BEARING THE BURDEN: OVER-REGULATION'S IMPACT ON SMALL BANKS AND RURAL COMMUNITIES

HEARING

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BEARING THE BURDEN: OVER-REGULATION'S IMPACT ON SMALL BANKS AND RURAL COMMUNITIES

THURSDAY, JUNE 9, 2016

HOUSE OF REPRESENTATIVES,
COMMITTEE ON SMALL BUSINESS,
SUBCOMMITTEE ON ECONOMIC GROWTH,
TAX AND CAPITAL ACCESS,
Washington, DC.

The Subcommittee met, pursuant to call, at 10:00 a.m., in Room 2360, Rayburn House Office Building. Hon. Tim Huelskamp [chairman of the Subcommittee] presiding.

Present: Representatives Huelskamp, Luetkemeyer, Kelly, and Chu.

Chairman HUELSKAMP. I call this hearing to order.

It has been just about 6 years since the passage of the Dodd-Frank Wall Street Reform, and in that time we have seen a steady stream of new rules and regulations imposed upon financial institutions. These hundreds of rules and thousands of pages of regulation have been touted as necessary to secure financial stability, and targeting just those large institutions which were blamed for the financial collapse. But as this Committee has learned, our small community banks have not been spared from the regulatory burden.

Across the country, community banks are seeing the costs of complying with regulations soar, and the result has been less capital available for the main street shop looking to expand, for the entrepreneur looking to start a business, and for our neighbors hoping to purchase a new home. The impact of regulation on community banks is felt especially hard in our country's rural areas, like my district in Kansas.

The rising cost of regulation is causing many small banks to be forced to merge with larger entities that may not understand the local community, or causing them to shut their doors entirely. In rural towns without many other alternatives for access to capital, the results of these top-down regulations can be devastating and impact the whole town and the entire county and region. Home mortgage lending, small business lending, agricultural lending, all areas where community banks play a leading role in providing capital, become much more difficult and much more costly to consumers.

Our rural communities are still feeling the harsh effects of the recession. During the so-called "recovery," growth in business establishments was reserved for the big cities. From 2010–2014, a full half of all new business were started in just 20 of our Nation's counties, all near large metro areas. During that same time, most rural counties have actually seen a decrease in business establishments. More businesses are closing for good than opening up.

At today's hearing, we will hear about the impact financial regulations are having on our rural communities from those who see it every day, including from within my home district, Kansas's "Big First" District. Discussions of financial reform are often centered on big cities and large institutions on Wall Street, but today we will hear from those areas of rural America, form Main Street, which can too often be overlooked in these conversations.

I thank the witnesses for being here this morning, and I look forward to your testimony.

I now yield to Ranking Member Chu for her opening remarks.

Ms. CHU. Thank you, Mr. Chair.

Just 6 years ago, our nation was in the early stages of recovery from one of the worst economic downturns in history. We lost 4 million jobs, 7 million people faced foreclosure, and families saw over $16 trillion in wealth disappear as the bottom fell out of the housing and stock markets. After taking extraordinary steps to stem the losses and stabilize the economy, Congress enacted the Dodd-Frank Act in 2010 to address the many loopholes that caused the collapse. The bill established strong new standards for the regulation of large, leveraged financial institutions and made the protection of consumers seeking mortgages and credit products a top priority.

Dodd-Frank was directed primarily at the largest financial services firms and significant efforts were made to ensure that any new regulatory burden on the small banking community was properly mitigated. For example, many of the Dodd-Frank Act provisions only apply to institutions with over $10 billion in assets, leaving 98 percent of all banks in the U.S. largely exempt. Additionally, the Consumer Financial Protection Bureau has gone to great lengths to balance the burden of new regulations on small banks with the ultimate goal of protecting consumers.

Initially, there was significant concern that regulatory burdens would have a negative effect on access to capital for small businesses, but fortunately, it appears to be having less impact than originally feared. According to the PayNet Small Business Lending Index, access to credit continues to improve for small businesses. In fact, lending is up 70 percent since Dodd-Frank's enactment. Similarly, the Wells Fargo Gallup Small Business Index poll indicates small business owner optimism is at its highest point since 2008. Furthermore, data from federal regulators also points to a healthy small business lending market. The Federal Reserve has found that lending standards for small firms have eased considerably since the recession while loan and lease balances at community banks have increased $21 billion in this past quarter alone. SBA lending, too, has come roaring back to surpass prerecession levels. In 2015, the Agency made 63,000 loans totaling $23.5 billion.

Although the small business lending environment appears to be robust, critics of the act continue to point to the decreasing number of small financial institutions as proof of burdensome regulation. However, it is important to remember that the decline in the number of community banks is not something that started happening after Dodd-Frank was implemented. The sector has actually been consolidating for the past 30 years.

Experts can disagree on the reasons for consolidation in the community bank sector but I think we can all agree that things are improving. Revenue is up, lending has increased, asset quality is steady, and credit worthiness of borrowers is on the rebound. As both lenders and borrowers, small businesses have much at stake when it comes to financial regulatory reform. The Dodd-Frank Act has the potential to make the entire system more stable and safer for small firms and the real economy to grow and create jobs. It is my hope that the testimony today will add important perspectives on the interaction between Dodd-Frank and Main Street, and I want to thank the witnesses for being here today.

Thank you. I yield back.

Chairman HUELSKAMP. Thank you, Ms. Chu.

If Committee members have an opening statement prepared, I would ask they be submitted for the record. Let me explain the opening statements and timing for the witnesses.

You each have 5 minutes to deliver your testimony. The light will start out as green. When you have 1 minute remaining, the light will turn yellow. And finally, at the end of your 5 minutes, it will turn red. I ask that you try to adhere to that time limit.

With that, I would like to introduce our first witness this morning, Mr. Roger Beverage, who is visiting us today from Oklahoma City, or Edmond. Mr. Beverage is the former Executive Vice President of the Nebraska Bankers Association and is currently the President and CEO of the Oklahoma Bankers Association. He has held this position for over 25 years. Mr. Beverage is testifying today on behalf of the American Bankers Association, and Mr. Beverage, we welcome you here today. You have 5 minutes, and you may begin.

STATEMENTS OF ROGER M. BEVERAGE, PRESIDENT AND CEO, OKLAHOMA BANKERS ASSOCIATION; SHAN HANES, PRESIDENT/CEO, FIRST NATION AL BANK OF ELKHART; MARCUS STANLEY, POLICY DIRECTOR, AMERICANS FOR FINANCIAL REFORM

STATEMENT OF ROGER M. BEVERAGE

Mr. BEVERAGE. Chairman Huelskamp, Ranking Member Chu, thank you so much for the opportunity to be here today to present about how the growing volume of bank regulation, particularly for smaller hometown banks in rural areas, is negatively impacting consumers.

Let me be clear. Banks are a resilient group. They have found ways to meet customers' needs despite the ups and downs of the economy, but it is a job that has become much more difficult because of new rules, guidances, and the seemingly ever-changing expectations of federal banking regulators. It is this cumulative impact of regulatory overload that often pushes small banks out of existence, either to merge or to sell. In fact, there are nearly 1,500 fewer community banks today than there were just 5 years ago.

When I came to Oklahoma in 1988, there were well over 400 banks in our state. Today in Oklahoma, there are 211 that are chartered by the State of Oklahoma or a national bank doing business in Oklahoma. But more frightening to me right now is the seeming lack of interest in granting new charters. This trend apparently will continue unless changes are made that provide relief to community banks, but particularly those that serve rural areas.

Let me also be clear about the kinds of banks I am talking about. These banks are very small. In Oklahoma, for example, out of the 211, 97 of them are under $100 million, 46 are under $50 million. Those are very, very small banks that had nothing to do with the financial crisis that led up to the issues of 2008 and Dodd-Frank. In Kansas, you have 156 banks that are under $100 million in total assets. These banks have a handful of full-time employees and they all perform a lot of different functions. There is no one functionality that you have in a small bank like that. These are the kinds of banks that serve rural America.

Regulations shape the way banks do business and can help or hinder the smooth functioning of the credit cycle, but every regulatory change that applies to America's hometown banks directly affects the cost of banking products and services for consumers. Even small changes can reduce credit availability. They can raise costs. What the ranking member talked about is driving consolidation. We have seen that considerably in our state. What that does is ultimately those three things limit consumer choice.

I believe Congress must take steps to ensure and enhance the banking industry's ability to serve their consumers and rural areas. When a bank reduces its product and service offerings or disappears, everyone in that community is impacted.

Importantly, in rural communities, local banks are in many instances the exclusive source of capital for farmers, ranchers, small business owners, and residents. Once that capital access system becomes dysfunctional in rural areas as it is today, then the community itself begins to encounter more difficult challenges in order to survive.

We ask for bipartisan support for legislation introduced by Congressman Tipton that would require regulators to tailor bank supervision and that would take into account the charter, the business model, and the scope of each bank's operations. Regulators should be empowered and directed to make sure that rules, regulations, and compliance requirements only apply to those segments of the industry where warranted. Representative Barr's American Jobs and Community Revitalization Act also contains provisions that will reduce regulatory requirements for smaller community banks in ways that make it easier for those banks to meet their customers' needs.

Additionally, Congress should help reduce needless impediments to mortgage lending that have constrained the ability of community banks to help homebuyers and dampen the growth of prosperity across our Nation's rural communities. In Oklahoma, approximately 25 percent of the state's banks are no longer in the home mortgage business. They have concluded that the litigation and regulatory risk are simply too great given the limited number of those kinds of loans that they make in a given year. That means that the consumer is denied credit or asked to find some other source for it.

We encourage Congress to support legislative efforts like H.R. 1210 that would treat loans held in portfolio, which is one of the most traditional and lowest-risk lending in which a bank can engage as qualified mortgages. This would provide a much needed direction to the current restricted standards.

There is additional legislation introduced by Representatives Luetkemeyer, Neugebauer, and Barr that contain measures to help America's hometown banks get back to serving their communities by ensuring that costs and benefits are considered before changing or issuing new regulations and that streamline currency transaction reporting and require a review and reconciliation of existing regulations.

ABA stands ready to help Congress address these important issues that will in turn help community banks, particularly those in rural areas, better serve their customers and their communities.

Thank you very much, and I will be happy to try and answer some of the questions you may have.

Chairman HUELSKAMP. Thank you, Mr. Beverage. I appreciate your testimony.

Our second witness this morning is Mr. Shan Hanes, who is visiting us today from Elkhart, Kansas, which is located in my home district, Kansas's "Big First." Elkhart is a community in southwest Kansas with a population just over 2,000 folks, and I might add, 26 graduates in the senior class. Where I come from that is actually kind of a big school. For the past 9 years, Mr. Hanes has served as president and CEO of the First National Bank of Elkhart—and by the way, when you are in Elkhart, you are not quite in Oklahoma or Colorado, but you can see them from there—and previously has served as President of the Kansas Ag Bankers Division of the Kansas Bankers Association.

Mr. Hanes, we welcome you here today. Thank you for joining us, and you may begin.

STATEMENT OF SHAN HANES

Mr. HANES. Thank you, Chairman Huelskamp, Ranking Member Chu, and members of the Subcommittee. My name is Shan Hanes, president and CEO of First National Bank of Elkhart, Kansas. I appreciate the opportunity to present the views of rural banks and the impact of overregulation in rural America.

First National Bank is a $78 million bank with a main bank location in Elkhart, Kansas, the county seat, and one branch serving Rolla, Kansas. We have 20 employees, and we are a typical agriculture (ag) bank. Despite our small size, we are the largest lender in the county and represent an average-size bank in rural Kansas.

I have been very proud to be an Ag banker in a rural community for 20-plus years. There are days we can still get in our unlocked pickup truck to go to work in the morning and have cash lying in the seat. We simply take it to work as it is a payment from a customer who will call us eventually and tell us which of their loans to apply it to.

One of my loan officer's customers actually won a multimillion dollar lottery, and he did not feel safe holding the ticket in his possession over the weekend, so he took it to his loan officer's house. He did not want us to put it in the vault. He just wanted him to hold the lottery ticket for him over the weekend. That is community banking. That is what it means to be a community rural banker.

When I started in lending, a typical consumer loan was one page and the consumer would actually read the note and disclosure. Now a typical consumer loan is closer to 20 pages with many documents to sign and customers have no interest in reading that many documents. We made a simple loan so complicated that customers simply will not read the documents.

The topic of today's hearing is very timely. Increased regulations made it much more difficult to lend and be a main driving force in our local community. Despite this, the banking industry is well-positioned to meet the needs of rural America.

In 2015, farm banks, like mine, increased ag lending 8 percent and now provide over $100 billion in total farm loans. Interest rates continue to be near record lows and banks have the people, capital, and liquidity to help rural America through any turbulence in the rural economy. Rural banks are healthy and continue to be forward-looking, growing capital, and increasing reserves.

I would like to thank Congress for its commitment to the guaranteed lending programs, both SBA and USDA. However, I believe Congress needs to consider reforms to these programs, specifically, to allow greater flexibility with SBA loans for agriculture and to raise the cap on USDA farm service agency guaranteed loans simply due to the rising cost of agriculture. There needs to be an additional in-depth look and discussion in modernizing these programs, providing something as simple as electronic signatures. Guaranteed loans have allowed our customers to continue to get access from banks like mine as they grow, ensuring credit for bank customers across the country.

We remain concerned, however, with competition on an uneven playing field. Overburdensome regulations and a lack of appraisers in rural America means small, rural banks simply cannot survive. The result would be devastating to the local residents in those communities. Every day my bank competes with other banks in parts of Kansas, but we also compete with Farm Credit System, which is a 300 billion GSE. This lender has a huge tax advantage over my bank. Currently, with the combined State and Federal tax rate of 38 percent, we have to work until July just to pay our tax bill. There needs to be serious discussion on leveling the playing field between banks and Farm Credit.

In addition to unfair competition, banks have to deal with ever-changing and expanding regulations. Due to the Dodd-Frank Act, a bank like mine has to outsource much of our compliance, and we are more than paying a full-time teller's salary for compliance and outside audit teams. The impact is one fewer bank employee serving our customers, one less paying job in a rural community.

Due to regulations, many banks in rural Kansas have moved out of the mortgage-lending business completely, often due to increased compliance. What used to be a staple for every community bank is no longer even a product offering. When you consider a bank like mine where we keep our loans in our portfolio, we are taking the risk, and any adverse decision affects our bottom line. This is why I believe that if the loan is held in portfolio, it should automatically be a qualified mortgage.

Through regulation, our loan closings have become much slower. We have had to hire an outside consultant to assist us in completing a pre- and post-closing review. In my area, there are many more houses on the market now. I believe it is partially due to the increased time it takes to close these loans. This only further slows down an already slowing rural economy.

On a real estate loan, the bank no longer makes a credit decision; the bank makes a compliance decision to determine if a loan will be made.

Lastly, there are a lack of rural appraisers, not just in Kansas, but across rural America. Increased regulations have made it harder for someone to become an appraiser, and it is especially hard for young people to get into that line of work. Lenders need appraisers or they cannot close a loan. Congress should examine the current rules of becoming an appraiser, especially in rural areas, so banks can continue to lend effectively.

Banks like mine are proud of the work we do to support our rural communities. However, it will be very difficult to simply survive to continue lending to our customers and provide for our community and your constituents if there are no reforms to the many obstacles that stand in our way. The lending decision should be made locally to customers by their community bank, not by rules and regulations from Washington, D.C. that does not understand my business or my customers.

Thank you. I would be happy to answer any questions you might have.

Chairman HUELSKAMP. Thank you, Mr. Hanes. I appreciate your testimony and you joining us today.

I now yield to Ranking Member Chu for the introduction of our final witness, Mr. Marcus Stanley.

Ms. CHU. Yes, I am honored to introduce Mr. Marcus Stanley. Marcus Stanley is the Policy Director of Americans for Financial Reform, a coalition of more than 250 national, state, and local groups, who have come together to improve regulation of the financial sector. Members of AFR include consumer, labor, civil rights, investor, retiree, community, faith-based, and business groups, along with prominent, independent experts. Mr. Stanley has a Ph.D. in public policy from Harvard University, previously worked as an economic and policy advisor to Senator Barbara Boxer, as a senior economic economist at the U.S. Joint Economic Committee, and as an assistant professor of Economics at Case Western Reserve University.

Dr. Stanley, thank you for joining us today.

Chairman HUELSKAMP. Thank you for the introduction. Mr. Stanley, you may begin. Thank you.

STATEMENT OF MARCUS STANLEY

Mr. STANLEY. Thank you. Chairman Huelskamp, Ranking Member Chu, and members of the Committee, thank you for the opportunity to testify here today.

Today's hearing asks us to consider the impact of the Dodd-Frank Act on small banks. I want to make two broad points. First, community banks face economic headwinds that are unrelated to Dodd-Frank, connected both to long-term trends and to the effects of the financial crisis itself.

Second, the big picture is that community banks have returned to profitability under Dodd-Frank. In 2015, just over 95 percent of community banks earned a profit. That is compared to 78 percent in 2010, the year Dodd-Frank was passed.

Consolidation in the banking industry is not a new phenomenon. The number of FDIC insured banks has declined by 2/3 over the past 30 years with the decline concentrated among banks with less than $1 billion in assets. The number of community banks has declined every single year since 1984.

The causes of these long-term trends include changes in economies of scale in banking and deregulatory measures that assisted the expansion of large regional and global banks. The catastrophic effect of the financial crisis made things worse. Over 400 community banks failed between 2008 and 2011. Facing huge losses in the Deposit Insurance Fund and historically devastating recession, FDIC's supervisors cracked down on risks in existing banks and made it more difficult to open new banks, a regulatory response that would have occurred even if the Dodd-Frank Act had never passed.

When we look at the well-being of community banks since the passage of Dodd-Frank, as well as specific provisions of the law, we see a better picture. Not only have more than 95 percent of community banks returned to profitability today, but return on equity has been steadily increasing. Average community bank ROE has gone up every year since the passage of Dodd-Frank and reached almost 9 percent in 2015, a level that some larger banks, such as Citigroup or Bank of America might envy.

One reason for this is that in drafting Dodd-Frank, Congress made major efforts to shield small banks from additional regulations targeted at the large banks and nonbanks who were at the center of the 2008 crisis. Smaller banks are exempted from numerous provisions in the law, including new heightened prudential standards in Title I, new over-the-counter derivatives regulation, and direct CFPB examination .

As detailed in my written testimony, regulators have continued this practice in implementing the law with efforts to shield small banks from compliance burdens in areas ranging from the Volcker Rule to new mortgage regulations. The Dodd-Frank Act was major legislation passed in response to the worst financial and economic crisis since the 1930s, so it clearly does have impacts throughout the financial system. But, those impacts are concentrated on the large banks and nonbanks that are, in fact, the major competitors of community banks.

At the same time, I do not wish to imply that there are not real issues with small business access to credit and issues in rural areas that this Committee can and should address. Although small business lending has increased significantly in recent years, it has still lagged during the recovery, and the economic expansion has been more concentrated in urban areas. Helping small banks to address this issue should be high on our agenda, but looking at the Dodd-Frank Act as it is caused seems misguided. Instead, I would urge the Committee to look at credit guarantees from entities like the Small Business Administration, the Department of Agriculture, and other forms of credit that are under the jurisdiction of the Committee.

We must also make sure that nonbank financial entities are competing on a level playing field with regulated banks. Online marketplace lenders are a rapidly growing provider of small business lending and are subject neither to consumer protection laws nor risk controls. The evidence indicates that they often provide a substandard and even exploitative product. Just 15 percent of small business borrowers from online lenders express satisfaction with their experience, while 75 percent of small business borrowers from community banks did. That is from a joint study by seven regional Federal Reserve banks that cover pretty much the whole country. Congress should consider expanding oversight of online marketplace lenders.

Thank you for the opportunity to testify, and I look forward to taking questions.

Chairman HUELSKAMP. Thank you, Mr. Stanley. We appreciate your testimony. We will now begin our questioning. I recognize myself for 5 minutes.

I will first start with Mr. Hanes. I cannot imagine you got into this business to navigate your way through miles of red tape. What brought you in this line of work, and what do you see as your role in the community of Elkhart, Kansas?

Mr. HANES. I have been a community lender for 20-plus years, do not want to give the exact number. I enjoy being part of production agriculture. Growing up on a farm myself, that was my lifestyle and that was my livelihood. Now I get the opportunity to help a number of customers continue their lifestyle and continue their goals. Being in a small community, being with the bank and being a leader in that community, you are on a number of boards, and we understand how vital it is to keep our community together, to keep our community whole. We need new businesses. We need people coming to town. The bank is the lifeblood of that. That is who is going to be able to bring those individuals to town. That is who is going to be able to fund those loans to allow them to realize their dreams. That is what I enjoy doing, seeing somebody be able to start their own business.

Chairman HUELSKAMP. You talked a little bit about home mortgage lending, perhaps small business loans as well. I would like for you to explain how the regulations have restricted your ability to meet those needs. Secondly, who will take care of those needs if the First National Bank of Elkhart were not there?

Mr. HANES. That is a huge challenge from our side. I brought a couple things I would like to show. When I came to banking 20-plus years ago, this was a real estate note. We had a note, green, nice pretty form being a bank. A mortgage, that was it. A customer would actually read that, understand it, ask us questions. This is a real estate note, now. It is a half-inch thick, lots of pages to sign. We could not get a customer to read this if we forced them to. It is just flat too thick. We have taken it from something simple to something overly complex.

In our local market we do not have a lot of secondary mortgage options. We were just informed some time ago that our secondary mortgage lender that has been a big supporter of southwest Kansas now will no longer make a real estate loan less than $50,000. Well, that seems small. The average loan size of residential loans in our portfolio, $33,000. There would not be anybody in our portfolio that would even qualify to apply for a residential loan. I understand that is not a jumbo loan in your line of work, but at our bank that is a house loan. That is a typical house loan. We have to continue to serve that market as best we can, but we have to figure out a way that we can do it within the regulatory constraints, and that is the challenge we are not meeting.

Chairman HUELSKAMP. I am hearing this from other communities as well. Who is going to issue the home mortgage in these situations? I know many of the folks in the Kansas Bankers Association, in Oklahoma as well, are exiting the marketplace. Mr. Stanley is worried about online and some of these other entities, but what are the other options you have?

Mr. HANES. There are not a lot of options because our customers do not fit the model. They do not always have a W-2 that allows them to get paid once a month, and it is an easy way to figure their income. They have farm income. They have Schedule Fs, it does not fit the box. The loans that we wind up with are the ones that do not have access, cannot get access to those other markets. As a result, they have limited access to credit.

Chairman HUELSKAMP. Thank you, Mr. Hanes.

Mr. Beverage?

Mr. BEVERAGE. If I might add to that just a moment, Mr. Chairman, as I said earlier, banks are fairly resilient and try to figure out a way to meet their customers' needs. One of the things that has happened in Oklahoma is that our Bankers Bank has created an opportunity for referrals to Oklahoma City for consideration of those rural mortgages, because they do a lot of them, and they are able to withstand the litigation and regulatory risk that a much smaller bank cannot. In addition, one bank family has created a mortgage business that they offer, but since you are giving it up to your competitor, you might not get quite as many referrals to that instance.

My point is that with that referral also goes access to the community bank, and it is that relationship that is at risk here. It is that relationship, that reliability, the trust, the bond of trust that a banker like Shan has with his customers. A community bank is just simply so much more than a bank.

Chairman HUELSKAMP. Does Dodd-Frank understand or take that into account at all?

Mr. BEVERAGE. Some of the language does, but in the real world, no. The answer is based on the reality that the mentality is one size fits all.

A friend of mine had a $15 million bank. Very, very small. 3-1/2 employees. He had to do the same thing that JPMorgan Chase does. He made cattle loans and he made wheat loans. That is it, he did not do anything else. He did not have any derivatives. I mean, I am not sure he could spell derivative. Nevertheless, he was just a simple community bank in a simple little town of about 250 people. He just sold because he could not deal with it anymore. He is not the only one that is going to do that, and that is part of the issue.

My question to you, Mr. Chairman, is if rural community banks go away, who is going to finance the business of food production?

Chairman HUELSKAMP. That is a worry I have as well, as a farmer and a resident of small town America in western Kansas. Thank you.

I next recognize Representative Chu for her questions.

Ms. CHU. Thank you. Mr. Stanley, low income and minority neighborhoods were devastated by predatory mortgage lending in the years leading up to the housing crisis. Do you think these communities are better off today with the ability to repay in qualified mortgage rules that were enacted under Dodd-Frank?

Mr. STANLEY. Yes, I do. One thing we saw prior to the crisis was that people with equity in their homes were being targeted for exploitative loans that they could not pay back, at which point the bank would seize the collateral and perhaps profit on a loan that never should have been made. I do think that the QM and the Ability-to-Repay rules have made a critical difference in a lot of areas across America and will make a critical difference in addressing that.

Ms. CHU. While small financial institutions are particularly critical of these rules, how has the CFPB, the Consumer Financial Protection Bureau, specifically tailored the rules to account for the relationship banking model of small institutions?

Mr. STANLEY. The CFPB has made a lot of efforts to do that. One thing we have heard several times from the other witnesses is the desire to exempt on portfolio loans, loans that are held in portfolio from regulation. That can make sense for a bank that truly has a relationship lending model, and the CFPB has, in fact, exempted loans held in portfolio from many of the requirements under the new mortgage rules. It has been very responsive to that.

One thing that we see here in Washington, D.C., is that when you actually look at legislation that would roll back parts of Dodd-Frank and would do things like exempt loans held on portfolio, you see it does not just apply to small rural banks. It does not just apply to community banks. It applies across the board to large regional banks. Frankly, the reason that legislation draws fire from organizations like Americans for Financial Reform, from proponents of reform, is that it is not limited to the kinds of banks that we are talking about here today. I think that there is space both with regulators, and even possibly in Congress on a bipartisan basis, for legislation that is truly targeted at the kind of small rural banks we are talking about today.

Ms. CHU. Yes, Mr. Beverage?

Mr. BEVERAGE. Just to add something to what Mr. Stanley said about the CFPB and their willingness to accommodate some of these issues, he is correct. But, it has taken a while to get there. One of the things that we have done is that we have invited CFPB employees to come to Oklahoma. Two of them have taken us up on that, and I have taken them to small rural banks to show them how they work. I think that has had an impact as it enables the CFPB experts to understand the differences between a $40 million bank in Allen, Oklahoma, and Bank of America. I think that is important. But Mr. Stanley is right; it is getting better.

Ms. CHU. Thank you. I do appreciate that greatly.

Dr. Stanley, the CFPB is required to carry out extensive analysis before issuing regulations that will impact smaller institutions. As you know, a number of changes were made to accommodate small, rural lenders under CFPB's mortgage rules. Do you think the small creditor exemption allows community banks to continue making the mortgages that are the best for the customers?

Mr. STANLEY. The small creditor exemption does include a lot of additional flexibility on things like balloon payments, escrow requirements, debt-to-income ratios, and these kind of things. That is the flexibility that we need to see in small rural areas. Yes.

Ms. CHU. We have heard on many occasions that Dodd-Frank is the reason for many of the problems facing community banks. Can you explain how the Dodd-Frank Act can actually do the opposite and help level the playing field with their larger multinational competitors?

Mr. STANLEY. Yes. What we saw prior to the crisis was large banks gaming the system in a lot of ways. They would use complex international models to claim that their assets were less risky than the assets held by smaller banks, and they would use that to hold less capital and borrow more, be overleveraged. And Dodd-Frank has taken a lot of steps to even that. I think the CFPBs' jurisdiction over nonbanks is also very significant in terms of leveling the playing field.

Ms. CHU. Can you elaborate on your testimony regarding the issue of the declining number of community banks and the role of the FDIC's s supervisorial practices?

Mr. STANLEY. Yes. I think there is no question that the FDIC cracked down as a supervisor on a lot of bank risks in the parade around the crisis. I think a lot of that was justified because there were a lot of banks that had made loans in the commercial real estate space that had valuations that were inflated. As the economy was damaged, some of those risks were excessive. We saw a lot of banks failing, and the FDIC was concerned about that. They did crack down. I think there are issues and questions. They also cracked down, as one of the witnesses mentioned, on the opening of new banks and put in new requirements because they saw a lot of newer banks fail during the crisis. That is something that could be reexamined and thought about in terms of how they have done that.

Ms. CHU. Thank you. I yield back.

Chairman HUELSKAMP. Next, I recognize Representative Trent Kelly for questions.

Mr. KELLY. Thank you, Mr. Chairman, and Ranking Member. Thank you, witnesses, for being here.

Community banks are very important. I am from Mississippi, in a rural area with a lot of manufacturing, and a lot of agriculture. Quite frankly, it used to be the post office was the center of gravity for most small communities. The post office has consolidated, so now you have a town because you have a community bank. When you lose that bank, you lose the town. It is not just the banking. It is the guy who coaches softball or kids' baseball with you. It is the guy who goes to church with you on Sunday and sits by the pew. Your banker in those small communities is much more than your banker, and I understand that.

Unfortunately, based on your testimonies here today, it is not just Dodd-Frank. I can tell you my bankers do not have the same view as Mr. Stanley about Dodd-Frank and the impact it has on small banks. I can tell you they have talked to me again and again. I can tell you that the regulations are five binders this thick that they have to comply with, and they do not get paid for compliance. They have to comply with that, and they do not have the expertise. The net effect of that is a cost to the consumer, it has to be sucked up by the consumer because it is a nonrevenue-generating process.

Based on that, what is the impact that Dodd-Frank and other regulations have on the consumer and their financial ability to get along? Mr. Hanes?

Mr. HANES. I appreciate the question because that is exactly why I am here. That has been the big challenge. As I testified earlier, it used to be a source of pride within our little community bank. When we would do audits, or something internally, we would use it as a cross-training opportunity. We would grab somebody that might be from the other side of the bank and have them audit a loan side, or have a loan side audit an operations side. It was a way we could educate, we could cross train, we could bring that next level of leaders into the bank. Because they have gotten so thick, so heavy, and frankly, they are ever-changing, we cannot do that anymore. We do not have the expertise. We cannot have the expertise in our little 20-employee shop. What we have had to do is outsource to outside firms that come in for a period of a week or a few days and do those audits. Well, that comes at a cost. In our respect, we are paying more than a full-time employee's salary to outside firms to come in and do audits that we used to be able to do ourselves. I do not have a problem doing the audits. I do not have a problem following the regs, but they have gotten so large, so cumbersome, and frankly, they seem to change and we cannot do that anymore. The effects one less employee, one less teller serving our customers, our customers do not get as good a service, one less job in the community. You are right, we are the t-ball coach and the swim coach and the basketball coach. It is one less job.

Mr. KELLY. Let me follow up on that a little bit because my community seems like it is a lot like yours in Elkhart. A lot of my loans are not $50,000, and a lot of times they are for homes because the state prices are much better in rural areas. You can get a lot more house for a lot less money. It is also because of the same economic things where you do not have the steady W-2 necessarily. What impact does it have for those $50,000 or less loans, for folks that are not going to be able to get that money anywhere, which means they do not have a house and those things. Can you expand on that just a little bit?

Mr. HANES. Sure. Thank you, I appreciate that.

The biggest house loan in town probably would struggle to get to six digits. We do not have that large of a housing market. The largest number of people looking for a house loan do not want, do not need, and would not ask for a loan in six digits. They are looking for that $50,000 to $60,000, that $40,000 house to get them started. The secondary market is not an option because they simply will not even take an application if it is under $50,000 because they have determined anything below that is not profitable for them. So, their only option is their local community bank, and the majority of the banks around me do not make residential real estate loans anymore. As a result of that, they have far less access to credit than they would have had before, and it has put them at a disadvantage both now and for the long term. They cannot own a house.

Mr. KELLY. Mr. Chairman, if I can, I will let Mr. Beverage comment.

Mr. BEVERAGE. I wanted to add to what Shan said. The primary impact on consumers is that it increases their costs. In a rural area, you simply do not have a pool of compliance officers who are knowledgeable about everything that is going on and everything that is required of a bank today. You do not have any choices regardless of what you would pay them, so you have to outsource. You have to use the association, or a program that we would sponsor, or your own private expert to help you get through what the OCC has told us is the principal issue for examination s. Compliance is one. Cyber security is two. Credit is three. That is important to understand.

Mr. KELLY. My time is expired. I yield back, Mr. Chairman, thank you.

Chairman HUELSKAMP. Thank you.

Next, I recognize Representative Luetkemeyer, Vice Chairman of the Committee. Welcome to the Subcommittee.

Mr. LUETKEMEYER. Thank you, Mr. Chairman. Glad to be with you.

I also serve on the Financial Services Committee, and so we have been working on some Dodd-Frank issues and some Dodd-Frank reform. We have heard a lot of testimony. Let me read you a few statistics. Before Dodd-Frank became law, 75 percent of banks offered free checking; now only 37 percent at the end of 2015. Dodd-Frank fueled a 21 percent surge in checking fees, 15 percent fewer credit card accounts since 2008 at a cost now of more than 200 basis points more than what they had. 73 percent of community banks report regulatory burdens are preventing them from making residential loans. We have heard that testimony. One last number here. The cost of the smallest commercial industrial loans has risen at least 10 percent from the pre-crisis average.

I can tell you, I am from Missouri, at the end of 2015, we had 44 banks that were $50 million or less. Those are little bitty guys. Remember, we are talking about small, rural communities, and that is probably the only bank in town, like probably yours is, Mr. Hanes, and those guys, out of 44, 26 lost money last year.

FDIC did a study back in 2013. It said within the next 5 years, any bank $250 million or less is probably going to go out of business. Not because they are bad banks, not because of the economy, but because the rules and regulations that are coming are going to force them to consolidate, and Dodd-Frank is the culprit. Dodd-Frank created all of this group of regulations that is out there.

Mr. Hanes, you talked a minute ago about QM rules. QM, at your size, you are supposed to be exempt from it; right? But, if you want to sell a mortgage to the secondary market, do you have to comply with it?

Mr. HANES. Yes, we do.

Mr. LUETKEMEYER. So even hough you were exempted, you still have to comply. These rules roll downhill, do they not?

Mr. HANES. That is the part I would like to say, Ms. Chu. We were supposed to be exempted from a lot of Dodd-Frank and that threshold. But what happened, whether intentionally or probably unintentionally, was the trickle-down effect, exactly what we are talking about. What is a best practice for Bank of America, the examiners see that and they see that is a nice stress test, that is a nice little study, why do you guys not do that, too? It trickles down to where, all of a sudden, we are doing that same thing as Bank of America. The big banks, they might have a team, a department, a program that they developed to handle that, we do not. We have got Excel. We have to come up with something that is going to work. That trickle-down effect is what we were not exempted from. I agree that is a challenge.

Mr. LUETKEMEYER. I have another question for you, Mr. Beverage. I have a question with regards to Dodd-Frank, we are losing one community bank a day across the country right now. Dodd-Frank was supposed to be the cure all here. It was supposed to keep the big guys under control, but I believe—let me make this statement, and Mr. Beverage, I will appreciate your comment on it—I believe Dodd-Frank has caused the big banks to get bigger and put the pressure on the small banks to go out of business and merge with them. Would that be a fair statement?

Mr. BEVERAGE. Yes, sir. It does not tell the whole story, but it is certainly relevant.

One of the things that I wanted to add to what Shan said, and in response to what Mr. Stanley testified about, is the exemption that banks under $10 billion are supposed to have from the CFPB. They do have exemption from direct examination authority, although there is ride-along authority, and that is a different issue, but they are not exempt from the rules and regulations that the CFPB has revised and imposed. They still have to follow those. The primary federal banking regulator is then the one that examines for compliance. In smaller banks, that is a cost, that does not bring a dime to the bottom line, which means less capital, and more importantly, less ability to lend to consumers.

Mr. LUETKEMEYER. Okay, very quickly. My experience keep discussing this with bankers across the country of all different sizes, and I have asked this question of a lot of them and they say anytime, because of the increased costs of compliance and the complexity of it. When you hire a loan officer, you have to hire one compliance officer. When you look at these small banks, when you hire a loan officer, the compliance officer does not make you any money. You have to spread those costs out over your bank, and you reach a point at which the rubber band breaks and then you have to do something different. This is where they are.

I think I could go on all day here but I see my time is about out, but I appreciate you gentlemen's testimony this morning, and I think that small banks make loans to small businesses. That was the testimony in this Committee not too long ago, and I think that we need to make sure that we keep the banks in business so the small businesses have an access to credit ability. Without that, small business communities dry up, and whenever rural America goes away it hurts the ability to produce food and produce all the rest of the things this country relies on.

Thank you very much for your testimony today.

Chairman HUELSKAMP. I appreciate those questions, I will note Mr. Hanes has come a long way and I would like to ask him another question. I think you drove 100-plus miles to an airport, then took a connection, two of them to get here. You have come a long way. One other subject you did bring up, Shan, is that you thought it an unfair playing field in the particular area of agriculture, which is the bread and butter of your bank, it is hard to compete. Can you describe that a little bit more and what would you suggest as a way to level that playing field?

Mr. HANES. I believe there are several ways. I believe you are referring to Farm Credit Services and their tax-exempt status on real estate loans. They currently have a tax rate of about 4 percent. If you compare that to my 38 percent bracket, that is a huge, unlevel playing field. There are several ideas that I would like to consider. The biggest and the most obvious is they do not pay income tax on income earned from interest on real estate loans. Give us that same opportunity. I do not mind competing with anybody, that is what made America great. But let us compete on a level playing field and do not let me start 34 percentage points behind them on a tax rate.

Chairman HUELSKAMP. I appreciate that.

I want to follow up with Mr. Stanley, in trying to understand your perspective of what is occurring here, and I do not know if you have ever been in a small town or a community bank we are talking about, looked at that, but frankly, Mr. Stanley, I do not know how they are able to compete with the Bank of America. The regulatory or the legal changes coming out hopefully at a Financial Services Committee, Bank of America does not want the changes. They do not want to change Dodd-Frank. They like the setup. As I understand, they are opposed to making changes. They found out how to game the system. But when you have Mr. Hanes and other banks across western Kansas, I think we all agree we want consumers to have more options, not fewer of them. When I hear from community banks that they are saying any loan under $100,000, and there are very few of those, are losers—they are going to lose money on them, and the Feds do not want them to do it anyway—they are left with some of the predatory lenders you are talking about. Bank of America is not going to come to Elkhart, Kansas. I guarantee you that. They have no desire. What they want to do is maybe buy up your bank. I do not know what they would want to do, I think they would just want to ignore that. I am just trying to understand from the perspective and the group you represent, which in inner cities I think you saw those predatory practices, but how does that apply to a small rural town if they are going to have no options when we are done with Dodd-Frank? I open it up to you, Mr. Stanley.

Mr. STANLEY. I think, first of all, you are going to see a lot of large financial institutions that end up supporting the package that comes out of Chairman Hensarling. I think that there is enormous diversity in the American banking system. We have 6,500 banks across all different sizes of communities. What we are very focused on and concerned about is that any changes to tailor these regulations, and there have been changes made both at the regulatory level and in the Dodd-Frank statute, do not become loopholes that can then be used by larger banks or can be used in rent-a-charter situations where somebody gets a bank charter and then sells stuff out into the secondary market that does not meet certain kinds of standards.

One thing I see with a lot of the legislation that comes out is it is not limited to the kinds of banks that are in Elkhart, Kansas. It is not limited to $100 million banks, $250 million banks. It does open the door to either banks that are in that $50 to $500 billion space, the very large regional banks that are among the largest couple dozen banks in the country, or even to the top six or seven global banks that dominate Wall Street. I think that there is space, there has been space in the Senate. Actually, there was a package passed for community banks that was limited to community banks, so I think there is bipartisan space for legislation that is very targeted and crafted to the kinds of banks that you are talking about in Elkhart, Kansas, but we do not often see that.

Chairman HUELSKAMP. Do you think they represent any threat to the economic system? Why are they being punished by these regulations at all? I mean, we have experts. They spent hours and days and weeks and months and years of putting it together, and the other day Mr. Hanes comes in and says most of my competitors are leaving the marketplace. The big city said, well, that is just too bad you cannot get a home mortgage in Elkhart, Kansas. That is one of the costs of taking care of the big banks. But I agree with Mr. Luetkemeyer. The end result is they are too big to fail and too small to succeed, and I think that is happening in this arena.

Mr. STANLEY. Would you like me to respond?

Chairman HUELSKAMP. Please.

Mr. STANLEY. I think there are a couple things. First of all, with respect to consumer protection, if something happens that damages a consumer, it may not matter to that consumer whether that happened at the hands of a small bank or a large bank. I think the vast majority of cases, there is no intent to harm consumers, some of these rules that we are talking about—overdraft fees, things like that, the CARD act that affected credit cards. That probably does not affect you guys much. But, overdraft fees were a source of revenue for small banks. There were abuses in terms of overdraft fees and there were consumer protection things that were done to address that. Interchange fees. That is something there were complaints about from small businesses, but small banks had issues and problems with the regulatory changes that were made for interchange fees. That is one set of things on these consumer protection things.

I think in terms of prudential protections, we do have to remember that even if you do not threaten the national global financial system, you are dealing with insured deposits. There is a backstop, a government backstop behind those deposits, so there is an interest by the FDIC in prudential risk regulation as long as those insured deposits are there.

Chairman HUELSKAMP. Mr. Stanley, I appreciate that, and I will note I do not know of a single bank in the western half of the State of Kansas that failed in this situation. They get to take on all the regulations, so I am not worried so much about consumer protection; I am worried that they will not have any more choices. We will probably be sitting here in 3 or 4 years saying gosh darn it, what are we going to do to make sure they can get a loan in Elkhart, Kansas? We are about at the end of that stick.

I am going to ask Ms. Chu or Mr. Luetkemeyer, I am being a little flexible here, if you have any follow-up questions.

Seeing none, or if you had another round of questions?

Mr. LUETKEMEYER. I have a couple more here.

Mr. Beverage, we have been discussing a little bit about new banks being chartered. There have only been, what, two in the last 5 years, I think?

Mr. BEVERAGE. Maybe three.

Mr. LUETKEMEYER. Maybe three? You know, if you are an investor and you go out here and you see the numbers we have been throwing around here today, especially small banks, if you are an investor, why would you want to invest in a business like this where you are going to get regulation from the top down, and more of it when the CFPB is just out of control with the TRID rule, the QM rule that basically runs real estate mortgages out of existence in small communities? If you are a new bank trying to get started, what are you going to make loans on? Can you give me some insight? I do not see why an investor would go in and try to buy, start a new bank.

Mr. BEVERAGE. In this environment, neither do I. I would advise against it until we get some changes that will help community banks serve consumers in ways that do not jeopardize them. I just cannot help but say this. Community bankers do not get up in the morning thinking about how they can screw their customers. They get up in the morning thinking about how they can take care of them because those customers are vital to the survival of that community. When a bank makes a loan, basically, there are two questions. You know this. One, can you and will you repay it? If all of that works, then the bank wins, the customer wins, and the community wins because you get jobs, you get economic involvement, you get economic activity. These people grow up together, for heaven's sake. They know everybody. They have a list of things that they can no longer do because they are afraid of fair lending allegations. They are afraid if I screw up on an appraisal or on a valuation, or if I do not dot an I, or cross a T properly, I am going to get sued. Now, rightly or wrongly, that is a fear.

Mr. LUETKEMEYER. One of the problems with the QM rule is that by saying it is a qualified mortgage means it is a qualified mortgage, inferring that it is a preferred mortgage. If it is a nonqualified mortgage, they are by inference saying there must be some additional risk there. There must be a problem here. It opens you up as a banker to a lot of liability exposure even though it may not be. Just the inference it is a nonqualified loan, by differentiating between the two, suddenly now you are put in a position to decide is there a liability risk that I have got to take here by making this kind of a loan, a nonportfolio loan? This is the predicament that banks are in, and this is why you wind up not making real estate loans and getting out of the business because you see the liability situation sit in front of you, like I cannot take this risk.

Mr. LUETKEMEYER. Mr. Hanes, I see you have been anxious to jump in here.

Mr. HANES. Sorry about that.

Number one, as I said earlier, we are now making a compliance decision, not a credit decision—when we look at a loan—and that is wrong. That is not what we are built to do. That is not what we should be doing, but we are making a compliance decision. Are we going to make this loan? Is this one that we are not going to get written up for later? Is this one that we are not going to have to redisclose everything because we got something on a wrong line? It is a compliance decision to not make a loan versus a credit decision.

I would like to follow up on your original comment there, I had an opportunity in 2011 to put a holding company together to buy the local bank, a great source of pride and a great opportunity. I have actually gone down that exact path. To follow up on what Mr. Stanley said, community banks have become profitable in spite of Dodd-Frank; definitely not because of Dodd-Frank. We continue to work around and with those rules. The reason you invest in the local small bank, I can tell you is because you want the bank there. You do not want it being sold. You do not want it closed. The group that we put together, they grew up there. They want their local bank there. They grew up knowing that that was their bank and that was where their kids banked, and those kids are now customers. They have moved on to California or wherever, and they are still our customers. The reason you get investors to invest is because they want their local bank and they want to be a part of their local bank. We are not getting investors from outside; we are getting investors from down the street and across the street.

Mr. LUETKEMEYER. Just to show you, I did not bring it with me this morning, but I have a sheet at home that details how you go through a real estate mortgage. There are 247 things on this sheet of paper here that you go down and you check a box. Okay, it is this size, so you go here. Then I got this kind of collateral, so you go here. It is a sole proprietorship or it is a husband and wife, so you go here. There are 247 ways you can get tripped up when you make a loan. A lot of that is on the CFPB. That is their problem.

QM, CFPB's own sheet is like this. You take two sheets and you put them together like this, it is like a Rubik's cube. You go through here, you go out here, you go here, and then you wind up going on this one. It is unbelievable, and you wonder why banks get out of lending. You wonder why they are getting exposed to this. You wonder why the costs of consumers go up. Somebody has to pay for this extra compliance cost when you have one loan officer for one compliance officer.

Thank you, gentlemen, for being here today. I yield back.

Chairman HUELSKAMP. I would like to thank all of our witnesses for their participation today. It is never easy to take time out of your busy schedules and to come and talk with us, but you help us understand the unique impact that overregulation can have on our rural communities. All too often it is our consumers, our small businesses, farms and ranches, and entrepreneurs that ultimately feel the burden. Here at the Committee, we remain dedicated to working to ensure that small businesses are allowed to grow, thrive, and provide economic opportunities to the community.

I ask unanimous consent that members have 5 days to submit statements and supporting materials for the record.

Without objection, so ordered.

This hearing is adjourned.

[Whereupon, at 11:06 a.m., the Subcommittee was adjourned.]

APPENDIX

June 9, 2016

Testimony of

Roger Beverage

On Behalf of the

AMERICAN BANKERS ASSOCIATION

before the

The Committee on Small Business
Subcommittee on Economic, Growth, Tax and Capital Access
of the
United States House of Representatives

American
Bankers
Association

Chairman Huelskamp, Ranking Member Chu and members of the subcommittee, my name is Roger Beverage, and I am the President and Chief Executive Officer of the Oklahoma Bankers Association. I appreciate the opportunity to present the views of the American Bankers Association (ABA) on the impact of regulations on rural communities. This is a subject near to my heart. The ABA is the voice of the nation's $16 trillion banking industry, which is composed of small, regional and large banks that together employ more than 2 million people, safeguard $12 trillion in deposits and extend nearly $8 trillion in loans.

ABA appreciates the opportunity to be here today to speak on how the growing volume of bank regulation—particularly for America's hometown banks—is negatively impacting consumers because these same, perhaps well-intentioned rules and regulations limit the ability of banks throughout the nation to meet the needs of our customers' and communities. This is not a new subject, yet the imperative to do something grows every day.

America's hometown banks are resilient, and have found ways of meeting our customers' needs in spite of the ups and downs of the economy. But it is a job that has become much more difficult because of the avalanche of new rules, guidances and seemingly ever-changing expectations of the regulators.

This new regulatory atmosphere—not the local economic conditions—is often the tipping point that drives small banks to merge. The fact remains that there are nearly 1,500 fewer banks today than there were 5 years ago—a trend that will continue until some rational changes are made that will provide some relief to America's hometown banks.

In fact, today in Oklahoma there are 211 banks chartered in the state. When I came to Oklahoma in 1988—there were well over 400 banks. More frightening is the lack of interest and ability for new charters. There have only been two true de novos since 2010, and none in Oklahoma.

Each and every bank in this country helps fuel our economic system. Each has a direct impact on job creation, economic growth and prosperity in the community it serves.

America's hometown banks are like other businesses—they buy their "product" at wholesale and then sell it at "retail." What that means is credit cycle that banks facilitate is simple: customer deposits provide funding to make loans. These loans allow customers of all kinds—businesses, individuals, governments and non-profits—to invest in their hometown and across the globe.

The profits generated by this investment flow back into banks as deposits and the cycle repeats—creating jobs, wealth for individuals and capital to expand businesses. As those businesses grow up, they, their employees and their customers come to banks for a variety of other key financial services such as cash management, liquidity, wealth management, trust and custodial services. For individuals, bank loans and services can significantly increase their purchasing power and improve their quality of life, helping them attain their goals and realize their dreams.

This credit cycle does not exist in a vacuum. Regulation shapes the way banks do business and can help or hinder the smooth functioning of the credit cycle. Bank regulatory changes—through each and every law and regulation, court case and legal settlement—directly affect the cost of providing banking products and services to customers. Even small changes can have a big impact on bank customers by reducing credit availability, raising costs and driving consolidation in the industry that limits consumer choice.

Everyone who uses banking products or services is touched by changes in bank regulation. It is imperative that Congress take steps to ensure and enhance the banking industry's ability to facilitate job creation and economic growth through the credit cycle. The time to address these issues is now before it becomes impossible to reverse the negative impacts. When a bank disappears everyone is impacted.

Importantly, in rural communities, smaller community banks are (in many instances) the exclusive source of capital farmers, ranchers, small business owners and its residents. Once that capital-access system becomes dysfunctional—as it is today—the community itself begins to encounter more difficult challenges in order to survive.

We urge Congress to work together—Senate and House—to pass legislation that will enhance the ability of community banks to serve their customers. In particular, Congress can take action to ensure credit flows to communities across the country by:

- Supporting tailored regulations for the banking industry;
- Improving access to home loans, and;
- Removing impediments to serving customers.

In the remainder of my testimony, I will highlight some specific actions under each of these suggestions that would help begin the process of providing meaningful relief to help community banks and help bank customers.

I. Support Tailored Regulation for the Banking Industry

Banks are in the business of serving customers and communities. Banks are where prospective homeowners obtain home loans, small businesses find capital, and customers receive advice on how to manage their nest eggs for a financially secure future.

But the role banks play serving their communities has been placed in jeopardy by the broad array of new regulations. For example, the typical small bank with one compliance officer has recently had to contend with more than 2,000 pages of new regulations, and that is just the housing, capital and remittance areas.

Moreover, the Dodd-Frank Act has charged federal financial regulators with writing and enforcing 398 new rules, resulting in at least 13,644 pages of proposed and final regulations, and that's with regulators only halfway through the rulemaking process. While not all of those rules apply to all banks, many do. Even the rules that do not, tend to have trickle down and become "best practices" as determined by the bank's primary federal banking regulator. Those regulators then apply those requirements to thousands of banks otherwise not subject to the rule.

The key to changing the consolidation trend is to stop treating all banks as if they are the same or as if all banks operate in the same manner as the largest and most complex institutions. They don't. Financial regulation and examination should not take a one-size fits all approach. To do so, only layers on unnecessary requirements that add little to improve safety and soundness, but add much to the cost of providing services—a cost which bank customers ultimately bear.

Instead, ABA has urged for years that a better approach to regulation is to tailor bank supervision to take into account the charter, business model, and scope of each bank's operations. This would ensure that regulations and the exam process add value for banks of all sizes and types.

Regulators should be empowered—and directed—to make sure that rules, regulations and compliance burdens only apply to segments of the industry where it is warranted. Only then can America's hometown banks be freed up to best serve their communities.

Tailor Regulation to a Bank's Business Model

The ABA recommends that Congress ensure that regulation is tailored to a bank's business model. Time and again, I hear from bankers wondering why the complex set of rules, reporting requirements, and testing that are imposed upon the largest most diverse and global institutions become the standard applied to the smaller community banks in the country. The approach seems to be: "If it's the 'best practice' for the biggest banks it must be the best practice for all banks." Such an approach makes no sense in our diverse banking system with different business models and strategies.

Of course, the supervisory process should assure risk is identified and managed prudently. This risk assessment must be appropriate to the type of institution. In the aftermath of the financial crisis, the pendulum of bank examination has swung to the extreme—affecting every sized bank. Overbroad, complicated restrictions supplant prudent oversight. Inconsistent examinations hinder lending, increase costs, and create procedural roadblocks that undermine the development of new products and services for bank customers.

The banking agencies should move towards customized examinations that consider the nature of a bank's business model, charter type, and perhaps most important, bank management's success at managing credits, including a borrower's character, prior repayment history and strength of personal guarantees. In today's complex banking environment, an array of risk factors has had a far greater impact on a banks' ability to serve its customers—as well as its likelihood to get in trouble—than an arbitrary asset size.

The ABA encourages Congress to support legislation that would ensure banks are regulated according to their business model, such as H.R. 2896, the Taking Account of Institutions with Low Operation Risk Act (TAILOR Act) of 2015, introduced by Rep. Scott Tipton (R-Colo.). This legislation would require regulators to tailor regulatory actions so that they apply only when the bank's business model and risk profile require them—not just based on asset size. This legislation empowers regulators to make sure that rules, regulations and compliance requirements only apply to segments of the industry where warranted.

II. Improve Access to Home Loans

The mortgage market touches the lives of nearly every American household. Banks help individual consumers achieve lifelong goals of homeownership by giving them access to the funding they need. Without home loans most Americans would not be able to purchase a home.

Banks are a major source of mortgage loans—holding more than $2 trillion in one-to-four family home loans on their books and originating others under government guarantees. In addition, banks support the housing industry with construction and development loans, and homeowners with home equity lines of credit. These critical services of banks results in more income and jobs in communities, along with a larger tax base for local governments.

Borrowers across the country—served by banks of all sizes—should be able to obtain safe, sound and well underwritten home loans. However, it is clear that new restrictive regulatory requirements have kept some creditworthy borrowers, particularly first-time homebuyers, from obtaining much needed mortgage credit. The complex and liability-laden maze of compliance has made home loan origination more difficult, especially for borrowers with little or weak credit history. Over-regulation of the mortgage market has reduced credit available to bank customers, raised the cost of services, and limited bank products. The result has been a housing market still struggling to gain momentum.

In Oklahoma, approximately 25 percent of the state's banks have simply elected to get out of the home mortgage lending business. They have concluded that both the litigation and regulatory risks they would encounter are simply too great given the limited number of such loans they normally would make in a given year. That means their customers are either denied credit or must search for an alternative source of capital. This is especially true for rural areas.

Congress can help reduce needless impediments to mortgage lending that have constrained the banking industry's ability to help first-time homebuyers and dampened the growth of prosperity across the nation's communities. For example, Congress should:

Treat Loans Held in Portfolio as Qualified Mortgages

The Dodd-Frank Act (DFA) is very restrictive in its definition of "ability to repay" (ATR) and Qualified Mortgage (QM)—having a detrimental impact on the market and consumer access to credit. Portfolio lending is among the most traditional and lowest-risk lending in which a bank can engage.

Loans held in portfolio are well underwritten because if a loan is to be held in a bank's portfolio, the bank carries all of the credit and interest rate risk associated with that loan until it is repaid. Therefore it must be conservative to protect the safety and soundness of the bank, and these loans are made with no risk to the nation's taxpayers.

ABA supports H.R. 1210, the Portfolio Lending and Mortgage Access Act, introduced by Rep. Andy Barr (R-Ky.), which passed the House on Nov. 18, 2015. It would treat any loan made by an insured depository institution and held in that lender's portfolio as complaint with the Ability-to-Repay/Qualified Mortgage requirements and would provide an important and much needed correction to the restrictive standards that now exist.

This legislation is fully consistent with the intent behind the Dodd-Frank Act in that it encourages "skin in the game" or risk retention by the originating lender. By encouraging banks to hold these loans on their books, the act will expand safe, affordable lending for more borrowers who look to America's hometown banks for safe, affordable credit.

TILA-RESPA Integrated Disclosure Rule (TRID)

The TILA-RESPA Integrated Disclosure Rule (TRID) became effective in October 2015 and changed all residential mortgage origination disclosures as well as systems which generate and track originations. The new rules are extremely lengthy and technical, and carry substantial administrative and legal liabilities.

ABA has expressed high concerns that this rule contains inadequacies that require immediate clarification and resolution for the Consumer of Financial Protection Bureau (CFPB). Uncertainty about the treatment of minor errors and oversights has broadly affected mortgage originators. Current legal uncertainties ultimately harm the consumer. Such uncertainties threaten liquidity in key portions of the market possibly restricting consumers' access to mortgage credit. In addition, lack of legal uncertainty poses risks that ultimately inflate prices to the consumer.

ABA and various industry partners have communicated to Director Cordray that immediate action is urgently needed to allay lender and investor concerns regarding TRID liabilities. We have requested that the CFPB: (1) formally publish authoritative guidance clarifying the scope and extent of TRID legal liabilities and assuring stakeholders that there are viable cure provisions for correcting technical errors and mistakes; (2) form an internal Task Force to engage with industry stakeholders to identify compliance and legal problems to be addressed via published guidance or interpretive rulemaking, and; (3) extend the current "good faith" implementation period for TRID until all regulatory issues and fixed and banks are granted a reasonable period to adapt compliance systems. Such actions will ensure a healthy bank mortgage lending environment, while ensuring consumers have access to well-priced financial options.

III. Remove Impediments to Serving Customers

Rules and requirements surround every bank activity. When it works well, bank regulation helps ensure the safety and soundness of the overall banking system. When it does not, it constricts the natural cycle of facilitating credit, job growth and economic expansion. Finding the right balance is key to encouraging growth and prosperity as unnecessary regulatory requirements lead to inefficiencies and higher expenses which reduce resources devoted to serving customers and communities.

Regulatory requirements for the banking industry have grown dramatically in recent years, hindering in particular rural banks' ability to take care of their customers and serve local communities. By reducing or minimizing regulatory requirements for these rural community banks, Congress would allow banks to provide more credit, products and services to meet the needs of their local communities.

Address the Cumulative Impact of the Increasing Number of Regulations

The ABA supports many bills that would address banks' concerns with growing regulatory requirements on consumers and especially rural areas. Several bills incorporating provisions which would provide regulatory relief to America's hometown bank have been introduced in the House and Senate, such as:

★ H.R. 1389, the American Jobs and Community Revitalization Act of 2015, introduced by Rep. Andy Barr (R-Ky.), and;

★ H.R. 1233, the Community Lending Enhancement and Regulatory Relief Act (CLEARR Act), introduced by Rep. Blaine Luetkemeyer (R-Mo.)

American Jobs and Community Revitalization Act of 2015

ABA supports Rep. Andy Barr's (R-Ky.) American Jobs and Community Revitalization Act of 2015 legislation which contains a number of provisions that will reduce the regulatory requirements for America's rural hometown banks around the county in ways that make it easier for them to meet their customers' needs. For example, the legislation includes provisions that would:

- **Require a review and reconciliation of existing regulations.** Congress should require a review and reconciliation of existing regulations that may be in conflict with or duplicative of new rules being promulgated by the banking agencies, or which in their application badly fit the variety of institutions that make up the banking industry.

- **Streamline currency transaction reporting.** Anti-money laundering efforts by financial institutions can be improved by eliminating needless currency transaction reporting through a "qualified customer" exemption to the Currency Transaction Reporting (CTR) rules. This would significantly reduce the more than 13 million CTRs filed annually, saving banks many hours each year in filling out unneeded and unused forms. Importantly, it would give them more time to devote to what they do best: take care of their customers and communities.

- **Ensure Subchapter S banks are treated equitably.** Banks are required to build capital under the Capital Conservation Buffer requirements of the agencies' Basel III regulations. However, the current regulations do not take into consideration the unique cash flows applicable to S Corporation banks where income is calculated prior to consideration of distributions for payment of taxes arising from S Corporation activities. This puts S Corporation banks at a disadvantage when compared to C Corporation banks.

Community Lending Enhancement and Regulatory Relief Act

ABA supports Rep. Blaine Luetkemeyer (R-Mo.) Community Lending Enhancement and Regulatory Relief Act (CLEARR Act) which contain a number of provisions that would lift or modify many unnecessary restrictions, better allowing community banks to meet the needs of their customers. In particular, this legislation would:

- **Ensure the costs and benefits are considered before issuing new regulation.** The bill also would require the Securities and Exchange Commission (SEC) to conduct an analysis of the costs and benefits, including economic benefits, of any new or amended accounting principle. Benefits to investors would have to outweigh costs before the SEC could recognize the principle.

- **Improve Access to Home Loans.** This bill also contains a number of provisions to ensure consumers have access to home loans as discussed above.

Evaluate Necessity of Basel III Complex Capital Requirements

In addition, Basel III poses a significant compliance requirements on most rural community banks. The banking agencies estimate that the direct compliance cost of ***only*** the risk weighted asset portion of the final rules to be $43,000 ***per institution*** for banks under $500 million in assets.

While complex, the risk weighted asset portion of Basel III is just one component of the final rules. The overall cost for banks over $500 million is almost certainly significantly higher. Unnecessarily, complex capital requirements force banks to devote resources away from lending opportunities.

Although the industry is over a year into implementation, many institutions continue to struggle with understanding the rule's complexities. The sections of Basel III ABA members most commonly cite as creating the greatest compliance burden include: (1) new definition of High Volatility Commercial Real-Estate (HVCRE); (2) new risk weighting methodology for private label securitizations; and; (3) new credit conversion factors for short-term lines of credit. Furthermore, even as America's hometown banks are working through Basel III implementation, the international Basel Committee has issued a steady stream of new proposals that could be adopted in the United States.

ABA believes that highly capitalized banks and particularly those that serve rural America, should be exempt from Basel III and any potential future changes to the Basel framework. Using data from the Federal Deposit Insurance Corporation (FDIC), ABA estimates that some 4,000 banks may already have far more capital than Basel III would require. For these banks, the considerable and costly work of Basel III compliance yields no additional supervisory or safety and soundness benefits, and provides no services to customers.

Conclusion

America's hometown banks have been the backbone of communities across nation. Our presence in small towns and large cities everywhere means we have a personal stake in the economic growth, health and vitality of nearly every community. Once again, this is particularly true for those banks that serve rural America.

A bank's presence is a symbol of hope, a vote of confidence in a town's future. When a bank sets down roots, communities thrive. When they leave or reduce services, communities, and consumers do not thrive. It's that simple.

We urge Congress to act now and pass legislation to help turn the tide of community bank consolidation and protect communities from losing a key partner supporting economic growth.

June 2016

Testimony of

Shan Hanes

before the

Small Business Committee

Economic Growth, Tax and Capital Access Subcommittee

United States House of Representatives

May 2016

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of the

United States House of Representatives

June 9, 2016

Chairman Huelskamp, Ranking Member Chu, and members of the Subcommittee, my name is Shane Hanes, and I am the President and CEO Board of First National Bank in Elkhart, Kansas. First National Bank is a $78 million bank with a main location in Elkhart, Kansas and one branch serving Rolla, Kansas and the surrounding area. We have 20 employees and we predominantly lend to agriculture. Despite our small size, the bank is the largest lender in the county and we represent an average sized bank in rural Kansas.

I am also a member of the American Bankers Association's Agricultural and Rural Bankers Committee. I appreciate the opportunity to present the views of the ABA on credit conditions and credit availability in rural America.

The nation's $16 trillion banking industry, which is composed of small, regional and large banks that together employ more than 2 million people, safeguard $12 trillion in deposits and extend nearly $8 trillion in loans. Rural credit issues are very important to the banking industry as banks have provided credit to rural areas since the founding of our country. Over 5,000 banks—over 82% of all banks—reported agricultural loans on their books at year end 2015 with a total outstanding portfolio of over $171 billion.

The topic of today's hearing is very timely. The rural economy has been slowing, with farm sector profitability expected to decline further in 2016 for the third consecutive decline. However, farm and ranch incomes for the past five years have been some of the best in history. With the new Farm Bill in place, farmers, ranchers, and their bankers have certainty from Washington about future agricultural policy and how it will affect rural America. Interest rates continue to be at or near record lows, and the banking industry has the people, capital and liquidity to help rural America sustain through any turbulence in the rural economy.

Banks continue to be one of the first places that farmers and ranchers turn when looking for agricultural loans. Our agricultural credit portfolio is very diverse—we finance large and small farms, urban farmers, beginning farmers, women farmers and minority farmers. To bankers, agricultural lending is good business and we make credit available to all who can demonstrate they have a sound business plan and the ability to repay.

In 2015, farm banks—banks with more than 15.5% of their loans made to farmers or ranchers—increased agricultural lending 7.9 percent to meet these rising credit needs of farmers and ranchers, and now provide over $100 billion in total farm loans. Farm banks are an essential resource for small farmers, holding $48 billion in small farm loans, with $11.5 billion in micro-small farm loans (loans with origination values less than $100,000). These farm banks are healthy and well capitalized and stand ready to meet the credit demands of our nation's farmers large and small.

In addition to our commitment to farmers and ranchers, thousands of farm dependent businesses—food processors, retailers, transportation companies, storage facilities, manufacturers, etc.—receive financing from the banking industry as well. Agriculture is a vital industry to our country, and financing it is an essential business for many banks, mine included.

Banks work closely with the Small Business Administration to provide credit through the 7(a) and Section 504 guaranteed lending programs. Additionally, banks like mine utilize USDA to make additional credit available by working with the Farm Service Agency to promote Guaranteed Farm Loan Programs and Rural Development for their many programs available for rural communities. The repeal of borrower limits on USDA's Farm Service Agency guaranteed loans has allowed farmers to continue to access credit from banks like mine as they grow, ensuring credit access for farmers across the country and the guaranteed funding of USDA's Rural Development programs has encouraged banks like mine to use these programs when applicable.

In my testimony today I would like to elaborate on the following points:

- Banks compete with competition on an uneven playing field;
- Banks must deal with the daily impact of new and enhanced bank regulations and impediments to growth for rural communities;
- Bank's specific impediments to growth and impact on rural lenders;
- The current issues with appraisers in rural America and the impact on our business as lenders.

I. Unfair competition

The Farm Credit System is a government sponsored entity that has veered away from its intended mission and now represents an unwarranted risk to taxpayers. The Farm Credit System was founded in 1916 to ensure that young, beginning, and small farmers and ranchers had access to credit. It has since grown into a $304 billion behemoth offering complex financial services. To put this in perspective, ***if the Farm Credit System were a bank it would be the ninth largest in the United States, and larger than 99.9% of the banks in the country.*** This system operates as a Government Sponsored Entity and represents a risk to taxpayers in the same way that Fannie Mae and Freddie Mac do. It benefits from significant tax breaks—valued at $1.3 billion in 2015—giving it a significant edge over private sector competitors. Moreover, the Farm Credit System enjoys a government backing, formalized by the creation of a $10 billion line of credit with the U.S. treasury in 2013. The Farm Credit System has veered significantly from its charter to serve young, beginning, and small farmers and ranchers, and now primarily serves large established farms, who could easily obtain credit from the private sector. In fact, the majority of Farm Credit System loans outstanding are in excess of $1 million. Any farmer able to take on over $1 million in debt does not need subsidized credit. Moreover, the volume of small borrower loans accounted for 14% of all new Farm Credit System loans in 2015. In addition to the Farm Credit System, the Credit Union industry has grown to over $1 trillion in assets and their tax benefit is estimated to exceed $26.75 billion over the next ten years.

II. Impact of new and enhanced bank regulations and impediments to growth for rural communities

One of the most daunting challenges has been the sheer volume of recent regulations. For many years, our compliance was primarily handled within the bank by employees. It allowed for cross-training of employees and fostered individual education regarding the regulations and bank policies. When necessary, the bank would outsource an audit to provide independence or a specific expertise. However, the rules and regulations change so often that a banker cannot stay abreast or competent to review the details of the new rules and regulations. Therefore, we have begun outsourcing most audits to a point that we are paying a full-time teller salary to compliance audit teams. **The impact is one fewer bank employee serving customers on a daily basis and one less salary paid to a member of our community.**

III. Specific impediments to growth and impact on rural lenders on real estate lending

Reduced Credit Offerings: Many banks in rural Kansas have moved out of the mortgage lending business. Not because the loans are not safe and profitable, but due to compliance. Historically, because we only make standard real estate loans with 20% down payment, these loans were safe and sound credit decisions with some of the lowest loss ratios and were the “bread and butter” for both the bank and community. In my bank, we don’t sell mortgages on the secondary market, so a poor credit decision would affect our bottom line and shareholders directly. Due to these factors in banks similar to mine, banks are exiting the mortgage lending market not due to credit decisions, but due to compliance and regulatory decisions. The mortgage lending rules were intended to address the credit risk side; however the compliance risk has become greater than the credit risk. **If the loan is held in the bank's portfolio, it should automatically be a qualified mortgage (QM) loan as the credit risk lies with the bank.**

Loan Closings: To try and comply with the onerous regulations, we've hired an outside consultant to assist us completing pre-closing and post-closing real estate reviews of all consumer real estate loans. This added time and expense became necessary as we did not possess the necessary compliance expertise in house. Additionally, my bank doesn't close enough consumer real estate loans on a monthly basis to gain the expertise in house. **This added compliance has increased the closing costs to the consumer and delayed the closing of their loan to allow for extra review of loan documents.**

Payment Structure and Reduced Standard Loan Options: One of the biggest advantages that rural banks had over large commercial banks was the ability to customize payment structure to meet their specific needs. We know our customers, we know when they receive paychecks and we know their cash flow needs. We could leverage this to compete against large lenders and better serve our community. However, due to the regulatory constraints, we've moved to a canned loan product system. We now make "monthly payment consumer loans" regardless of how and when the customer is paid. Because this product "fits the system." In an effort to protect the consumer, the regulatory environment has harmed the consumer's access to credit and flexibility of their bank to tailor the repayment to their specific needs. **Local lending decisions should be made locally, not by a bureaucrat in Washington, D.C.**

Costs to Make a Real Estate Loan: Every rural bank has a similar story: A little elderly lady with her house free and clear comes to the bank for a loan because her air conditioner unit is out. Historically, the bank would have placed a small mortgage on her house, produced a quick valuation on the home, and funded the purchase of a new air conditioner unit. However, due to the costs and time required to close a consumer real estate loan, the loan is not a profitable loan. We have to make a choice to either make the loan going through the regulatory hoops and cost to the borrower, or make the loan unsecured to the customer at a significantly higher interest rate and shorter repayment terms. The sad reality is that due to compliance on loans like this, some banks will not be involved in this type of lending. **We have chosen to make more loans, like the above example, unsecured as we believe it is our duty to help the customer despite increased regulatory costs.**

Houses for Sale: Historically, our rural town has 40 to 60 homes for sale as customers have their existing home for sale and are looking to upgrade to a larger home. However, we currently have between 100 and 120 homes for sale in a small county of 3,000 people. The unusually high number of homes for sale may be partially due to other external factors, but I would argue strongly that it is partially due to increased regulatory compliance and few lenders in that credit market. The lenders who are still in the mortgage credit space are more conservative, have higher closing costs, and are much slower to complete the transaction. **These factors all further slow-down an already slowing down rural economy.**

Secondary Market: The most widely used secondary real estate market provider in our market recently changed their policy to not make any real estate loans less than $50,000. The average residential real estate loan at our bank is less than $33,000. **Many of our customers would not qualify to even apply for a mortgage on the secondary market due to these new rules.**

IV. Current issues with appraisers in rural America and the impact on our business as lenders

Appraisers: When a bank is making a loan on an agricultural or commercial property, one of the initial steps is to receive a certified general appraisal. However, due to a shortage of appraisers and the ever increasing demands on appraisals, receiving a timely appraisal is very difficult. We've had to wait six months or more to receive an appraisal. Due to the impediments to becoming a certified appraiser, it is difficult for new individuals to acquire a license and there is limited desire for an existing appraiser to take on an apprentice who will eventually be his direct competitor. Customers shouldn't have to wait six months for a credit decision simply because the bank cannot receive a completed appraisal.

The American Bankers Association has been very involved in the issue of the lack of rural appraisers. The ABA has held two large meetings with various stake-holders to create a working solution on the appraisers issue. The most common them, however, is that there needs to be more incentive for individuals to become involved in the real estate appraisal business, especially in rural areas. Congress needs to get involved in making it easier to become an appraiser or we will continue to see long delays in customers closing on home mortgages.

Conclusion

Rural banks will continue to serve their customers to the best of their abilities despite the many obstacles that have hurt their business models. Rural banks will compete with anyone on a level playing field and they have not backed down from such competition in the past. But when there is a combination of an unfair playing field and over burdensome regulations, all banks have great difficulty in surviving, not just competing. Banks are drivers of the economy, and this is especially true for rural banks. With smart reforms to unfair competition, regulations that hold banks back from helping their customers and providing incentives for people to become involved in rural appraising, rural banks will once again be able to help their local economies grow.

Thanks you for the opportunity to address the subcommittee and share my view on rural banking. I would be happy to answer any questions that you may have.

Hearing Before House Small Business Committee
Marcus Stanley
Policy Director
Americans for Financial Reform
Thursday, June 9, 2016

Chairman Chabot, Ranking Member Velasquez, and members of the subcommittee, thank you for the opportunity to testify before you here today. My name is Marcus Stanley and I am the Policy Director of Americans for Financial Reform.[1]

Today's hearing asks us to consider the impact of the Dodd-Frank Act on small banks and rural communities. I believe that an unbiased consideration of the record leads to the conclusion that the overall impact of the Dodd-Frank Act on community bank lending has been very limited. At the same time, community banks clearly face long-term economic issues that have led to a significant decline in their number.

Regarding the relationship between Dodd-Frank and the economic well-being of community banks, I would like to make two broad points.

First, both long-term economic trends and the experience of the 2008 financial crisis and resulting Great Recession have put major pressures on the community banking sector. Neither of these factors should be ascribed to the Dodd-Frank Act, which is designed to prevent another harmful financial crisis and to protect consumers from abusive lending and financial practices.

Second, the period since the Dodd-Frank Act was passed in 2010 has been a period of economic recovery for community banks. Since 2010, the vast majority of community banks, over 95 percent, have returned to profitability. It is crucial to understand that the Dodd-Frank Act, both in its statutory language and its regulatory implementation, contains numerous exemptions that act to reduce regulatory impact on community banks and focus regulatory efforts on the larger banks and non-banks that were more central to the 2008 financial crisis. This focus on larger banks and on non-banks should in the long run help the competitiveness of community banks.

After discussing these two points, I will conclude with some thoughts on the broader issues related to small business lending and the recovery, including our concern that non-bank small business lenders are not competing on a level playing field with community banks.

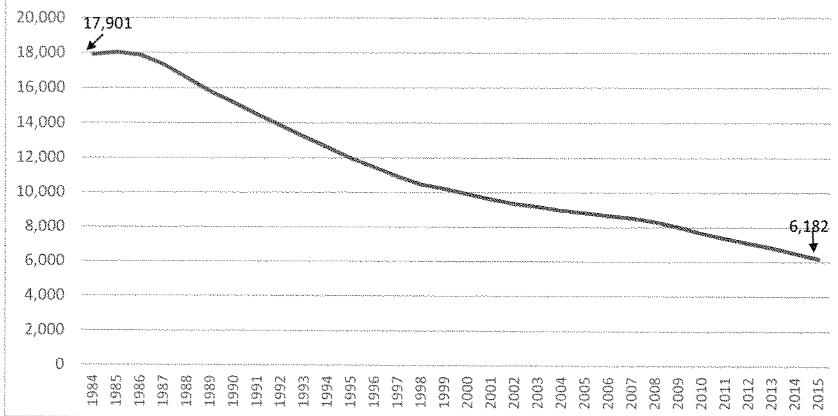
Economic Pressures on The Community Banking Sector Unrelated To Dodd-Frank

Figure 1 shows the total number of FDIC-insured banks over the past 30 years. As the figure shows, the number of banking entities has been steadily declining, and this pattern long predates Dodd-Frank. The decline is centered among community banks. Indeed, the number of U.S. community banks has declined every single year since 1984. The declining number of community banks is entirely due to the decline in the number of small banks with under $1 billion in assets, with the majority of the issue

[1] Americans for Financial Reform is an unprecedented coalition of more than 200 national, state and local groups who have come together to reform the financial industry. Members of our coalition include consumer, civil rights, investor, retiree, community, labor, faith based and business groups. A list of coalition members is available at http://ourfinancialsecurity.org/about/our-coalition/

related to a declining number of extremely small banks with under $100 million in assets.[2] Banking scholars believe that long-term economic and regulatory changes, including changes in economies of scale for banking activities, as well as bank consolidation following deregulation during the 1990s (such as the Riegle-Neal Act of 1994), are important contributors to these declines.[3]

FIGURE 1: Total Number of FDIC-Insured Institutions, 1984-2015



The impact of the 2008 financial crisis only accelerated these trends. The financial crisis had several interrelated effects. First, the failure rate of community banks significantly increased due to the fallout from the financial crisis. Figure 2 shows bank failures each year since 2000. As the financial crisis took hold in 2008, bank failures skyrocketed, reaching a high of 156 bank failures in 2010. Almost all of these failed banks were community banks, both because larger banks were often not permitted to fail and because community banks make up most of the banks in the U.S.

Over 400 banks failed between 2008 and 2011, or almost 5 percent of all the banks in the country. In contrast, only 26 banks total failed between 2000 and 2007. During the peak periods of the financial crisis, almost as many banks were failing in a month as failed in the entire eight years between 2000 and 2007. Only recently has the rate of bank failures returned to something like normal levels.

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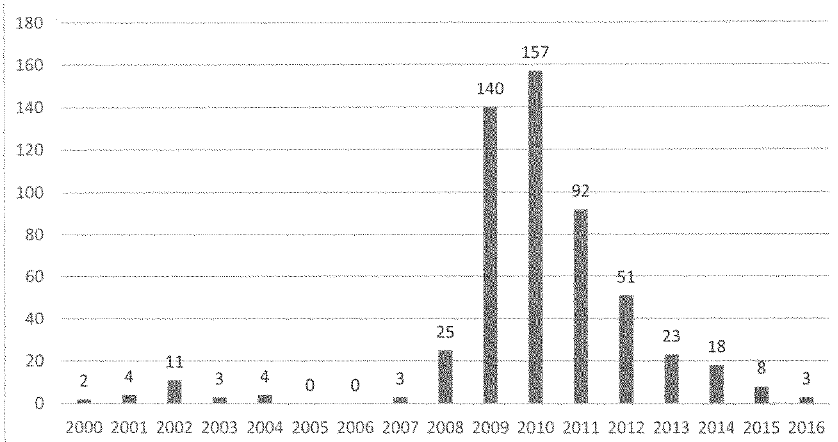
[2] FDIC Community Banking Study, Federal Deposit Insurance Corporation, December, 2012, available at https://www.fdic.gov/regulations/resources/cbi/study.html. See also more recent data from FDIC QBP.
[3] Jones, Kenneth D. and Tim Critchfeld, "Consolidation in the U.S. Banking Industry: Is the Long Strange Trip About to End?", FDIC Banking Review, Volume 17, No. 4, December, 2005. Available at https://www.fdic.gov/bank/analytical/banking/2006jan/article2/article2.pdf

FIGURE 2: Bank Failures By Year, 2000-2016



These bank failures occurred for multiple reasons, including overexposure to commercial real estate acquired during the real estate bubble period and the general economic weakness resulting from the crisis. The failures put severe pressure on the Federal Deposit Insurance Commission (FDIC). The deposit insurance fund was completely drained, and at its low point reached a negative balance of almost $21 billion at the close of 2009.

As the custodian of the deposit insurance fund and the primary regulator of community banks, the FDIC was naturally motivated to seek out and address excessive risks among community banks in order to prevent unnecessary bank failures and losses to the deposit insurance fund. Thus, a second effect of the financial crisis was a substantial increase in FDIC supervisory oversight of banks. While there is some evidence that supervisory stringency did not increase by any more than would be justified by the generally weak economy, there is no question that it did increase.[4]

Another important change in FDIC supervisory practice appears to have occurred in relation to the granting of new (de novo) bank charters. Since the financial crisis, there has been a collapse in the number of new entrants into the banking system, with de novo charters dropping to almost zero. This decline in new entrants – not an increase in bank closings – has led the number of community banks to decline more rapidly in recent years than would otherwise have been expected.[5] While the decline in de

[4] Bassett, William F., "Estimating Changes in Supervisory Standards and Their Economic Effects", Federal Reserve Board Finance and Economics Discussion Paper No. 2012-55, August 24, 2012. Available at http://www.federalreserve.gov/pubs/feds/2012/201255/201255pap.pdf

[5] McCord, Roisin, Edward Prescott and Tim Sablik, "Explaining the Decline In The Number of Banks Since The Great Recession", Federal Reserve Bank of Richmond Economic Brief, March, 2015. Available at https: //www.richmondfed.org/~/media/richmondfedorg/publications/research/economic_brief/2015/pdf/eb_15-03.pdf

novo entrants is related to weak economic conditions and low interest rates, there have also been a number of changes in FDIC practices related to de novo entrance that likely contributed as well. These include a 2009 change in FDIC policy that significantly increased in the length of enhanced supervisory oversight following the granting of a new charter, and possibly also an increase in the length and intensity of the charter approval process.[6]

It is important to note that the changes referred to above are essentially *unrelated to the Dodd-Frank Act* and are the result of changes in economic conditions and regulatory practices that would have occurred *even if the Dodd-Frank Act had never passed.*

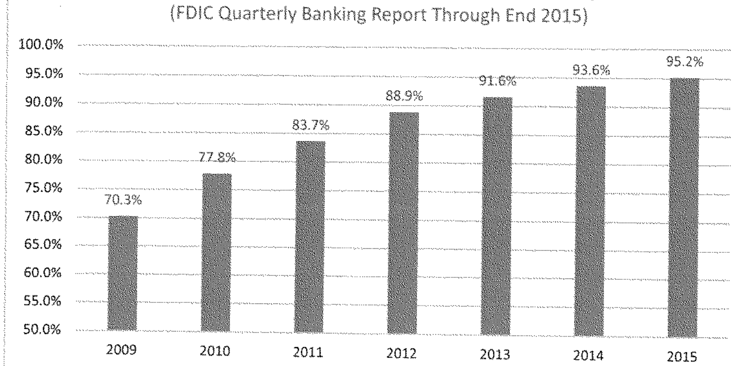
It should also be noted that there has been another supervisory change that is unrelated to either economic trends or to the Dodd-Frank Act, namely an increase in supervisory and legal enforcement of the Bank Secrecy Act and related anti money laundering (AML) provisions.[7] These changes may also increase compliance work at small banks. The Bank Secrecy Act was passed in 1970 and reflects concerns about money laundering, tax evasion, and criminal activities that long predate Dodd-Frank.

The Dodd-Frank Act and Community Banks

Since the passage of the Dodd-Frank Act in 2010, the profitability of community banks has significantly increased, as shown in Figure 3 below.

FIGURE 3: Percentage of Profitable Community Banks

(FDIC Quarterly Banking Report Through End 2015)



[6] "Enhanced Supervisory Procedures for Newly Insured Depository Institutions", FDIC Financial Institution Letters FIL 50-2009, August 28, 2009. Available at https://www.fdic.gov/news/news/financial/2009/fil09050.html. Peters, Andy, "Amish Bank Charter to Set Standard for Future Applications," American Banker, December 4, 2013.
[7] Paul Hastings Global Banking and Payment Systems Practice, "Key Trends in BSA/AML Compliance", Insights, April 14, 2015. Available at http://www.paulhastings.com/publications-items/details/?id=58f9e369-2334-6428-811c-ff00004cbded

As Figure 3 below shows, more than 95 percent of community banks were profitable over the full year of 2015, up from less than 78 percent in 2010, the year Dodd-Frank was passed. Average community bank return on equity has also increased every year since 2009, reaching 8.9 percent in 2015. In recent years loan growth at community banks has also outpaced loan growth at other types of banking institutions. Community bank loan growth reached 8.6 percent over each of the last two years, while loan growth at larger banks lagged at less than 6 percent.

Of course, these trends are more related to the economic recovery than to Dodd-Frank itself. But it certainly does not appear that Dodd-Frank has prevented community banks from taking advantage of the general economic recovery. A closer examination of Dodd-Frank and its relationship to community banks gives further reason to believe that this is the case. The Dodd-Frank statute is explicitly designed to exempt community banks from many of its major provisions. Even when the statute does not specifically exempt small banks, regulators have granted numerous small bank exemptions to key Dodd-Frank regulations.

There are too many explicit statutory exemptions for small banks in Dodd-Frank to easily list. Major exemptions include the following:

- Banks under $10 billion are exempted from all of the enhanced bank prudential standards laid out in Title I of Dodd-Frank, and banks under $50 billion are exempted from the great majority of them.

- The Commodity Futures Trading Commission was instructed to, and did, exempt small banks from most of the new derivatives oversight provisions, such as mandatory derivatives clearing and exchange trading, enacted in Title VII of Dodd-Frank.

- Banks under $10 billion are exempted from the examination authority of the Consumer Financial Protection Bureau. Their pre-Dodd Frank regulator continues to examine them for compliance with consumer laws.

- Banks under $10 billion are exempted from the direct effects of Dodd-Frank provisions regarding interchange fees (the 'Durbin Amendment').

In addition, numerous elements of Dodd-Frank simply do not affect small banks at all, such as provisions addressing investment advisors, insurance companies, investor protection, financial market utilities, Federal Reserve governance, and resolution of systemically important institutions.

Beyond the statutory focus on large banks and non-banks, regulators have also taken numerous steps to exempt smaller banks when implementing Dodd-Frank rules. Again, examples are too many to easily list, but some major instances include:

- The banking agencies have scaled new liquidity and capital requirements to bank size, with community banks entirely exempted from new liquidity requirements and subject to less stringent capital requirements.

- New derivatives margin rules include de minimis levels that effectively exempt community banks from most margin requirements.

- The Consumer Financial Protection Bureau (CFPB) has created significant exemptions from consumer and mortgage rules for small and rural lenders, including Qualified Mortgage (QM) rules, mortgage servicing requirements, and various escrow requirements.

- The banking regulators have set up a streamlined small bank compliance program for the Volcker Rule that effectively exempts almost all banks under $10 billion from Volcker Rule compliance burdens.

Beyond the numerous exemptions created for small banks, the focus in the Dodd-Frank Act on higher regulatory standards for large banks and increased regulatory coverage of non-banks, should in the long run help the competitiveness of community banks. Many provisions of Dodd-Frank are explicitly designed to ensure that large banks and non-banks are held to equal or higher regulatory standards as community banks. For example, Title I of Dodd-Frank requires that large banks be held to higher overall capital and prudential standards than small banks, and the Collins Amendment floors ensure that large banks will not be able to manipulate capital rules to hold lower levels of capital than smaller banks, as occurred prior to the financial crisis. The CFPB is explicitly charged with extending the coverage of consumer protections to non-bank financial entities.

With all this said, it is true that Dodd-Frank is a major regulatory reform that creates some direct and indirect effects for smaller banks. The 2008 financial crisis was the greatest financial system collapse since the Great Depression. The failure of regulatory oversight prior to the financial crisis created many trillions of dollars in avoidable economic costs, to community banks and rural areas as well as to many people in all parts of the country. The regulatory response to this crisis has been, and should be, a far-reaching one. While regulators have consistently sought to create appropriate small bank exemptions from the new regulatory requirements put in place in response to the financial crisis, the far-reaching reconsideration of financial risk management and consumer protection associated with Dodd-Frank and the new Basel rules will unavoidably have some impact on community banks. But a careful consideration of the implementation of Dodd-Frank and the economic record of the last several years shows that this impact is limited.

The Economic Recovery and Small Business and Rural Lending

I would like to conclude with some general thoughts on small business lending and the recovery, outside of Dodd-Frank. The evidence seems to show that the recovery of small business lending from the Great Recession has been slower and less complete than it should be. Surveys such as the Wells Fargo Small Business Index show that the proportion of companies reporting difficulties in obtaining credit is still elevated over pre-financial crisis levels.[8] Proxies for bank lending to small and rural businesses show that the absolute level of such lending has dropped somewhat compared to pre-crisis levels, and the proportion of lending going to small vs large businesses has declined even more.[9] In

[8] Wells Fargo Small Business Survey Top Line, Second Quarter 2016, available at https://wellsfargoworks.com/File/Index/gJdhq3IlPUG_VxjDIcqBLg

[9] FDIC data on loans to small businesses and farms, available at https://www.fdic.gov/bank/analytical/qbp/

general, the benefits of the economic recovery have been more concentrated in urban and highly populated geographic areas than has been seen in previous recoveries.[10]

These trends are almost certainly related to continuing economic weaknesses among non-financial small businesses. Business issues with customer demand and revenue will also affect credit availability, outside of any changes in credit supply. But it is also reasonable to look at what could be done to increase credit supply. This is especially true given the long-term pressures on community banking and the crucial role of community banks in providing high quality, relationship based small business lending.

As I have discussed above, I believe that looking to Dodd-Frank for the cause or solution of issues related to credit supply is misguided. However, there are other areas that this committee could and should consider. These include the possibility of expanding assistance to small business credit provided by the Small Business Administration and the Farm Credit System. In addition, given the crucial role of community banks in supporting small business lending, the Committee could examine additional ways to protect small banks from unfair competition by large 'too big to fail' banks.

I believe this Committee should also take a serious look at issues created by the rapid expansion of on-line lending to small businesses, a new area of non-bank competition with community banks. While on-line lending could be a valuable new source of credit, there is disturbing evidence that too much of such lending is marked by exploitative terms and excessive interest rates. For example, a recent joint study by seven regional Federal Reserve Banks found extremely high levels of dissatisfaction with on-line loans among small business borrowers.[11] Just 15 percent of small business borrowers expressed satisfaction with their treatment by on-line marketplace lenders, as opposed to 75 percent of those who borrowed from community banks. Sources of dissatisfaction included high interest rates, poor repayment terms, and non-transparent terms of the loan.

On-line marketplace lenders are not currently competing on a level playing field with community banks. Non-bank small business lenders are generally exempt from CFPB supervision and thus not subject to regulatory oversight concerning consumer protection while community banks are subject to oversight from banking regulators. Congress should consider empowering the CFPB with additional authority to do rulemaking and supervision in the small business lending space, particularly as it applies to non-bank small business lenders. This would go far to creating a level playing field for community banks and on-line marketplace lenders.

Thank you for the opportunity to testify before you today. I look forward to taking questions.

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[10] Economic Innovation Group, "The New Map of Economic Growth and Recovery", May 2016. Available at http://eig.org/wp-content/uploads/2016/05/recoverygrowthreport.pdf

[11] Federal Reserve Bank of Cleveland, "2015 Small Business Credit Survey: Report on Employer Firms", March 2016, Available at https://www.clevelandfed.org/community-development/small-business/about-the-joint-small-business-credit-survey/2015-joint-small-business-credit-survey.aspx

CUNA
Credit Union National Association

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June 8, 2016

The Honorable Tim Huelskamp
Chairman
Subcommittee on Economic Growth, Tax, and Capital Access
Small Business Committee
House of Representatives
Washington, DC 20515

The Honorable Judy Chu
Ranking Member
Subcommittee on Economic Growth, Tax, and Capital Access
Small Business Committee
House of Representatives
Washington, DC 20515

Dear Chairman Huelskamp and Ranking Member Chu:

On behalf of America's credit unions, I am writing to thank you for holding the hearing entitled, "Bearing the Burden: Over-regulations' Impact on Small Banks and Rural Communities." The Credit Union National Association (CUNA) represents America's credit unions and their more than 100 million members.

The financial impact of regulation on credit unions and their members is high and has increased significantly since the passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act. Since the financial crisis, credit unions have been subjected to more than 200 regulatory changes. To determine the impact of financial regulations on credit unions and their members, CUNA, with the support of state credit union leagues, commissioned Cornerstone Advisors to analyze the effects of the Dodd-Frank regulations. Cornerstone conducted an in-depth examination and quantification of the impact of regulations at credit unions of all sizes.

The study found that the costs credit unions bear as a result of regulation, even with conservative measures, are extremely high and have increased substantially since the financial crisis and Great Recession. The cost of regulatory burden to credit unions in 2014 is conservatively estimated to be $7.2 billion ($6.1 billion in regulatory costs, and $1.1 billion in lost revenue). The $6.1 billion in costs represents 17 percent of operating expenses of the entire credit union system. The burden is particularly significant for smaller credit unions since larger credit unions are able to spread compliance costs over a larger asset base. Smaller credit unions are devoting almost half of their staff time to dealing with regulations, taking time away from their members and impeding their ability to expand services and products offered. When small credit unions stop offering products and services, this limits the choices consumers have, which can be particularly problematic in rural and underserved areas of the country. If those numbers don't resonate, take it from credit union CEOs, themselves. When asked in a survey recently what they would do if those lost costs were returned, the top two answers were that they would turn around and provide members lower rates on loans and higher interest rates on deposits. So in effect, Washington's overreaction has taken money out of the pockets of credit union members for a problem credit unions did not cause.

The Consumer Financial Protection Bureau (CFPB) needs to exercise its discretionary authority more often so that smaller institutions are not unduly burdened with compliance costs. As you know, 329 House Members wrote to CFPB Director Richard Cordray in March reminding him that Congress "intentionally provided for regulatory flexibility to mitigate collateral damage on smaller financial institutions." The letter was signed by a majority of both political parties, as well as a majority of your subcommittee. We hope that in the future the CFPB will use its discretion more often to rein in predatory lenders, abusers of consumers, and those who caused the financial crisis without unduly burdening smaller community financial institutions.

We appreciate your conducting this hearing to demonstrate the high costs of overregulation on smaller entities like credit unions. Thank you for your support, and we look forward to continuing to work with you on providing relief for credit unions and other community financial institutions.

Sincerely,

Jim Nussle
President & CEO

Attachment

CUNA
Credit Union National Association

Credit Unions' Strongest Advocate™

Regulatory Burden Financial Impact Study

EXECUTIVE SUMMARY

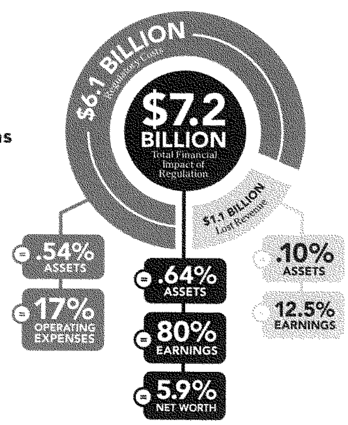
Credit unions recognize that they operate in a regulated industry and must bear reasonable costs of regulation. However, the total financial impact of regulation on credit unions and their members is high and has increased dramatically since the recent financial crisis.

With the support of state credit union Leagues, CUNA commissioned Cornerstone Advisors to perform a rigorous analysis of the current financial impact of regulation on credit unions, and how much it has changed since 2010.

Cornerstone Advisors conducted a two-phased study to gain an in-depth examination and quantify the impact of regulation at small, medium and large credit unions. The study gathered data in terms of increased costs, including staffing, third party expenses and capitalized expenses, and reduced revenue opportunities.

These financial impacts are considerable in terms of the scale of credit union operations.

Cost of Regulatory Burden to Credit Unions in 2014



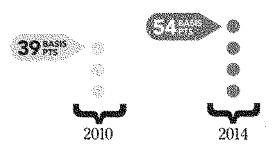
This summary was prepared by CUNA. Readers are encouraged to refer to the full study.

cuna.org/regburden

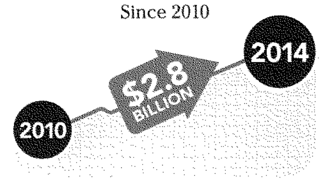
INCREASE IN REGULATORY IMPACT SINCE 2010

The regulatory cost of 54 basis points of assets in 2014 represents a 15 basis point increase from the 39 basis point cost the study found in 2010. This means that regulatory costs for credit unions in 2014 were $1.7 billion higher than they would have been without the changes that occurred from 2010 to 2014. Adding the 10 basis point reduction in revenues ($1.1 billion) yields an increase in total financial impact of 25 basis points ($2.8 billion), from 39 basis points to 64 basis points.

Regulatory Cost Increase
$1.7 Billion



Increase in Total Financial Impact
Since 2010

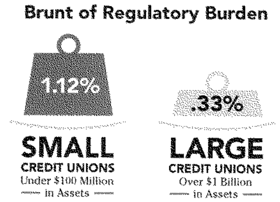


LOST REVENUE

The study considered how revenue has been influenced by regulation, especially by changes in regulation. Participants identified a number of business lines that had been affected by regulatory changes, primarily related to lending and interchange income.

Although, lending revenue has no doubt been affected by regulation, the amount is difficult to accurately quantify. Therefore, the only revenue reduction included in the study is that due to reduced interchange income as a result of the Durbin Amendment to the Dodd Frank Act. This means the study's $1.1 billion estimate for revenue reduction underestimates the actual amount.

Small Credit Unions Bear the Brunt of Regulatory Burden



Compares regulatory costs relative to assets

REGULATORY IMPACTS AND CREDIT UNION SIZE

The study found dramatic evidence of differential impacts by credit union size. Cost impacts were much stronger at smaller versus larger credit unions. There are basic fixed costs associated with complying with regulations, and at larger credit unions these costs can be spread over a larger asset base. In contrast, adverse revenue impacts were stronger at larger than smaller credit unions. This is because members of larger credit unions are more likely to generate interchange income by using a debit card from their credit union.

TYPES OF REGULATORY COST

The study collected data on three types of costs related to regulation: staff costs, third party expenses and depreciation of capitalized costs. For each cost category, care was taken to include only that portion of the costs that are driven by regulatory requirements. For example, for compliance staff, time spent on compliance with internal policies not required by regulation was not included as a regulatory expense.

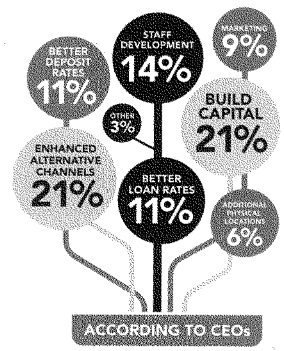
The largest component of regulatory expense was for staff, at 74% of the total. This is not surprising as compensation typically accounts for about half of total credit union operation expenses.

Of the staff costs driven by regulation, the largest component came in member-facing staff. This suggests that credit unions have to employ more such staff than otherwise, and/or that member facing staff have to divert much of their attention from serving members to complying with regulations.

STRATEGIC IMPACTS

The study solicited credit union CEOs' views on how the funds devoted to regulation would have been reallocated within the credit union had they not been drained by regulation. Better member pricing, better service delivery, and institutional strengthening topped the CEO's lists.

In addition to extensive data collection, the study solicited participating CEOs' viewpoints of where they had seen the greatest increase in regulatory impact in the areas of greater costs, reduced productivity, and reduced revenues. The greatest cost and productivity impacts occurred in compliance, mortgage and consumer lending and internal audit. The greatest revenue impacts were in mortgage lending, debit interchange and payments.



KEY THEMES

As a result of engaging with credit union executives over several months while conducting the study, Cornerstone Advisors analysts catalogued four key features of how credit unions view the impact of regulation:

UNCERTAINTY & AMBIGUITY around written rules complicates compliance.

INCONSISTENT INTERPRETATION of rules by examiners frustrates operations.

A STEADY STREAM of NEW REGULATIONS creates costly change management.

"ONE SIZE FITS ALL" rules are unfair and ineffective.

CONCLUSION

The study found that the costs that credit unions bear as a result of regulation, even when conservatively measured, are very high, and have increased substantially since the financial crisis and Great Recession. The burden is particularly egregious for smaller institutions.

This summary was prepared by CUNA. Readers are encouraged to refer to the full study.

ICBA
INDEPENDENT COMMUNITY BANKERS *of* AMERICA®

June 9, 2016

The Destructive Impact of Regulatory Burden on Rural Communities

On behalf of the more than 6,000 community banks represented by ICBA, we thank Chairman Huelskamp and Ranking Member Chu for convening today's hearing entitled: ""Bearing the Burden: Over-regulation's Impact on Small Banks and Rural Communities." ICBA is pleased to submit this statement for the record describing the destructive impact of regulatory burden on rural community banks and the customers and communities they serve. ICBA's "Plan for Prosperity," which is attached to this statement, provides a road map for needed regulatory relief.

America is mired in an anemic economic recovery, with GDP growth of a mere 0.5 percent at an annualized pace in the first quarter of 2016. America must do better to sustain our prosperity or the next generation will experience a starkly different way of life. What's worse, new business creation, a critical engine of economic growth and job creation, has been highly concentrated in a small number of urban areas in the current economic recovery. According to new research by the Economic Innovation Group, half of new business in the current recovery have been located in just 20 U.S. counties.[1] Rural counties have seen more businesses disappear than created. Similarly, in the current recovery, rural counties account for just 1 in 10 newly created jobs.

Access to bank credit – predominantly provided by community banks -- is critical to reversing this trend and revitalizing rural America. As an FDIC Community Banking Study showed, in one out of every five counties in the United States, the only physical banking offices are those operated by community banks.[2] Collectively, community banks provide nearly 50 percent of all small business loans in the country and 77 percent of all agricultural loans, according to a study from Harvard's Kennedy School.[3]

Regulatory relief for community banks is critically important to ensuring continued access to the credit in rural America. In recent years, community banks have experienced a sharply increasing regulatory burden. The nature of community banking has changed from lending and investing in local communities to compliance with ever-increasing rules and guidance. But the real crisis is

[1] "The New Map of Economic Growth and Recovery," The Economic Innovation Group. May 2016.
[2] FDIC Community Banking Study. December 2012.
[3] "The State and Fate of Community Banking." Marshall Lux and Robert Greene. Mossavar-Rahmani Center for Business and Government at the Harvard Kennedy School. February 2015.

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the customer impact. Simply put, regulatory burden is cutting off access to credit to credit worthy borrowers, especially in rural America.

The economic life of rural America depends on customized financial products and services that only community banks provide. Residential properties in small and rural communities are typically unique. They may sit on a large plot of land, be mixed-use in nature, or irregular in other ways. They are frequently outside of city limits. These are not suburban, tract-like properties and for this reason they often lack adequate comparables and don't fit the inflexible requirements of the secondary market. In addition, the borrowers may be farmers or small business owners whose debt-to-income ratios fall outside of secondary market parameters, despite their personal net worth and means to repay the loan. Community banks specialize in serving such borrowers, often with balloon payment or other non-conforming loans held in portfolio. Balloon payments protect the lender from the significant interest rate risk of a 30 year, fixed-rate loan. They have been made safely by community banks for decades.

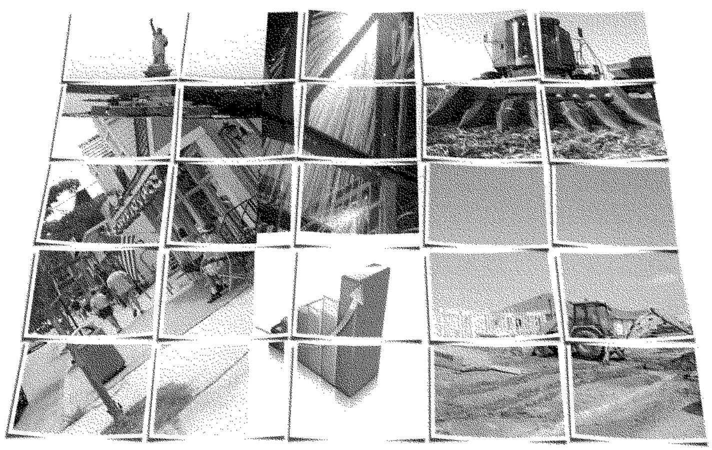
Small business lending in rural communities presents a similar story. Community banks extend credit based on their first-hand knowledge of the borrower, the community, and the local economy. A bank based outside the community simply cannot match this type of underwriting. As the Harvard study noted, in certain lending markets, there is no effective substitute for the "skills, knowledge, and interpersonal competencies" of a community bank. Agricultural lending in particular is a very specialized form of lending that requires extensive knowledge of farming, crops, and local conditions.

Community banks are disproportionately impacted by regulatory burden because they have a much smaller asset base over which to spread regulatory costs. Without dedicated legal and compliance departments, community banks have to divert valuable staff from other duties, including serving customers, to implement new rules and other changes, a process that can take weeks or months depending on the complexity of the change and the bank processes impacted. If consolidation continues apace and rural community banks disappear under the weight of regulatory burden, millions of rural customers – including farmers, small business owners, families and individuals – will be cut off from credit.

Attachment: ICBA's Plan for Prosperity

INDEPENDENT COMMUNITY BANKERS of AMERICA
One Mission. Community Banks.

Plan for Prosperity



A Pro-Growth Agenda to Reduce the Onerous Regulatory Burden on Community Banks and Empower Local Communities
2016

Plan for Prosperity: An Agenda to Reduce the Onerous Regulatory Burden on Community Banks and Empower Local Communities

America's more than 6,000 community banks are critical to the prosperity of the U.S. economy. Providing more than half of all small business loans under $1 million, as well as customized mortgage, consumer, and agricultural loans suited to the unique characteristics of their local communities, community banks serve a vital role in sustaining robust economic growth in communities of all sizes and in every region of the country.

In order to reach their full potential as catalysts for entrepreneurship, economic growth, and job creation, community banks must be able to attract capital in a highly competitive environment. An end to the exponential growth of onerous regulatory mandates is critical to this objective. Regulation is suffocating nearly every aspect of community banking and changing the very nature of the industry away from community investment and community building to paperwork, compliance, and examination. A fundamentally new approach is needed: Regulation must be calibrated to the size, lower-risk profile, and traditional business model of community banks.

ICBA's Plan for Prosperity ("Plan") provides targeted regulatory relief that will allow community banks to thrive by doing what they do best – serving and growing their communities. By reducing unsustainable regulatory burden, the Plan will ensure that scarce capital and labor resources are used productively, not sunk into unnecessary compliance costs, allowing community banks to better focus on lending and investing that will directly improve the quality of life in our communities. Each provision of the Plan was developed with input from community bankers nationwide and crafted to preserve and strengthen consumer protections and bank safety and soundness.

The Plan is a set of detailed legislative priorities positioned for advancement in Congress. Four Plan provisions were signed into law in 2015. A subset of these priorities is specifically dedicated to strengthening community bank viability by creating new options for capital raising and capital preservation. A number of regulatory relief measures would be tiered. The recommended thresholds are based on existing levels and statutory provisions, which may vary by provision.

ICBA is committed to advancing and enacting the provisions of the Plan with all due vigilance and the aggressive use of every resource at our disposal. The Plan is a flexible, living document that can be adapted to a rapidly changing regulatory and legislative environment to maximize its influence and likelihood of enactment. Provisions are described below.

ACCESS TO CAPITAL: CREATING NEW OPTIONS FOR THE CREATION AND PRESERVATION OF COMMUNITY BANK CAPITAL

ICBA is proposing a set of options to strengthen community bank viability by enhancing access to capital.

Basel III Amendments: Restoring the Original Intent of the Rule. Basel III was originally intended to apply only to large, internationally active banks. ICBA supports a full exemption from Basel III for non-systemically important financial institutions (non-SIFIs). If a full exemption is not possible, ICBA proposes the following amendments:

- *Exemption from the capital conservation buffer.* The new buffer provisions impose dividend restrictions that have a chilling effect on potential investors. This is particularly true for Subchapter S banks whose investors rely on dividends to pay their pro-rata share of the bank's tax. Exempting non-SIFIs from the capital conservation buffer would make it easier for them to raise capital.
- *Full capital recognition of allowance for credit losses.* Provide that the allowance for credit losses is included in tier 1 capital up to 1.25 percent of risk weighted assets with the remaining amount reported in tier 2 capital. This change would reverse the punitive treatment of the allowance under Basel III. The allowance should be captured in the regulatory capital framework since it is the first line of defense in protecting against future credit losses.
- *Amend risk weighting to promote economic development.* Provide 100 percent risk weighting for acquisition, development, and construction loans. Under Basel III, these loans are classified as high volatility commercial real estate loans and risk weighted at 150 percent. ICBA's proposed change would treat these loans the same as other commercial real estate loans and would be consistent with Basel I.

More Accurate Identification of "Systemic Risk." The current threshold of $50 billion for the identification of "systemically risky financial institutions" (SIFIs) under Title I of the Dodd-Frank Act is too low. It sweeps in too many banks that pose no systemic risk and should not be subject to higher prudential standards. A higher threshold and a more flexible "SIFI" definition under Title I would more accurately identify those institutions that impose systemic risk to our banking system.

Additional Capital for Small Bank Holding Companies: Modernizing the Federal Reserve's Policy Statement. Require the Federal Reserve to revise the Small Bank Holding Company Policy Statement – a set of capital guidelines that have the force of law. The Policy Statement, which makes it easier for small bank and thrift holding companies to raise additional capital by issuing debt, would be revised to increase the qualifying asset threshold from $1 billion to $5 billion. Qualifying bank and thrift holding companies must not have significant outstanding debt or be engaged in nonbanking activities that involve significant leverage.

Relief from Securities and Exchange Commission Rules. ICBA recommends the following changes to SEC rules which would allow community banks to commit more resources to their communities without putting investors at risk:

- Provide an exemption from internal control attestation requirements for banks with assets of less than $1 billion. The current exemption applies to any company with market capitalization of $75 million or less. Because smaller bank internal control systems are monitored continually by bank examiners, they should not have to sustain the unnecessary annual expense of paying an outside audit firm for attestation work. This provision will substantially lower the regulatory burden and expense for small, publicly traded banks without creating more risk for investors.

- Regulation D should be reformed so that anyone with a net worth of more than $1 million, including the value of their primary residence, would qualify as an "accredited investor." The number of non-accredited investors that could purchase stock under a private offering should be increased from 35 to 70.

TARGETED REGULATORY RELIEF

Supporting a Robust Housing Market: Mortgage Reform for Community Banks. Provide more community banks relief from certain mortgage regulations, especially for loans held in portfolio. When a community bank holds a loan in portfolio, it has a direct stake in the loan's performance and every incentive to ensure it is properly underwritten, affordable, and responsibly serviced. Relief would include:

- Providing "qualified mortgage" safe harbor status for loans originated and held in portfolio by banks with less than $10 billion in assets, including balloon mortgages.
- Exempting banks with assets below $10 billion from escrow requirements for loans held in portfolio.
- An exemption from the higher risk mortgage appraisal requirements for loans of $250,000 or less provided they are held in portfolio by the originator for a period of at least three years.
- Information reporting requirements under the Home Mortgage Disclosure Act (HMDA) should not apply to banks that originate a modest volume of mortgages. A new HMDA rule exempts lenders that originate fewer than 25 closed-end loans or fewer than 100 open-end lines in each of the two preceding calendar years. These exemption thresholds should be significantly increased.

Preserve Community Bank Mortgage Servicing. The provisions described below would help preserve the important role of community banks in servicing mortgages and deter further industry consolidation, which is harmful to borrowers:

- Increase the "small servicer" exemption threshold to 20,000 loans (up from 5,000). To put this proposed threshold in perspective, the average number of loans serviced by the five largest servicers subject to the national mortgage settlement is 6.8 million. An exemption threshold of 20,000 would demarcate small servicers from both large and mid-sized servicers.
- For banks with assets of $50 billion or less, reverse the punitive Basel III capital treatment of mortgage servicing rights (MSRs) and allow 100 percent of MSRs to be included as common equity tier 1 capital.

Strengthening Accountability in Bank Exams: A Workable Appeals Process. The trend toward oppressive, micromanaged regulatory exams is a concern to community bankers nationwide. An independent body would be created to receive, investigate, and resolve material complaints from banks in a timely and confidential manner. The goal is to hold examiners accountable and to prevent retribution against banks that file complaints.

Reforming Bank Oversight and Examination to Better Target Risk. ICBA makes the following recommendations to allow bank examiners to better target their resources at true sources of systemic risk:

- A two-year exam cycle for well-rated banks with up to $2 billion in assets would allow examiners to better target their limited resources toward banks that pose systemic risk. It would also provide needed relief to bank management for whom exams are a significant distraction from serving their customers and communities.
- Non-systemically important financial institutions (non-SIFIs) should be exempt from stress test requirements.
- Community banks should be allowed to file a short form call report in the first and third quarters of each year. The current, long form call report would be filed in the second and fourth quarters. The quarterly call report now comprises some 80 pages supported by almost 700 pages of instructions. It represents a growing burden on community banks without being an effective supervisory tool.
- The Community Reinvestment Act (CRA) asset thresholds should be modernized. The "small bank" threshold should be raised from $305 million to $1.5 billion, and the "intermediate small bank" should be raised from $1.221 billion to $5 billion. While no bank is exempt from CRA, asset thresholds are used to determine how a bank is assessed. The current asset thresholds do not reflect consolidation in the community banking industry. In addition, the threshold for determining how often a bank is assessed should be increased. Banks with assets up to $1 billion (up from $250 million) and an overall CRA rating of "outstanding" should be evaluated every five years, and those with an overall rating of "satisfactory" should be evaluated every four years. Community banks prosper by reinvesting local deposits and serving all customers in their communities. Too frequent or intrusive CRA exams unnecessarily expend resources that could otherwise be dedicated to serving customers.

Risk Targeting the Volcker Rule. Exempt non-systemically important financial institutions (non-SIFIs) from the Volcker Rule. The Volcker Rule should apply only to the largest, most systemically risky banks. Proposals to apply the rule to non-SIFIs carry unintended consequences that threaten to destabilize segments of the banking industry.

Balanced Consumer Regulation: More Inclusive and Accountable CFPB Governance. The following changes would strength CFPB accountability, improve the quality of the agency's rulemaking, and make more effective use of its examination resources:

- All banks with assets of $50 billion or less should be exempt from examination and enforcement by the CFPB and instead be examined and supervised by their prudential regulators for compliance with consumer protection regulation; and CFPB backup (or "ride along") authority for compliance exams performed by a bank's primary regulator should be eliminated.
- Change the governance structure of the CFPB to a five-member commission rather than a single Director. Commissioners would be confirmed by the Senate to staggered five-year terms with no more than three commissioners affiliated with any one political party. This change will strengthen accountability and bring a diversity of views and professional backgrounds to decision-making at the CFPB.

- The Financial Stability Oversight Council's review of CFPB rules should be strengthened by changing the vote required to veto a rule from an unreasonably high two-thirds vote to a simple majority, excluding the CFPB Director.

Eliminate Arbitrary "Disparate Impact" Fair Lending Suits. Amend the Equal Credit Opportunity Act and the Fair Housing Act to bar "disparate impact" causes of action. Disparate impact describes differential results that arise despite the use of practices that are facially neutral in their treatment of different groups. In June 2015, the U.S. Supreme Court limited the application of disparate impact theory under the Fair Housing Act so that statistical data alone is not sufficient to establish liability: a plaintiff must also cite a specific practice that results in disparate impact. Despite this limitation, lenders still have to consider factors such as race and national origin in individual credit decisions to protect themselves from fair lending regulatory enforcement actions and lawsuits. Moreover, the Supreme Court's decision does not extend to the Equal Credit Opportunity Act. Legislation is needed to eliminate disparate impact and ensure lenders that uniformly apply neutral lending standards are not subject to unnecessary regulatory enforcement actions or frivolous and abusive lawsuits under the Equal Credit Opportunity Act or the Fair Housing Act.

Ensuring the Viability of Mutual Banks: New Charter and Capital Options. A new charter for mutual national banks would allow institutions to choose the charter that best suits their needs and the communities they serve. Mutual institutions should be authorized to issue mutual capital certificates, an additional option for raising capital. Existing federal savings associations chartered under the Home Owners' Loan Act should be able to elect to have the rights and privileges of a national bank without changing charters.

Rigorous and Quantitative Justification of New Rules: Cost-Benefit Analysis. Provide that financial regulatory agencies cannot issue notices of proposed rulemakings unless they first determine that quantified costs are less than benefits. The analysis must take into account the impact on the smallest banks which are disproportionately burdened by regulation because they lack the scale and the resources to absorb the associated compliance costs. In addition, the agencies would be required to identify and assess available alternatives including modifications to existing regulations. They would also be required to ensure that proposed regulations are consistent with existing regulations, written in plain English, and easy to interpret.

Cutting the Red Tape in Small Business Lending: Eliminate Burdensome Data Collection. Exclude banks with assets below $10 billion from new small business data collection requirements. This provision, which will likely require the reporting of information regarding every small business loan application, will fall disproportionately upon smaller banks that lack scale and compliance resources.

Incentivizing Credit for Low and Moderate Income Customers and American Agriculture. ICBA supports the creation of new tax credits or deductions for community bank lending to low and moderate income individuals, businesses, and farmers and ranchers in order to offset the competitive advantage enjoyed by tax-exempt credit unions and Farm Credit System (FCS) lenders. Credit unions were initially created and granted a generous exemption from federal, state, and local tax for the specific purpose of serving people of modest means with a common bond. However, independent studies show that community banks do a better job of serving low and moderate income customers than credit unions. The tax subsidies granted to FCS lenders – often large, multi-billion dollar institutions serving the same customers served by much smaller community banks – distort the marketplace. The revenue loss associated with the credit union and FCS tax exemptions serves no public purpose. The creation of targeted tax credits or deductions for community banks would help to sustain and strengthen lending to low and moderate income customers and America's farmers and ranchers.

Modernize Subchapter S Constraints. Subchapter S of the tax code should be updated to facilitate capital formation for community banks, particularly in light of higher capital requirements under the proposed Basel III capital standards. The limit on Subchapter S shareholders should be increased from 100 to 200; Subchapter S corporations should be allowed to issue preferred shares; and Subchapter S shares, both common and preferred, should be permitted to be held in individual retirement accounts (IRAs). These changes would better allow the nation's 2,200 Subchapter S banks to raise capital and increase the flow of credit.

Limited Liability Corporation Option for Community Banks. In addition to modernization of Subchapter S for banks (as described above), ICBA supports the creation of a limited liability company (LLC) option for community banks. The LLC election would allow pass-through tax treatment for community banks without the limitations of Subchapter S organization.

Update Bank Qualified Bond Issuer Limitation. Since 1986, the tax code has provided a special incentive for banks to purchase bonds issued by municipalities, school districts, sanitation districts, and other public entities provided the issuer expects to issue no more than $10 million of bonds annually. These are known as "bank qualified bonds." Because the $10 million limitation has been severely eroded by inflation, today only a small number of issuers are eligible to take advantage of lower interest rates by issuing bank qualified bonds. The limitation was temporarily increased to $30 million by the American Recovery and Reinvestment Act of 2009. ICBA supports a permanent increase in the limitation to $30 million to be indexed prospectively. A higher limitation would allow local bank deposits to support needed, local public infrastructure investments at a lower interest rate, as originally intended by the 1986 Tax Reform Act.

Five-Year Loss Carryback Supports Lending During Economic Downturns. Banks with $15 billion or less in assets should be allowed to use a five-year net operating loss (NOL) carryback. The five-year NOL carryback is countercyclical and will support community bank capital and lending during economic downturns.

The Independent Community Bankers of America®, the nation's voice for more than 6,000 community banks of all sizes and charter types, is dedicated exclusively to representing the interests of the community banking industry and its membership through effective advocacy, best-in-class education and high-quality products and services. For more information, visit www.icba.org.

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June 8, 2016

The Honorable Tim Huelskamp
Chairman
Subcommittee on Economic
Growth, Tax and Capital Access
Small Business Committee
U.S. House of Representatives
Washington, D.C. 20515

The Honorable Judy Chu
Ranking Member
Subcommittee on Economic
Growth, Tax and Capital Access
Small Business Committee
U.S. House of Representatives
Washington, D.C. 20515

Re: The Impact of Over-regulation on Credit Unions

Dear Chairman Huelskamp and Ranking Member Chu:

On behalf of the National Association of Federal Credit Unions (NAFCU), the only trade association exclusively representing the federal interests of our nation's federally-insured credit unions, I write today in conjunction with tomorrow's hearing, "Bearing the Burden: Over-regulation's Impact on Small Banks and Rural Communities." NAFCU appreciates the subcommittee's attention to the devastating impact that over-regulation is having on community financial institutions and their communities, and looks forward to continuing to work with you to look for ways to cut down on crippling regulations.

Despite the fact that credit unions are already heavily regulated, were not the cause of the financial crisis, and actually helped blunt the crisis by continuing to lend to credit worthy consumers during difficult times, they are still firmly within the regulatory reach of Dodd-Frank, including all rules promulgated by the Consumer Financial Protection Bureau (CFPB). Lawmakers and regulators readily agree that credit unions did not participate in the reckless activities that led to the financial crisis, so they should not be caught in the crosshairs of regulations aimed at those entities that did. Unfortunately, that has not been the case thus far. Accordingly, finding ways to cut-down on burdensome and unnecessary regulatory compliance costs is a chief priority of NAFCU members.

During the consideration of financial reform, NAFCU was concerned about the possibility of over-regulation of good actors such as credit unions and was the only financial services trade association to oppose the CFPB having authority over credit unions. Unfortunately, many of our concerns about the increased regulatory burdens that credit unions would face under the CFPB have proven true. While there are credible arguments to be made for the existence of the CFPB, its primary focus should be on regulating the unregulated bad actors, not adding new regulatory burdens to good actors, like credit unions, that already fall under a prudential regulator. As expected, the breadth and pace of the CFPB's rulemaking is troublesome, and the unprecedented new compliance burden placed on credit unions has been immense.

The impact of this growing compliance burden is evident as the number of credit unions continues to decline. Since the second quarter of 2010, we have lost 1,499 federally-insured credit unions – over 20% of the industry. The overwhelming majority (96%) of these were smaller institutions below $100 million in assets – the type of institutions that are often found in rural areaas. While it is true that there has been a historical consolidation trend in the industry, this trend has accelerated since the passage of the *Dodd-Frank Act*. Many smaller institutions simply cannot keep up with the new regulatory tide and have had to either merge or be taken over. There is an urgent need for Congress to enact meaningful regulatory relief.

As member-owned not-for-profit cooperatives, credit unions consistently strive to provide their members with financial products and services designed to help each member achieve their individual financial needs and goals. Credit unions are dedicated to ensuring their members' financial health by providing responsible products and services. Therefore, NAFCU believes it is critical for regulators to try to avoid any rulemaking that unjustifiably restricts the ability of credit unions to provide their members with the types of services they desire. This can be done through greater use of exemptions for credit unions and better tailoring of rules to recognize the unique nature of credit unions. For example, we believe that the CFPB can go much further than it has when it comes to using its exemption authority under Section 1022 of Dodd-Frank. We would encourage the subcommittee to further explore this topic.

Credit unions are unique and their track record as good actors within the financial services industry proves they should not be grouped together with the unscrupulous entities that the CFPB seeks to restrict. Over-regulation has already had a substantially negative impact on credit unions and their members. Any additional unwarranted regulatory constraint is likely to further encumber products and services and ultimately hurt the consumers they mean to protect.

NAFCU looks forward to continuing to work with the subcommittee to curb the over-regulation and provide regulatory relief to community financial institutions such as credit unions. Thank you for the opportunity to share our thoughts with you today. If you have any questions, or if my colleagues or I can be of assistance in any way, please do not hesitate to contact me or NAFCU's Senior Associate Director of Legislative Affairs, Chad Adams, at 703-842-2265 or cadams@nafcu.org.

Sincerely,

Brad Thaler
Vice President of Legislative Affairs

cc: Members of the Subcommittee on Economic Growth, Tax and Capital Access