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COMMUNITY BANKS AND CREDIT UNIONS

Impact of the Dodd-Frank Act Depends Largely on Future Rule Makings

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Highlights

Highlights of GAO-12-881, a report to congressional requesters

Why GAO Did This Study

The Dodd-Frank Act includes numerous reforms to strengthen oversight of financial services firms and consolidate certain consumer protection responsibilities within CFPB. To help minimize its regulatory burden on small institutions, including community banks and credit unions, the act exempts such institutions from several of its provisions. However, the act also contains provisions that impose additional requirements on small institutions. Although no commonly accepted definition of a community bank exists, the term often is associated with smaller banks. Historically, community banks and credit unions have played an important role in providing credit to small businesses and other local customers.

This report examines (1) the significant changes community banks and credit unions have undergone in the past decade and the factors that have contributed to such changes, and (2) Dodd-Frank Act provisions that regulators, industry associations, and others expect to impact community banks and credit unions, including their small business lending. GAO analyzed regulatory and other data on community banks and credit unions; reviewed academic and other relevant studies; and interviewed federal regulators, community banks, credit unions, state regulatory and industry associations, academics, and others.

CFPB, federal banking regulators, and the Securities and Exchange Commission provided technical comments on this report, which GAO incorporated as appropriate. CFPB and the National Credit Union Administration generally agreed with the report.

View GAO-12-881. For more information, contact Lawrance Evans at (202) 512-8678 or evansl@gao.gov.

What GAO Found

While the number of community banks and credit unions has declined in recent years, they have remained important lenders to small businesses and other local customers. From 1985 through 2010, the number of banks under $10 billion in assets and credit unions declined by over 50 percent to 7,551 and 7,339, respectively. The decline resulted largely from consolidations, which were facilitated by changes in federal law that made it easier for banks and credit unions to expand geographically. Another factor that may have contributed to consolidations is economies of scale, which refer to how an institution's size is related to its costs. Although the existence of economies of scale in banking has been subject to debate, some recent research suggests that banks can save costs by expanding. Despite the decline in their number, community banks and credit unions have maintained their relationship-banking model, relying on their relationships with customers and local knowledge to make loans. Such institutions can use their relationship-based information to make loans to small businesses and other borrowers that larger banks may not make because of their general reliance on more automated processes. About 20 percent of lending by community banks can be categorized as small business lending (based on a commonly used proxy), compared to about 5 percent by larger banks. Community banks and credit unions also play an important role in rural areas, using relationship-based lending to serve customers with limited credit histories.

Although the Dodd-Frank Wall Street Reform and Consumer Protection Act's (Dodd-Frank Act) reforms are directed primarily at large, complex U.S. financial institutions, regulators, industry officials, and others collectively identified provisions within 7 of the act's 16 titles that they expect to have positive and negative impacts on community banks and credit unions. Industry officials told us that it is difficult to know for sure which provisions will impact community banks and credit unions, because the outcome largely depends on how agencies implement certain provisions through their rules, and many of the rules implementing the act have not been finalized. Thus, regulators and industry officials also have noted that the full impact of the Dodd-Frank Act on these institutions is uncertain. Nonetheless, some regulators and industry officials expect some of the act's provisions to benefit community banks and credit unions and other provisions to impose additional requirements on community banks and credit unions that could affect them disproportionately relative to larger banks. GAO analyzed a number of the Dodd-Frank Act provisions that regulators, industry officials, and others expect to impact community banks and credit unions. Several of the act's provisions, including its deposit insurance reforms, exemption from Section 404(b) of the Sarbanes-Oxley Act, and the Bureau of Consumer Financial Protection's (CFPB) supervision of certain nonbanks, could reduce costs and/or help level the playing field for community banks and credit unions. Other provisions, such as the act's mortgage reforms, may impose additional requirements and, thus, costs on generally all banks and credit unions, but their impact will depend on, among other things, how the provisions are implemented. Finally, industry officials generally told us that it is too soon to determine the Dodd-Frank Act's overall impact on small business lending and identified only one provision that contains a data collection and reporting requirement as potentially having a direct impact on such lending.