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Make Small Banks Great Again? Industry Buoyed by Trump

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The deconstruction of Dodd-Frank Act that's expected under President Donald Trump may make small and midsize banks great again.

Smaller institutions—rather than the nation's megabanks—may well have the most to gain from a rollback of the 2010 law, if recent legislative proposals and comments by Trump advisers are any indication.

"That's primarily the audience which the GOP is concerned with and it also reflects a concern that the regulatory burden on smaller institutions is holding back lending and hence job creation," Mark Calabria, director of financial regulation studies at the Cato Institute, told Bloomberg BNA in an e-mail. "There is also a sense that these weren't the banks behind the crisis."

Here are five early signs that smaller banks may wind up winners as the Trump administration and congressional Republicans take aim at Dodd-Frank:

A Higher Bar on Leverage

Rep. Jeb Hensarling (R-Texas) is expected to reintroduce a plan this month to overhaul the financial regulatory system. An expected key feature of Hensarling's Choice Act. 2.0 will be an "off-ramp" from the post-Dodd-Frank supervisory regime and Basel III capital and liquidity standards for banks of all sizes. To tap this relief, banks would have to maintain a leverage ratio of at least 10 percent and a CAMELS rating of 1 or 2.

The eight largest U.S. banks have an estimated average leverage ratio of about 6.6 percent, according to a summary of last year's version, using Securities and Exchange Commission filings. Most community banks tend to operate with far less leverage than their big-bank counterparts, the summary said, making it easier for them to access the regulatory "off-ramp."

Around half of community banks can meet the leverage ratio requirement, with the rest of them "pretty close in the high nines," Paul Merski, vice president of congressional relations and strategy for the Independent Community Bankers of America, told Bloomberg BNA in November.

There is a sense among financial lobbyists that Hensarling won't budge on the 10 percent leverage ratio provision, given that it is a foundation of the legislation and it sets up the "choice" for banks in the bill's name.

"It will be interesting to see if he tweaks it to try to get more support," Justin Schardin, director of financial regulatory reform at the Bipartisan Policy Center, said. "A number of banks thought it would be too hard to qualify under the original version."

A Friend at Treasury

The regulatory environment should support credit flows to all corners of the economy, particularly in rural and other less-populated areas, according to Steven Mnuchin, Trump's pick for Treasury secretary.

"We're losing the community banking business," he said during his Senate confirmation hearing. "We're losing the ability for small and medium-sized banks to make good loans to small and medium-sized businesses in the community where they understand those credit risks better than anybody else."

As Treasury secretary, Mnuchin would sit with other banking regulators on the Financial Stability Oversight Council (FSOC), another Dodd-Frank creation. In that role, he said he'd make sure that "we did what we could to have proper regulation" and not "end up with a world where we only have four big banks in this country."

Up for Re-Election

A financial overhaul bill will need some support from Democrats, who seem most open to policy changes that favor community banks. Areas where small lenders seek "some major relief" include mortgage lending, the Labor Department's fiduciary rule, and Basel III capital requirements, Merski told Bloomberg BNA Feb. 6.

Community bankers would also like to see the scrapping of Dodd-Frank's Collins Amendment, which also has to do with the complexity of how capital rules are put in place for many banks, Merski told Bloomberg BNA. In addition, the ICBA is pushing for repeal of the Durbin Amendment, which caps debit interchange fees charged by banks.

"It's a lot to roll back if we want to get aggressive about rolling back some of the regulatory burdens and costs," he said.

Schardin thinks there is a prevailing bipartisan support for helping community banks that will form the basis for any compromise package that could pass Congress.

“It helps that there are three Democrats on the [Senate] Banking Committee who are from red states and are up for re-election in 2018. They’ll want to get something done,” Schardin said in an e-mail, referring to Sens. Jon Tester (Mont.), Heidi Heitkamp (N.D.), and Joe Donnelly (Ind.).

Aside from Congress, Trump has another avenue for pursuing deregulation: populating the financial agencies with his people. Banks stand to benefit from a change in the enforcement and oversight philosophy over the next 12 months as Trump gets to replace the heads of the Federal Reserve, Office of the Comptroller of the Currency and Federal Deposit Insurance Corporation, according to Jaret Seiberg, an analyst at Cowen & Co.

“In addition, the vice chairman for supervision slot at the Federal Reserve remains vacant,” he wrote in a note Feb. 3. “Our point remains that control of the agencies provides the means to revamp Dodd-Frank rules without the need for legislation.”

Relief for the Regionals

Republican lawmakers will likely resurrect legislation that would change how regional banks—among them PNC Bank, SunTrust, Regions Bank, and Fifth Third—are designated as systemically risky.

Under Dodd-Frank, banks with more than $50 billion in assets face enhanced supervision. Mnuchin said he believes in a regulatory framework determined by complexity and activity, not simply asset size.

The Cato Institute’s Calabria thinks the House and Senate will include an asset threshold change to the FSOC designation process as it relates to the large regionals. “I could see numbers going as high as $350 billion, but more likely around $250 billion,” he said.

Sen. Richard Shelby (R-Ala.) pushed a bill in 2015 that established a $500 billion threshold for automatic SIFI designation, leaving the label for just a handful of big U.S. banks, such as JPMorgan and Bank of America. The House took a different approach in 2016. Legislation sponsored by Rep. Blaine Luetkemeyer (R-Mo.) would require regulators to consider factors such as a bank’s complexity, rather than size, before labeling it systemically important.

Schardin doesn’t expect a dollar figure in the House because Hensarling has said he doesn’t like those kinds of thresholds. But he thinks Congress may provide relief for midsize lenders.

“You could see some regional bank relief too, including something from the Senate to raise the $50 billion ‘bank SIFI’ threshold so that it just covers the most systemically important banks,” Schardin said. “Hensarling is also not a fan of the SIFI designation process or giving more discretion to regulators, so it’s hard to imagine him wanting a designation process for banks.”

Forces at Play

Trump may be tugged by two forces as he tries putting his stamp on financial regulation: economic nationalists and libertarians, according to Karen Shaw Petrou, a banking analyst with Federal Financial Analytics.

“Economic nationalists do not care much about a ten percent leverage rule for all their disdain of Dodd-Frank regulatory burden,” she wrote in a note Jan. 19. “What they want is a bigger, better, and if necessary even badder banking system that makes America even greater without resort to foreign capital.”

“For all their deregulatory zeal, libertarians are strong advocates of tough big-bank rules because they believe that these will force big banks to splinter into the small-town, free-enterprise finance that will make America great again as finance moves from the coasts into every small town by way of far smaller, freer financial companies,” she said.