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IN FOCUS

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Introduction to Financial Services: Banking

Banks serve an important role in the financial system and broader economy by aggregating the savings of households and businesses and lending to individuals, businesses, and federal and local governments. Economic output would be lower if businesses had to finance investments themselves or if individuals could only make expenditures (e.g., home and car purchases) out of savings. In addition, banks provide other important financial services, such as payments processing.

This In Focus provides a broad overview of various banking topics—key concepts in banking, overview of regulation, recent banking legislation, and policy issues.

Key Concepts in Banking

The word *bank* typically refers to institutions that accept deposits from savers, such as commercial banks and thrifts. (Credit unions are another type of depository.) To accept deposits, an institution must have a federal or state issued charter. Bank deposits are generally insured by the federal government, subject to certain limits. Using customer deposits and other funding, banks generally make loans and acquire certain other assets.

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

Deposit Insurance. Federal deposit insurance provides stability to the financial markets by guaranteeing individuals' bank deposits up to a $250,000 account limit. The insurance guarantee is backed by the full faith and credit of the United States (and thus ultimately the taxpayers). It is intended to prevent bank runs and promote financial stability. The Federal Deposit Insurance Corporation (FDIC) currently insures bank deposits, and the National Credit Union Administration (NCUA) insures deposits at member credit unions.

Overview of Regulation

Banks are regulated to ensure they comply with various statutory requirements. Two major components are prudential and consumer regulation.

Prudential. Prudential regulation (or "safety and soundness" regulation) is designed to promote bank profitability and avoid bank failures, and thus protect taxpayers and the stability of the financial system. A bank's primary federal prudential regulator is determined by charter type and corporate structure (see **Table 1**). Banks are chartered as national banks under the authority of the Office of the Comptroller of the Currency (OCC) or as state banks under the authority of a state regulator. The Federal Reserve (Fed) and the FDIC regulate state banks in conjunction with state bank regulators.

Table 1. Primary Federal Depository Regulators

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

Source: Congressional Research Service.

Basel III. Basel III is the latest in a series of evolving international agreements among central banks and bank supervisory authorities to standardize bank *capital and liquidity regulations*. Basel III strengthened these regulations in response to the 2007-2009 financial crisis. The Basel agreements do not have the same force as treaties; they can be tailored to suit the specific needs of each country.

Capital and Liquidity. Holding a high level of capital can make a bank's failure less likely because capital can be written down to absorb losses. In addition, banks need liquidity to meet short-term obligations. For these reasons, banks are generally required to maintain sufficient levels of capital to ensure solvency and protect bank depositors and taxpayers and to hold liquid assets or use stable funding to ensure adequate liquidity.

Consumer Compliance. Consumer compliance regulations seek to ensure that banks conform to applicable consumer protection and fair-lending laws. The Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act; P.L. 111-203) created the Bureau of Consumer Financial Protection (CFPB or BCFP) as a key regulator for consumer protection. Prudential regulators also regulate consumer compliance in some cases.

Recent Banking Legislation

In response to the 2007-2009 financial crisis, Congress passed the Dodd-Frank Act. It was a major congressional response to the crisis and the most comprehensive financial reform legislation since the 1930s.

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

Policy Issues

Congress continues to debate whether policy responses to the 2007-2009 financial crisis appropriately addressed the risks leading up to the crisis and did so in way that was not overly burdensome to the banking system and the economy. Congress may be interested in the impact of new regulations implementing P.L. 115-174 as well as various other policy issues, a selection of which are discussed below.

Bank Holding Companies. Most banks are owned by a parent company—called a Bank Holding Company or BHC—that owns other subsidiaries, and these overarching organizations are also commonly referred to as banks. Some BHCs have subsidiaries that engage in nonbank financial activities, such as underwriting and dealing in certain types of securities. The Dodd-Frank Act required the Fed to apply enhanced prudential standards (EPS) to BHCs with assets of $50 billion or more. P.L. 115-174 raises the thresholds at which EPS apply to BHCs with assets over $250 billion and allows regulators to determine which EPS are applicable to BHCs with assets between $100 billion and $250 billion. BHCs with assets less than $100 billion are, generally, exempt from EPS. Congress might continue to monitor the benefits or negative consequences of EPS.

Community Banks. A *community bank* is not officially defined, but is generally thought to mean a small (though size is not necessarily a determining factor) bank that services the credit needs of a local area. Congress has shown considerable interest in the state of community banks and how they affect the communities they serve.

The number of smaller community banks has declined in recent years, whereas the asset share of the largest banks has grown. There are 5,477 insured banks in the United States, which hold $17.7 trillion in assets and $16.5 trillion in deposits. The nine largest banks, each have over $250 billion in assets, hold nearly 50% of all assets and deposits. The 129 banks that are between $10 billion and $250 billion in asset size hold nearly 34% of all assets and 33% of all deposits. The remaining 5,339 banks, which are less than $10 billion in asset size, hold 16% of all assets and 17% of all deposits.

Although bank regulation is tailored in a number of ways to reduce the regulatory burden on these institutions, some observers argue that the regulatory burden is one of the factors that contribute to declining community banks.

A series of targeted relief to community banks below certain asset sizes is provided by P.L. 115-174. For example, banks with less than $10 billion in assets are exempt from the Volcker Rule and from capital and leverage requirements if they meet certain criteria. (The Volcker Rule generally prohibits banks from engaging in proprietary trading of securities, derivatives, commodity futures, and options on these instruments from their own account to generate profit.) Banks with less than $10 billion in assets are also exempt from certain Basel III-based regulation if they meet specific requirements. Banks with less than $5 billion in assets have reduced reporting requirements, whereas banks with less than $3 billion in assets can qualify for a less frequent examination by regulators. Some observers argue that tailoring does not go far enough and that additional regulatory relief should be provided to community banks.

FinTech. Financial Technology, or FinTech, usually refers to technologies with the potential to alter the way certain financial services are performed. Banks are affected by technological developments in two ways: (1) they face choices over how much to invest in emerging technologies and to what extent they want to alter their business models in adopting technologies and (2) they potentially face new competition from new technology-focused companies, who may or may not be subject to the same regulations. Such technologies include online marketplace lending, crowdfunding, blockchain and distributed ledgers, and robo-advising, among many others. Certain financial innovations may create opportunities to improve social and economic outcomes, but there is also potential to create risks or unexpected financial losses.

Community Reinvestment Act. Congress passed CRA to address geographical mismatch of deposit-taking and lending activities. CRA requires federally insured banks to make sufficient credit available in markets where they accept deposits to meet the needs of the local area's housing, agricultural, and small business credit needs. Regulators are in the process of updating the CRA regulatory framework to address changing market needs. Many in Congress have expressed an ongoing interest in how any new CRA regulations will affect the communities served by the banks and availability of affordable credit to low- and moderate-income communities.

CRS Resources

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

CRS Report R41350, *The Dodd-Frank Wall Street Reform and Consumer Protection Act: Background and Summary*, coordinated by Baird Webel

Raj Gnanarajah, rgnanarajah@crs.loc.gov, 7-2175
David W. Perkins, dperkins@crs.loc.gov, 7-6626

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