DODD-FRANK ACT'S EFFECTS ON FINANCIAL SERVICES COMPETITION

HEARING

BEFORE THE

SUBCOMMITTEE ON
INTELLECTUAL PROPERTY,
COMPETITION, AND THE INTERNET

OF THE

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DODD-FRANK ACT'S EFFECTS ON FINANCIAL SERVICES COMPETITION

TUESDAY, JULY 10, 2012

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON INTELLECTUAL PROPERTY,
COMPETITION, AND THE INTERNET,
COMMITTEE ON THE JUDICIARY,
Washington, DC.

The Subcommittee met, pursuant to call, at 4:07 p.m., in room 2141, Rayburn Office Building, the Honorable Bob Goodlatte (Chairman of the Subcommittee) presiding.

Present: Representatives Goodlatte, Coble, Chabot, Watt, Conyers, Jackson Lee, Waters, and Johnson.

Staff present: (Majority) Holt Lackey, Counsel; Olivia Lee, Clerk; and (Minority) Stephanie Moore, Subcommittee Chief Counsel.

Mr. GOODLATTE. Good afternoon. This hearing of the Subcommittee on Intellectual Property, Competition and the Internet will come to order.

Today's hearing examines the Dodd-Frank Wall Street Reform and Consumer Protection Act, better known as "Dodd-Frank," and its effects on competition in the financial services industry.

The free flow of capital is the linchpin of our capitalist economy. We must be extremely cautious about any attempts by the Federal Government to thwart the ability of the private sector to choose through the allocation of private sector resources which ideas and businesses are meritorious and which should be left on the cutting room floor.

Unfortunately, Dodd-Frank injects government bureaucrats into the decision-making process in the flow of capital. This raises unnecessary and artificial hurdles to our economic recovery and distorts competition in the financial services market.

Even before the 2007-2008 crisis, there was tremendous concentration in some markets related to the housing bubble and the toxic securities that brought our economy to the brink of collapse. The subprime mortgages at the root of the crisis were repurchased and securitized by the government-sponsored duopoly of Fannie Mae and Freddie Mac. The mortgage-backed securities that Fannie and Freddie created were given AAA ratings by the big three ratings agencies which controlled about 95 percent of the market. These securities were then purchased by the largest Wall Street banks which have consolidated an ever-larger share of the market over the past few decades. Perhaps more competition in all of these markets would have encouraged more responsible decision-making and helped to avert or limit the crisis.

However, instead of fostering more market competition, Dodd-Frank is likely to entrench current market leaders, making it harder for small and innovative banks and financial companies to compete. Dodd-Frank does nothing to decrease the market power held by Fannie, Freddie, and it will likely have the unintended effect of encouraging consolidation in banking and other financial sectors. Dodd-Frank will harm competition in the financial services industry because its regulations fall hardest on small banks and credit unions which makes it harder for them to compete with their larger counterparts.

Regulations always fall harder on small businesses than large. In the banking sector, the costs of complying with regulations have historically been two and a half times higher as a share of operating expenditures for small banks than for large. If the costs of complying with Dodd-Frank are too great, it could drive many local community banks out of business or force them to merge with larger competitors. If Dodd-Frank results in community banks and credit unions leaving the market, not only will competition suffer, but so will the communities and small businesses that these banks serve.

Small and mid-sized banks account for 54 percent of small business lending. America's small businesses need these loans so they can create jobs. The government should be doing everything possible to encourage small businesses to grow and create jobs. At a time of sustained unemployment and with the President proposing to raise taxes on America's small businesses, the last thing we should do is bury the community banks that finance small businesses beneath a new mountain of regulation.

The Dodd-Frank Act could also harm competition by designating certain banks and non-bank financial institutions as systemically important and creating special liquidation procedures for them outside of bankruptcy. These special liquidation procedures treat systemically important companies' creditors better than the bankruptcy law. As a result, systemically important institutions, already among the biggest companies in America, may receive favorable treatment in the credit markets. This could lead to even more concentration.

The Administration is fond of touting the supposed reinvigoration of antitrust enforcement out of the Department of Justice and the Federal Trade Commission, but the Dodd-Frank Act, like the Administration's other signature legislative achievement, The Affordable Care Act, will have the effect of hindering competition in one of the most important sectors of our economy.

It is now my pleasure to recognize the Ranking Member of the Subcommittee, the gentleman from North Carolina, Mr. Watt, for a different perspective.

Mr. WATT. Well, maybe not so. I thought I was in the Financial Services Committee here for a little bit.

I hope the Chairman will forgive me if I say bluntly at the outset that I believe this hearing is much ado about nothing. The Dodd-Frank Wall Street Reform bill, which I often affectionately call as a Member of the House "the Frank-Dodd reform bill," was the culmination of years of efforts to rein in predatory lending and other major abuses in the financial services sector, and to reduce the prospect that financial institutions get too big to fail and taxpayers end up getting stuck with the cost of bailing them out.

The bill establishes an entity for the first time in the Federal Government, the Consumer Financial Protection Bureau, that has as its primary purpose protecting consumers of financial products and erects a comprehensive regulatory regime designed to reduce the incentives that drove many financial institutions to pay much more attention to making excessive profits than to protecting the interests of their customers, our Nation, or our economy.

I cosponsored the legislation and, as a Member of the House Financial Services Committee, played a major role in crafting many of its provisions, and together with Ranking Member Conyers and our colleague, Ms. Waters, served as a conferee on the House-Senate conference that produced the final product. Although I served as a conferee representing the Financial Services Committee, I also brought to the conference my antitrust and other policy experiences from this Committee.

I believe the Dodd-Frank bill reflects the goals of both competition policy and stabilizing our financial institutions.

Mr. Chairman, I think my views on how this Committee addresses antitrust concerns are well known. While educating our citizens on pending antitrust matters serves a very important public good, I generally believe that we should allow the regulators to do their jobs, especially when they have access to a wealth of detail that is not in the public domain.

When Congress intervenes to affect the outcome of an antitrust investigation, I believe it can place undue pressure on the regulating bodies. But here we are having a hearing on the Dodd-Frank Act's effects on financial services competition, effects that have yet to be seen. There are no concrete set of concerns before us. We are simply relitigating issues that were carefully studied in crafting the Dodd-Frank legislation.

As for the Act itself, section 6 of the law contains a specific antitrust savings clause designed to ensure that antitrust policy continues to have a place within the regulatory framework. And I quote, "Nothing in this act or any amendment made by this act shall be construed to modify, impair, or supersede the operation of any of the antitrust laws unless otherwise specified," close quote. That is directly from the Dodd-Frank legislation.

Now, in the past decade, the Supreme Court has issued two decisions that have called into question the role of antitrust policy in regulated industries. The Trinko and the Credit Suisse cases have been the subject of hearings before this Committee and were not overlooked during the construction of the Dodd-Frank Act. In Trinko, the Court upheld the effect of a general antitrust savings clause, but found no violation of the antitrust laws. In Credit Suisse, the Court refused to give effect to a broad, nonspecific savings clause, finding instead that there was an implied antitrust immunity in essence to avoid conflict between incompatible regulatory regimes.

There are those who question the reach of both Trinko and Credit Suisse. Are they limited to the regulated industries involved in the facts of each case, telecommunications and securities respectively, or do they apply generally to all regulated industries?

Whatever the answer to those hypothetical questions, the fact of the matter is that many of the regulations that will shape our financial sector moving forward have yet to be issued or implemented. Moreover, the Obama administration adopted the position when it inherited a financial industry on the brink of collapse that it would increase antitrust enforcement in regulated industries and maintain enforcement during the economic crisis and recovery.

And the Justice Department has conducted four investigations into the financial services markets since the rulings in Trinko and Credit Suisse, three of which are ongoing into the municipal bonds, investment credit, credit derivatives markets, and the London Interbank Offered Rate, or LIBOR as it is sometimes called.

The Department of Justice has also been active in the rulemaking process mandated by Dodd-Frank.

Now, I am sure that there will be testimony today about how Dodd-Frank disadvantages small and community banks and advantages large financial institutions that some believe are, quote, "too big to fail." On this issue, I will simply make two points.

Number one, small and community banks were disadvantaged vis-à-vis large financial institutions long before there was a Dodd-Frank bill. In my view, Dodd-Frank significantly leveled the playing field between larger and smaller banks, and it seems to me that a major part of the dissatisfaction with Dodd-Frank is that we could never absolutely level the playing field, just as we have not found it possible over the history of our country to level the playing field between the rich and poor in this country.

Yes, I keep complaining about that, and I don't begrudge those who keep complaining about the disparity between large and small financial institutions. Perhaps we can and should do more, but I don't find it a very persuasive argument that we perhaps didn't come up with the perfect solution in Dodd-Frank. I refuse to let the perfect be the enemy of the good, and when I do, I should simply resign or leave this institution immediately.

Second, small and community banks got a lot more than they gave in the Dodd-Frank bill. The major source of competition that small and community banks were facing before the passage of Dodd-Frank was competition from unregulated check cashers, payday lenders, and other unregulated entities that operated by no rules while small community banks had to abide by regulations. Dodd-Frank brought all these unregulated entities under regulation and, in the process, made them operate by the same rules that apply to community banks. Most of my community banks praise that aspect of Dodd-Frank as fostering, not undercutting, competition and enhancing their ability to survive.

So while I am happy to hear from the witnesses on this panel on their various theories on how things may pan out with, quote, "too big to fail," the fact is that I think a more appropriate title for this hearing would be, quote, "too early to tell."

I yield back, Mr. Chairman.

Mr. GOODLATTE. I thank the gentleman for his comments and turn now to the Ranking Member of the full Committee, the gentleman from Michigan, Mr. Conyers.

Mr. CONYERS. Thank you, Chairman Goodlatte.

I want to associate myself with the remarks of the Ranking Member of this Committee, the parts that I understood, because this is a very complex subject.

I probably won't take the full 5 minutes, but I did want to put in a mild reservation about why we are holding this hearing in the first place.

I mean, it seems a little bit uncharacteristic that a bill that was passed a couple years ago is now being examined as if it is in full force. I don't think it is yet. But we needed the Wall Street reform act because "too big to fail" policies foreclose competition. And I am hoping that we will get an examination of how we got into this "too big to fail" and where it is going to lead and what it has cost us so far since the 2008 debacle.

Here, Members of the Committee, we have 5,400 banking mergers between the last 15 years and 74 of them were defined as mega-mergers. That means that the buyer and the seller each had more than $10 billion worth of assets.

Now, we need to do more to protect consumers and competition, and as a friend of the gentleman from Massachusetts, Mr. Frank, who was once a Member of the Committee on the Judiciary, I commend and support the Dodd-Frank bill—law.

I don't think I am the only person on this Subcommittee that feels that it should have gone further and that we have a responsibility, when we analyze this, to determine how that can be responsibly done. Why? Because we need to do more to protect consumers and competition in this Wall Street business that goes on. And so while the implementation process still goes on around Dodd-Frank, it is clear that the legislation is not enough to protect consumers and that the global market still remains basically predatory and anticompetitive practices rule in the financial industry world. JP Morgan Chase lost $2 billion with acknowledged irresponsible bets on the derivatives market. The British investigation into Barclays' deliberate inflation of key banking interest rates like the LIBOR have triggered revelations that Chase, Citigroup, other American firms may have undertaken similar actions.

And so what I am hoping will happen is that we will now sleep more comfortably in our beds at night now that title X of Dodd-Frank has not developed the horrible results that had been predicted.

I will put my statement in the record, Mr. Chairman, and I will welcome and await the testimony of our distinguished witnesses. Thank you.

[The prepared statement of Mr. Conyers follows:]

Prepared Statement of the Honorable John Conyers, Jr., a Representative in Congress from the State of Michigan, Ranking Member, Committee on the Judiciary, and Member, Subcommittee on Intellectual Property, Competition, and the Internet

The hearing today will allow us to explore the impact that the Dodd-Frank Act is having on financial service competition.

First, we needed the Dodd-Frank Act because too big to fail policies foreclosed competition.

Market concentration in the financial sector limits consumer choice, lowers quality, and raises prices.

Between 1990 and 2005, more than 5400 banking mergers occurred, including 74 mega-mergers where both the buyer and seller had more than $10 billion in assets. When the Bush-era financial crisis began, the ten largest banks controlled 55% of domestic financial assets and 45% of domestic deposits.

The TARP bailout and related Treasury Department actions occurred precisely because the market was so destabilized by the lack of competition in the financial sector.

Second, more needs to be done to protect consumers and competition.

While the law is still in the implementation process, it is clear that the legislation was not enough to protect consumers and the global market from remaining predatory and anti-competitive practices of the financial industry.

JP Morgan Chase lost $2 billion with irresponsible bets on the derivatives market. And the British investigation into Barclay's deliberate inflation of key banking interest rates like the Libor have triggered revelations that Chase, Citigroup, and other American firms may have undertaken similar actions.

We are still seeing the negative impact that big banks are having on the banking industry. With incentive structures rewarding short-term risk-taking, Wall Street has been in the business of getting bigger and more complex, and taking greater risks.

I will continue to fight for consumers especially those with financial hardships. Antitrust laws must remain in place to protect our economic freedoms against monopolization and anticompetitive restraints on trade. We must now refocus and bring back into the spotlight the need for change and aid to those who have fallen victim during these financially perilous times.

Mr. GOODLATTE. I thank the gentleman.

Without objection, all other opening statements will be made a part of the record.

And we are now pleased to turn to our witnesses. We have a very distinguished panel of witnesses today, and each of the witnesses' written statements will be entered into the record in its entirety. I ask each witness to summarize his testimony in 5 minutes or less. To help you stay within that time, there is a timing light on your table. When the light switches from green to yellow, you will have 1 minute to conclude your testimony. When the light turns red, it signals that the witness' 5 minutes have expired.

Before I introduce our witnesses, as is the custom of this Committee, I would like to ask them to stand and be sworn.

[Witnesses sworn.]

Mr. GOODLATTE. Thank you very much. Please be seated.

Our first witness today is Mr. Ellis Gutshall, President and CEO of Valley Financial Corporation and Valley Bank. Valley Bank was founded in 1995 in my hometown of Roanoke, Virginia, where Mr. Gutshall has worked as a banker since 1976. Mr. Gutshall is the current chairman of the Virginia Association of Community Banks. He is a graduate of Washington and Lee University and of the ABA

Stonier Graduate School of Banking. I am proud to call him my constituent and friend.

Our second witness is Professor Adam Levitin, a visiting professor at Harvard Law School and a professor at Georgetown University Law Center where he teaches courses in financial regulation. Professor Levitin served as Sspecial Counsel to the Congressional Oversight Panel supervising the Troubled Asset Relief Program. Professor Levitin holds a J.D. from Harvard Law School and two Master's degrees from Columbia University and a Bachelor's degree from Harvard College.

Our third and final witness is Mr. Alex Pollock, Resident Fellow at the American Enterprise Institute. After 35 years in banking, Mr. Pollock joined AEI where he focuses on financial policy issues. Prior to joining AEI, he served as President and CEO of the Federal Home Loan Bank of Chicago from 1991 to 2004. Mr. Pollock holds Master's degrees from Princeton University and the University of Chicago and a B.A. from Williams College.

I welcome all the witnesses and we will begin with you, Mr. Gutshall. Welcome.

TESTIMONY OF ELLIS L. GUTSHALL, PRESIDENT AND CHIEF EXECUTIVE OFFICER, VALLEY FINANCIAL CORPORATION

Mr. GUTSHALL. Chairman Goodlatte, Vice Chairman Quayle, Ranking Member Watt, and Members of the Subcommittee, my name is Ellis Gutshall, President and CEO of Valley Financial Corporation and its wholly-owned subsidiary, Valley Bank. My banks is a 17-year-old community bank headquartered in Roanoke, Virginia, and we have invested over $1 billion in our community in the form of loans during the 17-year period. Our company has assets of approximately $800 million and eight offices serving the Greater Roanoke MSA.

Well, thank you for inviting me to testify on the effects of Dodd-Frank on financial services competition.

We all appreciate the importance of regulation that protects the safety and soundness of our institutions and protects the interests of our customers. We know that there will always be regulations that control our business, but the reaction to the financial crisis has layered on regulation after regulation that does nothing to improve safety or soundness and only raises the cost of providing banking services, both credit and depository-related.

While community banks pride themselves on being quick to adapt to changing environments and determined to meet any challenge head on, there is a tipping point beyond which community banks will find it impossible to compete. During the last decade, the regulatory burden for community banks has multiplied 10-fold with more than 50 new rules in the 2 years before Dodd-Frank. Over the last decade, 1,500 community banks have disappeared from our communities.

Without quick and bold action to relieve regulatory burdens, we will witness an appalling contraction of the banking industry at a pace much faster than we have witnessed over the last decade. Holding oversight hearings like this one is critical to ensure that banks are allowed to do what they do best, namely, that is to meet the financial needs of our communities.

There are three key points I would like to make today.

First, the costs to implement new regulations are substantial and weigh most heavily on community banks. Make no mistake about it. That burden is keenly felt by all banks. However, many small banks do not have the resources to manage all the new regulations and the changes in existing ones. Besides the real, hard-dollar costs, there are important opportunity costs related to products and services that either cannot be offered or will be offered only at higher cost to our customers.

For our bank in 2011, we estimate that we spent over $500,000 in hard-dollar compliance costs. That translates to roughly 7 cents per common share to our shareholders. Historically, the cost of regulatory compliance as a share of operating expenses is two and a half times greater for small banks than for large banks. And I fear that gap may widen even more once Dodd-Frank is fully implemented.

For the industry as a whole, a very conservative estimate of all the hard-dollar compliance costs will be around $50 billion annually, and that is about 12 percent of total operating expenses.

Secondly, the lost opportunity costs are significant for community banks, their communities, and their customers. Excessive regulation saps staff and resources that should have gone to meeting the needs of our customers. Even a small reduction in the cost of compliance would free up millions of dollars that could facilitate lending activity and other banking services. If we are forced to become more internally focused in an attempt to deal with the avalanche of regulations, we will lose the competitive advantage that we have created and that has been so well received by our customers. Customer service levels will decline, and it is the customer who will be disadvantaged by all of these actions.

Thirdly, unintended consequences of Dodd-Frank have far-reaching effects on the very ones the legislation was designed to help and protect. Congress must be diligent in its oversight of the efforts to implement Dodd-Frank and to ensure that rules are adopted only if they result in a benefit that clearly outweighs the burden.

One unintended consequence occurring right now in our industry is the effort to find new and additional revenues to offset the rising costs of new regulations. Banks are increasing service-related fees in an attempt to generate the needed revenues to offset these rising costs. Free checking and no minimum balance products are disappearing from the marketplace, and it is happening at the megabanks and community banks as well.

There are many other unintended consequences of Dodd-Frank, such as a host of mortgage lending rules, a burdensome municipal advisor rule, swaps provisions that will hurt my commercial customers, and the largely unknown direction of the Consumer Financial Protection Bureau—what direction that will take.

In conclusion, the consequences of excessive regulation are real. Costs are rising and will continue to rise. With the regulatory overreaction, piles of new laws, and uncertainty about government's role in the day-to-day business of banking, meeting local community needs is proving difficult at best.

This scenario leads us to a banking industry with far fewer competitors than we have today which may be the largest unintended consequence of all from Dodd-Frank.

I thank you again for allowing me to appear before you today.

[The prepared statement of Mr. Gutshall follows:]

Prepared Statement of Ellis L. Gutshall, President and Chief Executive Officer, Valley Financial Corporation

Chairman Goodlatte, Vice Chairman Quayle, Ranking Member Watt, and members of the Subcommittee, my name is Ellis Gutshall, President and CEO of Valley Financial Corporation and its wholly-owned subsidiary, Valley Bank. My bank is a 17-year-old community bank, headquartered in Roanoke, Virginia. The Roanoke Region is the largest metropolitan area in Western Virginia and home to more than 300,000 residents. Our Company has assets of approximately $800million and eight offices serving the Greater Roanoke MSA. I also serve as the 2012 Chairman of the Virginia Association of Community Banks and as a Director of the Virginia Bankers Association Benefits Corporation. Our Bank is a member of the American Bankers Association and the Independent Community Bankers of America, both of which represent banks of all sizes and charters and are the voices of the nation's $13 trillion banking industry and its two million employees.

To begin with a brief background, in 1993, Dominion Bank, a 100-plus year old institution with over $10 Billion in assets headquartered in Roanoke, merged with First Union Corporation. During its heyday, Dominion Bank dominated the banking arena in the Roanoke Valley, controlling roughly one-half of the deposits in the marketplace. With the demise of Roanoke's community bank, the organizers of Valley Bank felt that a region as large and important as the Roanoke Region needed to have a locally owned and locally managed community bank if it were to continue to grow and prosper.Valley Bank opened for business in May of 1995 and in just 17 years, we have grown to the #4 market share in terms of deposits, surpassing even Bank of America, within the Roanoke MSA. I make this point to demonstrate just how critically important community banking is to communities all across this nation and how community banks such as Valley Bank can effectively compete against the much larger mega-banks. During this 17-year period, our share of the MSA deposit base has grown to nearly 10% while the leader's share, the former Dominion Bank which is now Wells Fargo after the merger with Wachovia, has declined to 27%. For decades, community banks have been the backbone of all the Main Streets across America, and for the Roanoke Region in particular, Valley Bank's presence has provided a strong catalyst to the economic growth, health, and vitality of our community as we have invested over $1 Billion of investment into our community in the form of loans during our 17-year history. It is our vision and mission to continue this role for many, many years to come. Unfortunately, the cumulative impact of years of new regulations is threatening the very existence of community banks.

We all appreciate the importance of regulation that protects the safety and soundness of our institutions and protects the interests of our customers. We know that there will always be regulations that control our business—but the reaction to the financial crisis has layered on regulation after regulation that does nothing to improve safety or soundness and only raises the cost of providing banking services, both credit and depository related, to our customers. New rules, regulations, guidance and pronouncements flood in to our bank almost daily. With Dodd-Frank alone, there are3,894 pages of proposed regulations and 3,633 pages of final regulations (as of April 13) and we're only a quarter of the way through the 400-plus rules that must be promulgated.

While community banks pride themselves on being agile, quick to adapt to changing environments and determined to meet any challenge head on, there is a tipping point beyond which community banks will find it impossible to compete. During the last decade the regulatory burden for community banks has multiplied tenfold, with more than 50 new rules in the two years ***before*** Dodd-Frank.Over the last decade1,500 community banks have disappeared from communities. Each new law or regulation in isolation might be manageable, but wave after wave, one on top of another, will certainly over-run many more community banks.

Without quick and bold action to relieve regulatory burdens we will witness an appalling contraction of the banking industry, at a pace much faster than we've witnessed over the last decade.

Congress must be vigilant in overseeing regulatory actions. Ifleft unchecked excessive regulation will surely negatively affect community banks'

ability to effectively compete. Holding oversight hearings like this one is critical to ensure that banks are allowed to do what they do best—namely, meet the financial needs of their communities.

There are three key points I would like to make today.

- The costs to implement new regulations weigh most heavily on community banks making it difficult to compete with the mega-banks, tax-exempt credit unions and nonbank financial firms
- The lost opportunity costs are significant for community banks, their communities and their customers
- Unintended consequences of Dodd-Frank have far-reaching effects on the very ones the legislation was designed to help and protect

I. The Costs to Implement New Regulations are Substantial and Weigh Most Heavily on Community Banks Making it Difficult to Compete with the Mega-Banks, Tax-Exempt Credit Unions and Nonbank Financial Firms

Make no mistake about it, this burden is keenly felt by all banks, however,many small banks do not have the resources to manage all the new regulations and the changes in existing ones. Besides the real, hard dollar costs, there are important opportunity costs related to the products and services that either cannot be offered or will be offered only at higher costs to our customers.

For our bank, in 2011, we estimate that we spent over $500,000 in hard dollar compliance costs. That translates to roughly 7 cents per common share to our shareholders.This includes salaries attributable to compliance, annual bank-wide compliance training, legal and compliance consulting services, compliance software and other IT expenses, printing expenses and privacy mailing costs, and various recordkeeping requirements. And there are other costs that we simply cannot capture. We have several dedicated compliance officers just to handle all the legal and paperwork requirements and, in addition, estimate that another one-half of our total staff have some compliance obligations they must fulfill. Historically, the cost of regulatory compliance as a share of operating expenses is two-and-a-half times greater for small banks than for large banks. I fear that gap may widen even more once Dodd-Frank is fully implemented.

Changes in existing regulations and the new regulatory requirements that will flow from Dodd-Frank have necessitated the need for us to add another full-time compliance person. That cost, plus many other ancillary costs of these new changes, will add another $75,000 to the overall cost. Of course, we are only in the early stages of the Dodd-Frank implementation, so we are bracing for additional costs that must somehow be borne. All these extra expenses could have been more productive if they were devoted to providing services to our customers.

As an $800 Million asset bank, we are better able to spread some of the compliance costs than our smaller brethren. In 2006, at a time when we were approaching $500 Million in assets, I made the decision to create an enterprise-wide risk management department that would be responsible for assessing and monitoring risks associated with all of the bank's compliance and non-credit operating units. Looking back now, this was one of the most significant things we could have done as we had fully developed a risk management department and staff prior to Dodd-Frank. I seriously doubt we would be able to do what we are doing now in terms of compliance and training without this enterprise-wide risk management group. However, this group has quickly been stretched to their limits. We will not be able to continue our high level of compliance expertise without additional staffing and training. The rising costs are just not in-house staffing requirements, but also the high costs of attending conferences and seminars, the many subscriptions to legal and accounting services that we feel we have to have just to make sure we do not miss anything, IT software up-grades to monitor our activities and the additional regulatory burden associated with proving we have complied with the new laws. The regulatory agencies want to see independent third-party confirmation, so besides internal audits, banks now have to have outside audits for compliance which is a significant expense for smaller banks. For the median-sized bank in this country with $166 million in assets and 38 employees, the burden is magnified tremendously. For larger banks, Dodd-Frank imposes significant changes that are already driving an entire reevaluation of business lines and models. Together with the new Basel capital and liquidity rules, these added costs likely will total in the hundreds of millions of dollars.

For the industry, a very conservative estimate of all the hard dollar costs would be about $50 billion annually, or about 12 percent of total operating expenses.This expense ratio is only surpassed by the salaries & benefits we pay to our employees.

We at Valley Bank have taken great pride during our 17-year history in the fact that our noninterest expense management has placed us in the top performing quartile of our FDIC peer group. In 2011, our personnel expenses were 22% below the peer average and our total noninterest expenses were 17% below the peer average. At the same time, our employees were managing $5.8 Million in assets per employee compared to $4.6 Million for the peer average, a 26% positive variance and a strong demonstration of the superior productivity of our staff. Our low overhead framework coupled with high productivity ratios have enabled our bank to effectively compete head-to-head with the mega-banks in our market and actually take market share away while also producing the levels of profitability our shareholders demand.However, new regulations just keep being piled on top of older outdated requirements and we are clearly experiencing expense ratios that are increasing much more rapidly than our ability to increase revenues.

II. The Lost Opportunity Costs Are Significant for Community Banks, Their Communities and Their Customers

The direct out-of-pocket expenses are just part of the story when one realizes the significance of the opportunity costs. Instead of teaching staff to reach out to new markets, trainers are bringing the employees up to speed on the latest regulations. Instead of employee time and focus being used to invest our precious capital to support loans to hardworking people and businesses in our communities, it is being spent interacting withconsultants, lawyers, and auditors. Instead of investing our time and efforts to develop new products and solutions to meet the ever-changing demands and needs of our customers, we are spending our time analyzing changes to software to assure compliance with all the new changes. Excessive regulation saps staff and resources that should have gone to meeting the needs of our customers. Even a small reduction in the cost of compliance would free up billions of dollars that could facilitatelending activity and other banking services. The differentiating factors that set community banks apart from the mega-banks are a) that ability to focus our complete attention on our local community and the local customer, and b) to provide local operational support and local decisions. These factors are customer-centric and customer driven. If we are forced to become more internally focused in an attempt to deal with the avalanche of regulations, we will lose the competitive advantage that we have created and that has been so well received by our customer base. Customer service levels will decline and it is the customer who will be disadvantaged by these actions. As I mentioned earlier, Valley Bank's presence has provided a strong catalyst to the economic growth, health, and vitality of our community as we have invested over $1 Billion of investment into our community in the form of loans during our 17-year history. We would like this to be our role for many, many years to come. If banks, especially community banks, find themselves so internally-focused on compliance related activities that they cannot attend to the job of extending credit,any hopes for a sustained economic recovery in this country will fade quite rapidly.

III. Unintended consequences of Dodd-Frank have far-reaching effects on the very ones the legislation was designed to help and protect

Congress must be vigilant in its oversight of the efforts to implement the Dodd-Frank Act to ensure that rules are adopted only if they result in a benefit that clearly outweighs the burden. There is an unintended consequence that is occurring right now in our marketplace and most likely throughout all of America. In an effort to find new and additional revenues to offset the rising costs of new regulations, banks of all sizes are reviewing and analyzing their service charges and fees associated with both loan and deposit products and services. Due to relatively weak loan demand and compressing net interest margins, the traditional spread income most banks, and especially community banks, relied on to support noninterest expense growth is not growing. Therefore, banks are increasing service related fees in an attempt to generate the needed revenues to offset these rising costs. Free checking and "no minimum" balance products are disappearing from the marketplace, and it is not just happening at the mega-banks. Additionally, banks are utilizing their customer profitability systems to a much higher degree to determine which customers are profitable and which ones are not. The result will surely be an effort to improve profitability throughout the spectrum which will result in either increased fees or decreased availabilityof services. In either case, the customer will be paying more or choosing not to use the service at all.

Another unintended consequence we are facing lies in residential mortgage lending. Following the residential mortgage meltdown that essentially obliterated the mortgage broker network, banks once again were viewed as a potential resource for home buyers and homeowners throughout the country. Banks were quite willing to jump in and fill this void and many banks immediately began the process of expanding residential mortgage loan operations. Our bank did exactly that. However, we are finding some rules under Dodd-Frank, if done improperly, ***could literally drive banks out of the mortgage business.*** These new rules on mortgage lending and on mortgage originator compensation are particularly problematic provisions.

One of the changes required in the Dodd-Frank Act is that lenders must show that borrowers meet an "ability to repay" test—***which can be challenged in court for the entire life of the loan,*** raising the risk of litigation tremendously. It also imposes broad risk retention requirements on most loans sold into the secondary market. These requirements have the potential to make it much more costly for banks to make loans and could have the unintended consequence of denying quality loans to creditworthy borrowers. Dodd-Frank does provide that banks can show they have met the ability to repay test by making loans that fall into a category known as a Qualified Mortgage or QM. The QM is intended to be a category of loans with certain low risk features made to borrowers shown to be creditworthy and able to meet the payment terms. The Consumer Financial Protection Bureau (CFPB) is tasked with finalizing a rule setting forth exactly what will qualify as a QM, but a number of concerns have arisen with regard to the approach which the CFPB may take. If the QM category is made too narrow by excluding too many loan types or by requiring borrowers to meet too high a standard of creditworthiness, then credit will contract and potential borrowers will be denied credit for which they would otherwise qualify.

How these exceptions are defined will dramatically impact the willingness and ability of banks to make mortgage loans, and of consumers' ability to qualify for credit.

The thought of quality institutions being forced from the mortgage market and of otherwise creditworthy borrowers being denied credit because of overly broad regulations is chilling—especially at a time when our housing economy has been severely battered and is just beginning to show signs of recovery.

There are many other issues raised in Dodd-Frank that will affect the competitiveness of banks and that will also negatively affect customers of banking services. Below, I describe two of those issues.

The municipal advisor proposal would limit services to municipalities by local community banks.

Banks offer public sector customers banking services and are regulated closely by several government agencies. It is generally believed that Dodd-Frank intended to establish a regulatory scheme ***for unregulated persons*** providing advice to municipalities with respect to municipal derivatives, guaranteed investment contracts, investment strategies or the issuance of municipal securities. The Securities and Exchange Commission has proposed a very broad definition of "investment strategies" that would cover traditional bank products and services such as deposit accounts, cash management products and loans to municipalities. This means that community banks would have to register as municipal advisors and be subject to a whole new layer of regulation on bank products for no meaningful public purpose.

Such regulation would be duplicative and costly. Consequently, community banks would not be able to offer services to municipalities at a price that would be competitive. As a result, many banks may decide not to provide banking services to their local municipalities—forcing these local and state entities to look outside of their community for the services they need. This proposal flies in the face of the President's initiative to streamline federal oversight and avoid new regulations that impede innovation, diminish U.S. competitiveness, and restrain job creation and economic expansion.

We urge Congress to oversee this implementation and ensure that the rule addresses unregulated parties and that neither Section 975 of Dodd-Frank nor its implementing regulation reaches through to traditional bank products and services.

The swaps push-out provision would create competitive imbalances between U.S. banks and foreign counterparties.

Section 716 of Dodd-Frank, will prohibit swap dealers from receiving various forms of federal assistance including FDIC insurance and access to the Federal Reserve discount window. This provision will essentially require banks that are swap dealers to "push out" many swaps transactions to a nonbank affiliate. We support repealing the push-out provision because failing to do so would have a negative impact on bank and bank customer risk management practices and create competitive imbalances between U.S. and foreign banks.

Banks currently have the ability to centralize risk management for each customer relationship by conducting a customer's swaps transactions together with that customer's other transactions. In other words, banks can assess the credit risk of the customer and negotiate loan, swap, collateral and other credit terms as part of a complete package. Customers benefit because they can receive more attractive loan terms or a higher credit limit if the bank can net and setoff different exposures from each of the customer's transactions. If the push-out provision is not repealed, bank customers will face higher costs and reduced credit availability.

Many customers also prefer to have a bank as a swap counterparty because it enables customers to centralize their own risk management of loans and other forms of credit. Customers now have "one stop shopping" for all of their credit needs, including swaps that may offset their credit risk. Swap customers may also prefer to have a bank as a counterparty from a credit risk standpoint. If banks have to push out some swaps transactions into a separate affiliate, then customers will not be able to centralize credit risk management with a bank even if it is their preferred swap counterparty.

The push-out provision would also create competitive imbalances between U.S. banks and their foreign counterparties. To date, it does not appear that other countries are considering adopting "push-out" requirements. Therefore, it is likely that foreign banks will still be able to offer integrated credit and risk management products in one entity. Customers who still want "one stop shopping" for their credit needs—including swaps—may choose to move their business to foreign banks. This may not ever affect my community bank in a direct manner, but letting our larger banks lose larger US customers to foreign banks concerns me greatly as I hope it does you.

If banks have to create a separate affiliate to conduct swaps transactions, then the affiliate also will have to be funded separately and meet separate capital requirements. The capital requirements for the affiliate may be entirely different from bank capital requirements if the swap transactions are done through a broker-dealer affiliate. Bank customers would have to sign new credit agreements with the bank and its affiliate. Considering all of these costs and complexities, it is likely that only large financial institutions would be able to create, fund, and capitalize a separate affiliate to conduct swaps activities that need to be "pushed out" of a bank. My own bank uses swaps as part of our commercial lending process, so this is a critical competitive issue for community banks as well as large banks.

CONCLUSION

The consequences of excessive regulation are real. Costs are rising and will continue to rise. To offset these rising costs, banks must find new and additional revenue sources, most likely from increased service fees, or cut back the services they provide. Both of these actions will adversely affect the customer.With the regulatory overreaction, piles of new laws, and uncertainty about government's role in the day-to-day business of banking, meeting local community needs is proving difficult at best.

My bank's philosophy—shared by community banks everywhere—has always been to treat our customers with respect and to strive to provide the best possible financial solutions to create economic growth and wealth creation. We will continue to do this, but with the many new hurdles being placed in our way, our customers' most basic banking needs will inevitably be more costly, more time consuming to complete and less beneficial to them as the end result.

In my view, there will be three scenarios that will evolve for the community banks of this country. There will be those community banks that will just be unwilling or unable to take on these hurdles and they will move to partner with others in the short term. There will be a second group of community banks that will accept the challenge but eventually fail to produce the return on investment their shareholders demand, and they will ultimately partner up as well. And finally, there will be a much smaller group of banks that are able to successfully navigate the regulatory landscape and be able to also providethe return on investment that just may ensure their independence for the foreseeable future. These scenarios lead us to a banking industry with far fewer competitors than we have today, which may be the largest unintended consequence of all from Dodd-Frank.

Thank you for allowing me to appear before you today.

Mr. GOODLATTE. Thank you, Mr. Gutshall.

Professor Levitin, welcome.

TESTIMONY OF ADAM J. LEVITIN, GEORGETOWN UNIVERSITY LAW CENTER

Mr. LEVITIN. Thank you. Good afternoon, Mr. Chairman Goodlatte, Ranking Member Watt, and Members of the Subcommittee. Thank you for inviting me to testify at this hearing.

My name is Adam Levitin. I am a Professor of Law at Georgetown University and Visiting Professor at Harvard Law School. Financial regulation is a major focus of my teaching and scholarship.

I wish to make two points about the effect of the Dodd-Frank Act on competition in the financial services industry. The first point is on "too big to fail," and the second point is on regulatory compliance costs.

The "too big to fail" problem long predates the Dodd-Frank Act. The Dodd-Frank Act is the first step in addressing the "too big to fail" problem. The Dodd-Frank Act's approach to "too big to fail" is to identify systemically important financial institutions, or SIFI's, and then subject them to increased regulatory scrutiny and requirements. Critically—and I want to emphasize this point—the identification of financial institutions as SIFI's does not make the institution systemically important. It merely recognizes a pre-existing reality.

There are two types of financial institutions that are designated as systemically important by the Dodd-Frank Act. First are all bank holding companies with over $50 billion in consolidated net assets. Second are non-bank financial holding companies designated as systemically important by a two-thirds majority vote of the newly created Financial Stability Oversight Council, and that vote has to also include the affirmative vote of the Treasury Secretary. To date, the Financial Stability Oversight Council has not designated any firms as systemically important. It has only published a final rule detailing how it will make such a determination.

The Dodd-Frank Act subjects the systemically designated firms, non-banks and large bank holding companies, to heightened regulatory requirements. These include risk-based capital requirements, the leverage limits, liquidity requirements, overall risk management requirements, the development of risk resolution plans known as living wills, credit exposure report requirements, and concentration limits. All of this will have the effect of increasing regulatory costs on "too big to fail" firms. We don't know how much it is going to increase the costs, but the Federal Reserve Board has recently proposed a set of standards that include 100 to 350 basis point capital surcharge on these large institutions.

The goal of the increased regulation of the systemically important financial institutions is two fold.

First, it aims to ensure that there is better upfront prudential regulation of the financial institutions that pose the most risk.

And second, increased regulation of these systemically important institutions may ultimately discourage financial institutions from becoming "too big to fail" by counterbalancing the funding benefits of being "too big to fail" with increased regulatory costs. If implemented correctly, the Dodd-Frank Act will make it unprofitable to be "too big to fail" and investors will demand the "too big to fail" firms break themselves up. This is a conceptually sound approach that should have the collateral effect of leveling the competitive playing field between "too big to fail" firms and smaller financial institutions.

Regarding regulatory costs, there is no doubt that regulatory burdens for all banks, large and small, have increased in recent years with provisions like the Safe Mortgage Licensing Act that predate Dodd-Frank. What is important to emphasize, though, is that the Dodd-Frank Act itself imposes very few regulatory burdens specifically on community banks. While the Dodd-Frank Act has become the flagship of financial regulatory reform, most of its provisions have little or no bearing on small banks. Thirteen of the acts 16 titles are unlikely to affect most small financial institutions.

Of the few provisions that do affect small banks, many have yet to go into effect, so they cannot be blamed for small banks' travails. For example, title X of the Dodd-Frank Act created the Consumer Financial Protection Bureau. Virtually all of the CFPB's rulemakings in progress could have been undertaken before Dodd-Frank by Federal bank regulators. The rulemakings are under preexisting powers. Yet, had that occurred, it would have been without the CFPB's required small business impact review under the Small Business Regulatory Enforcement Fairness Act, or SBREFA, and without the cost-benefit analysis required by the CFPB for rulemaking.

All in all, then Dodd-Frank is actually creating more protections for small financial institutions rather than creating problems for them.

The Dodd-Frank Act, in sum, is likely to help level the playing field between large and small financial institutions by imposing regulatory costs on "too big to fail" firms that will help offset their funding advantage from their implicit government guarantee. The creation of the CFPB will level the playing field between banks and non-banks, and it will give small financial institutions a voice in the regulatory process through SBREFA.

To be sure, there are general regulatory costs imposed by Dodd-Frank that are likely to be harder for small financial institutions to absorb, but overall, it would seem that the Dodd-Frank Act helps level the competitive playing field between large and small financial institutions.

Thank you.

[The prepared statement of Mr. Levitin follows:]

GEORGETOWN UNIVERSITY LAW CENTER

Adam J. Levitin
Professor of Law

Written Testimony of

Adam J. Levitin
Visiting Professor of Law
Harvard Law School

Professor of Law
Georgetown University Law Center

Before the
House Judiciary Committee
Subcommittee on Intellectual Property, Competition, and the Internet

"The Dodd-Frank Act's Effects on Financial Services Competition"

July 10, 2012
3:00 pm
2141 Rayburn House Office Building

Mr. Chairman Goodlatte, Ranking Member Watt, Members of the Subcommittee:

Good afternoon. Thank you for inviting me to testify at this hearing. While the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 has affected financial services competition in a number of ways, I am confining my prepared remarks to two issues:

(1) the impact of the continued existence of too-big-to-fail (TBTF) financial institutions on competition in the financial services industry, and

(2) the impact of the Dodd-Frank Act's regulatory burdens on smaller financial institutions' ability to compete.

I. Too-Big-To-Fail and Competition in Financial Services

The TBTF long pre-dates the Dodd-Frank Act. The Dodd-Frank Act is a first step in addressing the TBTF problem. The Dodd-Frank Act's approach to the TBTF problem is to identify systemically important financial institutions (SIFIs), and then subject them to increased regulatory scrutiny. Critically, this identification does not make financial institutions systemically important; instead, it is a recognition of a pre-existing reality.

The goal of the increased regulation of SIFIs is two-fold. First, it aims to ensure that there is better regulation of the financial institutions that pose the most risk. And second, increased regulation of SIFIs may ultimately discourage financial institutions from being TBTF by counterbalancing the funding benefits of being TBTF with increased regulatory costs. This is a conceptually sound approach that should have the collateral effect of leveling the competitive playing field between SIFIs and smaller financial institutions.

A. The Too-Big-To-Fail Problem

TBTF is a major problem for financial regulation in at least three distinct ways. First, the existence of TBTF financial institutions makes our economy vulnerable to the mismanagement of private firms that are capable of losing billions of dollars from a single miscalculation. The recent trading losses at JPMorgan Chase illustrate how even a bank that is supposedly well-run can lose a tremendous amount of money very rapidly.[1]

Second, the knowledge that TBTF institutions will be bailed out by the government if they run into trouble encourages these institutions to take greater risks. The upside of these risks is privatized, while the downside is socialized, creating a "heads I win, tails you lose" situation that encourages excessive risk-taking.

Third, TBTF institutions have competitive advantage over small financial institutions by virtue of their functional guarantee from the United States government. This guarantee makes TBTF institutions more credit-worthy and thus lowers their cost of funding. This means that TBTF institutions can pay lower interest rates or post less collateral than their smaller brethren. TBTF institutions receive this implicit guarantee from the United States government without paying any premium for it. In other words, TBTF institutions are unofficially subsidized by the

[1] *See, e.g.*, Steve Schaefer, *JPMorgan's London Whale Losses Could Hit $9 billion, Bank's Shares Slump*, FORBES.COM, June 28, 2012, *at* http://www.forbes.com/sites/steveschaefer/2012/06/28/jpmorgans-london-whale-losses-may-hit-9b-impact-earnings-and-capital-return/.

federal government. The result is a distinct competitive advantage over smaller institutions. It is estimated that in 2008 this advantage was nearly $84 billion.[2]

B. Dodd-Frank Act and the TBTF Problem

The Dodd-Frank Act attempts to address the TBTF problem by identifying systemically important institutions and imposing greater regulatory scrutiny and costs on them. At the least, this approach should mean that the Federal government is better able to regulate the risks taken by systemically important institutions, and at best, it will discourage bigness (by which I mean systemic importance, not necessarily asset size) by making it too costly.

The Dodd-Frank Act focuses primarily on holding company level regulation. The Federal Reserve Board already regulated all bank holding companies before Dodd-Frank. Dodd-Frank gives the Federal Reserve Board regulatory authority over those nonbank financial holding companies and their subsidiaries designated as systemically important ("designated nonbanks") by a 2/3-majority vote of the newly created Financial Stability Oversight Council (FSOC), including the affirmative vote of the Treasury Secretary as FSOC Chairperson.[3] To date, the FSOC has not designated any firms as systemically important; it has only published a final rule detailing how it will determine such a designation.[4]

The Dodd-Frank Act subjects designated nonbanks and large bank holding companies—those with total consolidated assets of over $50 billion—to heightened regulatory requirements.[5] The Act requires the Federal Reserve Board to "establish prudential standards for [these entities] that…are more stringent than the standards and requirements applicable to nonbank financial companies and bank holding companies that do not present similar risks to the financial stability of the United States".[6] These more stringent prudential standards are required to include risk-based capital requirements (with inclusion of off-balance sheet exposures), leverage limits, liquidity requirements, overall risk management requirements, development of resolution plans ("living wills"), credit exposure report requirements, and concentration limits.[7] They may also include contingent capital requirements, enhanced public disclosures, and short-term debt limits, or other requirements the Federal Reserve Board believes are appropriate.[8] All of this will have the effect of increasing regulatory costs for TBTF firms.

Final rules under the heightened regulatory requirements provision have not yet been promulgated. The Federal Reserve Board has proposed a set of standards based on the Basel III capital accord and the recommendations of the Basel Committee of Bank Supervisors that includes a 100-350 basis point capital surcharge comprised solely of common equity for

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[2] Deniz Anginer & A. Joseph Warburton, *The End of Market Discipline? Investor Expectations of Implicit State Guarantees*, Nov. 2011, *at* http://ssrn.com/abstract=1961656 at 33.

[3] Dodd-Frank Act § 113, *codified at* 12 U.S.C. § 5323.

[4] Authority To Require Supervision and Regulation of Certain Nonbank Financial Companies, 77 Fed. Reg. 21637 et seq., *codified at* 12 C.F.R. § 1310, April 11, 2012.

[5] The Dodd-Frank Act also requires heightened regulation of Systemically Important Financial Market Utilities (SIFMUs), such as clearinghouses and exchanges, and payment, clearing, and settlement activities. Dodd-Frank Act, §§ 804-810, *codified at* 12 U.S.C. §§ 5463-69.

[6] Dodd-Frank Act, § 165, *codified at* 12 U.S.C. § 5365.

[7] Dodd-Frank Act, § 165(b)(1), *codified at* 12 U.S.C. § 5365(b)(1).

[8] Dodd-Frank Act, § 165(b)(2), *codified at* 12 U.S.C. § 5365(b)(2).

designated nonbanks and bank holding companies with over $50 billion in consolidated assets.[9] Additionally, large bank holding companies and designated nonbanks are subject to an assessment to cover the costs of the Financial Research Fund.[10]

The Dodd-Frank Act's approach to TBTF is not the one I myself would have counseled; I continue to urge more direct action, specifically breaking up some of the TBTF institutions. Yet the Dodd-Frank Act may well achieve this result through its own methods, depending on whether TBTF institutions are subjected to sufficient additional regulatory burdens so as to deprive them of the benefits of bigness.

Some commentators have criticized the Dodd-Frank Act's approach as unworkable because regulators are unlikely to exactly balance regulatory costs with the TBTF funding benefits.[11] The result, these commentators claim, will either be that regulatory costs are too low, so SIFIs will continue to enjoy a TBTF funding advantage or too high, thereby resulting in the failure of SIFIs.

These commentators misconstrue Dodd-Frank's approach to TBTF. The goal of Dodd-Frank is not to balance out the TBTF funding advantage with increased regulatory costs. Such a balance would be impractical to achieve, but more importantly, it would produce the wrong equilibrium because it would not account for the systemic externalities created by TBTF institutions. Merely balancing out funding advantages with regulatory costs only negates the advantage of being TBTF to the SIFI. While this may help level the competitive playing field with smaller institutions, it does not compensate for the costs the SIFI imposes on the economy and political system by being TBTF. The primary purpose of the SIFI designation is to identify, regulate, and discourage systemic risk; leveling the competitive playing field is a collateral benefit.

Ideally, then, the Dodd-Frank Act's regulatory costs should *overwhelm*, not balance the funding advantage of being TBTF. Doing so would make being TBTF unprofitable; SIFI regulation, if done right, will impose a competitive *disadvantage* on TBTF firms. This would not result in the immediate failure of TBTF firms. Instead, their investors would demand that the TBTF be broken up. We would see spin-offs of different business lines until none of the spun-off firms would be TBTF and thus subject to SIFI regulation. In short, Dodd-Frank aims to make the whole of TBTF firms less profitable than the sum of their parts.

There is, of course, the possibility that regulators will not apply the SIFI designation and hence SIFI regulation correctly. There is the possibility of both Type I (false positive) and Type II (false negative) errors. Some entities that are not in fact systemically important could be labeled as SIFIs and subjected to greater regulatory costs, while some entities that are systemically important might escape SIFI designation and enjoy the benefits of being TBTF without incurring the regulatory costs.

While we should recognize the possibility of these errors in regulatory application, they are not a reason to shy away from this regulatory approach. Type I and Type II errors are inherent in any kind of regulatory selection process, and failure to regulate is guaranteed to result in Type II errors, as we know there are systemically important firms. Put another way, although

[9] Enhanced Prudential Standards and Early Remediation Requirements for Covered Companies, 77 Fed. Reg. 594, Jan. 5, 2012.

[10] 77 Fed. Reg. 29884-29895, *codified at* 31 C.F.R. § 150, May 21, 2012.

[11] *See, e.g.*, Peter J. Wallison, *Dodd-Frank's Too-Big-To-Fail Dystopia*, WALL ST. J., May 23, 2012.

the Dodd-Frank Act's approach to SIFIs is conceptually sound; we can only hope that its implementation will be too, but it is too early to reach conclusions about implementation.

II. Regulatory Burdens

The Dodd-Frank Act unquestionably increases regulatory burdens throughout the financial services industry, and these burdens may be harder for smaller institutions to absorb because they lack economies of scale for compliance purposes. Nonetheless, it is important not to overstate the regulatory costs created for small institutions by Dodd-Frank.

Often commentators concerned about the Dodd-Frank Act's regulatory costs point to sheer number of pages of the Dodd-Frank Act or the number of regulations required to be passed thereunder. These figures are grossly misleading, however, as most of the Dodd-Frank Act has little if any relation to the activities of smaller financial institutions. Thirteen of the Act's sixteen titles have little or no bearing on small banks and credit unions (collectively "small banks").[12] Only three titles, titles VI, X, and XIV, are likely to bear on small banks. Yet there is little in these titles that has increased small banks' regulatory burdens, and in some cases the Dodd-Frank Act could actually help to *decrease* these burdens.

Title VI of Dodd-Frank makes changes to the regulation of bank holding companies. By and large these changes are incremental; they do not add major new compliance costs. Instead, title VI does things like expand the limitation on loans to insiders to include derivative transactions that may be economically equivalent to a loan exposure.[13] While there is some increased compliance cost to determining if a derivative transaction with an insider qualifies, this is not a likely scenario for small banks.

Title X of Dodd-Frank creates the Consumer Financial Protection Bureau (CFPB). While the CFPB has been the focus of a great deal of angst from the financial services industry, it has not materialized as the boogeyman that was feared. To date, the CFPB has not undertaken any action that would warrant alarm except from those opposed to consumer protection as an ideological matter. The most immediate impact of the creation of the CFPB is to level the regulatory playing field between depositaries and nonbanks engaged in consumer finance. Nonbanks are now subject to the same regulator and must undergo examinations like banks. The very existence of the CFPB is a boon for community banks and credit unions vis-à-vis nonbank finance companies.

Beyond this, CFPB has had little effect on small banks thus far. First, the CFPB does not have examination authority over small banks.[14] That authority remains with the small banks' prudential regulators. Second, other than a rulemaking on remittances required by Dodd-Frank,[15] the CFPB has not yet engaged in a rulemaking under any new power created by Dodd-Frank. All other CFPB rulemaking activity has been under *pre-existing* federal consumer protection laws that were merely transferred to CFPB as part of Dodd-Frank. Therefore, it is

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[12] These thirteen titles are titles I (financial stability), II (orderly liquidation authority), III (changes to bank regulators), IV (investment advisors for hedge funds), V (insurance), VII (swaps), VIII (clearinghouses), IX (securities investor protection), XI (Federal Reserve system changes), XII (authorizing grants for experimental small dollar loan programs) XIII (TARP fund repayment), XV (miscellaneous issues like conflicts minerals), and XVI (section 1256 contracts).

[13] Dodd-Frank Act § 611, *codified at* 12 U.S.C. §1828(y).

[14] Dodd-Frank Act § 1026, *codified at* 12 U.S.C. § 5516.

[15] Dodd-Frank Act § 1073, *codified at* 15 U.S.C. § 1693o-1.

hard to point to Dodd-Frank as having already created additional regulatory burdens for small banks via the CFPB, with one exception: section 1071's requirement that the CFPB collect data on small business loans, to facilitate the application of the Equal Credit Opportunity Act, particularly to protect women-owned and minority-owned small businesses from discriminatory lending.[16]

Section 1071 requires all financial institutions that make loans to obtain and record some very basic information about a borrower and to keep it separate from the loan underwriting process: the date of the loan application, the type and purpose of the loan being applied for, the amount of credit applied for and approved, the bank's action on the loan (grant, deny, etc.), the census tract of the residence of the applicant's principal place of business[17], the applicant's gross annual income in the preceding year, and the applicant's race, sex, and ethnicity. This is less than a page of information to be requested from a borrower. Obtaining this information, recording it into an electronic record, and storing that record so that it cannot be accessed by the loan's underwriters involves some minor initial costs and then *de minimis* on-going compliance costs.

Thus far the creation of the CFPB has resulted in minimal regulatory costs for financial institutions, and the CFPB is structured to be particularly solicitous of the concerns of small financial institutions. The CFPB, unlike other federal financial regulators, is required to submit its rulemakings to small business panels for preliminary review under the Small Business Regulatory Enforcement Fairness Act of 1996 (SBREFA).[18] The SBREFA process mandates that the CFPB solicit input from small businesses on its major rulemakings and account for their feedback. This process gives small financial institutions a greater voice in the regulatory process than they have had before.

If and when the CFPB starts to use its Dodd-Frank rulemaking powers other than under the "enumerated consumer laws" transferred to the agency, this situation may change, but until that point, it is premature to point to title X or the CFPB as a source of increased regulatory burdens. So far, however, the transfer of existing federal laws to the CFPB is likely to reduce, rather than increase regulatory burdens as the result of rulemaking activity.

Finally, title XIV of the Dodd-Frank Act, the Mortgage Reform and Anti-Predatory Lending Act, creates a range of new requirements for mortgage lending. The CFPB has been charged with implementing title XIV via regulations. To date the CFPB has not promulgated any regulations under title XIV.

Most of the prohibitions in title XIV have limited impact on small banks; the prohibitions are aimed at the most exotic and aggressive mortgage products, namely those that fueled the housing bubble. These products were not generally part of small depositaries' offerings. (They were frequently offered by small finance companies.)

Title XIV actually offers an opening for *reducing* compliance costs for small banks. A major pre-Dodd-Frank Act compliance cost for small banks was the Reg Z escrow requirement

[16] Dodd-Frank Act § 1071, *codified at* 15 U.S.C. § 1691o-2.

[17] Census tract conversion is fairly simple, as the Federal Financial Institutions Examination Council's website enables free conversion of street addresses to census tracts. *See* http://www.ffiec.gov/Geocode/default.aspx.

[18] 5 U.S.C. § 609(d).

for high-cost Home Ownership and Equity Protection Act of 1994 (HOEPA) loans.[19] In July 2008, the Federal Reserve promulgated its first rulemaking under HOEPA. The rulemaking required that borrowers have the ability to repay, prohibiting some prepayment penalties, and requiring escrowing of taxes and insurance.[20] The escrow provision did not go into effect until April 2010, in response to community bank concerns about the difficulties and costs in setting up escrows.[21]

The reach of the escrow requirement is quite broad in a low interest rate environment. Higher priced loans are currently defined as those with APRs at least 1.5 percentage points higher than the prime rate for loans within the GSE conforming loan limit or at least 2.5 percentage points higher than the prime rate for loans larger than the conforming loan limit.[22]

Section 1461 of the Dodd-Frank Act authorizes the CFPB to exempt small originators or those in rural and underserved areas from escrow requirements.[23] While an understanding of the particular cost problems involved in escrowing would seem essential to any rulemaking,[24] it seems reasonable for the CFPB to exercise its authority to exempt some depositaries from the escrow requirement. The CFPB has not yet passed regulations under title XIV or on HOEPA loans, but it is important to recognize that CFPB regulatory action can *decrease* as well as increase regulatory burdens.

While many small banks and credit unions believe that their regulatory burden is too great, it has little to do with the Dodd-Frank Act. Therefore, concerns about the regulatory burdens on small banks do not provide a good justification for altering or repealing provisions of the Dodd-Frank Act. If there is a problem with the burdens created by specific regulations, then by all means, we should reexamine those regulations and decide if they make sense, but they do not provide a basis for a general assault on Dodd-Frank.

CONCLUSION

The Dodd-Frank Act focuses primarily on financial stability, not competitive equality among financial institutions. Nonetheless, it is likely to improve competitive fairness in the financial services market place. It helps level the playing field between large and small institutions by imposing regulatory costs on TBTF firms that will help offset their funding advantage from their implicit government guarantee. Moreover, the creation of the CFPB means that banks and nonbanks will be subject to the same regulations, including examinations, in consumer finance, and the SBREFA process ensures that small businesses voices will be heard in the regulatory process. To be sure, any general regulatory costs imposed by Dodd-Frank are likely to be harder for smaller institutions to absorb, but overall, it would seem that the Dodd-Frank Act helps level the playing field between large and small financial institutions.

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[19] 12 C.F.R. § 226.35(b)(3).

[20] 73 Fed. Reg. 44522-44614 (July 30, 2008). If the Federal Reserve Board had acted on its regulatory authority between 1994 and 2008 rather than deliberately refraining from regulation because of an ideological antipathy toward regulation, the housing bubble and ensuring financial crisis would have been much less severe.

[21] 73 Fed. Reg. 44562 (July 30, 2008).

[22] 15 U.S.C. § 1639d(b)(3)(A)-(B).

[23] Dodd-Frank Act § 1461, *codified at* 15 U.S.C. § 1639d(c).

[24] In the original HOEPA rulemaking, the Federal Reserve Board noted that "A few small lenders commented that the costs of setting up escrow accounts are prohibitively expensive but did not disclose what such costs are." 73 Fed. Reg. 44597 (July 30, 2008). Fact-based rulemaking requires a close analytic look at regulatory costs, rather than blithe acceptance of statements of interested parties.

Mr. GOODLATTE. Thank you, Professor Levitin.

Mr. Pollock, we are pleased to have your testimony as well.

TESTIMONY OF ALEX J. POLLOCK, RESIDENT FELLOW, AMERICAN ENTERPRISE INSTITUTE

Mr. POLLOCK. Thank you, Mr. Chairman and Ranking Member Watt, Chairman Conyers, Members of the Subcommittee.

I believe all major expansions of financial regulation have effects on competition, even though they are principally addressed to controlling risk, and in fact, they are often more successful at changing competition than they are at controlling risk.

For example, after the financial crises of the 1980's there were three major acts of Congress expanding regulation. It was predicted at the time that this would ensure we would never again have a financial crisis—a poor prediction, needless to say, but arguably among their effects was the dominance of Fannie Mae and Freddie Mac in the market for mortgages.

It is my view that similarly the Dodd-Frank Act will not prevent another crisis although, of course, proof awaits the unknowable future. However, it is certain and is universally agreed that Dodd-Frank has and will continue to expand the regulatory burden on financial businesses, including community banks.

The disagreement is about whether this expanded burden is worth it. My view is that it is not worth it, and among its effects will be competitive disadvantages for smaller banks. As the Chairman said, if complex, expensive regulatory requirements are placed on all competitors, the burden will be disproportionately heavier for small competitors and large firms will be relatively advantaged. Consider in this context the total staff of a median-sized bank, which is 37 employees.

Further, it is not unreasonable to think that Dodd-Frank's effects will impede the ability of small banks to raise capital as has been suggested by the Conference of State Bank Examiners.

Professor Amar Bhide has proposed that we reinstate, "old-fashioned banking where bankers know their borrowers and have case-by-case local knowledge." I bet that is a proposition we would all agree to, but contrast this to top-down regulatory formulas in mortgage lending as a key example, which reduce community banks' natural local advantages.

Regulation itself is one of the most important procyclical factors in credit markets, especially in the down cycle when regulators, reacting to past mistakes, clamp down forcefully. This contracts credit further than the crisis already has, as we have once again experienced.

Community banks can be very successful managers of residential mortgage credit to their own customers in their own towns. A healthy, competitive residential mortgage sector, in my opinion, should feature mortgage credit risk widely dispersed among knowledgeable local lenders, who also have the ability to share credits among themselves.

But what did the American GSE-centric mortgage system create instead? As we all know, a duopoly system of Fannie and Freddie with mortgage risk concentrated on the banks of the Potomac. One of the most important competitive effects of Dodd-Frank is its well-known failure to address the duopoly system of Fannie and Freddie in any way.

In the meantime, all actors in the residential mortgage market await and debate the QRM, or qualified residential mortgage, rules. These rules will determine when mortgage competitors are required to retain credit risk in mortgages which are securitized. This is the "skin in the game" idea. Now, I think having mortgage lenders retain credit risk in the loans they make is an excellent idea as long as the risk retention is a voluntary market transaction. The Dodd-Frank idea by contrast is not a voluntary market arrangement, but a mandatory and formulaic requirement.

Now, as has been said by many others, a notable provision of Dodd-Frank is the designation of systemically important financial institutions, or SIFI's. As has also been said, SIFI's will be subject to special regulatory requirements and oversight—a burden. But on the other hand, with regulators having devoted so much special effort to making them safe, the failure of a SIFI would be the obvious failure of the regulators themselves.

The logical conclusion for a potential creditor, large depositor, or counterparty of any kind to draw is that they will be safer with a SIFI, all political protestations to the contrary notwithstanding. Remember how various government officials tried to claim that Fannie and Freddie were not guaranteed by the government. But buyers of GSE debt and MBS did not believe such claims and they were right.

So what is the difference between a SIFI and a GSE? In my opinion, not much. Effectively creating more GSE's will tend to make the financial markets more consolidated and concentrated.

I want to just mention rating agencies, if I may, Mr. Chairman, because they are in Dodd-Frank. We are addressing a competitive issue, namely, a previous government-sponsored duopoly in the credit ratings business. My written testimony recommends a simple amendment to Dodd-Frank regarding the credit rating agency provisions which would create a more pro-competitive approach.

In conclusion, it is my belief that all proposed financial regulations should specifically take account of their effects on competition, just as this hearing is considering.

Thank you for the opportunity to share these views.

[The prepared statement of Mr. Pollock follows:]

Prepared Statement of Alex J. Pollock, Resident Fellow, American Enterprise Institute

Mr. Chairman, Ranking Member Watt, and members of the Subcommittee, thank you for the opportunity to be here today. I am Alex Pollock, a resident fellow at the American Enterprise Institute, and these are my personal views. Before joining AEI, I was the President and CEO of the Federal Home Loan Bank of Chicago for 13 years, where the customers were about 800 member financial institutions, most of them community banks. In all I spent 35 years working in financial services, and have extensively studied and written on the problems of financial cycles.

After every over-optimistic credit expansion comes the ensuing bust. After every bust, come legislation and expanded regulation to try to prevent the next crisis from happening—but it always happens anyway. For example, after the financial crises of the 1980s, we had the Financial Institutions Reform, Recovery and Enforcement Act of 1989, the FDIC Improvement Act of 1991, and the very ironically named Federal Housing Enterprises Financial Safety and Soundness Act of 1992. It was predicted at the time that this would ensure we would "never again" have a financial crisis—a poor prediction, needless to say, including the fact that Fannie Mae and Freddie Mac proved to be the opposite of safe and sound.

After the corporate accounting scandals of 2001–2002, we had the Sarbanes-Oxley Act, which attempted, among other things, to ensure business risks were controlled by expanded rules and procedures. They obviously were not.

After the great housing bubble and the collapse of 2007–2009, we got the Dodd-Frank Act. It is my view that the greatly increased bureaucracy and regulation mandated by this act will not prevent another crisis—to know whether this is correct we have to await the unknowable future. However, it is certain and universally agreed that Dodd-Frank has and will continue to significantly expand the regulatory burden on financial businesses, including community banks. The disagreement is about whether this expanded burden is worth it or not. About this there are of course conflicting views—my view is that it is not, especially considering the negative effects on overall competition in financial services.

I believe the central question posed by this hearing is excellent—indeed we should be required to ask and answer about every regulation: what are its effects on competition?

REGULATORY BURDEN FALLS DISPROPORTIONATELY ON SMALLER COMPETITORS

As a general principle, if complex, expensive regulatory requirements are placed on all competitors, the burden will be disproportionately heavier for small competitors and large firms will be relatively advantaged. Large firms already have internal bureaucracies accustomed to complicated paperwork, reporting and regulatory relationships, the costs of which they spread over large business volumes. These economies of scale are not available to small competitors.

Congress recognized this general problem in Dodd-Frank itself, when it reduced the burden on small public companies of the notorious bureaucracy of Sarbanes-Oxley's Section 404.

As Tom Hoenig (then President of the Federal Reserve Bank of Kansas City and now a Director of the FDIC) said, "Dodd-Frank has raised the cost of financial transactions in America and that encourages consolidation because it's the only way you can spread the costs over larger assets."

The CEO of M&T Bank, a well-managed regional bank, said last year that the paperwork of Dodd-Frank had so far required 18 full-time employees—that is before implementation of many other regulations now in some stage of development, including whatever the Consumer Financial Protection Bureau mandates, and before the arrival of the complicated new risk-based capital requirements. Compare this to the total staff of the median bank: 37 employees.

The complex new risk-based capital requirements, which are being applied to all banks, large and small, are an interesting case of the problem. Banking consultant Bert Ely concluded that "the highly granular features of many specific provisions in the regulatory capital proposal will mandate a substantial increase in the number of both financial and non-financial data items banks will have to collect on individual assets in order to generate the numbers. Data of the type now generally found in a bank's accounting records will not be sufficient. Inadvertent compliance errors, when calculating capital ratios, will increase." Ely speculates that these costs "could drive [smaller] banks to exit lines of business."

It is not unreasonable to think that Dodd-Frank's effects will impede the ability of small banks to raise capital. "Investors are concerned with a smaller bank's ability to respond to regulatory obligations," wrote the Conference of State Bank Examiners. "As investors vote with their money on the regulatory burden issue, policymakers should take notice that this is a very real issue with a potentially adverse economic impact."

Fletcher School Professor Amar Bhide has published an intriguing discussion of financial reform entitled *A Call for Judgment.* He points out the economic potency of competitive economies in which decentralization gives "many individuals the autonomy to make subjective judgments," and in which they must live with the results of their judgments. "Specifically," he writes, "I propose we reinstate old-fashioned banking, where bankers know their borrowers" and have "case by case local knowledge." Thus they confront "the unquantifiable uncertainty that is an important feature even of seemingly routine lending decisions."

Obviously, he is describing the competitive advantage of well-run community banks and recommending a system of decentralized credit decision-making and credit risk bearing. Top-down regulatory formulas, for example in mortgage lending, reduce this advantage, while complex, expensive regulations create relative advantages for large institutions.

THE EFFECTS OF DODD-FRANK ON MORTGAGE FINANCE

Regulation itself is one of the most important procyclical factors in credit markets—a problem well known to theoreticians of financial regulation. This is especially true in the down cycle, where we still are in housing finance, as the regulatory efflorescence mandated by Dodd-Frank continues. Reflecting each bust, including the most recent one, regulators, afraid of being criticized, seeing the depletion or disappearance of their deposit insurance fund, and reacting to the past mistakes now so apparent in hindsight, clamp down forcefully on banks, including refusing to charter new entrants which would bring unburdened new capital to the sector. This contracts credit further than the crisis already has, as we have once again experienced, this time in the residential mortgage market.

Community banks can be very successful managers of residential mortgage credit to their own customers in their own towns. A healthy, competitive residential mortgage sector, in my opinion, should feature mortgage credit risk widely dispersed among knowledgeable local lenders of the kind Bhide pictures, who also have the ability to share credits among themselves.

What did the American GSE-centric mortgage system create instead? A dupoly system of Fannie and Freddie, with mortgage credit risk concentrated on the banks of the Potomac, a system once claimed in Congressional testimony and elsewhere to be "the envy of the world." The result was that Fannie and Freddie lost every penny of all the profits they had made in the 35 years from 1971 to 2006, plus another $150 billion. They have been transformed in substance from insolvent GSEs to government housing banks, but they are still there and more dominant than before in mortgage finance.

One of the most important competitive effects of Dodd-Frank results from a lack of action: its well-known failure to address the concentrated, duopoly system of Fannie and Freddie in any way. Thus concentration in the mortgage business and mortgage credit risk bearing continues and grows. Indeed, some people are now calling for Fannie and Freddie to be combined into a single mortgage securitizer—to turn their conforming mortgage duopoly into a monopoly. I do not favor this proposal.

In the mean time, all actors in the residential mortgage market, including the community banks, are involved in the continuing complex development of two mortgage regulations in particular, arising from the requirement of Dodd-Frank: the "QM" (Qualified Mortgage) and "QRM" (Qualified Residential Mortgage) rules. By establishing top-down formulas and escalating the legal risks to the lender of making mortgage loans, these regulations will certainly increase the burdens and reduce the role of local judgment in the mortgage business.

The QRM rule will determine whether mortgage competitors are required to retain credit risk in mortgages sold into securitizations—the "skin in the game" idea (the regulations will exempt loans sold to Fannie and Freddie—another boost to concentrating mortgage risk in them). I think having mortgage lenders retain credit risk in the loans they make, when they are paid for so being in the mortgage credit business, is an excellent idea—as long as the risk retention is a voluntary, market transaction. In fact, for a community bank, bearing credit risk in your own loans to your own customers, even if they are being funded by the securitization market, is a logical business. It is the basis of the Mortgage Partnership Finance program which we invented 15 years ago, when I was at the Chicago Federal Home Loan Bank—a program which has had very good credit performance from 1997 to now, and which definitely helps community banks compete in the mortgage business.

The Dodd-Frank idea is not a voluntary market arrangement, but a mandatory and formulaic requirement. The better approach would be to facilitate and encourage mortgage credit risk retention by lenders, but not mandate it.

WHAT'S THE DIFFERENCE BETWEEN A SIFI AND A GSE?

A notable and much-debated provision of Dodd-Frank is the designation of very large financial firms as "SIFIs"—Systemically Important Financial Institutions. What will the competitive effects of this be?

SIFIs will be subject to special regulatory requirements and oversight—a burden. But on the other hand, this will cause them to be perceived as safer. Moreover, they will most probably benefit from being designated as of special interest and significance to the whole financial system and to the government. Having devoted so much special attention to making them safe, the failure of a SIFI would be the obvious failure of the regulators themselves, and a crisis will induce their normal bailout strategy. So in my view, becoming designated as a SIFI effectively makes a competitor a GSE—and we know to what lengths the government will go to protect the creditors of GSEs.

The logical conclusion for a potential creditor, large depositor, or counterparty of any kind, to draw is that they will be safer with a SIFI—all political protestations to the contrary notwithstanding. Remember how various government officials tried to claim that Fannie and Freddie were not guaranteed by the government. But buyers of GSE debt and MBS did not believe such claims, and the investors were right to believe instead that they were guaranteed by the taxpayers. I believe similar beliefs will apply to SIFIs.

So what's the difference between a SIFI and a GSE? Not much.

That means, as has been pointed out by many observers (and contested by others, but incorrectly, in my view) that SIFIs will be even more advantaged in the amount and cost of funding and deposits available to them, and will be preferred counterparties for financial transactions, compared to smaller competitors. This will tend to make the financial markets more consolidated.

An interesting comparison in this contest is the much more concentrated banking system of Canada, which has received a lot of praise over the last few years. Canadian banking is entirely dominated by five big, universal, nationwide banks, all of which are certainly SIFIs. Oligopolies are arguably more stable than competitive markets. Should we trade our 7,000 banks for such an oligopolistic structure? I wouldn't.

RATING AGENCIES

A pro-competitive provision of Dodd-Frank, one I firmly support, was to prohibit regulatory agencies from making the use of the ratings of credit rating agencies be required by regulation. This helps break up what was previously a government-sponsored duopoly in the credit ratings sector. However, the provision went too far, and has now caused a competitive issue for smaller banks.

Community banks have an advantage in local credit judgments, but a natural disadvantage in credit analysis of nationally-traded securities, as a matter of knowledge and scale. It makes perfect sense to allow them, without requiring them, to use credit ratings for their investment and money market portfolios. The Independent Community Bankers of America have proposed allowing use of external credit ratings, and I have been told that regulators have privately expressed the desire to gain flexibility in this matter by an amendment of the Dodd-Frank Act.

The problem is that Dodd-Frank provides (in Section 939A) that regulators must "remove any reference to or requirement of reliance of credit ratings." The fix is simple: delete the phrase " reference to or." The provision would then read that regulators must "remove any requirement of reliance on credit ratings." In other words, no requirements allowed, but use could be approved in the appropriate circumstances if proposed by the bank—this would remove an unintended competitive disadvantage for smaller banks.

PROMOTING ENTRY AND COMPETITION

A British Member of Parliament and former banker has recently recommended the following principle: "Regulators must have a specific objective to reduce barriers to entry and promote competition." A good idea. Proposed regulations, including those arising from Dodd-Frank, should specifically take account of their effects on competition among their costs and benefits—just as this hearing is considering.

Thank you again for the opportunity to share these views.

Mr. GOODLATTE. Thank you, Mr. Pollock.

And we will now turn to questions from Members of the Committee, and I will start with a question for you, Mr. Gutshall.

Does Valley Bank compete in Roanoke with branches of large banks covered by titles I and II of the Dodd-Frank Act?

Mr. GUTSHALL. Yes, we do.

Mr. GOODLATTE. And to the extent that these "too big to fail" institutions receive a funding advantage, how does that affect your ability to compete to offer loans in Roanoke?

Mr. GUTSHALL. Well, it does make it difficult. The larger banks do have better access to funding not only from depositors but from other sources. So their cost of funds are less than ours, in most cases as much as 50 basis points today, which is a huge hurdle to get over.

We do compete. We compete on price, but we compete on service primarily. And we get most of our customers because they want to deal with somebody like our bank, somebody who understands their business and willing to spend time with them. So we cannot compete. I don't think we will ever be able to compete with the Wells Fargos and BB&Ts of the world on pricing and cost, but we have to do it on service and that is the way we do it. We have taken market share from everybody in the Roanoke MSA. That is why we have grown to $800 million. And I think we are a shining example of what a community bank can do.

Mr. GOODLATTE. When a small bank is forced to spend a dollar on complying with regulations, is that a dollar the bank is unable to use to finance small businesses that could create jobs?

Mr. GUTSHALL. Now, we see a dollar of compliance cost or any other expense as a dollar against the profit, profits that flow to the bottom line. We can use those, leverage them up tenfold. Every dollar of capital should produce somewhere around $10 worth of loans and investments. So it is a 10 to 1 ratio.

Mr. GOODLATTE. And a higher percentage of your bottom line is going to pay for regulations that diminish that bottom line than a larger institution competing with you. Is that generally true?

Mr. GUTSHALL. Well, I think just from economy of scale concept, for us to comply with roughly the same regulations, maybe not to the same degree, but we have to do that as well and leverage that over $800 million in assets. A BB&T has got $155 billion in assets to do the same thing. We cannot afford in-house counsel or accountants on staff to help us with this. We have to go outside. We have to pay their fees to advise us on compliance issues. So a lot of that what we have to do, we have to go outside to get and it is more expensive.

Mr. GOODLATTE. Now, Professor Levitin says that a lot of these Dodd-Frank regulations don't apply to small banks like yours and that a lot of them haven't taken effect yet. But what impact is the concept of best management practices having in terms of bank regulators taking the regulations that they are required by Dodd-Frank to impose on larger banks and which they may not have to impose on a smaller bank, but do they anyway?

Mr. GUTSHALL. Well, we realize we are exempt from quite a bit of Dodd-Frank, and we certainly appreciate that. A lot of these things that flow through to the Federal Reserve, to other regulatory agencies, they find their way down to us as well. I mean, it is a best practices concept, and if it is deemed best practice, then we will see it I think without a doubt.

Mr. GOODLATTE. Mr. Pollock, are the risks of creating disparities in the cost of doing business particularly acute in the banking industry in which large and community banks have to compete not only for customers by also for investor dollars?

Mr. POLLOCK. Mr. Chairman, I think it does include investor dollars, but in particular it is money market funding dollars, large deposits which are not guaranteed by the government, and also all businesses in which you are a counterparty in various kinds of transactions, be they securities or derivatives transactions. In all those, as I said in my testimony, I think the large banks have an advantage which will be increased, in my judgment, by the SIFI role that has been defined by the Act.

Mr. GOODLATTE. If the banking industry became more concentrated and oligopolistic, would that harm the typical American consumer, and if so, how?

Mr. POLLOCK. If you look around the world, Mr. Chairman, we have an unusual banking system because it still has 7,000 banks in it. Most countries have very concentrated, more oligopolistic systems. I hope we don't move in that way. Big banks have an obvious competitive role to play, but I do think there is a special advantage in this country from keeping a vibrant, robust community bank sector.

Mr. GOODLATTE. What if we fail to do that? What is the impact on consumers going to be?

Mr. POLLOCK. I think it takes away a major consumer and business alternative, which is dealing in a local way based on the banker who really knows his customers and knows the local conditions. That is very important in maintaining a well functioning and growing entrepreneurial economy.

Mr. GOODLATTE. Thank you.

The gentleman from North Carolina, Mr. Watt, is recognized.

Mr. WATT. Mr. Chairman, I think I will defer to the other Committee Members since they may have someplace to go. I got to stay.

Mr. GOODLATTE. I will yield next to the gentleman from Michigan, Mr. Conyers, for 5 minutes.

Mr. CONYERS. Thank you, Chairman Goodlatte, and thank you, Ranking Member Watt.

Gentlemen, this is a very academic discussion of a problem that has some other dimensions. For example, can any of you explain to us about the amount of loss in the 2008 financial crisis in general?

Mr. POLLOCK. I will take a try at that, Mr. Chairman.

Mr. CONYERS. Thanks, Professor Pollock.

Mr. POLLOCK. Chairman Conyers, I have thought a lot about that. I have written a book on financial cycles called "Boom and Bust," which has the advantage of being short, if you ever want to look at it.

Mr. CONYERS. I am more interested than ever. [Laughter.]

Mr. POLLOCK. Financial cycles are apparent in all of financial history. They repeat. They always have multiple occasions. They always arise out of an over-optimistic group-think, you might say.

In our case, we have the interaction, as is often in a bubble, between asset prices in houses——

Mr. CONYERS. How much was lost?

Mr. POLLOCK. Oh, do you want a dollar number? It is many, many hundreds of billions of dollars.

Mr. CONYERS. It didn't reach the trillions.

Mr. POLLOCK. And the losses of Fannie and Freddie alone were $250 billion.

Mr. CONYERS. Right.

Mr. POLLOCK. So it is bigger than that.

Mr. CONYERS. And do any of you have something that you can tell us about the fact that in many countries around the planet, there is action being considered against the biggest banks, including UBS, JP Morgan, Citigroup? I mean, this was a worldwide collapse of our financial system, Professor Levitin, that seemed to have taken economists by surprise. But now that we look back on it, there is less justification for the surprise. Is that a fair statement?

Mr. LEVITIN. Well, not being an economist, I can't speak for it. But I think if you look back and place the Dodd-Frank Act into context, we saw a financial crisis, the likes of which certainly have not been seen in my lifetime, and you have to go back to the Great Depression to find anything like it. If anything, I think what the Dodd-Frank Act does on "too big to fail" is too modest. I think the approach is sound conceptually, but it leaves a lot to the regulatory implementation.

You asked about the cost of the crisis. I think it is very important that we be cognizant of—that we compare the costs imposed by financial crises with the costs that may be imposed by regulation. And if you are at all risk-averse, I think this is not even a close one, that the regulatory costs here are a small insurance premium for making sure that we do have not have an economic collapse.

Mr. CONYERS. Now, JP Morgan Chase, $2 billion loss, irresponsible bets in the derivatives market. You say it was $9 billion. My colleague says it was not $2 billion. It was $9 billion.

Barclays' deliberate inflation of key banking interest rates like LIBOR have triggered revelations that Chase, Citigroup, and others may have undertaken similar actions. Is that too drastic an accusation to be made publicly?

Mr. LEVITIN. I don't think so. I think it has been all over the newspapers. And I would say with that $9 billion, I think it is $9 billion and counting. We haven't seen the end of it unfortunately. I think that we are just starting to learn the extent of financial institution malfeasance before and after the financial crisis.

Mr. CONYERS. Could I get 15 seconds, Mr. Chairman, to ask——

Mr. GOODLATTE. Without objection, the gentleman is recognized for an additional minute.

Mr. CONYERS. Mr. Pollock his impressions of this line of discussion?

Mr. POLLOCK. Adam and I were discussing before the hearing, Mr. Chairman, this very interesting situation. One of the most interesting aspects of it is the potential involvement of the regulators and the central banks themselves. There are allegations that the Bank of England or the government were possibly encouraging or even directing the banks to do this. It was said today that the Federal Reserve Bank of New York was aware of this several years ago.

When we discuss any financial crisis, what we find is that it isn't true that regulation protects us. Adam, you and I may disagree on this. The regulators and the central banks are part and parcel of the problems. Everybody is all mixed together. That is what makes them so hard to anticipate and to manage. That is true in this LIBOR case as well, apparently.

Mr. CONYERS. Thank you, Chairman Goodlatte.

Mr. GOODLATTE. I thank the gentleman.

The gentleman from Ohio, Mr. Chabot, is recognized for 5 minutes.

Mr. CHABOT. Thank you, Mr. Chairman.

Mr. Gutshall, if I could ask you a question. I agree with you that our community-based financial service providers, both community banks like yours and credit unions for that matter, are absolutely essential pillars in the American banking system. It is clear that community banks and credit unions are facing an increasing amount of regulatory burden in terms of the breadth and pace of rulemaking from the CFPB and other regulators. Regulators including all of those that sit on the Financial Stability Oversight Council have a responsibility to information-share and coordinate with each other in an effort to make the post-Dodd-Frank environment as manageable as possible for those institutions serving Main Street.

You mentioned in your testimony that Valley Bank has invested over $1 billion of investment loans during your 17-year history. You also mentioned the significant opportunity costs that come from Dodd-Frank compliance.

My question is if you had had to comply with Dodd-Frank over your entire 17-year history, approximately how much do you think that Dodd-Frank compliance would have cost you out of that $1 billion?

Mr. GUTSHALL. That is a very good question and a very tough one to answer as well. Typically if we are allocating somewhere close to 8 to 10 basis points of our earning assets for compliance issues, that would have taken 10 cents off of every dollar. So that $1 billion could have shrank to, say, $6 billion or $7 billion—$600,000 or $700,000 per year. So it could have cut our lending by about 3 or 4 percent.

Mr. CHABOT. And, Mr. Pollock, let me ask you. The name of your book again was "Boom and Bust"?

Mr. POLLOCK. "Boom and Bust."

Mr. CHABOT. "Boom and Bust," okay. You get it on Amazon or where is it available?

Mr. POLLOCK. If I am allowed to say this, you can buy it on Amazon for $9.95. [Laughter.]

Mr. CHABOT. I think you are allowed to say that.

And like Mr. Conyers, the fact that it was short kind of appealed to me as well. But that is what I would like to read.

And with your knowledge about the financial cycles that we have seen over the years repeated again and again—and most of that time was, obviously, not during Dodd-Frank's existence. We now have it. Are there things that could have been done that would have made sense, that could have dealt with the financial meltdown and other things short of Dodd-Frank or different from Dodd-Frank? Or do you have an opinion on that?

Mr. POLLOCK. Yes, Congressman, I do. With regard to mortgages in particular, I actually have published a list of 10 things that one could have done or should have done. Of course, notable among them is dealing with Fannie Mae and Freddie Mac.

Fannie and Freddie I think played a role which is often not understood, which was allowing large amounts of foreign money to drive up the prices in American real estate without taking any risk. I think a general principle is if you want to invest your money and take the risk, that is fine, but by the government guarantees, as I said, denied, but nonetheless real, they allowed large amounts of money to come in, drive up real estate prices, drive up risk, but not take any risk themselves. Investors have their risk now being paid for by ordinary taxpayers as they provide the money to pay off Fannie's and Freddie's obligations.

So the biggest thing would have been to deal with them in restructuring the mortgage finance market which was the center of the problem in what became in the bubble the insidious interplay of rising asset prices and ever-expanding credit. They were major factors in that credit expansion.

Mr. CHABOT. Thank you. My time is rapidly expiring. Just let me ask you one more question, if I could, Mr. Pollock.

The Community Reinvestment Act. Do you have an opinion as to the relationship between that and the ultimate financial crisis that we found ourselves in in this country?

Mr. POLLOCK. Anytime one is directed to make loans that look riskier to you in order to fulfill a regulation, I believe that is a mistake. Loans ought to be made as objectively as possible to good credits in order to create good credit, and the more we have a system like that, the better it will be.

Mr. CHABOT. Thank you.

Mr. GOODLATTE. I thank the gentleman.

The gentlewoman from California, Ms. Waters, is recognized for 5 minutes.

Ms. WATERS. Thank you very much, Mr. Chairman.

Let me just start off by saying that I agree with Mr. Watt that this hearing is quite unnecessary, but we know what is going on. As we approach the 2-year anniversary of the passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act, some of my colleagues on the other side of the aisle want to mark this occasion by trying to make the case for repeal of the Act or otherwise try to undermine the regulation of an industry that nearly brought our economy to its knees in 2008. And I don't think we need to go into what happened during the crisis and what caused the crisis. We all know what the subprime meltdown was all about.

But we put a lot of time and effort into Dodd-Frank and we listened to everybody that had something to say about it. And we have a bill that really does attempt to reform the industry. But since Dodd-Frank passed, the Republican efforts to undermine Dodd-Frank have been extraordinary. They have passed legislation to try and defund regulators, repeal the orderly liquidation of authority, repeal risk retention, delay derivatives regulations for 2 years, repeal liability for credit rating agencies, prohibit CFTC and SEC regulation of international swaps, all of this while we are witnessing some other kinds of actions that are taking place that should cause us all concern. We should be concerned about MF Global. We should be concerned about the Bickwell in London and the proprietary trading that we attempt to try and deal with with the Volcker Rule. We should be concerned about the LIBOR manipulations, et cetera.

So here is what I would like to say to the community banks. You have a lot of friends in Congress, and we know that Dodd-Frank really doesn't have a lot to do with the fact that you are at some disadvantage with the big banks. We understand that. And a lot of people, even in Dodd-Frank, as we were going through the conference committee, took actions to try and relate to some of the problems of the community banks.

I just feel really strange about community banks being roped into these antics of my friends on the opposite side of the aisle as they attempt to dismantle Dodd-Frank piece by piece. And I would suggest to you that if you have not seen the FDIC White Paper entitled "Impact of Dodd-Frank Act on Community Banks," that you ought to read it. You ought to read it because if you read this paper and if you are not familiar with a lot of what was done with Dodd-Frank that is to your advantage, I think that you may change your mind about joining with people who have other agendas that may not be in the best interest of community banks.

Let me just ask quickly about some of the white paper that describes the impact of Dodd-Frank on community banks.

Assessment base. As a result of Dodd-Frank, FDIC assessments will now be based on average consolidated assets, less average tangible equity, rather than total domestic deposits. Is this helpful to community banks?

Mr. GUTSHALL. Absolutely.

Ms. WATERS. That is.

Secondly, the offset of effect of increased reserve ratio. In addition, Dodd-Frank increased the minimum reserve ratio for the Deposit Insurance Fund from 1.15 percent of estimated insured deposits to 1.35 percent. Is that helpful to community banks? Mr. Pollock, you know everything. What do you have to say?

Mr. POLLOCK. I try to pretend like I know everything.

Ms. WATERS. I know.

Mr. POLLOCK. No, I don't think that is. That suggests a higher deposit insurance premium for community banks, in fact, which is an increased expense.

Ms. WATERS. Okay. Let's go to increased deposit insurance coverage. Dodd-Frank permanently increased the FDIC's basic insurance coverage limits to $250,000. This higher coverage level should help community banks attract and retain core deposits. Is that helpful to you, Mr. Gutshall?

Mr. GUTSHALL. That is helpful, yes.

Ms. WATERS. All right.

And in "too big to fail," as with the increased deposit insurance coverage, the end of "too big to fail" will make it easier for smaller institutions to compete with larger institutions. A level playing field will help to eliminate the subsidy that "too big to fail" banks have enjoyed and encourage market discipline. Do you think that is true? Is that a statement that you could agree with, Mr. Gutshall?

Mr. GUTSHALL. Well, I believe that the "too big to fail" has obviously benefitted the larger banks. I mean, a lot of customers feel more comfortable with their money in those banks, and I think the TAG program that we all participate in, which we hope will be extended, is a huge issue for community banks.

Ms. WATERS. Well, let me just——

Mr. GOODLATTE. The time of the gentlewoman has expired.

Ms. WATERS. Unanimous consent for at least 30 more seconds.

Mr. GOODLATTE. Without objection, the gentlewoman is recognized for an additional minute.

Ms. WATERS. Mr. Pollock, exemption from section 404 of Sarbanes-Oxley. For many years, community banks expressed concerns about the auditor attestation requirements in section 404 of Sarbanes-Oxley for publicly traded companies. Dodd-Frank effectively exempts public companies with less than $75 million in capitalization from these requirements which cover many publicly traded community banks. Is that helpful, Mr. Pollock?

Mr. POLLOCK. Congresswoman, the exemption from the onerous bureaucracy of section 404 for small companies was a pro-competitive provision in Dodd-Frank, which I applaud.

Ms. WATERS. Which you applaud. Say it loudly so everybody can hear you, Mr. Pollock.

I have a whole list of things here that is identified in this white paper that is helpful.

Let me just say this as I wrap up, that again, you have a lot of friends on both sides of the aisle who want to be helpful to community banks. I don't want you to get caught up in something else that is going on here which is not helpful to community banks. I believe that what we have done——

Mr. GOODLATTE. The time of the gentlewoman has expired.

Ms. WATERS [continuing]. In Dodd-Frank—we will continue to work with community banks because we think you have real value in the community. We think people prefer to deal with you. We think it is customer-friendly and all of those things. So let's be careful about being, you know, right up here to deal with these issues in the way that you are dealing with them because I don't think it helps your cause. It hurts rather than helps.

I yield back the balance of my time if I have any left.

Mr. GOODLATTE. The gentlewoman is well aware that she does not.

And the gentleman from Georgia is recognized for 5 minutes.

Mr. JOHNSON. Thank you, Mr. Chairman.

Yes, I myself am also rather disturbed that you, Mr. Gutshall, would be here to testify on this issue, Dodd-Frank. You are not a bank that is too large to fail, but you are a community bank and a darned good one, I would say, one that is a 17-year-old community bank, assets of $800 million. You are the number four in terms of market share with respect to deposits in the Roanoke Metropolitan Statistical Area, surpassing even Bank of America within that area. So for a 17-year-old bank to do that, I think if we have banks that are the backbones of the Main Streets throughout America that are as well run as yours, America would be in great shape. So I do appreciate you and I appreciate community banks in general. In fact, when I was a practicing lawyer, my accounts were at a local community bank. So I am a community bank guy.

And I don't understand why the majority, or the folks on the other side, would bring a community banker up here to help in the effort to get rid of Dodd-Frank which is mostly concerned with banks that are "too big to fail". And I know that community banks have a lot of regulations that they have to abide by, and there are certainly more regulations that have been applied to the "too big to fail" entities. And I think they should be the ones up here to talk about over-regulated they are in the face of $9 billion losses like JP Morgan has admitted to, finally. I think they are the ones who should be here sitting in your chair. We should be talking about community banks specifically, how we can help them become more competitive with these "too big to fail" entities, which it seems like that is basically who my colleagues on the other side of the aisle are concerned about. So why bring you up here as a sheep in wolf's clothing kind of? We don't buy that. We really don't buy that.

But, look, what impact did the repeal of Glass-Steagall have on this "too big to fail" problem that it seems like it is getting even larger with a $9 billion loss? It was $2 billion just a few weeks ago when it was announced. It was announced, I think, on Friday and then on Monday it was a $3 billion loss, and now several weeks, it is a $9 billion loss and no end in sight is what I am hearing. What impact did the Glass-Steagall repeal have on Wall Street and the "too big to fail" phenomenon, Mr. Pollock?

Mr. POLLOCK. Congressman, with specific reference to the JP Morgan trading embarrassment, I think the answer is none as far as——

Mr. JOHNSON. Well, I am talking about——

Mr. POLLOCK [continuing]. Activity could be done——

Mr. JOHNSON. I am talking about on Wall Street in general, the Wall Street meltdown back in——

Mr. POLLOCK. I understand.

Mr. JOHNSON. Yes.

Mr. POLLOCK. And with respect to——

Mr. JOHNSON [continuing]. Contribute to Freddie Mac and Fannie Mae.

Mr. POLLOCK. Glass-Steagall had little or nothing that I can think of to do with Fannie Mae and Freddie Mac.

Mr. JOHNSON. Did Fannie Mae and Freddie Mac trade in derivatives, by the way?

Mr. POLLOCK. Yes. They were major users of derivatives and, as you know, had a large accounting scandal about derivatives that cost the management their jobs.

Mr. JOHNSON. And we need to regulate that kind of trading especially when it is for the account of the entity itself. Is that not correct?

Mr. POLLOCK. Well, all of these things are happening inside regulated entities, Congressman. I think overall if you look——

Mr. JOHNSON. But not in the community banking sector, though, is it?

Mr. POLLOCK. It certainly isn't. They have their own and different——

Mr. JOHNSON. They do it the old-fashioned way.

Mr. POLLOCK. Well, if they do it right, it is old-fashioned, and that is another thing I applaud.

And if I could just say so also, Congresswoman, in the couple thousand pages of Dodd-Frank, there are only two provisions which I fully support.

Ms. WATERS. Say it real loud. [Laughter.]

Mr. JOHNSON. You already had your 10 minutes, Congresswoman. [Laughter.]

But anyway, Professor Levitin——

Mr. GOODLATTE. The time of the gentleman has expired. Without objection, the gentleman is recognized for 1 additional minute.

Mr. JOHNSON. Thank you.

Professor.

Mr. LEVITIN. Regarding Glass-Steagall?

Mr. JOHNSON. Yes.

Mr. LEVITIN. I think there are two effects that are important to note.

First, Glass-Steagall separated investment banking from commercial banking. Putting them back together exposes insured deposits—in other words, the government ultimately—to risk taking that banks do in investment banking, and that is a problem.

Secondarily, and I think——

Mr. JOHNSON. Subject to the $250,000 per account.

Mr. LEVITIN. Yes.

Mr. JOHNSON. Yes.

Mr. LEVITIN. Secondarily—and I think often overlooked on this—is a political effect that was lost. Glass-Steagall divided the financial services industry. And if you go back 30 years or so, 40 years, you would see that the commercial banks and the investment banks and the life insurance companies didn't get along. They would fight with each other. They would fight with each other on legislation. They would fight about regulations and they would litigate. And this affected the way their lobbying worked because they were not presenting a unified lobbying front that if you took a position that was adverse to the commercial banks, the investment banks would love you and vice versa.

What has happened is that they have found that it is easier to unite and be a united front, and what that does is it makes it much harder, I think, politically for Members of Congress and for regulators to prevent deregulation. What we have seen with the demolishment of Glass-Steagall is really a politically united financial services industry, and I think that is a huge impact that really has not been noticed.

Mr. GOODLATTE. The time of gentleman has expired.

The gentlewoman from Texas, Ms. Jackson Lee, is recognized for 5 minutes.

Ms. JACKSON LEE. I thank the Chairman and the Ranking Member for this hearing.

And I would like to start out, I think as many have started out, to indicate to the panelists that I appreciate their testimony and I appreciate Mr. Gutshall's representation of community banks. And just for the record, I want to acknowledge the vital role that community banks play and the interest and commitment that your customers, clients, have. They love their banks. I love my community banks that are in my constituency and work very closely with them. And I want to see them as strong—and as I noted by one of my colleagues, your record is certainly strong in terms of assets. Many others have strong assets.

And so as we are debating the health care repeal—and you would ask the comparison—I always recognized that bills passed are not in their most perfect form. And we work through the legislative initiatives to ensure that we do address concerns needing to be concerned. I certainly don't want to see a repeal of the Affordable Care Act. I want to see the bill implemented to save lives.

Dodd-Frank has the same basis. One might not say saving lives, but those who have fell victim to some of the excesses of some of our huge, multinational banks might think that they are in fear of their lives. They have lost their assets. Small businesses don't have access to resources. Major foreclosures, still an epidemic, if you will, in the financial structure where people's homes are still being foreclosed.

Not having heard your testimony—and I apologize for being delayed in another hearing, but I will be posing a question to you as to singularly some item that might be responsive to some of the concerns. As you well know, you are a bigger community bank. There are certainly a lot smaller ones that many of us work with, but we do believe you are enviable to an asset to the financial system.

So I am first going to go, however, to Dr. Levitin. And tell me, as you look at the FSOC and its intent—and I just want to read its name into the record because maybe if we heard its name, Financial Stability Oversight Council, that is a good-sounding purpose, at least if you take the words literally. But it has gotten in the eye of the storm. The President had to do a response through his own presidential authority, which I support. But tell me what good can come to Mr. Gutshall with this kind of structure, even though it seems to focus on—it seems to have a consumer protection element, of course, but what is your perspective on that?

Mr. LEVITIN. I want to make sure that we are speaking about the same thing: the Financial Stability Oversight Council or the Consumer Financial Protection Bureau?

Ms. JACKSON LEE. I want to speak about both of them. So let me start with the Consumer Protection Bureau first. Thank you.

Mr. LEVITIN. Sure.

With the Consumer Financial Protection Bureau, the first good thing that can come to community banks is the creation of the CFPB levels the regulatory playing field between banks and non-banks. Non-banks compete in all kinds of consumer finance activities, and before the creation of the CFPB, they were very thinly regulated. Now they are subject to examinations just like community banks are, and this means that they are going to have to bear the same kind of regulatory costs as community——

Ms. JACKSON LEE. Could you pause for a moment? Mr. Gutshall, does that help you?

Mr. GUTSHALL. It does. I think that is a step in the right direction, and they were the ones who should have been looked at at the beginning.

Ms. JACKSON LEE. And those are entities that deal in real estate matters and other things or financial products, let me just say, that would overlap.

Mr. GUTSHALL. Most of the overlap—I think where we saw problems was in the mortgage business. The brokerage outfits did push the banks, especially community banks, out of the mortgage business.

Ms. JACKSON LEE. I see common ground. Let me move on to the Financial Stability Oversight Council, Professor.

Thank you, Mr. Gutshall.

Mr. LEVITIN. The Financial Stability Oversight Council you can think of sort of a justice league of regulators, that it is a collection of various financial regulators. And I think the real benefit for community banks from having the Financial Stability Oversight Council is that the FSOC is going to designate which institutions it believes are systemically important, and then it is required to impose additional regulation on those institutions.

Ms. JACKSON LEE. So let's get to the bottom line. Can we find common ground for a banking structure of the community banks, juxtaposed to "too big to fail," as compatible with Dodd-Frank? Would you find that they can actually find common ground and find a positive response to their needs as opposed to a negative response?

Mr. LEVITIN. I would think that there are numerous provisions in Dodd-Frank that would be good for community banks. There is some increased regulatory burdens. There is no question about that. But there is also a lot of things that help community banks by leveling the playing field between either community banks and "too big to fail" banks or community banks and non-banks. And I think those things are really good for——

Ms. JACKSON LEE. Is the regulatory scheme one that can be ironed out, for lack of a better term? Is it something that we should be looking at there critiquing and not undermine the bill but be able to respond to it?

Mr. LEVITIN. I think that if community banks have particular provisions in Dodd-Frank that they are concerned about, those provisions should be examined, but concerns about community banks are not an excuse for a wholesale repeal of Dodd-Frank.

Ms. JACKSON LEE. I would just conclude by saying, Mr. Gutshall, we look forward to working with you. You have great value. I am glad to hear that are some components that work for you. Can we not work with the association that represents many community banks and look at it as to how we structure some of the review—and I have no commitment that anyone would want to review it—but some of the review to constructively make sure we have this structure in place but respond to your concerns?

Mr. GUTSHALL. I think we can and I appreciate that. Most community bankers are concerned about the commoditization of banking. And a lot of times when we win customers, it is because we are more agile. We offer more options. It is just not plain vanilla cookie cutter stuff, and it is very important that community banks be allowed to continue to do that not only in the residential mortgage business but also in the business-related credit.

Ms. JACKSON LEE. Discretion is important in your business. It really is.

Mr. Chairman, I believe that I missed getting Mr. Pollock, but I am sure he has absorbed the Q&A that I just engaged in and he finds common ground to be able to support Dodd-Frank and sees its great value. So I am sorry, Mr. Pollock, I did not get a chance to seek any answers from you. [Laughter.]

But I have already gotten agreement and I am going to yield back right now. Thank you. I yield back.

Mr. GOODLATTE. The time of the gentlewoman has expired, and the Ranking Member, the gentleman from North Carolina is recognized.

Mr. WATT. Thank you, Mr. Chairman, and I thank my colleagues for being here for the hearing.

I guess I better give Mr. Pollock a chance to tell us which two provisions in the Dodd-Frank bill—— [Laughter.]

He considers good. I am just doing cleanup now since I deferred to all the other Members till last. So go ahead and let's put that in the record here.

Mr. POLLOCK. Thank you, Ranking Member Watt.

One is, as previously discussed, the exemption from Sarbanes-Oxley, another regulatory expansion bill. For small public companies, I think that was a very good idea. I am in support of that.

The other is not allowing bank regulation to require the use of credit ratings by credit rating agencies since credit rating agencies were, as I said, a government-sponsored duopoly with Standard & Poor's and Moody's. However, that second provision actually needs a slight amendment which I recommend in my written testimony to help——

Mr. WATT. I will be sure and take a look at that. And I assume we would be taking that up in Financial Services not in Judiciary. So I am glad to get those two points into the record.

I want to publicly agree with Mr. Pollock that we never thought that Dodd-Frank would prevent any future financial crises. History, based on the research we were doing, and all of the studies, when we were doing Dodd-Frank, indicated that every 27 years or so, there is going to be a crisis because you regulate and then you deregulate, and the profit motive becomes a lot more salient than the regulatory motive. And over time, that is what has happened throughout the history of our country. So we are figuring Dodd-Frank is good for maybe 27 years if we are lucky. So I agree with you.

The final point I want to make is also something that you said. You seem to applaud the value of "know your customer" in one of your comments. I just wanted to remind you that I was the Chair of one of the Subcommittees when we were dealing with "know your customer," and it requires substantial regulations. All of the banks were complaining about the regulations that went with "know your customer." So the good, old days ain't as good as they seem sometimes.

So I appreciate all of you being here. I didn't think much of the hearing, as I said in my opening statement, but you know, sometimes even good things come out of bad hearings.

I yield back, Mr. Chairman.

Mr. GOODLATTE. I thank the gentleman for his admission that good things come out of the hearings that are scheduled in this Committee, and I happen to agree with that.

And I would like to thank our witnesses for their testimony today.

And without objection, all Members will have 5 legislative days to submit to the Chair additional written questions for the witnesses which we will forward and ask the witnesses to respond as promptly as they can so that their answers may be made a part of the record.

Without objection, all Members will have 5 legislative days to submit any additional materials for inclusion in the record.

And with that, I again thank the witnesses.

Mr. WATT. Mr. Chairman, might I ask that we just put into the record the study that Ms. Waters was making reference to so that we get that preserved in the record?

Mr. GOODLATTE. Certainly. Without objection, the study will be made a part of the record.

Ms. WATERS. It is entitled "Impact of the Dodd-Frank Act on Community Banks."

Mr. GOODLATTE. Great. If you will provide a copy of that to Committee staff, we will make sure it is made a part of the record.

[The information referred to follows:]

Impact of the Dodd-Frank Act (DFA) on Community Banks

While community banks, like other financial institutions, naturally have concerns about the DFA, they will, in fact, benefit from a number of the Act's changes. Moreover, a number of the law's toughest provisions were designed to address questionable practices of certain non-bank financial services providers and to provide greater oversight of the largest financial institutions to bring stability to the banking system. The following are specific examples of provisions in Dodd-Frank that we believe will benefit community banks.

- Assessment Base. As a result of Dodd-Frank, FDIC assessments will now be based on average consolidated assets less average tangible equity, rather than total domestic deposits. We estimate the assessment base change and related changes to the assessment system will benefit more than 7,500 institutions, mainly community banks and thrifts that rely chiefly on deposits for funding. Community banks will see their share of deposit insurance premiums reduced from approximately 30 percent to 23 percent, an aggregate decrease of almost $1 billion annually.

- Offset of Effect of Increased Reserve Ratio. In addition, Dodd-Frank increased the minimum reserve ratio for the Deposit Insurance Fund (DIF) from 1.15 percent of estimated insured deposits to 1.35 percent, which will strengthen the DIF. Moreover, Dodd-Frank extended the time period for reaching that point until the third quarter of 2020 and also requires that the largest institutions, rather than community banks, pay for the increase.

- Increased Deposit Insurance Coverage. Dodd-Frank permanently increased the FDIC's basic insurance coverage limit to $250,000. This higher coverage level should help community banks attract and retain core deposits. The legislation also temporarily provides (through 12/31/12) full deposit insurance coverage for true non-interest bearing transaction accounts. This change should help community banks retain corporate payroll and other large transaction accounts that often have large uninsured balances. Since community banks rely more heavily on deposit funding than larger banks do, these changes should be of more benefit to community banks than to their larger competitors.

- Ending "Too Big to Fail." Several provisions in Dodd-Frank give regulators the tools to end "Too Big to Fail." The FDIC's new resolution authority is a key tool that empowers regulators to end Too Big to Fail. In addition, Dodd-Frank requires the largest and most interconnected financial companies to provide resolution plans (or "living wills") to demonstrate how they can be wound down in an orderly manner without creating systemic risk, and the new law mandates enhanced supervision of these entities. As with the increased deposit insurance coverage, the end of TBTF will make it easier for smaller institutions to compete with larger institutions. A level playing field will help to eliminate the subsidy that TBTF banks have enjoyed and encourage market discipline.

- Exemption from Section 404 of Sarbanes-Oxley. For many years, community banks expressed concerns about the auditor attestation requirements in section 404 of Sarbanes-Oxley for publicly traded companies. Dodd-Frank effectively exempts public companies with less than $75 million in capitalization from those SOX requirements, which cover many publicly-traded community banks.

- Capital. Section 171, known as the Collins amendment, requires for the first time that the generally applicable capital requirements for community banks will serve as the floor for the capital requirements for the largest banks and bank holding companies as well as those non-bank financial companies that the Federal Reserve Board might designate for supervision. Although some banks and their holding companies may have concerns because they cannot issue new trust preferred securities (TruPS), the Collins amendment will strengthen capital in the system and ensure that large banks and their holding companies will be subject to capital requirements that are as stringent as those that apply to community banks. Going forward, then, there will be greater parity -- these large firms will not be able to use their internal models to lower their capital requirements below the levels required for community banks. Additionally, the Collins amendment contains specific transition provisions for smaller banking organizations.

- Consumer Financial Protection Bureau. Dodd-Frank created a new Consumer Financial Protection Bureau, which will be an independent agency funded by the Federal Reserve. We believe that the CFPB will reduce the unfair competitive advantage that some non-banks have long enjoyed as compared with regulated financial services providers. This new approach is yet another step in helping level the playing field that has so often tilted against community banks in recent years.

- Incentive Compensation. Section 956 of the DFA gives the financial agencies an opportunity to address excessive incentive compensation practices that contributed to the recent financial crisis. However, the provision appropriately only applies to large institutions, as it expressly carves out institutions with assets of less than $1 billion. Addressing these types of misaligned incentives is critical to efforts to prevent future financial crises.

- Volcker Rule and Related Matters. Dodd-Frank requires the SEC, CFTC and the FBAs to adopt regulations generally prohibiting proprietary trading and certain acquisitions of interests in hedge funds or private equity funds. The Dodd-Frank Act also authorizes regulators to engage in a rulemaking to set minimum standards for certain swaps activities and gives insured depository institutions up to 24 months to divest swaps entities or cease swaps activities. Since community banks do not generally engage in these types of activities, the regulations implementing these provisions seem unlikely to significantly affect those institutions. Moreover, the prohibitions in the Volcker Rule regarding proprietary trading and certain acquisitions of interests in hedge funds or private equity funds should benefit community banks by minimizing systemic risks arising from such activities by larger banking organizations.

For more detailed information, please visit the FDIC's Dodd-Frank financial reform page at http://www.fdic.gov/regulations/reform/

Mr. GOODLATTE. And I thank the witnesses and declare the hearing adjourned.

[Whereupon, at 5:32 p.m., the Subcommittee was adjourned.]

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