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OPINION

When It Comes to Banking, Size Does Matter

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In a reaction to the last major financial crisis, Dodd-Frank (the Wall Street Reform and Consumer Protection Act) was passed, and with it came hundreds of new regulations designed to provide additional financial stability, as well as ending the bailouts of "too big to fail" giant financial institutions. In its effort to prevent a future crisis from occurring, however, Dodd-Frank and its newly created Consumer Financial Protection Board directly or indirectly created many regulations that have resulted in unintended consequences, many of which have led to more harm than good.

Today, many of the new regulatory and compliance costs are being disproportionately borne by smaller banks and credit unions, compared to their larger counterparts, which ultimately affects consumer and small business access to capital. This is because larger banks can better absorb these costs through economies of scale.

For example, in its effort to regulate and identify systematic financial risk, the act targets bank holding companies with assets of $50 billion or more and identifies these as "systematically important financial institutions." As a result, most U.S. credit unions have been swept up as systematically important, subjecting them to enhanced prudential standards, additional reporting, various regulatory and compliance add-ons and possibly stress tests.

Wasn't Dodd-Frank supposed to focus on "too big to fail" banks?

A rule of this kind, as with many other new rules like it, creates a substantial cost burden on smaller banks and credit unions. Because large banks have economies of scale that can withstand these regulatory costs, they are competitively advantaged over their smaller counterparts. So, it should be of no surprise that big banks keep getting bigger and smaller ones are disappearing. In fact, since the financial crisis, the largest 100 banks have growth in terms of assets by over 30 percent, while there are fewer smaller banks in operation.

In other words, Dodd-Frank's goal to end the "too big to fail" problem has failed miserably by pushing a disproportionately greater cost burden on smaller banks and credit unions. A 2017 study, conducted by Cornerstone Advisors, finds that among the nation's credit unions

regulatory burden costs have increased by $800 million in just the last two years – that one in every five credit union employee are devoted to regulatory compliance.

Smaller banks and credit unions are an important source of capital for consumers and small businesses. During the financial crisis, it was the large banks that would not lend, while credit union loans increased by 40 percent. Today, big banks have become a less important source for home mortgages, which means that onerous regulations from Dodd-Frank are making things worse, not better for consumers and not better for small business, particularly in rural communities. This is just one example of many new regulatory flaws that are reducing consumer access to capital.

Fueled by Dodd-Frank, the CFPB was given an unprecedented and broad mandate that has brought on many new regulations. There is clearly a policy need to recalibrate this mandate.

The newly introduced Economic, Growth, Regulatory Relief, and Consumer Protection Act does just that. Introduced by Sens. Mike Crapo (R-Idaho), Joe Donnelly (D-Ind.), Heidi Heitkamp (D-N.D.), Jon Tester (D-Mont.), and Mark Warner (D-Va.) — and now with 12 Republicans, 11 Democrats and 1 independent co-sponsoring it — the bill resets minimum standards for residential mortgage loans, increases consumer access to loans, eliminates barriers to employment, and requires the Treasury to submit a report to Congress on cyber threats. The bill also allows credit unions to give mortgages to members who want to buy a 1- to 4-family dwelling, instead of treating the mortgage under a business loan cap. It is hard to understand how rules that restrict loans will somehow benefit consumers.

The bill does much more than just resize regulations for smaller financial institutions and increase access to capital, it also provides protections for homeowners, seniors and veterans. In addition, this proposed legislation would turn back a rule that requires a 3-day waiting period before a bank or credit union can offer a mortgage applicant a lower rate. Why would consumers need protection from lower mortgage rates? This proposal stops this regulatory overreach that only leaves consumers worse off.

Dodd-Frank set out to add financial stability, but some of its provisions have led to adverse consequence for smaller banks and credit unions, small businesses and, most importantly, consumers. The recalibration of these regulations is needed, and Congress is on the right track to do this.

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