

## Introduction to Financial Services: Banking

Banks serve an important role in the financial system and broader economy. They aggregate the savings of households and businesses and lend to individuals, businesses, and federal and local governments. Economic output would be lower if, instead of banks, businesses had to finance investments themselves or individuals had to rely on their savings alone to make expenditures (e.g., home and car purchases). Banks also provide other important financial services, such as payments processing.

This In Focus reviews key concepts in banking, provides an overview of banking-related regulations and recent banking regulation, and highlights emerging policy issues.

### Key Concepts in Banking

*Bank* generally refers to an institution that accepts deposits, makes loans, and processes payments, including commercial banks and thrifts (but generally not credit unions, which have a different ownership model). To accept deposits, an institution must have a federal or state issued charter. Bank deposits are generally insured by the federal government, subject to certain limits. Using customer deposits and other funding, banks generally make loans and acquire certain other assets.

**Balance Sheet.** An understanding of a bank’s balance sheet—its assets, liabilities, and capital—provides the foundation for analyzing many banking issues. Loans made and securities owned by a bank typically comprise the majority of assets on a bank’s balance sheet. To get the funding to make loans and acquire assets, banks use liabilities and capital. Customer deposits (e.g., checking and savings account deposits) and any debt that a bank issues (e.g., bonds, repurchase agreements) are liabilities of the bank, as the bank owes these funds to its customers and creditors. The difference between the assets and liabilities is the bank’s equity (i.e., ownership interest).

**Deposit Insurance.** Federal deposit insurance is intended to prevent bank runs and promote financial stability to the financial markets by guaranteeing individuals’ bank deposits up to a \$250,000 account limit. Although the deposit insurance is funded by the industry, it is backed by the full faith and credit of the United States (and thus, ultimately by the taxpayers). The Federal Deposit Insurance Corporation (FDIC) insures bank deposits.

### Overview of Regulation

Two major components of bank regulation are prudential and consumer compliance regulation.

**Prudential.** Prudential regulation (or “safety and soundness” regulation) is designed to promote bank profitability and avoid bank failures, thereby protecting taxpayers and the stability of the financial system. A bank’s

charter type and corporate structure determine its primary federal prudential regulator (see **Table 1**). Banks are chartered and regulated as national banks under the authority of the Office of the Comptroller of the Currency (OCC) or as state banks under the authority of a state regulator. The Federal Reserve (Fed) and the FDIC regulate state banks in conjunction with state bank regulators. Most banks are owned by a parent company—called a bank holding company (BHC). Some BHCs have subsidiaries that engage in nonbank financial activities, such as underwriting and dealing in certain types of securities. The Fed is the primary regulator of BHCs.

**Table 1. Primary Federal Depository Regulators**

Regulator	Oversees
Office of the Comptroller of the Currency (OCC)	Nationally chartered banks and national thrifts
Federal Reserve (Fed)	Bank holding companies; and Fed member state banks and thrifts
Federal Deposit Insurance Corporation (FDIC)	Non-Fed member state banks and thrifts
National Credit Union Administration (NCUA)	Federally chartered or insured credit unions

**Source:** Congressional Research Service.

Capital and liquidity rules are important prudential regulation tools. Holding a high level of capital can make a bank’s failure less likely because capital can be written down to absorb losses. For this reason, banks are generally required to maintain sufficient levels of capital to ensure solvency and protect bank depositors and taxpayers. Banks need liquidity to meet short-term obligations; thus, banks are generally required to hold liquid assets or use stable funding to ensure adequate liquidity.

**Consumer Compliance.** Consumer compliance regulations seek to ensure that banks conform to applicable consumer protection and fair-lending laws. The Consumer Financial Protection Bureau (CFPB), created by the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act; P.L. 111-203), is primarily responsible for issuing the rules that all banks must comply with. CFPB is the primary supervisor for consumer compliance at banks with more than \$10 billion in assets. Prudential regulators are the primary supervisors for consumer compliance at banks with \$10 billion or less in total assets.

### Recent Banking Legislation

Congress passed the Dodd-Frank Act in response to the 2007-2009 financial crisis. This major response was arguably the most comprehensive financial reform legislation since the 1930s.

Debates have arisen over whether the benefits generated by the changes implemented under the act (e.g., greater financial stability and consumer protections) justify the costs (e.g., compliance costs to banks and reduced credit availability). To address concerns related to a perceived regulatory burden imposed on banks by the Dodd-Frank Act, Congress passed the Economic Growth, Regulatory Relief, and Consumer Protection Act (P.L. 115-174) in 2018, which modified certain aspects of the Dodd-Frank Act and bank regulation.

## Policy Issues

Congress continues to debate whether policy responses to the 2007-2009 financial crisis and subsequent reform through P.L. 115-174 and regulation are appropriate. Other ongoing policy issues of interest to Congress are highlighted below.

**Coronavirus Disease 2019 (COVID-19).** The COVID-19 pandemic could lead to losses on bank loans, which could affect bank profitability and the availability of credit. In response, banks have received temporary regulatory relief from regulators and the CARES Act (P.L. 116-136).

**Large Bank Regulation.** The Dodd-Frank Act required the Fed to apply enhanced prudential standards (EPS) to BHCs with assets of \$50 billion or more. P.L. 115-174 raised that threshold to \$250 billion and granted the Fed discretion to determine which EPS are applicable to BHCs with \$100 billion to \$250 billion.

### Market Concentration and Community Banks.

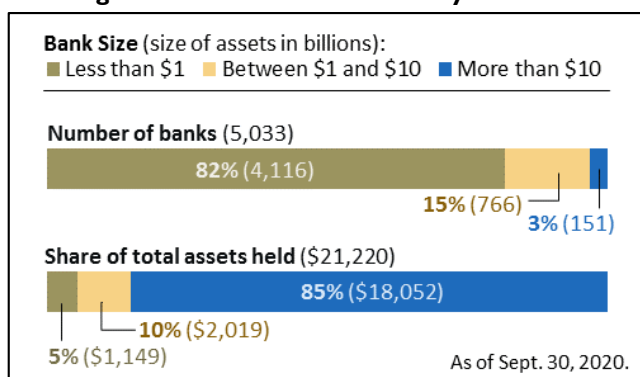
*Community bank* is not officially defined but generally refers to a small (though size is not necessarily a determining factor) bank that services the needs of a local area. Congress has shown considerable interest in the status of community banks.

Bank consolidation has led to a high concentration of bank assets in a small number of larger banks, as shown **Figure 1**. The number of smaller community banks has been in decline for decades, and the asset share of the largest banks has grown. As of September 2020, there were 5,033 insured banks in the United States, down from a peak of 18,083 in 1986. The industry held \$21.2 trillion in assets, 85% of which were held by 151 of the largest banks, each of which had more than \$10 billion in assets (the top 13 banks hold 55% of all assets). The 766 banks with assets of between \$1 billion and \$10 billion held nearly 10% of all assets, and the remaining 4,116 banks with less than \$1 billion in assets collectively held about 5%.

Several factors have contributed to bank consolidations in the past 35 years. The significant deregulation of interstate branch and banking restrictions in the 1980s and early 1990s played a role. Technological advances may have increased economies of scale in banking. Some have argued small bank regulatory burden is another factor, as smaller banks might have fewer resources to dedicate to compliance. Small banks are subject to fewer regulations than large banks, and P.L. 115-174 included provisions providing targeted relief to banks below certain asset sizes.

Some observers argue that tailoring regulations does not go far enough to relieve regulatory burden on small banks.

**Figure 1. Asset Concentration by Bank Size**



**Source:** Created by CRS with information from FDIC's Quarterly Banking profile.

**Fintech.** Financial technology, or “fintech,” usually refers to technologies with the potential to alter the way certain financial services are performed. Technological developments affect banks in two ways: (1) banks face choices over how much to invest in emerging technologies and to what extent to alter their business models to adopt technologies; and (2) they potentially face competition from new technology-focused companies, which may offer similar products but may not be subject to the same regulations as banks. One subject of debate is whether aspects of the regulation of banks and fintech companies are being appropriately calibrated given recent developments.

**Community Reinvestment Act (CRA).** Congress passed CRA (P.L. 95-128) to address a lack of lending in low-income neighborhoods. CRA requires regulators to evaluate how well banks are meeting credit needs in the areas where they function and consider those evaluations when banks want to operate in new areas. In 2020, to address changing market needs, the OCC issued a final rule and the Fed proposed a rule, but without consensus between them on how to reform CRA. Many in Congress have expressed ongoing interest in how any new CRA regulations would affect the communities served by banks and the availability of affordable credit to low- and moderate-income areas.

## CRS Resources

CRS Report R45518, *Banking Policy Issues in the 116th Congress*, coordinated by David W. Perkins

CRS Report R46422, *COVID-19 and the Banking Industry: Risks and Policy Responses*, coordinated by David W. Perkins

CRS Report R45073, *Economic Growth, Regulatory Relief, and Consumer Protection Act (P.L. 115-174) and Selected Policy Issues*, coordinated by David W. Perkins

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