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IN FOCUS

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Introduction to Financial Services: Banking

The word “bank” is commonly used to refer to entities that act as financial intermediaries to coordinate the flow of resources from savers to borrowers. Commercial banks and thrifts accept deposits from savers in order to make loans to individuals, businesses, nonprofits, and governments. In federal regulatory policy, bank is often reserved for firms with special banking charters and their parent companies. This *In Focus* will use the term *bank* to refer to firms (or subsidiaries) with bank, thrift, or credit union charters that are depository institutions.

Structure of Banking

Assets, Liabilities, and Equity. Customer borrowings (loans) and the securities banks acquire typically comprise the majority of the assets on a bank’s balance sheet. The deposits the customers make at the bank (i.e., checking, savings, and other types of deposit accounts) are liabilities of the bank, as these funds are owed to its customers. Any debt a bank issues is also a liability. The difference between assets and liabilities is the bank’s equity (i.e., ownership interest); it is the bank’s capital.

Regulators. Banks in the United States are incorporated as national banks either under the authority of the Office of the Comptroller of the Currency (OCC) or the state. The Federal Reserve (Fed) and the Federal Deposit Insurance Corporation (FDIC) regulate state banks. **Table 1** lists the primary federal bank regulators and their oversight responsibility.

Table 1. Federal Bank Regulators

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

Source: The Congressional Research Service (CRS).

Note: One or more federal and state regulators may regulate the financial activity of a bank.

Deposit Insurance. Federal deposit insurance provides stability to the financial markets by guaranteeing bank deposits up to the insured limit; in essence, it is intended to prevent bank runs and limit causes of systemic failure of the U.S. banking system. The Deposit Insurance Fund is financed through premiums paid by banks, and backed by the full faith and credit of the United States. The FDIC currently insures commercial bank deposits in the United States up to $250,000.

Credit Unions (CUs). Unlike banks that have a profit motive, arguably, CUs are nonprofit depositories, owned by members and often offer services similar to commercial banks. The National Credit Union Administration (NCUA) regulates CUs and insures their deposits in the United States up to $250,000.

Bank Holding Companies (BHCs). One or more depository subsidiaries may be part of a BHC that may own other financial subsidiaries that are not deposit subsidiaries. The Banking Act of 1933 (P.L. 73-66), commonly referred to as Glass-Steagall Act, prevented commercial banks from engaging in investment bank activities. In 1999, the Gramm-Leach-Bliley Act (P.L. 106-102) repealed portions of the Glass-Steagall Act and the Bank Holding Company Act of 1956 (P.L. 85-511). As a result, bank holding companies can now have non-depository financial subsidiaries, including investment banks. Investment banks engage in raising capital and underwriting securities for their clients; advise buyers and sellers on mergers and acquisitions; and match up buyers and sellers of securities (derivatives, bonds, stocks, currencies, and commodities). Investment banks cannot accept insured deposits and are not subject to the prudential regulation regime administered by the bank regulators listed in **Table 1**.

Policy Issues

The Dodd-Frank Wall Street Reform and Consumer Protection Act

The 111th Congress passed the Dodd-Frank Wall Street Reform and Consumer Protection Act (P.L. 111-203; Dodd-Frank) in response to the financial crisis that began a few years earlier, making broad changes to the U.S. financial regulatory system. A number of its significant banking provisions are addressed below.

The Dodd-Frank Act preserved the thrift charter but eliminated the thrifts’ regulator, the Office of Thrift Supervision, and merged its functions with other financial regulatory agencies. Dodd-Frank created the Consumer Financial Protection Bureau (CFPB) as an independent agency within the Fed. Many of the consumer financial protection functions that were previously delegated to other bank regulatory agencies were transferred to the CFPB. Dodd-Frank also permanently increased the deposit insurance coverage limit to $250,000 and strengthened the Deposit Insurance Fund.

The Dodd-Frank Act requires enhanced prudential regulation of bank holding companies with assets of $50 billion or more. These banks are also classified as systemically important financial institutions (SIFIs). The enhanced regulations require more stringent standards for these SIFIs.

Volcker Rule. Section 619 of the Dodd-Frank Act, the "Volcker Rule," generally prohibits banks from engaging in short-term proprietary trading of securities, derivatives, commodity futures, and options on these instruments for their own account. The rule also prohibits banks from owning, sponsoring, or having certain relationships with hedge funds or private equity funds. The rule does make exceptions for certain types of activities. Banks are allowed to participate in market making, hedging, securitizing, and underwriting activities. U.S. Treasury securities and municipal securities are exempt from the Volcker Rule.

Basel III

Basel III is a comprehensive set of banking reforms, developed by the Basel Committee on Banking Supervision, located in Basel, Switzerland. Basel III is the latest in a series of evolving agreements among central banks and bank supervisory authorities globally to standardize bank capital and liquidity requirements. The Basel agreements are not treaties; individual countries can make modifications to suit their specific needs. Parts of Basel III were implemented in the United States in 2013.

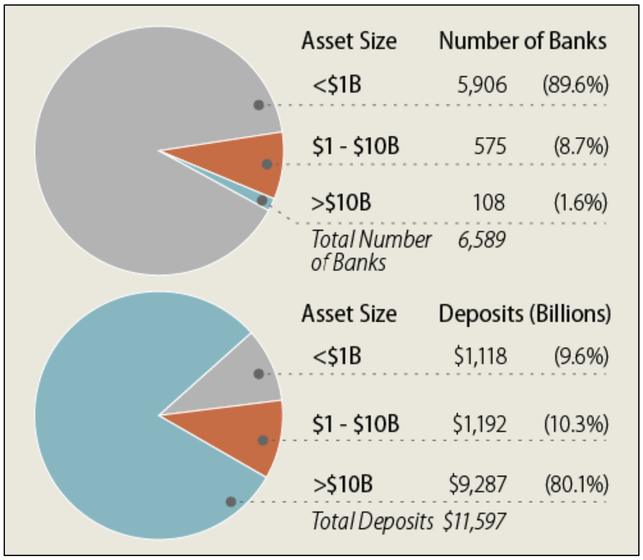
Capital Requirements. Banks that accept federally insured deposits are required to maintain sufficient capital reserves to protect bank depositors. Liabilities, including deposits, are funds the bank owes. Bank capital can be written down to absorb losses. Banks can increase capital by retaining earnings or by issuing additional stock.

Liquidity Coverage Ratio. Liquid assets are held by banks to meet short-term obligations. The liquidity coverage ratio is designed to ensure that financial institutions have the necessary liquidity on hand to meet cash outflows during a 30-day period. Cash and near cash items, such as central bank reserves, and government and corporate debt that can be converted easily and quickly into cash meet the definition of liquid asset. Generally, only SIFIs and banks with $10 billion of foreign exposure on the balance sheet are required to meet the liquidity coverage ratio.

Market Concentration

As shown in **Figure 1**, as of September 30, 2014, the FDIC insures 6,589 depository institutions, which hold $11.6 trillion in deposits. The largest 108 (1.6%) banks hold $9.3 trillion, or 80% of the total deposits. The remaining 6,481 (98.4%) banks hold $2.3 trillion, or 20% of the total deposits. The number of smaller "community" banks has declined in recent years, while the asset size of the largest banks has grown.

Figure 1. Deposit Concentration, by Bank Size



Source: CRS.

Note: Information was obtained from FDIC Quarterly Banking Profile as of September 30, 2014.

Issues in the 114th Congress

Congress may evaluate issues and policies related to regulatory regime for community banks, challenges to community bank growth, the effects of the Dodd-Frank Act and Basel III on the cost and availability of credit, mortgage reforms, fair valuation of loans and securities, and whether "too big to fail" banks pose systemic risk. Additionally, Congress may consider differences in regulation between credit unions and banks, anti-money laundering and counter terrorism financing, mobile pay, and cybersecurity challenges.

CRS Resources

CRS Report R43002, *Financial Condition of Depository Banks*, by Darryl E. Getter

CRS Report R41718, *Federal Deposit Insurance for Banks and Credit Unions*, by Darryl E. Getter

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

CRS Report R43087, *Who Regulates Whom and How? An Overview of U.S. Financial Regulatory Policy for Banking and Securities Markets*, by Edward V. Murphy

CRS Report R42744, *U.S. Implementation of the Basel Capital Regulatory Framework*, by Darryl E. Getter

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