

NOTES

DON'T (COMMUNITY) BANK ON IT: HOW THE CURRENT REGULATORY FRAMEWORK AND NEW FEDERAL REGULATIONS THREATEN THE U.S. COMMUNITY BANKING INDUSTRY

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Patrick T. Carlson*

INTRODUCTION

In today's modern world, it is impossible to operate as a business, governmental entity, or individual without the use of the financial system. In 2018, the financial industry accounted for approximately 7.4% or \$1.5 trillion of the total United States Gross Domestic Product.¹ That same year, at least twenty-eight financial services corporations were listed on Fortune's Global 500 largest corporations.² Within the massive financial industry, there are four major subsections—banking, asset management, insurance, and venture capital.³ As of 2018, the United States banking system held \$17.9 trillion in assets with a net income of \$236.8 billion.⁴ As such, the United States has the largest diversity of banks and the largest concentration of

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¹ *Financial Services Spotlight: The Financial Services Industry in the United States*, SELECT USA, <https://www.selectusa.gov/financial-services-industry-united-states> (last visited Oct. 29, 2020).

² *Id.*

³ *Id.*

⁴ *Id.*

private credit anywhere in the world.⁵ Since the 1980s, however, the banking industry has become increasingly more concentrated in the top five firms.⁶ Studies suggest those five firms account for approximately 45–50% of the total market.⁷ In reality, those top five firms only account for a sliver of the registered financial institutions.⁸ Financial institutions with deposits greater than \$10 billion make up only 2% of the overall industry.⁹ The remaining 98% are those institutions that have less than \$10 billion in assets.¹⁰

The enormity of the financial industry necessitates federal oversight and regulation. There are six agencies that are responsible for regulating the financial industry.¹¹ The agencies are: the Federal Reserve System, the Department of the Treasury, the Securities and Exchange Commission, the Federal Deposit Insurance Corporation, the Commodities Futures Trading Commission, and the National Credit Union Administration.¹² These six agencies, along with Congress and state regulators, act to safeguard the public from banking malpractice through enacting legislation and promulgating new rules.¹³ These agencies and Congress have recently approved two regulations—Basel III and the Community Bank Leverage Ratio Act—which place new burdens on large and small banks.¹⁴

⁵ *Id.*

⁶ See Kenneth Kimutai too, *Largest Banks in the United States*, WORLD ATLAS (Mar. 26, 2018), <https://www.worldatlas.com/articles/the-largest-banks-in-the-us.html> (explaining that JP Morgan Chase, Bank of America, Wells Fargo, Citigroup, and Goldman Sachs are the largest five banks in terms of assets in the United States).

⁷ Lawrence J. White, *Antitrust and the Financial Sector*, MONEY & BANKING (Jan. 21, 2019), <https://www.moneyandbanking.com/commentary/2019/1/18/antitrust-and-the-financial-sector>.

⁸ FED. DEPOSIT INS. CORP., FDIC COMMUNITY BANKING STUDY 1-4 (2012), <https://www.fdic.gov/regulations/resources/cbi/report/cbsi-1.pdf> [hereinafter COMMUNITY BANKING STUDY].

⁹ *Id.*

¹⁰ *Id.*

¹¹ See Lee Hudson Teslik, *The U.S. Financial Regulatory System*, COUNCIL ON FOREIGN RELATIONS (Oct. 1, 2008), <https://www.cfr.org/backgrounders/us-financial-regulatory-system>.

¹² *Id.*

¹³ See EDWARD V. MURPHY, CONG. RESEARCH SERV., R43087, WHO REGULATES WHOM AND HOW? AN OVERVIEW OF U.S. FINANCIAL REGULATORY POLICY FOR BANKING AND SECURITIES MARKETS 3, 19 (2015), <https://fas.org/sgp/crs/misc/R43087.pdf>.

¹⁴ See *infra* Part III.

This Note will address how the current regulatory regime and the implementation of Basel III and the Community Bank Leverage Ratio Act will impact the largest section, by volume, of the banking industry. These new regulations, in combination with the regulatory regime as it presently stands, have caused and will continue to cause community banks to struggle to survive. As a result, it will become necessary for these community banks to significantly increase their total assets or to disband all together due to rising costs.

This Note will begin with a discussion of the overall structure of the United States banking system. Part I will define what it means to be considered a community bank. Next, it will explain the important agencies that regulate the United States financial industry and discuss the impact compliance has on community banks. Parts II and III will then describe the Basel III and the Community Bank Leverage Ratio Act and their impact. Finally, Part IV will suggest a more comprehensive four-part solution to ensure that community banks can survive increased regulation while maintaining consumer protection in the marketplace.

I. FINANCIAL INSTITUTIONS AND THEIR STRUCTURE

A. *What Is a Community Bank?*

A community bank is one that typically operates within its local community.¹⁵ As a result, community banks predominantly rely upon relationships with a local consumer base.¹⁶ They obtain a large majority of their deposits from the local community and, in part, base lending decisions on specialized knowledge of the community instead of traditional underwriting principles.¹⁷ Thus, where loan officers at larger banks make lending decisions based on credit score and statistical models, loan officers at community banks consider a wide variety of factors, such as the character of the borrower, the relationship between the borrower and the bank, and special features of the local economy.¹⁸ Further, as community banks are more connected to the local economy, they can oversee the loan in a way that larger institutions cannot.¹⁹ This personalized review of lending decisions is why many

¹⁵ COMMUNITY BANKING STUDY, *supra* note 8, at 1-1.

¹⁶ *Id.*

¹⁷ *Id.*

¹⁸ William Keeton, Jim Harvey & Paul Willis, *The Role of Community Banks in the U.S. Economy*, FED. RES. BANK KAN. CITY ECON. REV., Second Quarter 2003, at 15, 24-25, <https://www.kansascityfed.org/publicat/econrev/pdf/2q03keet.pdf>.

¹⁹ *Id.* at 25.

community banks are colloquially known as “relationship bankers,” in contrast to their larger financial institution counterparts, which are known as “transactional bankers.”²⁰ As a result, community banks are essential for the accumulation of capital for small businesses, local citizens, and farmers because they offer personalized service to their customers and provide loans that credit-centered larger financial institutions do not.²¹ One of the main reasons for this flexibility is that community banks are closely held²² and are thus tied into their local markets, economies, and communities, while larger institutions are linked more closely to capital markets.²³

As these characteristics can be found in more than just community banks, the Federal Deposit Insurance Corporation (FDIC) has issued further guidance as to what constitutes a community bank. The first criteria for community bank classification is that the bank hold fewer than \$10 billion in total assets.²⁴ This arbitrary line, however, based upon total assets, is not always accurate; thus, the FDIC has developed and implemented a more thorough five-step analysis to determine whether to classify a bank as a community bank.²⁵ First, they “aggregate all charter-level²⁶ data under each holding company into a single banking organization.”²⁷ Second, they “exclude any banking organization where more than 50% of total assets are held in certain specialty banking charters.”²⁸ Third, they include organizations that engage in banking activities as measured by a total loans

²⁰ COMMUNITY BANKING STUDY, *supra* note 8, at 1-1.

²¹ See Keeton et al., *supra* note 18, at 24–27.

²² Adam Hayes, *Closely Held Corporation*, INVESTOPEDIA, <https://www.investopedia.com/terms/c/closely-held-corporation.asp> (last updated Mar. 29, 2020) (“A closely held corporation is any company that has only a limited number of shareholders. Often, its stock is exchanged only infrequently but which are often listed on public exchanges, although they often also trade on over-the-counter (OTC) exchanges.”).

²³ COMMUNITY BANKING STUDY, *supra* note 8, at 1-1.

²⁴ *Id.*

²⁵ *Id.* at 1-1 to 1-2.

²⁶ Julia Kagan, *What is a Chartered Bank?*, INVESTOPEDIA, <https://www.investopedia.com/terms/c/charteredbank.asp> (last updated July 31, 2020) (“A chartered bank is a financial institution whose primary roles are to accept and safeguard monetary deposits from individuals and organizations, as well as to lend money out.”).

²⁷ COMMUNITY BANKING STUDY, *supra* note 8, at 1-2.

²⁸ *Id.*

to assets ratio of greater than 33% and a ratio of core deposits to assets of greater than 50%.²⁹ Fourth, they include banking organizations that are limited in geographic scope and size.³⁰ Fifth, the community bank must comply with an asset-size limit of \$10 billion.³¹ Through this analysis, the FDIC determines the prominence of the community bank.³²

In 2010, there were 6,914 banking organizations registered in the United States.³³ Of those, 94%, or 6,524 banks, were designated as community banks.³⁴ These banks accounted for \$1.923 trillion in total assets.³⁵ The remaining 390 registered banks fell outside this definition for various reasons, such as asset size or geographic footprint.³⁶ Therefore, community banks account for the largest portion of chartered banks, as well as a significant percentage of the total assets in the financial industry.

B. *The United States Financial Regulatory System*

The United States divides their regulatory structure among multiple governing agencies.³⁷ There are three main agencies, along with the United States Congress, that regulate and oversee the banking industry. These agencies are the Federal Reserve Board (Federal Reserve), the FDIC, and the Office of the Comptroller of the Currency (OCC).³⁸ Collectively, these three agencies promulgate rules, in conjunction with the international Basel Accords and under authority given by the United States Congress.³⁹

²⁹ *Id.* at 1-3.

³⁰ *Id.*

³¹ *Id.* (holding that the definition established an asset size limit, but the actual number is defined on page 1 as \$10 billion).

³² *See id.* at 1-4 tbl.1.2.

³³ *Id.* at 1-3.

³⁴ *Id.*

³⁵ *Id.* at 1-4 tbl.1.2.

³⁶ *Id.* at 1-3.

³⁷ *See supra* Introduction.

³⁸ Eugene Goyfman, Comment, *Lets Be Frank: Are the Proposed US Rules Based on Basel III an Adequate Response to the Financial Debacle?*, 36 FORDHAM INT'L L.J. 1062, 1066-67 (2013).

³⁹ *Id.* at 1067.

The Federal Reserve is the central bank of the United States.⁴⁰ It is responsible for controlling the United States money supply.⁴¹ It controls the money supply through a network of twelve intermediary reserve banks that require banks to keep a percentage of their total asset capital on “reserve” with the Federal Reserve.⁴² The Federal Reserve has regulatory authority over 38% of U.S. commercial banks.⁴³ Thus, the Federal Reserve is a primary prudential regulator for a variety of lending institutions, including those institutions that are designated as systematically significant.⁴⁴ In addition to being a primary regulator, the Federal Reserve implements monetary policy, monitors the financial system, and regulates payment services.⁴⁵ Therefore, the Federal Reserve is greatly involved with banks and their interest rates, liquidity ratios, leverage ratios, and capital ratios.⁴⁶ This broad oversight responsibility granted the Federal Reserve the authority to adopt and adapt the international Basel III framework.⁴⁷

The FDIC was created in 1933 for the general population as a “backstop” against bank asset evaporation.⁴⁸ The FDIC will insure \$250,000 per person per bank and \$250,000 for retirement accounts.⁴⁹ Banks must qualify for FDIC insurance pursuant to FDIC regulatory requirements, thus the FDIC’s regulatory authority flows from a bank’s qualification.⁵⁰ Banks qualify through the payment of yearly premiums.⁵¹ The idea behind deposit insurance is to ensure that even well-capitalized

⁴⁰ Teslik, *supra* note 11.

⁴¹ *Id.*

⁴² *Id.*

⁴³ *Id.*

⁴⁴ MURPHY, *supra* note 13, at 21.

⁴⁵ *Id.* at 23.

⁴⁶ Press Release, Bd. of Governors of the Fed. Reserve Sys., Federal Reserve Board approves final rule to help ensure banks maintain strong capital positions (July 2, 2013), <https://www.federalreserve.gov/newsevents/pressreleases/bcreg20130702a.htm> [hereinafter Press Release, Strong Capital Positions].

⁴⁷ *See id.*

⁴⁸ MURPHY, *supra* note 13, at 21.

⁴⁹ Teslik, *supra* note 11.

⁵⁰ *Id.*

⁵¹ MURPHY, *supra* note 13, at 21.

banks can manage to survive a “run on banks” by depositors.⁵² Deposit insurance is funded through a premium placed on banks, and it provides depositors with full-faith and credit.⁵³ The necessity for banks to have deposit insurance grants the FDIC broad regulatory authority over all federal and state chartered banks.⁵⁴ If a bank does not have at least 6% of its assets managed in reserve, they are subject to FDIC control.⁵⁵ When this type of extreme “undercapitalization” occurs, the FDIC can engage in corrective measures.⁵⁶ Such measures may include the administration of the resolution process after a forced closure order by the Federal Reserve, with a two-thirds vote by the Financial Stability Oversight Council.⁵⁷

The OCC is the primary agency the Department of the Treasury uses to regulate U.S. banks.⁵⁸ It was created by the National Currency Act of 1863, making it the oldest regulatory agency in the country.⁵⁹ The OCC’s primary goal is to ensure the stability of the bank system.⁶⁰ This is done by monitoring “a bank’s loan and investment portfolios, funds management, capital, earnings, liquidity, sensitivity to market risk, and compliance with consumer banking laws.”⁶¹ In addition, the OCC publishes reports on aspects within the U.S. commercial banking industry.⁶² Further, the OCC has broad examination powers that allow it to enforce its regulations in an effort to carry out its purpose.⁶³ This includes the ability to issue a cease and desist order or revoke the charter of covered banks.⁶⁴

⁵² *Id.*

⁵³ *Id.*

⁵⁴ *See id.* at 22.

⁵⁵ Teslik, *supra* note 11.

⁵⁶ *Id.*

⁵⁷ MURPHY, *supra* note 13, at 22.

⁵⁸ *Id.* at 21.

⁵⁹ *History*, OFF. COMPTROLLER CURRENCY, <https://www.occ.gov/about/who-we-are/history/index-history.html> (last visited Nov. 16, 2020).

⁶⁰ Teslik, *supra* note 11.

⁶¹ *Id.*

⁶² MURPHY, *supra* note 13, at 21.

⁶³ *Id.*

⁶⁴ *Id.*

Not only are banks accountable to the Federal Reserve, FDIC, and the OCC, but they are also responsible for adhering to the state's regulatory framework. State regulators are responsible for promoting "safety and soundness, consumer protection and local economic growth."⁶⁵ States rely on their specialized local knowledge to promulgate regulations.⁶⁶ States also have the authority to charter a bank within their state.⁶⁷ Many community banks are state chartered but they are still responsible for answering to the federal regulators.⁶⁸

The complex and fragmented nature of the current regulatory framework between multiple agencies and states creates significant overlapping authority.⁶⁹ First, the head of the OCC, the Comptroller of the Currency, is also a board member at the FDIC and a voting member on the Financial Stability Oversight Council.⁷⁰ Second, the OCC's responsibilities and the FDIC's responsibilities overlap. Both agencies have oversight authority over banks to ensure compliance with liquidity regulations and risk sensitivity.⁷¹ They also have very similar enforcement and examination powers for banks that they regulate.⁷² Further, they both have the ability to grant charters to banks.⁷³ This ability is also shared with the states.⁷⁴ Third, the OCC and the Federal Reserve are the primary regulators and, as such, have very similar market oversight powers.⁷⁵ Fourth, multiple layers of overlap exist among

⁶⁵ *The Role of State Financial Regulation*, CONF. FOR ST. BANK SUPERVISORS (Oct. 26, 2017), <https://www.csbs.org/policy/role-state-financial-regulation>.

⁶⁶ *Id.*

⁶⁷ MARC LABONTE, CONG. RESEARCH SERV., R44918, WHO REGULATES WHOM? AN OVERVIEW OF THE U.S. FINANCIAL REGULATORY FRAMEWORK 24 (2020), https://www.everycrsreport.com/files/20200310_R44918_8448f8813e769930dd2403bcf31091ff31028c8.pdf.

⁶⁸ *Id.*

⁶⁹ U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-16-175, FINANCIAL REGULATION, COMPLEX AND FRAGMENTED STRUCTURE COULD BE STREAMLINED TO IMPROVE EFFECTIVENESS 86 (2016), <https://www.gao.gov/assets/680/675400.pdf>.

⁷⁰ MURPHY, *supra* note 13, at 21.

⁷¹ Teslik, *supra* note 11.

⁷² MURPHY, *supra* note 13, at 21.

⁷³ *See id.*; Teslik, *supra* note 11.

⁷⁴ LABONTE, *supra* note 67, at 24.

⁷⁵ MURPHY, *supra* note 13, at 23.

the agencies that oversee consumer safety.⁷⁶ This is a function that the states, the FDIC, and the Federal Reserve all share.⁷⁷ Fifth, the FDIC handles deposit insurance, which requires it to regulate all federally insured banks.⁷⁸ Thus, the FDIC's responsibilities overlap with the market oversight powers of the OCC and Federal Reserve, which also overlap with each other.⁷⁹ This list of regulatory overlap is not exhaustive. This spider-web of financial regulations means that one financial institution will fall under the control of multiple regulators.⁸⁰ It is a heavy financial burden for banks to comply.

This regulatory burden is considered to be among the greatest challenges facing all banks, specifically community banks.⁸¹ Since the 2008 financial crisis, the banking industry has spent trillions of dollars in enforcement actions, fines, settlements, and compliance costs.⁸² In the ten years post-2008, banks spent \$321 billion on enforcement actions, fines, and settlements.⁸³ Further, banks spend an estimated \$270 billion per year on compliance, which accounts for at least 10% of the banks' yearly operating costs.⁸⁴ Some reports estimate that compliance costs could double by 2022.⁸⁵ Large banks can typically handle the higher compliance costs but community banks cannot. Their small-scale economies exacerbate the impact of compliance costs.⁸⁶ For example, banks with less than \$100 million in

⁷⁶ U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-16-175, FINANCIAL REGULATION, COMPLEX AND FRAGMENTED STRUCTURE COULD BE STREAMLINED TO IMPROVE EFFECTIVENESS 16 (2016), <https://www.gao.gov/assets/680/675400.pdf>.

⁷⁷ *Id.*

⁷⁸ *Id.*

⁷⁹ *Id.*

⁸⁰ *Id.* at 86.

⁸¹ Drew Dahl, Jim Fuchs, Andrew Meyer & Michelle Neely, *Compliance Costs, Economies of Scale and Compliance Performance*, FED. RES. BANK ST. LOUIS, Apr. 2018, at 1, <https://www.communitybanking.org/~media/files/compliance%20costs%20economies%20of%20scale%20and%20compliance%20performance.pdf>.

⁸² Stuart Brock, *The Cost of Compliance*, INT'L BANKER (Nov. 7, 2018), <https://internationalbanker.com/technology/the-cost-of-compliance/>.

⁸³ *Id.*

⁸⁴ *Id.*

⁸⁵ *Id.*

⁸⁶ Dahl et al., *supra* note 81, at 4; Will Kenton, *Economies of Scale*, INVESTOPEDIA, <https://www.investopedia.com/terms/e/economiesofscale.asp> (last updated July 1, 2020) ("The size of the business

assets estimate that 10% of their expenses are on compliance.⁸⁷ Compare that percentage with banks with assets between \$1 billion and \$10 billion, which estimate that approximately 5% of their expenses go to compliance.⁸⁸ Thus, the larger the bank, the less they proportionally spend on compliance.⁸⁹ As a result, many banks are consolidating.⁹⁰ This trend “has been driven by new financial technologies, operating inefficiencies, demographic changes, pressure from nonbank competitors, and perhaps most important[ly], regulation.”⁹¹ Approximately 85% of bankers considered regulatory compliance costs an important reason to merge with other banks.⁹²

II. THE NEW FINANCIAL INDUSTRY REGULATORY STRUCTURE

A. *Basel III*

Basel III is a set of international banking standards promulgated in December of 2017 by the Group of Central Bank Governors and Heads of Supervision (GHOS).⁹³ GHOS is the controlling entity of the Basel Committee’s oversight board.⁹⁴ Basel III is to be fully implemented by January of 2022.⁹⁵ The Federal Reserve states that the Basel III “framework requires bank[s] to hold more and higher quality capital, which acts as a financial cushion to absorb losses, while reducing the incentive for firms to take excessive risk.”⁹⁶ In order to achieve this, the framework demands that banks comply with new and more stringent requirements.

generally matters when it comes to economies of scale. The larger the business, the more the cost savings.”).

⁸⁷ Dahl et al., *supra* note 81, at 4.

⁸⁸ *Id.*

⁸⁹ *Id.*

⁹⁰ *Id.*

⁹¹ *Id.*

⁹² *Id.*

⁹³ *Basel III—Implementation*, FIN. STABILITY BOARD, <https://www.fsb.org/work-of-the-fsb/implementation-monitoring/monitoring-of-priority-areas/basel-iii/> (last visited Oct. 29, 2020).

⁹⁴ *Id.*

⁹⁵ *Id.*

⁹⁶ See Press Release, Strong Capital Positions, *supra* note 46.

Under Basel III, all banks must maintain a leverage ratio of 4%.⁹⁷ Larger financial institutions that have an active international presence, however, are required to maintain an increased leverage ratio.⁹⁸ A leverage ratio measures a bank's equity against total average assets.⁹⁹ Leverage ratios are commonly used to measure the capital adequacy of a bank.¹⁰⁰ Banks are considered "well capitalized" by the FDIC when they have a tier 1 leverage ratio of greater than 5%.¹⁰¹ Basel III requires banks to hold more tier 1 capital and adjusts the calculation method for tier 1 capital.¹⁰² Tier 1 capital is widely recognized as the most loss-absorbing form of capital, as it is permanent and places shareholders' funds at risk of loss only in the event of insolvency.¹⁰³ In general, tier 1 capital is a combination of treasury stock, retained earnings, and other comprehensive, safe forms of assets.¹⁰⁴ The new Basel III requirement generally only applies to large financial institutions that hold in excess of \$10 billion in international assets.¹⁰⁵ However, in conjunction with Basel III, the Federal Reserve also executed a new Liquidity Coverage Ratio (LCR) on all banks.¹⁰⁶

⁹⁷ *Id.*

⁹⁸ *Id.*

⁹⁹ See *Understanding Banking Ratios*, US BUS. REP., http://www.activemedia-guide.com/busedu_banking.htm (last visited Nov. 16, 2020) (defining a leverage ratio as equal to the bank's total stockholders' equity divided by the average total assets).

¹⁰⁰ *Id.*

¹⁰¹ FED. DEPOSIT INS. CORP., RISK MANAGEMENT MANUAL OF EXAMINATION POLICES 2.1-1 (2019), <https://www.fdic.gov/regulations/safety/manual/section2-1.pdf> [hereinafter RISK MANAGEMENT MANUAL]; see also Letter from Hugh Carney, Vice President, Am. Bankers Ass'n, to Robert E. Feldman, Exec. Sec'y, Fed. Deposit Ins. Corp. (Apr. 9, 2019), <https://www.aba.com/-/media/documents/comment-letter/community-bank-leverage-ratio-comment-letter-4-9-19.pdf?rev=e02f434a2ed546b28cf776247fee817b> [hereinafter Community Bank Leverage Ratio Comment Letter].

¹⁰² See Press Release, Strong Capital Positions, *supra* note 46.

¹⁰³ RISK MANAGEMENT MANUAL, *supra* note 101, at 2.

¹⁰⁴ *Id.*; see also James Chen, *Safe Assets*, INVESTOPEDIA, <https://www.investopedia.com/terms/s/safe-asset.asp> (last updated May 10, 2019) ("Safe assets are assets which, in and of themselves, do not carry a high risk of loss across all types of market cycles.").

¹⁰⁵ Press Release, Bd. of Governors of the Fed. Reserve Sys., Federal Reserve Board proposes new rule to strengthen liquidity positions of large financial institutions (Oct. 24, 2013), <https://www.federalreserve.gov/newsevents/pressreleases/bcreg20131024a.htm>.

¹⁰⁶ *Id.*

The LCR is relevant because it applies to banks that are not internationally active and that have more than \$50 billion in assets.¹⁰⁷ This liquidity ratio was absent from the Basel I and II frameworks.¹⁰⁸ Now, banking organizations are required to “hold high-quality liquid assets sufficient to survive a thirty-day period of significant market distress.”¹⁰⁹ The LCR further limits what a bank may consider a high-quality asset.¹¹⁰ Level 1 assets are limited to coins, bank notes, marketable securities guaranteed by sovereign entities, and central bank reserves, among other liquid assets.¹¹¹ Class 2A includes corporate debt not issued by a financial institution and covered bonds not issued by banks.¹¹² Proven common equity shares that are not issued by financial institutions fall into class 2B.¹¹³ These new classifications are the result of the 2008 financial crisis and significantly impact banks’ holding patterns.¹¹⁴

High quality liquid assets are only the numerator in this analysis. “The denominator of the LCR is total net cash outflows that would result from specified stress scenarios such as a partial loss of unsecured wholesale funding, a significant ratings downgrade, partial loss of retail deposits, collateral calls, and increased off-balance sheet exposure.”¹¹⁵ This denominator effectively equals the net cash outflows over the next thirty days for a financial institution.¹¹⁶

Lastly, Basel III introduces a new capital conservation buffer.¹¹⁷ Unlike many provisions in Basel III, the capital conservation buffer applies to all banks, regardless of their size.¹¹⁸ The purpose of this buffer is to provide banks an additional layer of

¹⁰⁷ *Id.*

¹⁰⁸ Andrew L. McElroy, *An Examination of Basel III and the New U.S. Banking Regulations*, 14 WAKE FOREST J. BUS. & INTELL. PROP. L. 5, 21 (2013).

¹⁰⁹ *Id.*

¹¹⁰ *Id.*

¹¹¹ *Id.* at 22.

¹¹² *Id.*

¹¹³ *Id.* at 23.

¹¹⁴ *Id.* at 20.

¹¹⁵ *Id.* at 23.

¹¹⁶ *Id.* at 21.

¹¹⁷ FIN. STABILITY INST., THE CAPITAL BUFFERS IN BASEL III—EXECUTIVE SUMMARY 1 (2020), https://www.bis.org/fsi/fsisummaries/b3_capital.htm.

¹¹⁸ *Id.*

safe capital that can be used when the bank incurs a loss.¹¹⁹ The capital conservation buffer “requires banks to maintain a conservation buffer of common equity Tier 1 Capital of 2.5% of risk weighted assets in addition to the total capital ratio requirements.”¹²⁰ This will ultimately require 7% of a bank’s capital to be comprised of common equity.¹²¹ The buffer’s impact on banks, however, is proportional to the tier 1 capital ratio. For example, if a bank has a tier 1 capital ratio between 4.5% and 5.125%, the bank is required to withhold 100% of its earnings.¹²² If the bank’s tier 1 capital ratio is greater than 7%, no restriction is placed on the bank.¹²³ If the bank falls in the first category, they cannot issue dividends, share buybacks, make discretionary payments on other tier 1 capital, or give bonuses to staff.¹²⁴ As a result, the buffer requires banks to hold more tier 1 capital, far in excess of the requirements, otherwise they cannot pay bonuses, pay off tier 1 capital, or pay dividends to shareholders.¹²⁵

B. *The Community Bank Leverage Act*

The Community Bank Leverage Act (CBLA) was introduced in Section 201 of the Economic Growth Act, Regulatory Relief and Consumer Protection Act of 2017.¹²⁶ The CBLA, consistent with the FDIC’s definition, defines a community bank as a financial institution that holds less than \$10 billion in total consolidated assets.¹²⁷ Under the CBLA, the regulatory institutions shall “develop a Community Bank Leverage Ratio of not less than 8% and not more than 10% for qualifying

¹¹⁹ *Id.*

¹²⁰ Goyfman, *supra* note 38, at 1088.

¹²¹ *Id.*

¹²² BASEL COMM. ON BANKING SUPERVISION, BUFFERS ABOVE THE REGULATORY MINIMUM 6 (2019), https://www.bis.org/basel_framework/chapter/RBC/30.htm (“Definition of earnings: Earnings are defined as distributable profits calculated prior to the deduction of elements subject to the restriction on distributions. . . . Where a bank does not have positive earnings and has a CET1 ratio less than 7% . . . it would be restricted from making positive net distributions.”).

¹²³ *Id.* at 4.

¹²⁴ *Id.* at 6.

¹²⁵ *Id.*

¹²⁶ See Economic Growth, Regulatory Relief, and Consumer Protection Act, Pub. L. No. 115-174, 132 Stat. 1296 (2018).

¹²⁷ § 201(a)(3)(A), 132 Stat. at. 1306; see also COMMUNITY BANKING STUDY, *supra* note 8, at 1-1 to 1-2.

community banks.”¹²⁸ Thus, the new leverage ratio applicable to all community banks must be between 8 and 10%, which is higher than the current 5% requirement.¹²⁹ The ratio was set at 9%.¹³⁰

The CBLA also requires qualified community banks to comply with the Prompt Corrective Action (PCA) of the Federal Deposit Insurance Act.¹³¹ This requires all community banks to maintain a “well capitalized” leverage ratio.¹³² The CBLA imposes a more stringent standard on community banks than the current PCA.¹³³

III. THE IMPACT ON COMMUNITY BANKS

The combination of the Basel III framework, LCR, and CBLA, as currently constructed, places a heavy burden on community banks. Each new regulation presents a challenge to community banks.

Basel III and the LCR requirements for community banks were reduced in response to comments by community banks.¹³⁴ Even so, community banks will still have to make a significant transition to obtain and maintain compliance.¹³⁵ The LCR will require banks to sell off many of their riskier assets, in an effort to increase their numerators. High quality liquid assets cannot be pledged as collateral or a credit enhancement.¹³⁶ This provision will further limit banks’ ability to lend off of their existing assets. Further, the LCR incentivizes holding Level 1 assets, rather than Level 2 assets, due to the haircut provisions.¹³⁷ As a result, community banks will

¹²⁸ § 201(b)(1), 132 Stat. at. 1306.

¹²⁹ Community Bank Leverage Ratio Comment Letter, *supra* note 101, at 4–5.

¹³⁰ *Id.* Under Section 4012 of the CARES Act, the community bank leverage ratio was temporarily lowered to 8% in response to the COVID-19 pandemic, to be increased to 8.5% beginning in 2021, and 9% in 2022. *Agencies Temporarily Lower Community Bank Leverage Ratio to 8%*, AM. BANKING ASS’N BANKING J. (Apr. 6, 2020), <https://bankingjournal.aba.com/2020/04/agencies-temporarily-lower-community-bank-leverage-ratio-to-8/>.

¹³¹ § 201(c)(1)(B), 132 Stat. at. 1307; 12 U.S.C. § 1831o (2018); *see also* Community Bank Leverage Ratio Comment Letter, *supra* note 101, at 2–3.

¹³² *See* Community Bank Leverage Ratio Comment Letter, *supra* note 101, at 5.

¹³³ *Id.* at 3.

¹³⁴ *See* Press Release, Strong Capital Positions, *supra* note 46.

¹³⁵ *Id.*

¹³⁶ McElroy, *supra* note 108, at 22.

¹³⁷ *Id.* at 21–22 (“[T]he LCR imposes a 15% haircut for Level 2 assets and none for Level 1 assets.”).

have to “sit on” more assets, offer fewer loans, and spend significant resources on legal fees to stay within compliance. Under the current fractional reserve banking system, financial institutions generate revenue through lending and subsequent interest on those loans. It is essential that banks lend as large a percentage of their capital as possible to generate sufficient revenue.

The CBLA will have an even larger impact on community banks. The CBLA imposes a 9% leverage ratio.¹³⁸ This increase in percentage, from 8%, will exclude some 600 community banks from the new framework and force them into the Basel III framework.¹³⁹ There is concern in the community banking industry that the new CBLA requirements will not be optional, despite language stating the opposite.¹⁴⁰ Other local banks will pressure community banks to comply, which will inhibit local examiners ability to “opt-out” of the framework.¹⁴¹ The implication is that any bank that does not comply with the new leverage ratio is a riskier bank, and one that people should avoid. As such, any bank with that designation would struggle to survive unless they increased the ratio. Additionally, the new “risk based capital standards” inhibit community banks’ ability to engage in their core functions.¹⁴² Community banks rely upon specialized local knowledge to make loans to their clients.¹⁴³ The limitations placed on this process will exclude a large portion of the loan base upon which community banks rely upon to generate revenue.

Further, increased financial leverage could result in the destabilization of otherwise functional markets because of asset sell offs to unwind riskier positions.¹⁴⁴ This could produce artificial market prices and the accidental creation of a cycle in which banks severally sell off assets.¹⁴⁵ This downward price pressure from a “fire sale” will severely weaken the balance sheets of both small and large banks.¹⁴⁶

¹³⁸ Community Bank Leverage Ratio Comment Letter, *supra* note 101, at 3.

¹³⁹ *ICBA Policy Resolution: Regulatory Capital*, INDEP. COMMUNITY BANKERS AM., <https://www.icba.org/advocacy/our-positions-a-z/regulatory-capital-basel-iii-and-the-standardized-approach> (last visited Oct. 29, 2020).

¹⁴⁰ Community Bank Leverage Ratio Comment Letter, *supra* note 101, at 3–4.

¹⁴¹ *Id.*

¹⁴² *Id.* at 2.

¹⁴³ See COMMUNITY BANKING STUDY, *supra* note 8, at 1-1.

¹⁴⁴ McElroy, *supra* note 108, at 18.

¹⁴⁵ *Id.*

¹⁴⁶ *Id.*

The impact of these regulations will require community banks to make institutional changes to stay in compliance. The increased capital requirements of the CBLA will impose a huge cost upon small banks.¹⁴⁷ Many community banks cannot afford higher compliance costs.¹⁴⁸ As a result, many banks would have to locate outside capital to operate.¹⁴⁹ Typically, there are two ways for a community bank would obtain such capital. The first is through loans given by a large financial institution.¹⁵⁰ The second is through a merger with other community banks to increase their size.¹⁵¹ Each option uniquely impacts the industry.

Community banks may choose to obtain loans from larger financial institutions in order to afford the cost of operation; however, this is not a perfect solution. Community banks are local in nature and keep interest rates low in order to provide loans to the local community.¹⁵² However, when they receive a large loan from another financial institution, they become beholden to the repayment of that loan. Thus, the bank will have to increase its profitability in order to offset the growing expenditure. This pressure would lead community banks to become more risk-averse in their lending practices. This, in turn, would impact the community at large, which relies upon these loans to start businesses or buy houses.¹⁵³ Further, because community banks would likely need to increase interest rates, local residents would be forced to seek loans at larger financial institutions. Over time, community banks would struggle to compete with these larger banks and may ultimately be unable to survive.

The second option to obtain outside capital, the merger of community banks, would also lead to a host of problems. A merger of community banks would allow them to obtain the critical economies of scale necessary to absorb the new

¹⁴⁷ Adam R. Lewis, *North Carolina Community Banks: Survival Strategies for Turbulent Times*, 17 N.C. BANKING INST. 333, 333 (2013).

¹⁴⁸ *Id.*; see also Adam J. Levitin, *Safe Banking: Finance and Democracy*, 83 U. CHI. L. REV. 357, 362–63 (emphasizing the high cost of compliance for banks under the modern regulatory system); *supra* Section II.B.

¹⁴⁹ Lewis, *supra* note 147, at 345–46.

¹⁵⁰ *Id.*

¹⁵¹ *Id.*

¹⁵² See COMMUNITY BANKING STUDY, *supra* note 8, at 1-1.

¹⁵³ *Id.*

compliance cost and to attract private equity.¹⁵⁴ However, if community banks merge together, they may no longer be classified as community banks. First, a merger of two or more community banks may cause geographic overreach.¹⁵⁵ Community banks are limited in geographic scope.¹⁵⁶ If they exceed that scope, they will no longer be categorized by the FDIC as a community bank.¹⁵⁷ As a result, they would fall under the Basel III regulation that they are currently exempt from.¹⁵⁸

Moreover, by merging two community banks, the new bank may exceed \$10 billion in assets. For example, if two community banks each with assets of \$7 billion merge, the resulting new bank would have \$14 billion in assets. This would exceed the defined \$10 billion limitation placed upon community banks.¹⁵⁹ As a result, the new bank would now fall outside the CBLA and into the Basel III framework. The new bank could avoid this by selling off assets to stay under the threshold. However, the bank would be selling off deposits and loans to a larger financial institution. Likely, this would sow distrust within the local community that the community banks serve and rely upon.

Increased leverage ratios, if they result in a “fire sale” that weakens financial institutions’ balance sheets, could be a large problem for smaller community banks. Large financial institutions have a lot more assets in comparison to small banks.¹⁶⁰ A community bank cannot survive a downward move in its total assets. Thus, increased leverage ratios increase the risk of possible insolvency among community banks.

IV. A FOUR-PART SOLUTION TO MAINTAIN COMMUNITY BANKS AND CONSUMER PROTECTION

The impact on community banks, as a result of the two new rules and regulations proposed, can be mitigated with a four-part solution. First, the FDIC needs to expand its definition of a “community bank” to allow for bank expansions

¹⁵⁴ Lewis, *supra* note 147, at 350–51; Dahl et al., *supra* note 81, at 4 (explaining that the more assets held by a bank the less percentage of expenses goes towards compliance); *supra* Section I.B.

¹⁵⁵ See COMMUNITY BANKING STUDY, *supra* note 8, at 1–3.

¹⁵⁶ See *id.*

¹⁵⁷ *Id.*

¹⁵⁸ *Id.*; ICBA Policy Resolution: Regulatory Capital, *supra* note 139.

¹⁵⁹ COMMUNITY BANKING STUDY, *supra* note 8, at 1-1.

¹⁶⁰ Kimutai too, *supra* note 6.

and mergers. Second, Congress, the FDIC, and the OCC should permanently lower the leverage ratio required of community banks to 6% rather than raise it to 9%. Third, the Federal Reserve should eliminate the Capital Conservation Buffer to allow for tax deductions and increased capital expenditure. Fourth, Congress, the states, and the federal regulating agencies need to simplify the regulatory structure to enable banks to spend less on regulatory compliance.

A. *Expanding the Definition of a Community Bank*

Under the current FDIC definition of a community bank, such banks are limited in asset size, geographic scope, and total risk weighted assets.¹⁶¹ The asset limitation is only \$10 billion.¹⁶² This is a low number. There is precedent for increasing the asset limit to keep pace with changing financial conditions. The asset limit was \$250 million in 1985 and increased to \$1 billion in 2010.¹⁶³ It is now set at \$10 billion.¹⁶⁴ Raising the asset limit would grant leeway to community banks to merge while still complying with the asset threshold.

Next, the FDIC should expand the geographic scope requirement. Under the current definition, a community bank may not maintain more than seventy-five offices.¹⁶⁵ Like the asset limit, the office limit has increased since 1985, when the limit was forty.¹⁶⁶ Further, no single office can have more than \$5 billion in deposits—up from \$1.25 billion in 1985.¹⁶⁷ These limits should be increased again to 125 offices per bank and \$7.5 billion in deposits. The last geographic limitation is that a bank may not maintain branches in more than three states and two large metropolitan areas.¹⁶⁸ These two fixed maximums should be expanded to four states and three major metropolitan areas. The expansion of the geographic scope will open up community banks to mergers and expansions into new target areas, allowing them to raise more capital to keep up with increased compliance costs.

¹⁶¹ COMMUNITY BANKING STUDY, *supra* note 8, at 1-3.

¹⁶² *Id.*

¹⁶³ *Id.* at 1-1.

¹⁶⁴ *Id.*

¹⁶⁵ *Id.* at 1-3.

¹⁶⁶ *Id.*

¹⁶⁷ *Id.*

¹⁶⁸ *Id.*

It is important, moreover, for community banks to stay in their intended banking category. Community banks are considered “relationship bankers” as opposed to “transactional bankers.”¹⁶⁹ This difference means that community bankers rely upon their relationship to the community to make loans and garner business. As such, they have to be careful not to over-expand. As they expand, they must maintain close ties to the stakeholders and local communities they operate within.

B. Lower the Leverage Ratio Requirement

A leverage ratio is equal to the total stockholders' equity divided by the total assets. Prior to the CBLA, the PCA set the ratio at 6%.¹⁷⁰ Under the new CBLA, it would be raised to 9%.¹⁷¹ Problematically, under the CBLA, no bank can intentionally opt-out of the new leverage ratio. The purpose behind the CBLA is to exclude banks from the Basel III framework, since they already meet the required capital adequacy.¹⁷² The American Bankers Association believes that a leverage ratio of 8% is sufficient.¹⁷³ However, maintaining the limit at 6% would be better. Banks, as an operational matter, tend to hold more capital than the leverage ratio requires. If the ratio is set at 6%, then banks are likely to hold 8 or 9%.¹⁷⁴ Therefore, in practice, banks will stay in compliance with the CBLA while not being forced to withhold too much capital. Under this framework, a “well capitalized” bank would have a leverage ratio of greater than 6%, an “undercapitalized” bank would have a leverage ratio of less than 6%, and a significantly “undercapitalized” bank would have a leverage ratio under 4.5%. This would allow every community bank to stay capitalized and, thus, protected from high risk loss.

C. Eliminate the Capital Conservation Buffer

The capital conservation buffer is a roadblock to the raising of new capital by community banks for three reasons. First, in order for a community bank to pay out dividends, bonuses, and pay down tier 1 capital, they have to maintain a tier 1 capital ratio in excess of the required minimum of 4.5%. Many community banks will hold

¹⁶⁹ *Id.* at 1-1.

¹⁷⁰ See Community Bank Leverage Ratio Comment Letter, *supra* note 101, at 2.

¹⁷¹ *Id.*

¹⁷² *Id.*

¹⁷³ *Id.*

¹⁷⁴ See generally *id.* at 4-5.

capital far in excess of that percentage—as high, if not higher, than 7% excess capital so they can operate normally. The result of this practice is that a large amount of excess safe tier 1 capital must be held and not used to grow the bank assets.

Second, the buffer hurts community banks that hold tier 1 equity shares in other financial institutions. Many community banks rely on their retained earnings to raise necessary capital.¹⁷⁵ Inadvertently, if the bank in which the community banks owns shares is not in compliance with the buffer, the bank cannot issue dividends to the community bank. Thus, noncompliance limits the amount of income the community bank can obtain from those shares and use for investment or tax payments.

Third, the buffer impedes Congress's intent in creating S-corps community banks.¹⁷⁶ The buffer could prohibit banks from paying dividends to the community bank, which would then put the tax burden on the bank's shareholders despite the fact they never received a dividend.¹⁷⁷ In most cases, the bank could pay the dividend and take on the tax liability, but because it would violate the capital conservation buffer, banks cannot do so.¹⁷⁸ Because of this, the buffer is harmful to the purpose of S-corp community banks, which are designed to stimulate investment into small businesses.¹⁷⁹ Both the American Bankers Association and the Independent Community Bankers of America agree that the capital conservation buffer is unnecessarily punitive.¹⁸⁰ Thus, any policy correction that allows for community bank expansion must eliminate this policy so that community banks may maintain capital in stock of other financial institutions without a heavy tax burden.

¹⁷⁵ *Id.*; see also Will Kenton, *Retained Earnings*, INVESTOPEDIA, <https://www.investopedia.com/terms/r/retainedearnings.asp> (last updated Feb. 6 2020) (“Retained earnings is the amount of net income left over for the business after it has paid out dividends to its shareholders.”).

¹⁷⁶ Community Bank Leverage Ratio Comment Letter, *supra* note 101, at 8; see also Julia Kagan, *S Corporation (S Subchapter) Definition*, INVESTOPEDIA, <https://www.investopedia.com/terms/s/subchapters.asp> (last updated May 25, 2020) (“An S Corporation . . . refers to a type of corporation that meets specific Internal Revenue Code requirements. The requirements give a corporation with 100 shareholders or less the benefit of incorporation while being taxed as a partnership. The corporation may pass income directly to shareholders and avoid double taxation.”).

¹⁷⁷ Community Bank Leverage Ratio Comment Letter, *supra* note 101, at 4–5.

¹⁷⁸ *Id.*

¹⁷⁹ *Id.*

¹⁸⁰ See generally *id.*; ICBA Policy Resolution: *Regulatory Capital*, *supra* note 139.

D. *Simplify the Regulatory Structure*

The financial regulatory system, as currently constructed, is burdensome and expensive for banks and the government alike.¹⁸¹ The combination of the Federal Reserve, FDIC, OCC, and the states is designed to regulate all aspects of the banking industry in order to maintain a safe and efficient financial system. Despite this strong regulatory regime, the market crashed in the 1980s and again in 2008.¹⁸² Accordingly, financial regulation cannot simply be eliminated. It is clear that self-regulation by the market will not keep the market's worst impulses in check. However, the overlapping and fragmented nature of the current framework makes financial oversight difficult and inefficient.¹⁸³ As Federal Reserve Chairman Jerome Powell¹⁸⁴ has stated, "I support adjustments designed to enhance the efficiency and effectiveness of regulation without sacrificing safety and soundness or undermining macroprudential goals."¹⁸⁵ Thus, it is essential to simplify the framework in a way that enhances the efficiency of the overall system. No one solution is going to solve the immense complexity of financial regulations, but the following four suggested solutions would provide a strong starting point.

First, the OCC and the Federal Reserve have major oversight power over the banking industry. Community banks have to research and comply with rules promulgated by both agencies to avoid investigation and sanctions. It is simply cheaper to only answer to one agency. The Federal Reserve is the certified federal bank of the United States. As such, it should continue its role as the primary regulator, as it holds the funds that protect the whole financial industry. The OCC should promulgate regulations to simplify and eliminate its role as an oversight regulator on small banks, leaving community banks to answer only to the Federal Reserve.

Second, the FDIC's primary function is to grant deposit insurance to banks to help solidify consumer trust in the market. The FDIC should focus more on this important core function. By refocusing, the OCC can take over more control of liquidity and market risk. The OCC, under the Department of the Treasury, has a

¹⁸¹ Levitin, *supra* note 148, at 362–63.

¹⁸² *Id.*

¹⁸³ U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-16-175, FINANCIAL REGULATION, COMPLEX AND FRAGMENTED STRUCTURE COULD BE STREAMLINED TO IMPROVE EFFECTIVENESS 86 (2016), <https://www.gao.gov/assets/680/675400.pdf>.

¹⁸⁴ Jerome Powell is the 16th chair of the Federal Reserve. He has been in office since February of 2018.

¹⁸⁵ Jerome Powell, Chairman, Fed. Reserve, Brief Remarks at the Global Finance Forum (April 20, 2017).

greater ability to oversee the market and grant bank charters. Small community banks will then only have to look to one agency for this function.

Third, states should have complete control over local economies and consumer protection for all banks chartered in their state. Community banks are mostly chartered at the state level. Under the current system, they have to follow the guidance of the state and the FDIC for consumer safety and protection. States are more responsive to the local market and, as such, should take more control over consumer safety for state-chartered banks. This process will create a simpler regulatory regime more tailored to the market the community bank operates within. This will result in lower compliance costs and cheaper fees for consumers.

Fourth, increased agency coordination will help to eliminate redundant regulation. For example, when it comes to oversight on liquidity, it is not necessary for both the OCC and the FDIC to be involved. The two branches could coordinate to determine which entity would oversee liquidity and which agency would exit that realm. By doing so, banks will only have to look to one agency. Further, increased coordination and collaboration will help to manage inconsistencies and duplicative regulation.¹⁸⁶ Increased coordination, however, is not a comprehensive solution and will have to develop in conjunction with a simplification of the overall system.¹⁸⁷

E. Impact of this Policy Solution for Community Banks

This new four-part policy solution will help to ease the regulatory burden on community banks in three ways. First, it will help with asset management and growth. Second, it will help community banks maintain their relationship-oriented lending function. Third, it will decrease the overall costs.

The first point is the most crucial. The definition of a community bank is essentially based upon its total asset size. An expanded definition will allow for community banks to merge and acquire to build assets without losing their charters, which is essential. Also, the inclusion of a lower leverage ratio and less stringent liquidity requirements will help community banks increase their capital. They will be able to do this, in part, because they will not be obligated to hold an extreme and overabundant amount of liquid capital. Liquid capital is necessary but hinders asset growth. Asset growth is required if community banks are to survive in an ever-centralized financial market.

¹⁸⁶ U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-16-175, FINANCIAL REGULATION, COMPLEX AND FRAGMENTED STRUCTURE COULD BE STREAMLINED TO IMPROVE EFFECTIVENESS 86 (2016), <https://www.gao.gov/assets/680/675400.pdf>.

¹⁸⁷ *Id.*

Second, the key value of a community bank is its status as a “relationship banker” rather than a “transaction banker.” Local small businesses, individuals, and farmers rely upon community banks to obtain capital and credit to operate their businesses, farms, and live their lives. Without community banks, the economy will struggle and be more controlled by large multinational corporations. The expanded definition will help community banks expand into new markets and grow their assets without fear of losing their charters. A fair and lowered leverage ratio will allow community banks to lend to riskier clients based upon relationships rather than risk tables and underwriters, as large institutions are required to do. Lastly, decreased compliance costs will grant banks more capital and assets to lend. For instance, a community bank that has \$10 billion in assets spends an estimated 5% of their total expenses on compliance. If their expenses are \$1 billion a year, then the bank is spending approximately \$50 million a year. If that number could be cut in half by simplifying the regulatory framework, that would free \$25 million for community banks that can go into other areas, such as marketing and lending. Both areas that bring in new business rather than restrict it.

Third, simplifying the regulatory structure helps all banks, not just community banks. A large bank with assets in excess of \$20 billion can afford to pay the compliance costs. Small banks cannot. However, costs are not the only concern with an over burdensome regulatory scheme. Banks spend extensive time adjusting their lending and depository policies in order to comply. A less burdensome regulatory scheme would permit banks to spend more engaging in bank functions that help their surrounding communities.

V. CONCLUSION

The United States federal government and its financial regulatory arm passed Basel III and the CBLA in response to the 2008 financial crisis. Each new regulation is designed to increase the safety of banks to ensure against insolvency. Basel III is an adoption of the policy set forth by International Basel Committee and is mainly directed to impact large banks. The CBLA was introduced by Congress in 2017 to provide a new regulatory framework for community banks.

However, the increased cost of regulatory compliance due to the overlap of Basel III and the CBLA will adversely impact community banks, which are already strapped for capital. Many community banks will not be able to pay for the compliance costs nor survive the more stringent capital requirements being put forth. The 2008 financial crisis was not the fault of community banks, and they should not be punished as such. Now, community banks will have to take corrective measures that may ultimately place them further under Basel III—a framework unfriendly to small community banks.

To solve this problem, the United States government should make the following corrective changes. First, the FDIC should expand the definition of a community bank to encompass growing and merging banks. Second, Congress should alter the CBLA's requirement of a leverage ratio between 8 and 10% so the FDIC can implement a leverage ratio of 6%, as the PCA does. Third, the capital conservation buffer should be eliminated to allow community banks to continue to maintain their capital inflows using common-stock and a tax shelter. Fourth, Congress, the states, and the federal regulatory agencies need to simplify the regulatory framework banks are forced to comply with. If these changes are made, the community banking industry can merge and increase their assets to allow them to lend more and to withstand increasing compliance costs. Ultimately, this solution would allow community banks, a vital part of the world's largest economy, to continue to operate in the way they were intended to, as "relationship bankers."