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White House in denial about effects of Dodd-Frank

By Alfredo Ortiz / Contributing writer

This summer marks the sixth anniversary of the passage of the Dodd-Frank financial reforms, the biggest regulation in the country's history affecting nearly every aspect of the financial services industry. Coinciding with the occasion, the White House Council of Economic Advisors released a report this month analyzing the law's impact on community banks, which have been disappearing at a rate of one per day since the legislation passed.

In contrast to the conclusions of several high-profile studies, the White House claims Dodd-Frank has had no impact on the decline of community banks. "There's no evidence at all that Dodd-Frank has had a negative impact on this sector," said Jason Furman, chairman of the council.

The White House, which proposed and spearheaded the legislation in 2009, backed up its surprising conclusion by noting that lending at most community banks has increased since it passed in 2010. No doubt. In 2010 banks were in survival mode only months removed from the worst recession since the Great Depression. Picking 2010 as a starting point for a lending volume trend doesn't reveal anything meaningful.

But there's no denying the disappearance of community banks. By one count, only three new community banks have opened since the law's passage, compared to a historical figure of around 100 per year. There are 20 percent fewer community banks today than there were before this legislation took effect. The White House doesn't ignore this, but chalks it up to secular trends within the community banking industry and a generally weak economy.

While these explanations have merit, there's no question that Dodd-Frank regulations have also contributed to the struggles of community banks and the associated lack of access to credit that is holding back small businesses and the economic recovery. Its 22,000 pages of regulations are aimed at big investment banks in hopes of preventing another financial crisis, but have disproportionately fallen on small Main Street banks that resemble their Wall Street counterparts in name only.

The Minneapolis Federal Reserve finds that adding just two members to the compliance department, often too few to process Dodd-Frank regulations, makes a third of small banks unprofitable. According to recent studies by the Government Accountability Office and the Mercatus Center, Dodd-Frank has caused community banks to increase compliance staff, training and time-allocation, as well as reconsider what loans to offer.

Unlike investment banks, whose risky bets on the mortgage industry contributed to the financial crisis, community banks have relatively low profit margins, earning revenue largely through interest on loans in the community. But most of Dodd-Frank doesn't make a distinction. Its onerous capitalization requirements, for instance, aren't necessary for community banks holding safe and simple assets.

The demise of small banks has big implications. Community banks are the lifeblood of towns across the country, providing the loans that big banks will not. These are the loans made on personal relationships, local knowledge and a handshake – something that no loan algorithm can match.

Small banks have only 10 percent of the industry's assets, but make one-quarter of the country's commercial loans, two-thirds of its small business loans and three-quarters of its agricultural loans. Their disappearance has made it more difficult for small businesses to access the startup capital they need to succeed. A recent national poll of small business owners commissioned by the Job Creators Network finds that a lack of access to credit is one of the biggest hurdles facing small businesses today.

The White House should work with legislators, small businesses and bankers to reform Dodd-Frank so that it doesn't hit community banks so hard. But first it has to admit there's a problem. Unfortunately, it seems willing to deny economic reality in order to justify its political conclusion.

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