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Over the Line: Asset Thresholds in Bank Regulation

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Over the Line: Asset Thresholds in Bank Regulation

SUMMARY

As of December 31, 2020, there were over 5,000 banks in the United States. While certain kinds of banks may be similar to each other, the industry as a whole is made of up institutions that differ in a variety of ways, in some ways quite drastically. How concentrated a bank is in loan making, how concentrated that lending is in specific loan types or geographic markets, how many other financial services the bank provides, and how much risk it is willing to take on are just a few characteristics across which banks may differ significantly. Perhaps the most striking disparity across the industry is bank size, typically measured as the value of the assets a bank owns.

Nearly a fifth of banks hold less than $100 million in assets, and the industry median is about $300 million. Meanwhile, the largest U.S. bank has over $3 trillion in assets, with three others over or near $2 trillion. Relative to large banks, small banks also tend to focus more on traditional commercial bank activities such as loan making and deposit taking; be less or not at all involved in other activities such as securities dealing and derivatives; have fewer resources to dedicate to regulatory compliance; and individually pose less or no risk to the stability of the financial system. For these reasons, there is general consensus that bank regulations should be tailored to account for bank differences, although questions over how much regulation should be tightened or relaxed for different groups of banks and to exactly which banks the changes should apply are matters of perennial debate.

Tailoring bank regulation in general produces certain benefits (e.g., achieving the goals of a regulation at less cost; not subjecting a group of banks to needless, costly regulation; freeing small bank resources for lending) but at certain costs (e.g., potential increased risk of failure for banks that qualify for relatively lax regulation, creating the opportunity for regulatory arbitrage). Furthermore, the reliance on asset thresholds has strengths and weaknesses. As a simple criterion, it makes regulatory treatment objective and transparent and minimizes opportunity for regulatory arbitrage. However, when application of a rule relies on a single, binary criterion, it can create distortionary "cliff" effects.

In practice, policymakers tailor regulation on an ad hoc, law-by-law, and regulation-by-regulation basis. Most, but not all, thresholds use asset size, sometimes in combination with other metrics. Many of these thresholds were introduced or raised by the 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act (P.L. 111-203) or the 2018 Economic Growth, Regulatory Relief, and Consumer Protection Act (P.L. 115-174). The result is a regulatory framework in which banks become subject to differing treatment under numerous regulations over a range of thresholds. For example, banks' corporate governance and auditing requirements become more strict at $500 million in assets and then become stricter at $1 billion; banks below $3 billion can qualify for less frequent examination and take on more debt to merge; banks below $5 billion file simpler quarterly reports; banks below $10 billion are not subject to proprietary trading restrictions (the Volcker Rule), limitations on debit card interchange fees, or primary consumer compliance supervision by the Consumer Financial Protection Bureau. The largest banks are subject to a regime of increasingly stringent enhanced prudential regulations to mitigate the systemic risk they pose.

Recent trends and developments have implications for thresholds that may draw policymaker attention. Assets across the industry rose quickly and perhaps permanently due to the effects of the COVID-19 pandemic and policy responses to it. As a result of industry consolidation over the past 35 years, the number of small banks and their share of industry assets has declined, while the number of large banks and their share of industry assets have grown, meaning that low thresholds now apply to an increasingly small portion—and high thresholds an increasingly large portion—of the industry. Finally, inflation means that the mostly static thresholds, which are not adjusted for inflation, are getting smaller over time in real terms.

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Introduction

Banking is one of the most heavily regulated industries in the United States due to its key role in the economy, its inherent risks, and the potential taxpayer exposures it creates. All banks are subject to numerous regulations regardless of size and other characteristics.[1] However, banks differ from each other across numerous aspects of their business models, including balance sheet size, breadth of products and services offered, funding sources, and risk appetite.[2] Policymakers and experts generally agree that bank regulation should be applied differently to different groups of banks, or "tailored," to account for these differences between institutions.[3] This is one way that policymakers attempt to reduce regulatory burden on smaller banks.[4]

As a result, certain regulations apply to banks based on one or more criteria. Often, but not always, the criteria involve asset size. Asset thresholds are a simple metric in the sense that they are transparent, objective, and easy to understand. For example, banks are subject to or exempt from certain regulations based on whether the total value of the assets a bank owns falls above or below a certain threshold, such as $500 million, $1 billion, $10 billion, or $250 billion in total assets.

Policymakers have tailored bank regulation on an ad hoc, statute-by-statute, and regulation-by-regulation basis generally to maximize benefits relative to costs of a particular regulation. Over time, these regulations have accumulated into a regulatory framework in which many regulations with varying goals and addressing various risks come into effect at numerous asset-size thresholds ranging from as small as $48 million to as large as $700 billion. Whether these thresholds are set at appropriate levels is often a policy consideration for Congress. In addition, some question whether tailoring based predominantly on asset size is the best approach or if other criteria should play a larger role. Meanwhile, the effect on bank balance sheets from the COVID-19 pandemic, the long-term trend of bank industry consolidation, and inflation all have implications in the asset-threshold-based framework.

This report provides an overview of asset thresholds that determine the regulatory treatment of banks. It begins with a background on the rationale and costs of bank regulation tailoring generally and then examines the strengths and weaknesses of a system that uses asset thresholds as the predominant tailoring criteria. It then describes a number of specific thresholds and the changes in regulatory treatment that occur when banks cross them. The report concludes with an outlook of how market forces and trends are affecting bank asset size.

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[1] Julie Stackhouse, *Why Are Banks Regulated?*, Federal Reserve Bank of St. Louis, January 31, 2017, https://www.stlouisfed.org/on-the-economy/2017/january/why-federal-reserve-regulate-banks.

[2] In general, this report uses the term *bank* to refer to insured depository institutions (IDIs)—that is, institutions insured by the Federal Deposit Insurance Corporation (FDIC)—or organizations that own one or more IDIs, including bank holding companies (BHCs), financial holding companies, intermediate holding companies, and savings and loan holding companies. Some asset thresholds apply to IDIs, whereas others apply to BHCs or other holding companies.

[3] Former Federal Reserve Governor Daniel K. Tarullo, "A Tiered Approach to Regulation and Supervision of Community Banks," remarks at the Community Bankers Symposium, November 7, 2014, pp. 1-2, https://www.federalreserve.gov/newsevents/speech/tarullo20141107a.htm.

[4] For other examples, see CRS In Focus IF10162, *Introduction to Financial Services: "Regulatory Relief"*, by Marc Labonte.

Overview

Bank regulation aims to achieve certain potential benefits (e.g., better-managed risks, increased consumer protection, greater systemic stability) that justify potential costs of the regulation (e.g., reduced credit availability for certain consumers and businesses, slower economic growth over some period of time).[5] The size of the realized benefits and costs of a regulation for any individual bank or group of banks are likely to depend on the characteristics of that bank or group. Thus, appropriately tailoring regulation to banks of different types is an important component of designing effective and efficient regulation. One possible criterion on which to group banks, and the one primarily used in the existing bank regulatory framework, is asset size. This section begins by providing conceptual descriptions of popularly understood bank types and then examines the rationales and costs of tailoring regulation and the strengths and weaknesses of using asset size as the predominant criterion.

Unofficial Categories of Banks

Although they are not formal or legal concepts, describing conceptual bank archetypes can provide context for the different characteristics among bank size, business models, activities, and risks.

Community Banks

The terms *community bank* and *Main Street bank* typically refer to a bank that uses a traditional, simple deposit-taking and loan-making business model to meet the credit needs of a certain community. Size-based regulatory exemptions are often rationalized as a means to provide regulatory relief to community banks.

No consensus exists about what the specific size threshold for defining a community bank should be. In addition, many have observed that most small banks are generally different from large banks in a variety of ways besides asset size. Although community banks are typically small in terms of asset size, conceptually size does not necessarily have to be a determining factor. For example, the Federal Deposit Insurance Corporation (FDIC), for research purposes, identifies community banks through a number of criteria, including the size of certain balance sheet items relative to others and geographic considerations, although there is also an asset-size component.[6] Any bank with assets above an inflation-adjusted threshold ($1.74 billion as of December 2020) must meet certain criteria—such as having a high concentration of loans or deposits or having a small geographic footprint—to be defined as a community bank by the FDIC. Also, a bank below the threshold is not a community bank if it has a certain specialty concentration.[7] Under this definition, 284 banks with more than $1.74 billion of assets—including one with almost $23

[5] To what degree current financial regulation appropriately balances these considerations is also a contentious issue that is examined in this report. For more in-depth analysis on this topic, see CRS Report R44869, *Financial Regulatory Relief: Approaches for Congress, Regulators, and the Administration*, coordinated by Marc Labonte.

[6] For example, the Federal Reserve sets the threshold at $10 billion, and the Office of the Comptroller of the Currency (OCC) sets it at $10 billion. See Board of Governors of the Federal Reserve System, *Community Banking*, http://www.federalreserve.gov/bankinforeg/topics/community_banking.htm; and OCC, *Comptroller's Handbook, Examination Process; Community Bank Supervision*, September 2019, p. 1, https://www.occ.gov/publications-and-resources/publications/comptrollers-handbook/files/community-bank-supervision/index-community-bank-supervision.html.

[7] FDIC, *FDIC Community Banking Study*, December 2020, p. A-1, https://www.fdic.gov/resources/community-banking/report/2020/2020-cbi-study-full.pdf.

billion in assets and nine others with more than $10 billion in assets—were classified as community banks. Meanwhile, 52 banks with less than $1.74 billion in assets—including 41 with less than $500 million—were not classified as community banks.[8]

Community banks are likely to be more concentrated in core commercial bank businesses of making loans and taking deposits and less involved in other activities such as securities trading or holding derivatives. Community banks also tend to operate within a smaller geographic area. These banks are generally more likely to practice *relationship lending* wherein loan officers and other bank employees have a longer-standing and perhaps more personal relationship with the local consumers and businesses.[9] Due in part to these characteristics, proponents of community banks assert that these banks are particularly important credit sources to local communities and otherwise underserved groups. Finally, compared to large banks, small banks are likely to have fewer employees and fewer resources to dedicate to regulatory compliance and are less likely individually to pose a systemic risk to the broader financial system.[10] For more information on the regulation of small banks, see CRS Report R43999, *An Analysis of the Regulatory Burden on Small Banks*, by Marc Labonte.

Although Congress frequently justifies size-based thresholds in terms of reducing regulatory burden on community banks, existing thresholds often use a simple size-based definition and typically do not incorporate more complex or sophisticated criteria used in "community bank" definitions, such as the one provided by the FDIC. However, more sophisticated thresholds are also used. For example, while some of the provisions in the 2018 Economic Growth, Regulatory Relief, and Consumer Protection Act (P.L. 115-174), designed to provide community bank regulatory relief, use size-only criteria, others use alternative qualifying criteria—such as meeting certain capital standards and limitations on trading assets and liabilities—or explicitly grant regulators the authority to use other criteria when implementing a provision.[11] The 2018 law's inclusion of criteria other than asset thresholds and discretionary regulator authority may point to the use of more nuanced community bank qualifying criteria by Congress in coming years. For more information on P.L. 115-174, see CRS Report R45073, *Economic Growth, Regulatory Relief, and Consumer Protection Act (P.L. 115-174) and Selected Policy Issues*, coordinated by David W. Perkins.

Wall Street Banks

Wall Street bank is an informal term for a very large, very complex bank that is involved in many business lines outside of what is viewed as the traditional commercial bank activities of making loans and taking deposits. Such a bank could have hundreds of billions or trillions of dollars' worth of assets, and its corporate structure could involve hundreds or thousands of separate subsidiaries under a parent *bank holding company* (BHC).[12] Although at least one of these subsidiaries must be a chartered bank, many others could be nonbanks, such as broker-dealers,

[8] FDIC, *FDIC Community Banking Study Reference Data*, as of December 31, 2020, https://www.fdic.gov/resources/community-banking/cbi-data.html.

[9] FDIC, *FDIC Community Banking Study*, December 2012, https://www.fdic.gov/regulations/resources/cbi/report/cbi-full.pdf.

[10] Drew Dahl, Andrew Meyer, and Michelle Neely, "Scale Matters: Community Banks and Compliance Costs," Federal Reserve Bank of St. Louis, *The Regional Economist*, July 2016, https://www.stlouisfed.org/~/media/Publications/Regional-Economist/2016/July/scale_matters.pdf.

[11] For example, P.L. 115-174, §§201-203.

[12] Small banks are also often owned by BHCs. However, in these cases a single insured depository is often the only subsidiary the BHC holds.

asset managers, and insurance brokers or companies. Wall Street banks may be internationally active and have a global presence.[13]

The term *Wall Street bank* comes from the prominent role many of these institutions play in underwriting and trading securities, activities that commonly take place on Wall Street in New York City. However, an institution of the aforementioned size and complexity may not necessarily be headquartered or even active on the actual Wall Street. Further, the largest banks vary significantly based on the extent that their activities and assets are focused on the traditional banking activities of lending and deposit taking as opposed to more complex activities or nonbank activities.

Too Big to Fail (TBTF) *bank* is another term to characterize a large, complex financial institution based on the (unobservable ex ante) possibility that the government will consider financial intervention when the bank becomes distressed. A bank is said to be TBTF when industry observers and market participants judge that its failure would cause such serious disruptions to the financial system that the resulting economic and social outcomes would be unacceptable to the government. To avoid these outcomes, the government would feel compelled to save the institution from failure, perhaps by directly giving it funding. Characteristics that could make an institution so important to the functioning of the financial system include its size, interconnectedness, complexity, or central role in a certain market or sector. Although a bank that is not among the very largest could still be TBTF for these reasons, no small or mid-sized bank is viewed as meeting this description. The belief among market participants that the government will protect a certain bank or groups of banks could lead to *moral hazard*, wherein bank management takes on excessive risks, and equity and debt investors do not adequately assess or monitor risk because they all feel protected from potential losses, increasing systemic risk and unfair funding advantages. In addition, government "bailouts" expose taxpayers to potential losses. Whether the policy reforms after the financial crisis (described in the section below entitled "Enhanced Prudential Regulation") effectively addressed these problems is a matter of debate. For more information on the TBTF issues, see CRS Report R42150, *Systemically Important or "Too Big to Fail" Financial Institutions*, by Marc Labonte.

Banks Somewhere in Between

The terms *regional bank* and *mid-size bank* generally refer to banks that do not fit neatly into a "very large, complex, and systemically important" or "small and simple" dichotomy. The set of banks to which these terms refer can vary. Often, the terms describe a bank that has a traditional, simple business model that focuses on taking deposits and making loans but has a large amount of assets and services in a certain region of the country.[14] Other times, the terms mean a bank that is significantly larger and more complex than the thousands of community banks, but nevertheless its failure would not pose a risk to systemic stability.[15] In either case, the goal is often to describe banks that are in some way different than small banks servicing communities but are not of a scale such that the material distress at a single bank would destabilize the entire financial system. There is considerable disagreement about where to draw the lines among community banks, regional banks, and large banks.

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[13] Dafna Avraham, Patricia Selvaggi, and James Vickery, "A Structural View of U.S. Bank Holding Companies," *Federal Reserve Bank of New York Economic Policy Review*, July 2012, pp. 65-68, https://www.newyorkfed.org/medialibrary/media/research/epr/12v18n2/1207avra.pdf.

[14] Bankrate Glossary, "What Is a Regional Bank," https://www.bankrate.com/glossary/r/regional-bank/.

[15] Robert Pozen, "The Heavy Burden of Being Labelled Systemically Important," *Financial Times*, March 20, 2016, https://www.brookings.edu/opinions/the-heavy-burden-of-being-labelled-systemically-important/.

Rationale for Tailoring

Systemic Risk

There are numerous potential sources of systemic risk, including activities undertaken by small banks. For example, systemic risk concerns related to bank runs underlie the economic rationale for the creation of the Federal Reserve (to act as a lender of last resort) and the FDIC (to provide deposit insurance). Nevertheless, given the role of large banks in the 2007-2009 financial crisis, policymakers have been particularly focused on the systemic risk posed by large, complex, interconnected banks and ensuring that they are not TBTF.[16] The Dodd-Frank Act attempted to address this problem by imposing heightened prudential regulatory standards on the largest banks relative to small and medium-size banks, discussed in detail in the "Enhanced Prudential Regulation" section below.

Costs of Compliance

The costs of regulatory compliance include investment in software and information systems, manpower, and specialized knowledge (e.g., legal expertise, accounting expertise). In absolute terms, regulatory compliance costs are likely to rise with size, but regulatory compliance might involve fewer resources for large banks than small banks in proportion to overall revenues. In particular, as regulatory complexity increases, compliance may become relatively more costly for small banks than for large banks.

Suppose a new regulation leads to a small bank with a total staff of 20 having to hire a new accountant. Proportionally, this is highly burdensome compared to a large bank that already has whole departments of accountants on staff. From a cost-benefit perspective, if regulatory compliance costs are subject to economies of scale, then the balance of costs and benefits of a particular regulation will differ depending on the size of the bank. For the same regulatory proposal, economies of scale could potentially result in costs outweighing benefits for smaller banks but the benefits outweighing costs for larger banks.

Critical Mass

Another potential reason for tailoring a regulation applicable to a particular activity would be few banks within a group (based on size or some other metric) engaging in that activity. Compliance costs incurred to address a risk that few banks in a group are exposed to are more likely to exceed benefits. In this scenario, tailoring can be used to ensure that the regulation applies only if there is a critical mass of banks for which it is relevant. For any given area of regulation, there might not be a critical mass among small banks because of differences in business model from large banks. Or there could be no critical mass because regulation is aimed at policy issues that are perceived to exist primarily at large banks. In either case, one could argue it would be an inefficient use of resources for both regulators and banks to regulate an activity at all banks when few banks are engaged in it.[17]

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[16] Tarullo, "A Tiered Approach to Regulation and Supervision of Community Banks."

[17] Based on this argument, using an activity-based threshold instead of an asset-based threshold would arguably be more efficient, assuming the activity is easy to observe and measure.

Promoting Community Banks

Underpinning much tailoring in regulation is a general policy position that community banks should be supported because they may be an important source of credit and other financial services for consumers and businesses in local market segments that may be underserved by large banks.[18]

Costs of Tailoring

One of the primary purposes of rigorous "safety and soundness" regulation and supervision is to minimize bank failures. Exempting certain banks from aspects of regulation or relaxing certain rules could make those banks more susceptible to failure. Bank failures impose a number of costs, including to the government (so potentially the taxpayer) through exposure to losses at the FDIC's Deposit Insurance Fund (DIF). When a bank fails, it can eliminate a source of credit and other financial services to the market it serves (although in practice, the FDIC resolution process typically involves transferring the failing bank's branches or customers to a healthy bank). Because the FDIC charges banks fees, called *assessments*, to fund itself and the DIF, more frequent failures could result in higher assessments across the whole banking industry and thus reduce the funds available to lend in the economy. Furthermore, an increased frequency of bank failures could undermine the public's trust in the banking system, potentially leading to fewer people placing deposits in the banking system (even despite the FDIC's deposit guarantee), thus reducing the funding available to lend.

These risks are not trivial. Historically most bank failures have been small banks (though that is due in part to the fact that most banks are small banks and does not necessarily mean that small banks are more susceptible to failure). For example, of 507 post-financial crisis bank failures that occurred from 2008 through 2014, 438 had less than $1 billion in assets.[19] In terms of systemic stability, while it is true that a small institution may individually pose less systemic risk, large numbers of small bank failures could lead to widespread financial and economic stress. For example, over 1,043 mostly small institutions failed during the savings and loan crisis of the 1980s and early 1990s, a systemic event that cost taxpayers about $124 billion, according to one estimate.[20]

Tailoring can also create market incentives to engage in *regulatory arbitrage*, wherein banks structure themselves to avoid regulation or reduce compliance costs rather than basing their decisions on business and efficiency reasons. Assuming the regulation achieves a broad policy goal (such as consumer protection), if this occurred it could undermine the regulation's effectiveness and economic efficiency.[21] A reduction in the undesirable activity at banks above the threshold could be offset by an increase in those activities at banks below the threshold. The distortionary regulatory effects of this outcome are examined further in the "Weaknesses of Asset-Size Based Tailoring" section below.

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[18] FDIC, *FDIC Community Banking Study*, December 2020, Chapter 4.

[19] FDIC, *Bank Failures in Brief*, data download available at https://www.fdic.gov/bank/historical/bank/.

[20] Timothy Curry and Lynn Shibut, "The Cost of the Savings and Loan Crisis: Truth and Consequences," *FDIC Banking Review*, vol. 13, no. 2 (2000), pp. 26-33.

[21] One exception, discussed above, would be regulations that aim to ameliorate the TBTF problem. These regulations can potentially improve economic efficiency because of moral hazard. Under some size threshold, banks are no longer potentially TBTF, so exempting such smaller banks would not undermine the regulation's effectiveness or lead to regulatory arbitrage, in principle.

Strengths of Asset-Size Based Tailoring

One of the advantages of using asset size as a qualifying criterion for tailored regulation is simplicity and transparency. By establishing a single "bright line," there is no ambiguity about whether a bank does or does not qualify, and no complex analysis is required by banks or regulators to make a determination. Asset-threshold rules may limit the opportunity for regulatory arbitrage. If multiple, complex qualifying criteria are used, there may be multiple avenues through which a bank could find ways to structure itself and alter its operations to qualify for relaxed regulation.

Asset size may also be preferable to using another single, objective, easily observed criterion because it is correlated with many of the other bank characteristics that affect the benefits and costs of particular regulations. As mentioned in the "Community Banks" section, small banks are more likely to practice relationship lending and have fewer resources to dedicate to compliance. In addition, they tend to be less active (and often not at all active) in complex trading activities and less likely to hold derivatives and hold more capital compared to larger institutions. For more information on these correlations, see CRS Report R45051, *Tailoring Bank Regulations: Differences in Bank Size, Activities, and Capital Levels*, by David W. Perkins.

Weaknesses of Asset-Size Based Tailoring

If asset size is the predominant criterion to qualify for tailored regulation, this may create distortionary market "cliff" effects, as banks hesitate to cross thresholds. Suppose a particular $9.9 billion bank, absent certain regulations, would be most profitable and provide funding to the optimal number of consumers and businesses if it were to expand operations and become a $10.1 billion bank. However, the additional regulations that come into effect at the $10 billion threshold could lead the bank to decide to remain at $9.9 billion in assets. As a result, economically efficient lending and other activities might otherwise not take place.

Multivariable qualifying criteria for exemptions could be designed so that this particular bank would not be so reluctant to cross the asset threshold. For example, an exemption could be available to any bank with less than $10 billion in assets or a bank with more than $10 billion provided it had less than 5% of total assets as trading assets and a capital leverage ratio of at least 9%. Under those conditions, banks that were larger but well-capitalized and not involved in complex trading would avoid added compliance costs.

Some data suggest that these cliff effects may already be occurring. For example, CRS estimates that, as of the end of 2020, 160 banks held assets that are between 95% and 100% of one of the asset thresholds covered in the next section (i.e., they are close to a threshold but not over), while 128 banks were between 100% and 105% of a threshold (i.e., over but only slightly). A disproportionate number of banks were just below an otherwise arbitrary asset size, although the regulatory threshold is not the only possible explanation.

Another way thresholds could distort markets is by creating a preference for bank mergers and acquisitions over "organic" growth. Some research suggests that banks approaching such thresholds are motivated to merge, because they would prefer entering a more stringent regulatory regime with cost savings from a big jump in economies of scale to incrementally crossing the line.[22] This "in-for-a-penny-in-for-a-pound" strategy makes intuitive sense: If a bank is going to

[22] Hailey Ballew, Michael Iselin, and Allison Nicoletti, "Accounting-Based Thresholds and Growth Decisions in the Banking Industry," *Review of Accounting Studies,* forthcoming 2020, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2910440.

enter a new regulatory regime, it would be better to leap over the line by hundreds of millions or billions of dollars in assets rather than incurring added regulatory costs for a small amount of extra assets.

Another issue with using asset size as a tailoring criterion is that, while correlated with certain bank characteristics, it often does not directly measure the aspect or aspects of a bank's operations that are the basis for providing regulatory relief. For example, if policymakers want to provide tailoring for banks that use a traditional deposit-taking and loan-making business model, a qualifying criterion based on the portion of bank assets that are loans and liabilities that are deposits could achieve that more directly than asset size.

Selected Thresholds and Classifications

There are numerous thresholds at which banks become subject to additional or more stringent regulations. The following sections do not include an exhaustive and detailed examination of every regulatory classification and exemption threshold. Instead, after providing historical context on the use of asset thresholds, the next section presents data indicating how many banks fall above and below the thresholds and how many are near a threshold. The following sections examine a selection of prominent thresholds and classifications facing banks, some of which have been raised multiple times.

How asset size is defined in these regulations varies. Typically, the regulations use assets as reported in banks' call reports (formally, the Report of Condition and Income) and measure assets over some time period, such as in the most recent calendar year or the average over the last four quarters. Some regulations use an asset threshold but give regulators discretion to reject individual banks from the exemption. For example, regulators may deny small banks the right to adhere to the Community Bank Leverage Ratio (CBLR) if they are deemed too risky. In some instances, an asset threshold is combined with an activity threshold to create a two-part exemption test. For example, the Volcker Rule has a cap on asset size and trading assets and liabilities.[23]

Provisions applying to banks with less than $20 billion in assets are summarized in **Table 1** and cover a wide variety of policy areas. Provisions applying to banks with $50 billion in assets or more are summarized in **Table 3**.

Table 1. Size-Based Exemptions and Tailoring in Bank Regulation

$20 Billion or Less in Assets

Provision	Asset Threshold(s)
Home Mortgage Disclosure Act reporting requirements	$48 million
Management interlock restrictions	$50 million, $10 billion
Insurance activities	$50 million
Streamlined SEC reporting requirements	$150 million
Expedited acquisition eligibility and/or streamlined acquisition reporting requirements	$300 million, $3 billion, $7.5 billion
Community Reinvestment Act requirements	$330 million, $1.322 billion

[23] Others exemptions use an activity threshold. For example, mortgage servicers, including banks, are exempt from certain servicing requirements if they service fewer than 5,000 mortgages annually. 12 C.F.R. §1026.41(e)(4)(ii).

Provision	Asset Threshold(s)
BHC risk-based capital requirements	$500 million
Corporate governance requirements	$500, million, $1 billion, $3 billion
Flood insurance escrow requirements	$1 billion
High-priced mortgage threshold	$2.23 billion
Small BHC Policy Statement, Collins Amendment exemption	$3 billion
18-month examination cycle	$3 billion
Streamlined stock buyback and redemption reporting requirements	$3 billion
Tailored call reports	$5 billion
CFPB primary regulator for consumer compliance	$10 billion
Interchange fee cap (“Durbin Amendment”)	$10 billion
Volcker Rule	$10 billion
Portfolio QM	$10 billion
Mortgage escrow requirements	$10 billion
CBLR eligibility	$10 billion
Swap margin and capital requirements	$10 billion
Thrift charter opt out	$20 billion

Source: CRS.

Notes: In some cases, size is one of multiple criteria that must be met for eligibility. See text for details.

History

Size-based tailoring in bank regulation is not a new phenomenon. For example, Section 7 of the National Banking Act of 1864, as enacted, generally required a national bank to have initial capital of $100,000 but required national banks located in cities with a population of greater than 50,000 to have $200,000 of capital. In addition, the Treasury Secretary could approve national banks with $50,000 of capital in places with populations of less than 6,000.[24]

Asset-size-based tailoring exemptions have been included or added to bank statutes and regulations on an ad hoc, and arguably inconsistent, basis over time. For example, Section 309 of Home Mortgage Disclosure Act (P.L. 94-200, Title III, §309; 89 Stat. 1128)—aimed at reducing discrimination against certain groups in mortgage lending—included an exemption from reporting requirements for banks with less than $10 million in assets when it was enacted in December 1975. (An amendment to account for inflation was added by P.L. 104-208 in 1996.) The Community Reinvestment Act (CRA; P.L. 95-128, Title VIII, §§801-806; 91 Stat. 1147-1148)—enacted less than two years later in October 1977, and aimed at ensuring banks provided credit to the neighborhoods in which they operated, including those that had been discriminated against historically[25]—did not originally include tailoring. (CRA was amended by P.L. 106-102 in 1999 to provide for less frequent evaluation for banks with less than $250 million in assets and to grant regulators the authority to implement additional tailoring.)

[24] Act of June 3, 1864, ch. 106, §7, 13 Stat. 101.

[25] U.S. Congress, House Committee on Financial Services, *The Community Reinvestment Act: Thirty Years of Accomplishments, but Challenges Remain*, 110th Cong., 2nd sess., February 13, 2008, pp. 7-9.

Broadly, policymakers have been increasingly likely to include tailoring in recent years. Notably, the Dodd-Frank Act and Basel III added more tailoring in response to the 2007-2009 financial crisis. Together, they introduced the most significant package of new reforms in a generation, and policymakers intentionally decided to exempt some banks from parts of them. As enacted, all banks under $50 billion were exempted from the new Federal Reserve enhanced prudential regulatory regime intended to address systemic risk posed by the large banks, and some banks over $50 billion were exempted from certain parts of the regime and parts of Basel III. The Dodd-Frank Act also exempted smaller banks from some other requirements that were unrelated to systemic risk, such as the Durbin Amendment, primary supervision by the Consumer Financial Protection Bureau (CFPB), and the Collins Amendment.

In the years after the financial crisis, the pendulum swung to providing regulatory relief. The most substantive statutory change to financial regulation during this period was the Economic Growth, Regulatory Relief, and Consumer Protection Act (EGRRCPA; P.L. 115-174), enacted in May 2018, which aimed to provide regulatory relief to banks and other financial entities from certain Dodd-Frank provisions, as well as other, long-standing regulatory requirements. P.L. 115-174 introduced or raised a number of thresholds discussed below, such as relief from call report requirements, bank exams, qualified mortgage (QM) rules, escrow requirements, and capital requirements via the Small Bank Holding Company policy statement and the CBLR.

The regulatory requirements mentioned in this section are described in more detail below.

Current Asset-Size Data

To illustrate how many banks are subject to each of the regulatory requirements described in this report, **Table 2** shows the number of banks within each asset range based on the size thresholds highlighted in this report.

The pandemic has created challenges to interpreting the most recent data on bank assets. As discussed in more detail in the "Challenges Facing Banks Due to Recent Asset Growth" section, the economic uncertainty caused by the pandemic and the huge disbursement of funds by the government in response to the pandemic has led bank deposits and assets to surge, perhaps temporarily. To account for this possibility, this section presents the number of banks with assets in each size group at both the end of 2020 (the most recent data available) and the end of 2019 (the last available data point largely unaffected by the crisis and the measure being used for a number of regulatory asset thresholds, as discussed in the "Policy Responses Taken Under Existing Regulator Authorities").

As of December 31, 2020, 3,404 banks[26]—more than two-thirds of the industry—were below the $500 million asset threshold. Of those, 84 banks (fewer than 3%) held at least 95% of the threshold amount (i.e., between $475 million and $500 million total assets) and so were closely approaching the threshold. The number of banks below $500 million was notably smaller compared to a year earlier. Some of the reduction is due to bank mergers, but some banks grew out of the group "organically"—that is, internal growth without merging. Although nearly all other size groups grew from 2019 to 2020, the decrease in the number of banks below $500 million was large enough to cause the total number of banks to decline.

As discussed earlier, banks have an incentive to prevent asset growth from causing them to pass a threshold that would trigger additional regulatory requirements. If this incentive were significant, one might observe an unusually large share of banks just below the various thresholds. In total, a

[26] In this case, the term *bank* is used to mean an FDIC-insured depository institution that submitted the required call report.

relatively small portion (3%) of banks were closely approaching a threshold, though cumulatively 160 banks were near one of the thresholds discussed in this section.

Table 2. Number of Banks By Asset Size*

Total Number in Asset Size Range, and Number Under Upper Threshold but Within 95%

	End of 2020		End of 2019	
Total Assets	**Total Number**	**Within 95%**	**Total Number**	**Within 95%**
<$500m	3,404	84	3,770	55
$500m-$1b	716	38	658	54
$1b-$3b	567	13	482	13
$3b-$5b	108	8	86	9
$5b-$10b	104	9	91	5
$10b-$20b	55	5	55	3
$20b-$50b	47	2	42	1
>$50b	49	n/a*	43	n/a*
Total	**5,050**	**160**	**5,227**	**141**

Source: CRS calculations; Federal Financial Institutions Examinations Council Central Data Repository's Public Data Distribution, Bulk Data download, https://cdr.ffiec.gov/public/PWS/DownloadBulkData.aspx.

***Notes:** These are counts of banks at the FDIC-insured depository institution (IDI) level. As discussed in detail in the "Enhanced Prudential Regulation" section below, BHCs above $50 billion are subject to a tiered enhanced prudential regulation framework that is based on asset size and other criteria. At the end of 2019, one IDI and its parent BHC were within 95% of the $250 billion threshold. Both exceeded that threshold in 2020. At the end of 2020, one IDI was within 95% of the $100 threshold. Its parent was already above that threshold with more than $125 billion. m = million; b = billion; n/a = not applicable.

Thresholds Below $500 Million

Some regulatory thresholds are set relatively low. A number of them exempt banks and their BHCs from certain reporting requirements. Banks under $48 million assets are exempt from reporting requirements under the Home Mortgage Disclosure Act, which requires banks to maintain and report data on the mortgage applications and loans that can be checked for discriminatory lending patterns.[27] Publicly listed state banks that are members of the Federal Reserve with under $150 million in assets can substitute call reports for SEC-required filings.[28] Savings and loan holding companies with under $150 million in assets have streamlined reporting requirements for permissible nonbank acquisitions.[29] Well-run BHCs with under $300 million in assets are exempted from certain reporting requirements for an acquisition of another bank or eligible nonbank firm.[30]

[27] This threshold is adjusted annually for inflation to the nearest million. See 12 U.S.C. §2808(b); and CFPB, "Home Mortgage Disclosure (Regulation C) Adjustment to Asset-Size Exemption Threshold," 85 *Federal Register* 83409-83411, December 22, 2020.

[28] 12 C.F.R. §208.36(b).

[29] 12 C.F.R. §238.53(c)(2)(iii)-(iv).

[30] 12 C.F.R. §225.14(a)(1)(vi) and 12 C.F.R. §225.23(c)(5)(ii).

Other exemptions allow banks or their management to engage in activities that would otherwise not be permissible. Management interlock restrictions limit the ability of a management official or director to work for more than one unaffiliated bank at a time, but banks with less than $50 million in assets are exempted if they are located in the same metropolitan area (but not the same community).[31] BHCs with under $50 million in assets may engage in certain insurance activities that may not otherwise be permitted.[32] Well-managed BHCs under $300 million in assets are not subject to risky asset limits that would make them ineligible for expedited action on acquisitions.[33]

In addition, banks above a $330 million asset threshold (but below $1.322 billion) are classified as *intermediate small banks* under regulations implementing the CRA, which subjects banks to an evaluation on how well they meet community credit needs.[34]

$500 Million

Banks with assets of less than $500 million are generally exempt from certain corporate governance regulations pertaining to independent auditing, financial reporting, and internal controls implemented under Section 36 of the Federal Deposit Insurance Corporation Improvement Act (FDICIA; P.L. 102-242).[35]

BHCs with less than $500 million in assets are exempted from risk-based capital requirements if they are not engaged in significant nonbanking activities and do not have a material amount of debt or equity registered with the Securities and Exchange Commission.[36]

$1 Billion

Banks with assets of more than $1 billion are subject to more strict corporate governance regulations pertaining to certain independent auditing, financial reporting, and internal controls implemented pursuant to the FDICIA.[37]

Banks with less than $1 billion in assets are exempt from regulations requiring lenders to establish flood insurance escrow accounts for loans secured by residential real estate or mobile homes in certain flood areas.[38] The regulations implement the Biggert-Waters Flood Insurance Reform Act of 2012 (Division F, Title II of P.L. 112-141) and the Homeowner Flood Insurance Affordability Act (P.L. 113-89). An escrow account is an account that a "mortgage lender may set

[31] 12 C.F.R. §212.3(b) and 12 C.F.R. §348.3(b).

[32] 12 C.F.R. §225.28(b)(11)(vi).

[33] 12 C.F.R. §225.14(c)(6)(ii) and 12 C.F.R. §225.23(c)(5)(ii).

[34] This threshold is adjusted annually for inflation to the nearest million. See 12 C.F.R. §§228.12(u)(2), 345.12(u)(2); and Federal Reserve and FDIC, "Community Reinvestment Act Regulations," 85 *Federal Register* 83747-83749, December 23, 2020.

[35] 12 U.S.C. §1831m(j). The statute mandated an exemption threshold of at least $150 million but explicitly granted the FDIC the authority to set a higher threshold "by regulation." See 12 C.F.R. §363.1.

Separate from the FDICIA requirements, banks with publicly traded stock (like all companies with publicly traded stock) are subject to management reporting and external auditing requirements under the Sarbanes-Oxley Act of 2002 (P.L. 107-204), including any publicly traded bank with less than $500 million in assets. Banks meeting the FDICIA's corporate governance requirements are generally meeting the Sarbanes-Oxley standards.

[36] 12 C.F.R. Part 225, Appendix A.

[37] 12 C.F.R. §363.2-363.5.

[38] 12 C.F.R. §339.5(c)(1).

up to pay certain recurring property-related expenses."[39] Escrow accounts provide a way for homeowners to make monthly payments for annual or semi-annual expenses, but maintaining escrow accounts for borrowers is potentially costly for banks.

As mentioned above, CRA compliance examination is simpler for banks below a $1.322 billion threshold, which classifies those banks as *small banks*.[40] While not exactly a $1 billion threshold because of an annual inflation adjustment, banks over $1 billion are close to being over this threshold.

$3 Billion

Before crossing the $3 billion threshold, banks with less than $2.23 billion (adjusted for inflation from a $2 billion initial threshold set in 2013) do not have to establish escrow accounts for mortgages with interest rates that exceed average rates by certain amounts.[41]

Banks can also become eligible for less frequent examination if they hold less than $3 billion in assets (last raised in P.L. 115-174 from $1 billion).[42] Generally, federal bank regulators must conduct an on-site examination of the banks they oversee at least once in each 12-month period. However, if a bank below this asset threshold meets certain criteria related to capital adequacy and scores received on previous examinations, then it is examined once every 18 months.

The Federal Reserve Small Bank Holding Company (BHC) and Small Saving and Loan Holding Company Policy Statement applies to BHCs with under $3 billion in total assets. In the policy statement, the Federal Reserve permits BHCs with under $3 billion in total assets to take on more debt in order to complete a merger (provided they meet certain other requirements concerning nonbank activities, off-balance-sheet exposures, and debt and equities outstanding) than would be allowed for a larger BHC.[43] The threshold in the statement has been raised several times since it was first introduced, most recently by P.L. 115-174. In addition, Section 171 of the Dodd-Frank Act (sometimes referred to as the "Collins Amendment")[44] exempts BHCs subject to this policy statement from having to meet the same capital requirements at the holding company level that depository subsidiaries face.[45] As a result, the bank subsidiaries of BHCs with less than $3 billion are required to be well-capitalized and comply with all capital requirements, but Basel III capital requirements are not applied to the parent holding company.

The Fed has linked some unrelated requirements to the Small Bank Holding Company threshold. BHCs with under $3 billion in assets also have streamlined reporting requirements for purchase

[39] CFPB, "What Is an Escrow or Impound Account?," http://www.consumerfinance.gov/askcfpb/140/what-is-an-escrow-or-impound-account.html.

[40] Banks below this threshold but above $330 million are placed in a small bank subset called *intermediate small banks*. Federal Reserve and FDIC, "Community Reinvestment Act Regulations," 85 *Federal Register* 83747-83749, December 23, 2020.

[41] CFPB, "Truth in Lending Act (Regulation Z) Adjustment to Asset-Size Exemption Threshold," 85 *Federal Register* 83411-83415, December 22, 2020, https://www.federalregister.gov/documents/2020/12/22/2020-28231/truth-in-lending-act-regulation-z-adjustment-to-asset-size-exemption-threshold.

[42] 12 U.S.C. §1820(d)(4).

[43] 12 C.F.R. Appendix C to Part 225.

[44] 12 U.S.C. §5371(b)(5)(C).

[45] For banks with $15 billion or less in assets at the end of 2009, the preferential capital treatment of trust preferred securities issued before May 2010 is grandfathered. "Treatment of Certain Collateralized Debt Obligations Backed Primarily by Trust Preferred Securities with Regard to Prohibitions and Restrictions on Certain Interests in, and Relationships with, Hedge Funds and Private Equity Funds," 79 *Federal Register* 5224, January 21, 2014.

or redemption of their own securities or acquisition of another bank or eligible nonbank firm.[46] Under the regulations implementing the FDICIA corporate governance regulations, banks with more than $3 billion face additional requirements related to audit committee membership.[47]

$5 Billion

All banks must submit a report of condition and income to the federal bank agencies at the end of every financial quarter of the year (often referred to as the "call report"). As early as 1976, bank regulators required more information in these reports from large banks than from small banks.[48] Today, banks file one of three main versions of the call report based on size, whether a bank has offices in other countries, and bank complexity, with small simple banks filing the shortest version and large complex banks the longest. In addition, there are numerous line items and memoranda that banks are required to fill out only if they are above various asset thresholds.[49]

Enumerating all the call report differences implemented by regulators is beyond the scope of this analysis of selected thresholds. However, one statutorily mandated difference is notable.

Section 205 of P.L. 115-174 mandated that the bank regulators reduce the reporting requirements in the first and third quarters of the year for banks with assets under $5 billion in assets.[50] In June 2019, the regulatory agencies issued a final rule pursuant to the provision, raising the threshold for banks permitted to file the shortest form of the call report from $1 billion to $5 billion and removing certain line items from the first- and third-quarter requirements.[51]

$10 Billion

The CFPB is the primary federal agency for consumer compliance supervision and enforcement at banks with more than $10 billion in assets. Banks with fewer assets have their prudential bank regulators as the primary supervisors for consumer compliance.[52] The CFPB may issue rules that would apply to smaller banks from authorities granted under the federal consumer financial protection laws, however.[53]

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[46] 12 U.S.C. §225.4(b)(2)(iii) and 12 C.F.R. §225.14(a)(1)(v)(A) and 12 C.F.R. §225.23(a)(1)(iii)(A). For acquisitions, the threshold is $7.5 billion for qualifying community banks subject to the CBLR, and the reporting requirements differ.

[47] 12 C.F.R. §363.5(b).

[48] For example, Form FFIEC 015 (Formerly 105-S), Large Bank Supplements to the Consolidated Report of Condition, was collected from 1976 to 1983. See Federal Reserve, "CALL Micro Report Series Description," https://www.federalreserve.gov/apps/mdrm/pdf/Call_59.pdf.

[49] The longest version, known as the FFIEC 031, is filed by banks that either (1) have domestic and foreign offices, (2) have only domestic offices but more than $100 billion of assets, or (3) are classified as an "advanced approaches" bank due to size or complexity. The middle version, FFIEC 041, is filed by banks that have only domestic offices, have less than $100 billion of assets, and are not an advanced approaches bank. The shortest form, FFIEC 051, is filed by banks with less than $5 billion of assets that do not have to file the 041 for risk-based criteria.

[50] 12 U.S.C. §1817(a)(12).

[51] Federal Reserve, OCC, and FDIC, "Reduced Reporting for Covered Depository Institutions," 84 *Federal Register* 29039-29044, June 21, 2019.

[52] 12 U.S.C. §5315, 12 U.S.C. §5516.

[53] Title 12, Section 5581(12), of the *U.S. Code* transferred to the CFPB primary rulemaking authority over 19 "enumerated consumer laws."

The interchange fees that banks with over $10 billion in assets receive when customers use debit cards to make purchases are capped by the Federal Reserve pursuant to Section 1075 of the Dodd-Frank Act (sometimes referred to as the "Durbin Amendment").[54]

Section 619 of the Dodd-Frank Act—often referred to as the Volcker Rule—generally prohibited banks from engaging in proprietary trading or sponsoring hedge funds or private equity funds.[55] Proprietary trading refers to owning and trading securities for a bank's own portfolio with the aim of profiting from price changes.[56] Section 203 of P.L. 115-174 created an exemption from the Volcker Rule for banks with (1) less than $10 billion in assets and (2) trading assets and trading liabilities less than 5% of total assets.

In addition to the Volcker Rule exemption, several other provisions of P.L. 115-174 also created an exemption for banks under $10 billion in assets:

- Section 101 creates a new QM compliance option for mortgages that banks or credit unions with less than $10 billion in assets originate and hold in portfolio. To be eligible, the lender has to consider and document a borrower's debts, incomes, and other financial resources, and the loan has to satisfy certain product-feature requirements.[57]
- Section 108 exempts any loan made by a bank or credit union from certain escrow requirements if the institution has assets of $10 billion or less, originated fewer than 1,000 mortgage loans in the preceding year, and meets certain other criteria.
- Section 201 directs regulators to develop a CBLR and set a threshold ratio of between 8% and 10% capital to unweighted assets—compared with the general leverage ratio requirement of 5%—to be considered well capitalized. If a bank with less than $10 billion in assets maintains a CBLR above that threshold, it would be exempt from all other leverage and risk-based capital requirements. Banking regulators may determine that an individual bank with under $10 billion in assets is not eligible to be exempt based on its risk profile.[58]

Two other recent $10 billion exemptions are not from P.L. 115-174. Management interlock restrictions limit the ability of a bank manager or director to work for more than one unaffiliated bank at a time, but banks with less than $10 billion in assets are exempted if they are not located in the same metropolitan area or if they collectively control less than 20% of deposits in the

[54] For more information, see CRS Report R41913, *Regulation of Debit Interchange Fees*, by Darryl E. Getter.

[55] The rule is named after Paul Volcker, a former chair of the Federal Reserve, a former chair of President Obama's Economic Recovery Advisory Board, and a vocal advocate of a prohibition on proprietary trading at commercial banks.

[56] OCC et al., "Revisions to Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships with, Hedge Funds and Private Equity Funds," 84 *Federal Register* 35008, July 22, 2019, https://www.govinfo.gov/content/pkg/FR-2019-07-22/pdf/2019-15019.pdf.

[57] For background on QM, see CRS In Focus IF11761, *The Qualified Mortgage (QM) Rule and Recent Revisions*, by Darryl E. Getter.

[58] A detailed discussion of each of these provisions can be found in CRS Report R45073, *Economic Growth, Regulatory Relief, and Consumer Protection Act (P.L. 115-174) and Selected Policy Issues*, coordinated by David W. Perkins. For background on the CBLR, see CRS Report R45989, *Community Bank Leverage Ratio (CBLR): Background and Analysis of Bank Data*, by David W. Perkins. Banks must comply with capital requirements as part of safety and soundness regulation. The CBLR is an alternative capital requirement regime for qualifying banks with less than $10 billion in assets.

community or metropolitan area.[59] The bank regulators raised this threshold from a combined $1.5 billion and $2.5 billion exemption in 2019.[60]

The Dodd-Frank Act subjected non-cleared swaps to margin and capital requirements. P.L. 114-1 created exemptions from these requirements for certain entities, including for banks with less than $10 billion in assets.[61]

$20 Billion

Section 206 of P.L. 115-174 creates a mechanism for federal savings associations (or "thrifts") with under $20 billion in assets to opt out of the federal thrift regulatory regime and enter the national bank regulatory regime without having to change their charters. An institution that makes loans and takes deposits can have one of several types of charters—including a national bank charter and federal savings association charter, among others—each of which subjects the institutions to regulations that can differ in certain ways.[62] Without this provision, if an institution wanted to switch from one regime to another, it would have to change its charter, which can be time consuming and costly.[63]

Enhanced Prudential Regulation

One pillar of the Dodd-Frank Act's response to addressing financial stability and ending TBTF was a new enhanced prudential regulatory (EPR) regime that applies to large BHCs and foreign banks operating in the United States.

Under this regime, the Federal Reserve is required to apply a number of safety and soundness requirements to large banks that are more stringent than those applied to smaller banks. These requirements are intended to mitigate systemic risk (the potential to cause financial instability) posed by large banks:

- **Stress tests and capital planning** ensure banks hold enough capital to survive a crisis.
- **Living wills**—officially called resolution plans—provide a plan to safely wind down a failing bank.
- **Liquidity requirements** ensure that banks are sufficiently liquid if they lose access to funding markets.
- **Counterparty limits** restrict the bank's exposure to counterparty default.
- **Risk management** requires publicly traded companies to have risk committees on their boards and banks to have chief risk officers.

[59] 12 C.F.R. §212.3(c) and 12 C.F.R. §348.3(c).

[60] Federal Reserve, FDIC, OCC, "Agencies Issue Final Rule to Update Management Interlock Rules," press release, October 2, 2019, https://www.federalreserve.gov/newsevents/pressreleases/bcreg20191002a.htm. The Depository Institution Management Interlocks Act (12 U.S.C. §3201 et seq.) gives the agencies authority to adjust the thresholds by regulation to allow for inflation or market changes.

[61] Federal Reserve et al., "Agencies Finalize Rule Exempting Certain Commercial and Financial End Users from Initial and Variation Margin Requirements," press release, August 1, 2016, https://www.federalreserve.gov/newsevents/pressreleases/bcreg20160801b.htm.

[62] Federal Financial Institutions Examination Council, Interagency Statement on Regulatory Conversions (FIL-40-2009), July 7, 2009.

[63] OCC, "Covered Savings Associations," 83 *Federal Register* 47102, September 18, 2018.

- **Financial stability** requirements provide for regulatory interventions that can be taken only if a bank poses a threat to financial stability.
- **Capital requirements** under Basel III, an international agreement, require large banks to hold more capital than other banks do to potentially absorb unforeseen losses.

The Dodd-Frank Act automatically subjected all BHCs and foreign banks with more than $50 billion in assets to EPR. In 2018, P.L. 115-174 created a more "tiered" and "tailored" EPR regime for banks. It eliminated most EPR requirements for banks with assets between $50 billion and $100 billion, with the exception of risk management requirements (see **Table 3**). Banks that have been designated as global systemically important banks by the Financial Stability Board (an international, intergovernmental forum) or have more than $250 billion in assets automatically remain subject to all EPR requirements, as modified. Section 401 of P.L. 115-174 gives the Federal Reserve discretion to apply most individual EPR provisions to banks with between $100 billion and $250 billion in assets on a case-by-case basis only if the provisions would promote financial stability or the institution's safety and soundness.

Under the Federal Reserve's implementing rules, large banks are placed in one of four categories based on their size and complexity, and progressively more stringent requirements are imposed on them.[64] The number of banks in each category is shown in **Table 4**. Foreign banks performing certain activities in the United States are required to form intermediate holding companies (IHCs) for those activities. Foreign banks are placed in the same Categories II-IV, based on their U.S. assets, with requirements for each category similar to those applied to U.S. banks. Most requirements are applied to the U.S. IHC, but a few would apply to all U.S. operations, including U.S. branches and agencies. Overall, the rule would mostly continue to defer to home-country regulation for foreign banks operating in the United States whose IHCs do not qualify as Category II or III banks. The rule also extended EPR for the first time to large savings and loan (thrift) holding companies that are not predominantly engaged in insurance or nonfinancial activities.[65]

[64] Federal Reserve, "Federal Reserve Board Finalizes Rules That Tailor Its Regulations for Domestic and Foreign Banks to More Closely Match Their Risk Profiles," press release, October 10, 2019, https://www.federalreserve.gov/newsevents/pressreleases/bcreg20191010a.htm; Federal Reserve, "Federal Reserve Board Issues Final Rule Modifying the Annual Assessment Fees for Its Supervision and Regulation of Large Financial Companies," press release, November 19, 2020, https://www.federalreserve.gov/newsevents/pressreleases/bcreg20201119a.htm; Federal Reserve, FDIC, OCC, "Agencies Issue Final Rule to Strengthen Resilience of Large Banks," press release, October 20, 2020, https://www.federalreserve.gov/newsevents/pressreleases/bcreg20201020b.htm; Federal Reserve, FDIC, "Agencies finalize changes to resolution plan requirements; keeps requirements for largest firms and reduces requirements for smaller firms," press release, October 28, 2019, https://www.federalreserve.gov/newsevents/pressreleases/bcreg20191028b.htm.

[65] For a summary of the rule, see Federal Reserve, "Requirements for Domestic and Foreign Banking Organizations," https://www.federalreserve.gov/aboutthefed/boardmeetings/files/tailoring-rule-visual-20191010.pdf.

Table 3. EPR Requirements

Requirement	Category I (G-SIBs)	Category II (>$700B assets or see notes)	Category III (>$250B or see notes)	Category IV (Other $100B-$250B)	Uncategorized ($50B-$100B)
Provisions previously applied to BHCs with >$10B assets:					
Company-run stress tests	annual	annual	biannual	none	none
Risk committee	applies	applies	applies	applies	applies
Provisions previously applied to BHCs with >$50B assets:					
Fed-run stress tests	annual	annual	annual	biannual	none
Capital plan	annual	annual	annual	annual	none
Living wills	biennial	triennial	triennial	none[a]	none[a]
Liquidity stress test (firm-run), reporting, and risk management	most stringent	most stringent	less stringent[b]	least stringent	none
LCR	more stringent	more stringent	less stringent[b]	none[c]	none
NSFR	more stringent	more stringent	less stringent[b]	none[c]	none
SCCL	more stringent	less stringent	less stringent	none	none
Chief risk officer	applies	applies	applies	applies	applies
Emergency provisions	applies	applies	applies	none	none
Subject to assessments for:	OFR, EPR, OLA	OFR, EPR, OLA	OFR, EPR, OLA	EPR (less stringent), OLA	OLA
Simplified capital treatment of certain assets	no relief	no relief	no relief	applies	applies
Stress capital buffer[d]	applies	applies	applies	applies	none
Provisions previously applied to BHCs with >$250B assets or >$10B in foreign exposure:					
SLR	more stringent (eSLR)	less stringent	less stringent	none	none
Advanced approaches	applies	applies	not required	not required	not required
AOCI included in capital calculation	mandatory	mandatory	optional	optional	optional
Countercyclical capital buffer	applies	applies	applies	none	none
Provisions previously applied to G-SIBs:					
TLAC	applies	none	none	none	none

Requirement	Category I (G-SIBs)	Category II (>$700B assets or see notes)	Category III (>$250B or see notes)	Category IV (Other $100B-$250B)	Uncategorized ($50B-$100B)
G-SIB capital surcharge	applies	none	none	none	none

Source: CRS.

Notes: LCR = Liquidity Coverage Ratio, NSFR = Net Stable Funding Ratio, SCCL = Single Counterparty Credit Limit, SLR = Supplementary Leverage Ratio, eSLR = enhanced Supplementary Leverage Ratio, G-SIB = Global Systemically Important Bank, AOCI = Accumulated and Other Comprehensive Income, TLAC = Total Loss Absorbency Capacity, OFR = Office of Financial Research, EPR = Enhanced Prudential Regulation, OLA = Orderly Liquidation Authority, IHC = Intermediate Holding Company. Banks by category are listed in **Table 4**. Banks under $700 billion in assets are ranked as Category II if they have over $75 billion in cross-jurisdictional activity. Banks under $250 billion in assets are ranked as Category III if they have more than $75 billion in nonbank assets, weighted short-term wholesale funding, or off-balance sheet exposure. *Previously applied thresholds* refers to rules under the Dodd-Frank Act and Basel III before amendments from P.L. 115-174, as applied to U.S. banks. For brevity, this table does not specify whether each requirement is applied to a foreign bank's IHC or total U.S. operations.

a. Foreign banks with >$250 billion in global assets in these categories face a less stringent requirement than do U.S. banks.
b. Category III banks with >$75 billion in weighted short-term wholesale funding face the more stringent version of the rule.
c. Category IV banks with >$50 billion in weighted short-term wholesale funding face the least stringent version of the rule.
d. The stress capital buffer was not implemented until after the enactment of P.L. 115-174.

Table 4. Number of Holding Companies Subject to EPR

Category	2020	2019
Category IV	10 U.S., 5 foreign IHC	12 U.S., 5 foreign IHC
Category III	5 U.S., 7 foreign IHC	4 U.S., 6 foreign IHC
Category II	1 U.S., 0 foreign IHC	1 U.S., 0 foreign IHC
Category I	8 U.S., 0 foreign IHC	8 U.S., 0 foreign IHC

Source: Federal Reserve, *Supervision and Regulation Report*, November 2020, https://www.federalreserve.gov/publications/supervision-and-regulation-report.htm; Federal Reserve, *Visual*, October 10, 2019, https://www.federalreserve.gov/newsevents/pressreleases/bcreg20191010a.htm.

Notes: For EPR categories, data are as of October 2019 and November 2020. For definitions of EPR categories, see text. For foreign banks, most EPR requirements are imposed only on their IHCs.

$50 Billion

Any bank with over $50 billion in assets is required to meet risk management requirements. Specifically, it is required to form a risk committee and appoint a chief risk officer.

Banks with over $50 billion and under $100 billion in assets are no longer required to comply with other EPR standards, pursuant to P.L. 115-174.

Category IV ($100-$250 Billion)

Banks with over $100 billion in assets that do not meet the criteria of Categories I, II, or III are classified as Category IV banks.

Category IV banks are subject to Federal Reserve–run stress tests—which measure how much banks' capital levels would decline in a stressed scenario—every other year.

The stress test results feed into the banks' capital requirements through the stress capital buffer, with which Category I-IV banks must comply. Category I-IV banks must also submit annual capital plans, which explain how they will comply with capital requirements under the stress tests based on the banks' planned dividends, share buybacks, and debt and equity issuance.

Category IV banks with over $50 billion in short-term wholesale funding are required to meet a number of liquidity requirements. They must comply with a reduced Liquidity Coverage Ratio (LCR), which requires a minimum proportion of liquid assets, and a reduced Net Stable Funding Ratio (NSFR), which requires a minimum proportion of stable funding. All Category IV banks are required to conduct quarterly company-run liquidity stress tests, which measure how much liquidity would be needed in a stressed environment, and comply with reduced liquidity risk management standards.

Category I-IV foreign banks with over $250 billion in global assets are required to meet the single-counterparty credit limit, which limits how exposed a bank can be to one counterparty, imposed in their home country.

Category III ($250-$700 Billion)

Banks with over $250 billion in assets that are not Category I or II banks are classified as Category III banks. Banks with between $100 billion and $250 billion in assets that pose more systemic risk—because they have over $75 billion in nonbank assets, short-term wholesale funding, or off-balance-sheet exposure—are also classified as Category III banks.

In addition to the requirements noted above, Category III banks must perform company-run stress tests every other year. They are also subject to a less stringent version of the LCR, the NSFR, and monthly liquidity reporting requirements unless their short-term wholesale funding exceeds $75 billion, in which case they are subject to the more stringent requirements.

Category I-III banks are subject to Federal Reserve–run stress tests every year. They are also subject to the countercyclical capital buffer, which gives the Federal Reserve the option to raise capital requirements in periods of heightened systemic risk. They are also subject to monthly internal liquidity stress tests and liquidity risk management standards. In addition, these banks are subject to a number of provisions in the Dodd-Frank Act that can be invoked only in case of emergency. These include reporting requirements to the Financial Stability Oversight Council; early remediation requirements at the holding company level; the ability of the Federal Reserve to limit a firm's mergers and acquisitions, restrict specific products it offers, terminate or limit specific activities, or require the firm to divest assets; the ability of the Federal Reserve to block a nonbank acquisition on financial stability grounds; the ability to subject banks to an emergency 15-to-1 debt-to-equity ratio; and expanded FDIC examination and enforcement powers. Banks that are not Category I-III banks are allowed to use a simplified method to determine capital requirements for certain assets, such as mortgage servicing assets and deferred tax assets.

Category II and III banks are subject to a less stringent version of the supplementary leverage ratio, a capital requirement that includes off-balance-sheet assets. They are also subject to a less stringent version of the single-counterparty credit limit. They are also required to submit living wills on a three-year cycle.[66]

[66] Foreign banks with over $250 billion in global assets that are not Category I, II, or III banks would be required to submit reduced living wills on a three-year cycle.

Category II ($700 Billion)

Banks with over $700 billion in assets that are not Category I banks are classified as Category II banks. Banks with between $100 billion and $700 billion in assets that have over $75 billion in cross-jurisdictional (overseas) activity are also classified as Category II banks. There is currently one Category II bank (Northern Trust) that qualifies because of its cross-jurisdictional activities. It has around $150 billion in assets.

In addition to the requirements noted above, Category I and II banks are subject to annual company-run stress tests. They must use the more complex "advanced approaches" method to comply with capital standards. They must comply with the full LCR and NSFR and daily liquidity reporting. They cannot opt out of holding capital against other comprehensive income.

Category I: Global Systemically Important Banks (G-SIBs)

Basel III created a designation for certain banks that (if one were to fail or become distressed) could inflict destabilizing losses and contagion effects throughout the global financial system, calling such institutions *global systemically important banks* (G-SIBs).[67] Each year, the Financial Stability Board updates its list of G-SIBs around the world. In the United States, the Federal Reserve designates banks as G-SIBs based on a scoring system using two methods (called method 1 and method 2) to measure an institution's *systemic importance*—the likelihood that distress at or failure of the institution could destabilize the global financial system.[68] A detailed examination of how the scores are calculated and what qualifies a bank as a G-SIB is beyond the scope of this report; what is pertinent is that the size of the institution constitutes one of 12 indicators measured under method 1 and one of nine indicators in method 2.[69] As a result, the eight U.S. banks designated as G-SIBs as of the end of the third quarter of 2020 are not the eight largest U.S. banks (rather they are the six largest and the 11th and 15th largest).

The eight U.S. G-SIBs are classified as Category I banks and are subject to the most stringent regulations and supervisory scrutiny of any group of banks.[70] In addition to the requirements noted above, they must hold additional capital to avoid facing certain limitations on shareholder payouts and bonus payments.[71] Specifically, G-SIBs face two capital requirements, the *G-SIB surcharge*, which requires them to hold higher levels of risk-weighted capital, and the *enhanced supplementary leverage ratio (eSLR)*, which requires them to meet a higher leverage ratio that is not risk-weighted. In addition, these banks must hold a certain percentage of capital and debt that meets certain quality requirements designed to ensure that the banks have adequate *total loss*

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[67] Basel Committee on Banking Supervision, *Global Systemically Important Banks: Assessment Methodology and the Additional Loss Absorbency Requirement*," November 2011, at http://www.bis.org/publ/bcbs207.pdf.

[68] Federal Reserve System, "Regulatory Capital Rules: Implementation of Risk-Based Capital Surcharges for Global Systemically Important Bank Holding Companies; Final Rule," 80 *Federal Register* 157, August 14, 2015, https://www.gpo.gov/fdsys/pkg/FR-2015-08-14/pdf/2015-18702.pdf.

[69] The first scoring method closely adheres to the standards agreed to in Basel III. The second method is based on the Basel III system but includes certain changes made by the Federal Reserve that place more emphasis on the banks' funding sources. Both scoring methods include indicators of interconnectedness, complexity, and cross-jurisdictional activity. Method 1 also measures substitutability—how easily its client servicing or infrastructure support could be picked up by another institution—and method 2 measures an institution's use of certain funding markets.

G-SIB scoring uses bank exposures as the size indicator rather than assets, although the asset-size indicator is more commonly used in most U.S. bank regulation thresholds.

[70] Although some foreign G-SIBs have U.S. operations, none is considered a domestic G-SIB for purposes of EPR.

[71] Federal Reserve System, "Regulatory Capital Rules: Implementation of Risk-Based Capital Surcharges for Global Systemically Important Bank Holding Companies," 80 *Federal Register* 49082-49089, August 14, 2015.

absorbing capacity, thus improving their ability to survive losses and the likelihood they could be resolved in an orderly fashion in the event of failure.[72] They are also required to submit living wills on a two-year cycle.

Supervisory Differences Based on Size

Up to this point, this report has only considered how regulations differ based on banks' asset size. But regulators also supervise banks—through examinations and oversight of a bank's compliance with bank regulations, for example—differently based on size. For example, the largest banks are subject to onsite monitoring, more frequent examinations, and more specialized examinations.

Some are concerned that supervision practices that are intended to apply only to large banks could trickle down to small banks.[73] One way that regulators address these issues is by structuring their internal organizations so that different parts of the agencies have responsibility for supervising different banks:

- The OCC has a Senior Deputy Comptroller for Midsize/Community Banking Supervision, who focuses on addressing supervisory issues related to small and midsize national banks, and a Senior Deputy Comptroller for Large Bank Supervision, who addresses issues related to the largest, most complex banks national banks. The OCC also has separate booklets in the *Comptroller's Handbook* that describe the different ways that large banks and community banks are to be examined.[74]
- A subcommittee of Federal Reserve board members on Smaller Regional and Community Banking was established in 2011 "with a primary goal … [of] an understanding of the unique characteristics of community and regional banks and … the potential for excessive burden and adverse effects on lending. Since its establishment, the subcommittee has led a number of initiatives focused on reducing regulatory burden on community banking organizations."[75] "To take account of differences in business models, risks, relative regulatory burden, and other salient considerations,"[76] the Federal Reserve has separate supervisory frameworks for G-SIBs and the most complex foreign banks (the Large Institution Supervision Coordinating Committee), other foreign banks and banks with over $100 billion in assets, banks with assets between $10 billion and $100 billion, and banks with less than $10 billion in assets.[77]
- The FDIC has a separate Office of Complex Institution Supervision and Resolution that focuses on large and complex financial institutions. The Division

[72] Federal Reserve System, "Total Loss-Absorbing Capacity, Long-Term Debt, and Clean Holding Company Requirements for Systemically Important U.S. Bank Holding Companies and Intermediate Holding Companies of Systemically Important Foreign Banking Organizations," 80 *Federal Register* 74926-74931, November 30, 2015.

[73] Former Federal Reserve Governor Tarullo discussed the possibility of "supervisory trickle down" for stress testing. See Tarullo, "A Tiered Approach to Regulation and Supervision of Community Banks."

[74] OCC, *Comptroller's Handbook*, http://www.occ.gov/publications/publications-by-type/comptrollers-handbook/index-comptrollers-handbook.html.

[75] Federal Reserve Board, *Annual Report 2013*, http://www.federalreserve.gov/publications/annual-report/2013-supervision-and-regulation.htm#xbox4.easingregulatoryburdenoncommun-99a70003.

[76] Tarullo, "A Tiered Approach to Regulation and Supervision of Community Banks."

[77] Federal Reserve, *Supervision and Regulation Report*, November 2020, https://www.federalreserve.gov/publications/2020-november-supervision-and-regulation-report-supervisory-developments.htm.

> of Risk Management Supervision examines the remaining FDIC-supervised institutions. To give additional emphasis to community banks, the FDIC has an internal Advisory Committee on Community Banking[78] and maintains the Community Banking Research Program.[79]

Some of the regulatory requirements with statutory thresholds discussed above involve bank supervision, such as the reduced frequency of exams for smaller banks.

Issues for Congress

Regulatory Implications of Recent Asset Growth

Challenges Facing Banks Due to Recent Asset Growth

As the pandemic and the congressional response to it unfolded, deposits at banks increased rapidly. Market uncertainty likely resulted in people and businesses moving their funds into the relative safety of bank accounts. Also, the Paycheck Protection Program (PPP) made loans to businesses, and other programs sent stimulus checks to individuals and supplemental unemployment insurance payments to the unemployed. Most people and businesses deposited the disbursed funds in their bank accounts.[80] Although bank lending has grown during the pandemic—largely as a result of participation in the PPP and drawn-down credit lines—banks did not turn all the new deposits into loans. This was because either (1) they were wary of making many new loans during an unprecedented economic contraction, (2) there was insufficient demand for that many new loans, (3) there are capital constraints and logistical considerations to underwriting so many new loans, or (4) some combination of these factors. Instead, banks held a portion of the new funds in the safe assets of their Federal Reserve account balances and U.S. Treasuries. In addition, the Federal Reserve's response to the pandemic greatly increased banks' account balances at the Federal Reserve and indirectly increased deposits and total assets.[81]

This rapid expansion of bank balance sheets has a number of regulatory implications. Banks become subject to additional regulation when they cross certain asset-size thresholds discussed in this report. In addition, capital requirements are based on the amount of assets a bank holds, and leverage ratio requirements—in which all assets are treated equally regardless of how risky they are—may be particularly problematic. In risk-weighted capital requirements, Federal Reserve account reserves and Treasuries are assigned a 0% weight—and thus do not require banks to hold capital against them—but leverage ratios do not weight the assets and so require capital be held against the safe assets. Finally, the fees (called *assessments*) that all banks pay to the FDIC and that national banks pay to the OCC are determined by formulas that include assets as a factor.

Thus, banks that participated in the PPP or otherwise have an increase in assets during the pandemic could—absent congressional or regulator action—incur additional regulatory costs and be required to raise more capital quickly to maintain their capital ratios. One possible response banks may take would be to slow asset growth or even reduce assets going forward, possibly by

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[78] See FDIC, "Advisory Committee on Community Banking," https://www.fdic.gov/about/advisory-committees/community-banking/.

[79] See FDIC, "Community Banking Research Program," https://www.fdic.gov/resources/community-banking/.

[80] Hugh Son, "U.S. Banks Are 'Swimming in Money' as Deposits Increase by $2 Trillion Amid the Coronavirus," *CNBC*, June 21, 2020, https://www.cnbc.com/2020/06/21/banks-have-grown-by-2-trillion-in-deposits-since-coronavirus-first-hit.html.

[81] See CRS Report R46411, *The Federal Reserve's Response to COVID-19: Policy Issues*, by Marc Labonte.

making fewer new loans. Another possible bank response would be to stop accepting new deposits. Either course would likely be detrimental to the economy and its recovery from the pandemic.

It is unclear whether this increase in bank assets is temporary or permanent and depends in part on future policy decisions. Asset growth tied to PPP loans, for example, is likely to be reversed when the PPP ends and those loans are transformed to federal grants. But asset growth tied to the growth in bank reserves held at the Fed is, overall, caused by the growth in the Fed's balance sheet due to its asset purchases and emergency COVID-19 programs. Although those programs have mostly expired, the Fed's asset purchases continue for the time being. After the 2007-2009 financial crisis had ended, the Fed eventually stopped purchasing assets but never sold any of the assets it had purchased, and so the Fed's balance sheet remained large and bank reserves remained over $1 trillion higher than they were before the financial crisis.

Whether this increase in bank asset size is permanent or temporary—and will reverse itself after the pandemic ends—has implications for policy. Temporary growth in bank balance sheets might be most efficiently addressed through temporary exemptions based on bank asset size, whereas a permanent increase might call for more sophisticated and permanent changes to regulations.

Policy Responses Taken Under Existing Regulator Authorities

To address the issue of banks temporarily crossing regulatory asset thresholds, the Federal Reserve, OCC, and FDIC issued an interim final rule in December 2020 under which the assets a bank held as of December 31, 2019, will be set as the bank's asset size for the purposes of numerous regulatory thresholds discussed in this report provided that asset size was less than $10 billion. This rule expires on January 1, 2022.[82]

To address the effects PPP participation would have on bank capital ratios, Section 1102 of the CARES Act mandated that PPP loans be given a 0% risk-weight for the purposes of determining banks' risk-based capital requirements, meaning banks would not have to hold additional capital to maintain their risk-weighted ratios when holding PPP loans. In addition, the bank regulators' PPP rule exempted PPP loans pledged as collateral to the Federal Reserve PPP Lending Facility from all risk-weighted and leverage ratios in capital rules.[83]

To negate the effect PPP participation could have on bank assessments, the FDIC also exempted PPP loans from banks' assessment schedules,[84] and the OCC allowed national banks to choose their December 31, 2019, total asset amounts as the basis for their mid-2020 assessments.[85]

[82] Federal Reserve, OCC, and FDIC, "Temporary Asset Thresholds," 85 *Federal Register* 77345-77349, December 2, 2020.

[83] The PPP Lending Facility provides credit to financial institutions making loans under the PPP. Because banks are not required to hold capital against these loans, this facility increases lending capacity for banks facing high demand to originate these loans. See Federal Reserve, OCC, and FDIC, "Federal Bank Regulators Issue Interim Final Rule for Paycheck Protection Program Facility," press release, April 9, 2020, https://www.fdic.gov/news/news/press/2020/pr20050.html.

[84] FDIC, Final Rule Mitigating the Deposit Insurance Assessment Effect of Participation in the Paycheck Protection Program (PPP), the PPP Liquidity Facility, and the Money Market Mutual Fund Liquidity Facility, June 22, 2020, https://www.fdic.gov/news/financial-institution-letters/2020/fil20063.html.

[85] OCC, Office of the Comptroller of the Currency Fees and Assessments: Amended Interim Calendar Year 2020 Fees and Assessments Structure, August 7, 2020, https://www.occ.treas.gov/news-issuances/bulletins/2020/bulletin-2020-73.html.

Potential Responses Needing Additional Regulator Authority from Congress

Certain regulatory thresholds were not included in the December 2020 rule, notably the CFPB supervisory authority for consumer compliance for banks with more than $10 billion in assets. The rulemaking did not specify a reason for the omissions. In any case, if Congress determined that a December 31, 2019, asset measurement should temporarily be more widely applied, it could mandate that in legislation. In addition, regulators did not provide temporary relief to banks with over $10 billion in assets in this rule (although larger banks did benefit from the PPP exemptions from capital requirements).

Bank regulators may need additional authority from Congress to address the regulatory implications of COVID-19 asset growth for other purposes, however. For example, under the Collins Amendment, BHCs are required to meet the same risk-weighted and leverage capital ratios that depositories must meet, and those requirements cannot be less than they were at the enactment date of the Dodd-Frank Act.[86] According to Vice Chair of the Federal Reserve Randal Quarles, the leverage ratio requirements present a problem under the conditions brought about by the pandemic.[87]

Although risk-weights on account balances held at the Federal Reserve and Treasuries are set at 0% and thus do not require banks to hold capital against them, leverage ratios treat all assets the same. As a result, banks must hold capital against even these safe assets, and as banks' reserve account balances grow, all else equal, their leverage ratios fall. Due at least in part to these concerns, Quarles expressed in a letter to then-Senate Banking Committee Chairman Mike Crapo that the Federal Reserve may want to temporarily provide banks with flexibility in meeting leverage ratio requirements but that a legislative modification to the Collins Amendment was needed to do so.[88] (The Federal Reserve determined that it had the authority to exempt these assets from the supplementary leverage ratio, which applies only to the largest banks, but not the leverage ratio and granted banks that relief until March 31, 2021.) Certain observers may argue for the importance of having a strong leverage ratio requirement to complement the risk-weighted ratios and that the purpose of the leverage ratio is to measure the amount of bank capital against assets regardless of risk. In their view, exempting safe assets undermines the usefulness of the leverage ratio requirement.[89]

Industry Consolidation Trends

In recent decades the banking industry has consolidated significantly. In general, the number of small institutions and the share of industry assets those institutions held have steadily declined,

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[86] 12 U.S.C. §5371.

[87] Randal Quarles, Federal Reserve Vice Chair for Supervision, letter to Senator Mike Crapo, April 22, 2020, https://www.banking.senate.gov/imo/media/doc/Fed%20Response%20to%20Crapo%204.8.20%20Letter.pdf.

[88] Quarles, letter to Crapo.

During consideration of a coronavirus relief package in August 2020, Senator Crapo introduced to S.Amdt. 2499 to S. 178. The amendment would have allowed bank regulators to "make such temporary adjustments to the method of calculating the generally applicable leverage capital requirements … as the appropriate Federal banking agency determines necessary to address or avoid a severe economic stress situation." Any adjustments made under this authority would have lasted no longer than 12 months. See U.S. Senate, *Congressional Record*, daily edition, August 4, 2020, pp. S4856-S4857. Neither the amendment nor the final bill were ultimately passed by the Senate.

[89] Former Federal Reserve Governor Daniel K. Tarullo, "Departing Thoughts," remarks at the Woodrow Wilson School, Princeton University, April 4, 2017, pp. 11-13, https://www.federalreserve.gov/newsevents/speech/files/tarullo20170404a.pdf.

whereas the number of large banks and their share of industry assets have grown.[90] For example, as of December 31, 2020, there were 13 insured depository institutions with more than $250 billion in assets that together accounted for more than 56% of industry assets. That is an increase from the three institutions over $250 billion that accounted for 18% of industry assets 20 years earlier. Over that same period, the number of institutions with less than $1 billion fell from 9,362 to 4,074, and their share of industry assets fell from 17% to 5%.[91] Observers disagree over the degree to which different causes have driven this industry consolidation.[92] Regardless of the causes, the changing industry structure has implications for a framework using mostly static thresholds.

Consolidation means that, over time, any relatively low asset thresholds provide regulatory exemptions and relaxed regulations for fewer and fewer institutions representing a smaller share of the industry. Meanwhile, moderate and higher thresholds are increasingly applying additional regulations to more banks and a larger share of the industry. This development is not necessarily problematic if those thresholds are still balancing benefits and costs well. However, policymakers set many existing thresholds to apply to an industry that had a fundamentally different structure than it has today.

The Effects of Inflation on Thresholds Over Time

Another issue to be considered regarding banks exceeding fixed thresholds over time is the effect of natural growth in the nominal value of assets due to inflation, the growth of the economy, and the growth of the financial industry. A few thresholds are regularly adjusted for inflation. For example, banks under an inflation-adjusted threshold are exempt from reporting requirements under the Home Mortgage Disclosure Act,[93] and banks below certain inflation-adjusted thresholds are classified as *small banks* and *intermediate small banks*, making them eligible for tailored evaluation frameworks under the CRA.[94] However, many thresholds are not indexed, and as a result, fixed thresholds are continually declining over time in terms of real asset value or institution size relative to the economy or the financial industry. If Congress decided thresholds should be raised to match inflation year to year, it could index them to some measure of inflation. Alternatively, it could index thresholds to the increase in nominal GDP or industry assets.

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[90] For more information, see CRS Report R43999, *An Analysis of the Regulatory Burden on Small Banks*, by Sean M. Hoskins and Marc Labonte; and the "Community Banks" section of CRS Report R44855, *Banking Policy Issues in the 115th Congress*, by David W. Perkins.

[91] FDIC, Quarterly Banking Profile data, accessed November 16, 2017, https://www.fdic.gov/bank/analytical/qbp/timeseries/ratios-by-asset-size-group.xls.

[92] The preface to a 2007 interagency study on regulatory burden stated that "it is difficult to accurately measure the impact regulatory burden has played in industry consolidation." FFIEC, *Joint Report to Congress: EGRPRA*, July 31, 2007, p. 3, http://egrpra.ffiec.gov/docs/egrpra-joint-report.pdf. A 2014 study found that at least 75% of the decline of new bank charters could be attributed to macroeconomic conditions. See Robert M. Adams and Jacob P. Gramlich, *Where Are All the New Banks? The Role of Regulatory Burden in New Charter Creation*, Federal Reserve Board, December 16, 2014, http://www.federalreserve.gov/econresdata/feds/2014/files/2014113pap.pdf. For additional information on possible causes, see CRS Report R46699, *Banking Policy Issues in the 117th Congress*, coordinated by David W. Perkins.

[93] 12 U.S.C. §2808(b). Currently set at $48 million. CFPB, "Home Mortgage Disclosure (Regulation C) Adjustment to Asset-Size Exemption Threshold," 85 *Federal Register* 83409-83411, December 22, 2020.

[94] See 12 C.F.R. §§228.12(u)(2), 345.12(u)(2). Currently, small banks are banks with less than $1.322 billion of assets, and intermediate small banks are those below that threshold with at least $330 million in assets. Federal Reserve and FDIC, "Community Reinvestment Act Regulations," 85 *Federal Register* 83747-83749, December 23, 2020.

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