three of those started only to facilitate an acquisition of a failed bank and another for a credit union to convert to a bank. ***That means only 3 real new banks in the last 5 years.*** Even more telling is the contrast between the lack of de novo bank formations and the recovery of new business formations across all industries since the recession.



Sadly, the forces that have acted to stop new bank charters are the same ones that have led to the dramatic consolidation of the banking industry—excessive, and complex regulations that are not tailored to the risks of specific institutions. Beyond Dodd-Frank, there are new capital hurdles, unreasonable regulatory expectations on directors, funding constraints, an inflexible regulatory infrastructure, and tax-favored competition from credit unions and the Farm Credit System that weigh on community banks. These—not the local economic conditions—are often the tipping point that drives small banks to merge with banks typically many times larger and is a barrier to entry for new banks.

The question that the CEA should be asking is how prudent regulatory relief will contribute to economic growth. Stemming the tide of consolidation in the industry will help preserve the unique banking system that has led to the strongest economic country in the world. If we continue to watch the industry shrink by one bank every business day, the availability of financial services will decline, particularly in the thousands of smaller communities where the bank is the only financial institution serving the area.

Each and every bank in this country helps fuel the U.S. economy. Each has a direct impact on job creation, economic growth and prosperity. Community banks have always prided themselves on being flexible in order to meet the unique circumstances of each customer. These institutions are working hard to drive economic activity in America's cities and hometowns, but the regulatory environment is holding them back.

Comprehensive regulatory relief is long overdue for community banks. This is why it is imperative that the Administration and Congress take steps to ensure and enhance the banking industry's capacity to serve their customers, thereby facilitating job creation and economic growth. And each day another community bank leaves the field, it makes that community—and our economy—poorer.

Sincerely,

**BOB NICHOLF**

cc: Jeffrey S. Goldstein