ENDING THE DE NOVO DROUGHT: EXAMINING THE APPLICATION PROCESS FOR DE NOVO FINANCIAL INSTITUTIONS

HEARING

BEFORE THE

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AND CONSUMER CREDIT

OF THE

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ENDING THE DE NOVO DROUGHT: EXAMINING THE APPLICATION PROCESS FOR DE NOVO FINANCIAL INSTITUTIONS

Tuesday, March 21, 2017

U.S. HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON FINANCIAL INSTITUTIONS
AND CONSUMER CREDIT,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The subcommittee met, pursuant to notice, at 2:03 p.m., in room 2128, Rayburn House Office Building, Hon. Blaine Luetkemeyer [chairman of the subcommittee] presiding.

Members present: Representatives Luetkemeyer, Rothfus, Royce, Ross, Pittenger, Barr, Tipton, Williams, Love, Trott, Loudermilk, Kustoff, Tenney; Clay, Maloney, Scott, Velazquez, Green, Ellison, Heck, and Crist.

Ex officio present: Representative Hensarling.

Chairman LUETKEMEYER. The Subcommittee on Financial Institutions and Consumer Credit will come to order.

Without objection, the Chair is authorized to declare a recess of the subcommittee at any time.

Today's hearing is entitled, "Ending the De Novo Drought: Examining the Application Process for De Novo Financial Institutions."

Before we begin, I would like to thank the witnesses for appearing today. We appreciate your participation and look forward to a robust conversation.

I will now recognize myself for 3 minutes for an opening statement.

Banking isn't what it used to be, according to Ernest Patrikis, a 30-year veteran of the Federal Reserve. In a 2015 interview with CNNMoney regarding the lack of de novo charters, Mr. Patrikis added that the Dodd-Frank Act was like football players jumping on top of the pile.

Unfortunately, Mr. Patrikis was right, banking isn't what it used to be. My father spent his adult life working as a community banker in our town of 300 people. I got into the business before I was a teenager collecting deposits at our front door since we didn't have a night deposit at our local bank. After college, I spent 2 years as a State bank examiner before I came back home to work in the bank for the next 35 years, and I have seen lots and lots of changes in the landscape since then.

Today, the de novo application process is managed in some cases by overzealous examiners paralyzed by the fear of making mistakes. Banks and credit unions fortunate enough to make it through the chartering process then face an unmanageable regulatory onslaught. It is not surprising that I hear too many lenders lament that they wouldn't encourage their children to follow in their footsteps.

From 2000 to 2008, there were more than 1,300 de novo bank charters granted and 75 new credit union charters. Let's compare that to a post-Dodd-Frank world. From 2010 to 2016, there were just 5 new bank charters and 16 new credit union charters. And since 2010, more than 2,000 charters have disappeared.

Thankfully, we have seen an uptick in the number of de novo charters since President Trump took office. According to recent data compiled by The Wall Street Journal, there have been eight de novo bank applications in the past few months alone.

From Connecticut to California, it seems that de novo financial institutions are beginning to stage a modest comeback. Perhaps this is because, for the first time in a long time, people have confidence in the economy and see a path forward with more responsible regulation.

Today's hearing will serve to examine the causes of the de novo drought stemming from both the application process itself and the regulatory environment for banks and credit unions alike. Over the next 2 years, this subcommittee will devote its time to pursuing financial reform that benefits Main Street, that fosters choice and accessibility in the financial marketplace, and that puts all Americans on a path to financial independence.

But the simple truth is that we can't do that without banks and credit unions. We have an excellent panel of witnesses today, some of whom are in the midst of or have recently gone through the chartering process. I know your insights will be most valuable to the members of the subcommittee.

With that, the Chair now recognizes the ranking member of the subcommittee, the gentleman from Missouri, my good friend, Mr. Clay, for 5 minutes for an opening statement.

Mr. CLAY. Thank you, Mr. Chairman.

And I guess I will use the analogy that we see things differently sometimes. When you see a half glass of water, some people see it as half full; others see it as half empty. But since the financial crisis there have been relatively few de novo or new bank and credit union charters.

I have long supported community financial institutions, as they are the best institutions to finance our Nation's small businesses and meet the financial needs of everyday Americans. However, I am concerned that the proposed fix that my colleagues want would only make the future of community banks and credit unions much bleaker.

New charters of financial institutions are not just affected by financial regulation, but also existing economic conditions, including the level of interest rates and the lingering effects of the financial crisis and the ongoing consolidation of the banking industry, which began more than 30 years ago.

In fact, by rolling back merger and concentration limits for the largest banks, as the Financial CHOICE Act proposes, Republicans would likely accelerate the decline of the community bank.

What is also frustrating is that the Majority continues to suggest that the Dodd-Frank Act is harming community banks, credit unions, and business lending. And yet, business lending is up 75 percent since Dodd-Frank. Imagine that.

In addition, most of Dodd-Frank's bank rules impose new requirements on community bank competitors, the megabanks and nonbanks, thereby helping level the playing field. As a result, it is not surprising that small banks are posting record profits and credit unions are expanding membership.

It is my hope that the witnesses today will comment not just on ways to improve the de novo chartering process, but also on what the future of community banking would be if the reins are taken off of megabanks and nonbank lenders.

I yield back.

Chairman LUETKEMEYER. I recognize the gentleman from Tennessee, Mr. Kustoff, for 1 minute.

Mr. KUSTOFF. Thank you very much.

I would like to thank the chairman and the ranking member for holding this hearing today to discuss the importance of de novo financial institutions to the banking industry. And I do want to thank the witnesses for joining us today in this discussion.

Over the last 6 years, we have seen a dramatic decline in de novo charter applications. In fact, there have been 5 new bank and 16 new credit union charters issued since 2010. If you compare that to the 8 years prior to the implementation of Dodd-Frank, the numbers are staggering, because during that time we saw over 1,300 bank applications and 75 credit union charters issued in those 8 years prior to Dodd-Frank.

I am looking forward today to hearing from all of you about your experiences. I want to read a quote from a banker in my district, in Gibson County, which is in rural west Tennessee.

He said, "Dodd-Frank has had a direct cost to our community bank of at least $100,000 per year, not including additional salaries and benefits for support people to monitor and to make sure we are in compliance. Another $25,000 has been spent making sure our auditors are keeping us in compliance. Dodd-Frank has taken away much of the essence of allowing us to serve our communities."

Thank you, Mr. Chairman. I yield back the balance of my time.

Chairman LUETKEMEYER. The gentleman's time has expired.

With that, we will recognize the gentleman from Michigan, Mr. Trott, for 1 minute, if he is ready.

Mr. TROTT. Thank you, Mr. Chairman. And thank you for holding this hearing today.

When I travel around my district, I hear from small bankers every time who are worried about their future. And these are not fat cats from Wall Street with big expense accounts; these are people who likely sponsor your child's little league team, give you a loan for your first home, help the new sandwich shop open up, or set up a bank account that helps you save for college.

They worry because they see their peers disappearing by the hundreds each day. They see their profits flow into negative territory and wonder if they will be next. Their small-business clients wonder if the bigger bank that took over the previous lender will give them the same chance.

Mr. Chairman, when I come to Washington, it almost feels like a different world. I read reports by people in this town saying that our regulators make it easier for small banks to thrive. I don't think I have found anyone in southeast Michigan who believes this.

I have spent the past few weeks speaking with bankers in southeast Michigan. They say in the past, they would have needed a few million dollars in assets to be profitable. Now, they can barely hope to become profitable until they have a billion dollars in assets. This is too high. No new banks are likely to start if they know they need to reach this height.

I see my time is over. But, Mr. Chairman, we need our small banks. We also need regulations. However, regulations must be smart. I yield back the balance of my time.

Chairman LUETKEMEYER. The gentleman's time has expired.

With that, opening statements are over, and we want to welcome our guests.

First, we have Mr. Ken Burgess, the chairman of FirstCapital Bank of Texas, who is testifying on behalf of the American Bankers Association.

Second, we have Mr. Keith Stone, the president and chief executive officer of The Finest Federal Credit Union, who is testifying on behalf of the National Association of Federally-Insured Credit Unions. I am sure it is a wonderful credit union, if it is the finest one.

Next, we have Mr. Patrick Kennedy, a managing partner of Kennedy Sutherland LLP, who is testifying on behalf of the Subchapter S Bank Association.

And finally, we have Ms. Sarah Edelman, the director of housing finance at the Center for American Progress.

Each of you will be recognized for 5 minutes to give an oral presentation of your testimony. And without objection, each of your written statements will be made a part of the record.

Before we hear testimony, I would like to yield to the gentleman from Texas, Mr. Williams, for an introduction. Without objection, the gentleman from Texas is recognized.

Mr. WILLIAMS. Thank you, Mr. Chairman.

It is always a pleasure to introduce a fellow Texan to testify before our subcommittee, even if he did go to Texas Tech instead of TCU.

Ken Burgess went to work for the original First National Bank of Midland after graduating from Texas Tech, moving to Waco in 1985, where he served as executive vice president of Texas National Bank of Waco.

In 1993, Mr. Burgess and his family moved to Abilene, where he took the position of president of Security State Bank of Abilene. Upon the sale of the bank in 1998, Mr. Burgess left to form the First National Bank of Midland, now known as the FirstCapital Bank of Texas. The bank presently stands at $993 million in assets.

In addition to his role at FirstCapital, Mr. Burgess serves as Chair-elect of the American Bankers Association, having previously served as chairman of the Community Bankers Council. He also is the most recent past chairman of the Texas Bankers Association.

So to say the least, we are honored that you are here today, and we look forward to hearing your unique experience and perspective on the current trends and challenges facing new bank formation.

So with that, Mr. Chairman, I proudly yield back.

Chairman LUETKEMEYER. I would now like to take a moment of personal privilege. In the audience today is a former president of the Missouri Bankers Association, my State, Mr. Dan Robb, and his wife Diana.

Raise your hand, Dan.

And I understand that this is also sort of a fly-in day for a lot of the other bankers around the country. So do we have any other bankers in the audience? I see a few name tags of those who may be bankers. If you wouldn't mind holding your hands up? The whole back row, cheap seats, all right. Great.

Welcome, thank you very much. We welcome your participation. And hopefully you can keep the cheering down in the back of the room back there just in case. But it is great to have you, and we welcome you.

With that, we want to open up the testimony with Mr. Burgess. Mr. Burgess, you are recognized for 5 minutes.

STATEMENT OF KENNETH L. BURGESS, CHAIRMAN, FIRSTCAPITAL BANK OF TEXAS, ON BEHALF OF THE AMERICAN BANKERS ASSOCIATION (ABA)

Mr. BURGESS. Thank you, Mr. Chairman.

Chairman Luetkemeyer and Ranking Member Clay, my name is Ken Burgess, and I am chairman of the FirstCapital Bank of Texas. My bank was chartered in 1998, and in less than 20 years we have grown our assets to just over $1 billion. We serve the Midland, Lubbock, and Amarillo markets in west Texas, as well as a new market in central Texas near the Austin area. We are primarily a commercial bank lending to small businesses, and we also have a strong mortgage lending arm.

ABA appreciates the opportunity to testify on the drought of new bank charters. The lack of de novo banks is strong evidence that the economics for new community banks doesn't work. Investors have options. If the impediments to starting a new bank are too great, they will invest elsewhere.

Sadly, the forces that have acted to stop new bank charters are the same ones that have led to the dramatic consolidation of the banking industry: excessive and complex regulations that are not tailored to the risks of specific institutions. This, not the local economic conditions, is often the tipping point that drives small banks to merge with one another and is a barrier to entry for new banks.

Since the Dodd-Frank Act was enacted in 2010, community banks have shown great resilience and have worked to provide credit in spite of the onslaught of new regulations. The fact that they continue to lend and strive for profitability in no way suggests that the Dodd-Frank Act and its 25,000 pages of proposed and final rules has not had a negative impact on banks' customers and their communities. It has had an impact.

While not the sole reason, it is very troubling that 1,917 banks, or about 24 percent of the industry, have disappeared since Dodd-Frank was enacted. Contrast that with only six de novo banks since Dodd-Frank.

In April, the FDIC announced some welcome changes to help prospective de novos. Unfortunately, they did not address the underlying barriers to entry: capital hurdles; unreasonable regulatory expectations on directors; funding constraints; and an inflexible regulatory infrastructure.

When my bank was started, we raised $6.5 million to capitalize the bank. The expectation for de novos now is somewhere between $20 million and $30 million, many multiples beyond what successful banks needed in the past for a startup.

For my bank, the $6.5 million was an amount we felt we could grow into in a reasonable period of time, which would allow us to provide a reasonable return to our shareholders and grow the bank in a safe and sound manner.

As we grew, we raised additional capital 6 different times to keep the bank adequately capitalized, but we were careful not to overcapitalize. Had we raised it all in the beginning, shareholders would have been unhappy and would not have been willing to invest more when the time came and that capital was needed for growth.

I would not start a bank under today's conditions. Even though with my experience, I could likely raise the funds necessary, I would have to grow the bank so quickly to put the capital to work that it would pose undue risk on our shareholders.

Starting a new bank in a small community would be even more difficult. It would be very hard to raise capital and impossible to grow the bank quickly enough to utilize that capital.

Moreover, with all the regulations, a highly experienced compliance officer is needed. Yet, good compliance officers now easily make six figures, far more than what the highest paid staff member receives in most small community banks. This makes it very hard to start and run a profitable bank.

It is time to think differently to encourage new banks by requiring less startup capital, reducing regulatory burden, permitting greater flexibility in business plans, and lifting funding restrictions.

I grew up in a banking family. My father managed three small community banks in west Texas. From childhood, I saw the impact that a small town community bank has on its community. They are involved in or behind almost every initiative, they support almost every nonprofit, and they support the small businesses in those communities like no other bank can. When a small community loses its bank, it quickly begins to die.

We urge Congress to act now and pass legislation to help turn the tide of community bank consolidation, to create an economic environment that encourages new bank charters, and to protect communities from losing a key partner to support economic growth.

Thank you. I would be glad to answer any questions when the time comes.

[The prepared statement of Mr. Burgess can be found on page 48 of the appendix.]

Chairman LUETKEMEYER. Thank you.
With that, we recognize Mr. Stone for 5 minutes.

STATEMENT OF KEITH STONE, PRESIDENT AND CHIEF EXECUTIVE OFFICER, THE FINEST FEDERAL CREDIT UNION, ON BEHALF OF THE NATIONAL ASSOCIATION OF FEDERALLY-INSURED CREDIT UNIONS (NAFCU)

Mr. STONE. Good afternoon, Chairman Luetkemeyer, Ranking Member Clay, and members of the subcommittee. My name is Keith Stone, and I am testifying today on behalf of NAFCU. I appreciate the opportunity to share with you my experience with chartering a new credit union.

I currently serve as the president and CEO of The Finest Federal Credit Union, headquartered in New York City. The Finest's charter was approved in January of 2015 to serve the needs of New York State's law enforcement community. We currently have $5 million in assets and serve over 2,400 members.

The idea for the Finest Federal Credit Union came from Mr. Paul McCormack, a retired NYPD deputy inspector. In his travels, he was introduced to officials from Saint Raphaels Garda Credit Union, the largest credit union in Ireland. Mr. McCormack was intrigued and amazed at the services offered by this cooperative, which led him to ask the question: Why doesn't the world's largest police force, the NYPD, have their own credit union tailor made to fit their own unique needs?

In 2007, Paul and several other organizers went to work trying to find a way to fund the venture. After more than a year of research and organizing, it became apparent that the financial crisis of 2008 scared away the would-be capital sources, so their efforts were put on hold.

A few years later, AmTrust Financial Services announced its interest in helping fund our credit union launch. Once funding was secured, we went to work drafting the application and business plan and finally submitted them to NCUA. This process lasted over 18 months.

As we learned, chartering a credit union is not quick or easy. The process involves 17 steps that I outlined in my written testimony. The entire process can take up to 3 years, depending on the complexity of the business model and how many amendments must be made.

While we were fortunate to have support, the initial capital infusion and cash outlays to start a credit union are often too great for many communities. Starting a new credit union is essentially an altruistic endeavor as there is no ultimate financial incentive for those who are successful.

Furthermore, the complex chartering process may seem relatively easy and straightforward when compared to what a de novo credit union will face once it is chartered and operating. The industry has seen a significant decline in the pace of de novo credit unions post-Dodd-Frank enactment, averaging nearly eight charters per year before but only about two afterwards. Approximately one-third of credit union charters established in recent years have not survived.

Despite the challenges, we have been successful at The Finest due to some key factors, including our commitment to keep the underlying goal in focus, to provide specific help and services to the officers of the NYPD through all stages of life, and our ability to secure a financial supporter in AmTrust Financial Services to help fund the chartering effort.

Even after securing funding, we continued to face a number of challenges, such as the significant cost needed to run day-to-day operations and keep up with the ever-changing post-Dodd-Frank regulatory environment and limitations in our current powers that deny us the ability to fully serve our member needs by offering expanded products, such as mortgages.

While NCUA is an important partner, and their Office of Consumer Protection takes an active role in helping new credit unions form, there are additional steps that they can take to help de novo charters meet their unique challenges. The agency could establish timetables for responses at various stages of the chartering process and set an advocate at the agency for de novo credit unions to work with. NCUA could also provide limited flexibility on a case-by-case basis for new credit unions, such as additional time to meet certain requirements or faster approval for additional services.

Congress can also help de novo charters by passing meaningful and comprehensive regulatory relief, including providing credit unions greater relief from some of the burdens in the Dodd-Frank Act and by adopting more flexibility in the Federal Credit Union Act, such as expanding access to supplemental capital, ability to serve underserved areas, and modernizing outdated governance provisions in the Act.

In conclusion, chartering a new credit union is not an easy process, and de novo credit unions face a series of challenges once they are created. Still, new credit unions are an important way to meet the unmet needs of the American financial consumer. Both Congress and the regulators need to do more to help reverse the declining trend of new charters.

We thank you for the opportunity to share our thoughts with you today. I welcome any questions you may have.

[The prepared statement of Mr. Stone can be found on page 74 of the appendix.]

Chairman LUETKEMEYER. Thank you.

Mr. Kennedy, you are now recognized for 5 minutes.

STATEMENT OF PATRICK J. KENNEDY, JR., MANAGING PARTNER, KENNEDY SUTHERLAND LLP, ON BEHALF OF THE SUBCHAPTER S BANK ASSOCIATION

Mr. KENNEDY. Mr. Chairman, Ranking Member Clay, and members of the subcommittee, my name is Patrick J. Kennedy, Jr., and I want to thank you for inviting me to appear at this hearing and to submit written testimony.

I have been a practicing lawyer for 30-plus years representing community banks, their shareholders, directors, officers, and related entities on a wide range of corporate regulatory matters. And over those years, together with my various partners, our firm has represented over 30 de novo charter groups, and we are today honored to be representing a group of Florida businessmen who have filed the first national bank charter in the United States since 2008.

I also am president and founder of the Subchapter S Bank Association, which is primarily an educational organization which provides substantive advice and content to shareholders, directors, and officers of banks that have elected Subchapter S tax treatment under the Internal Revenue Code.

There are over 2,000 banks in the United States which maintain that S election, accounting for approximately a third of the charters in the United States. Ninety percent of these Sub S banks are under a billion dollars in total assets, and 90 percent of that number are located in rural communities.

In 2008, there were 101 applications for new bank charter insurance filed with the FDIC, of which 28 were approved. Thirty-three were filed in 2009, but none were approved. The filings dropped to 6 in 2010 and a total of 10 from 2011 through June 30, 2016, with only 3 charters being approved in that period of time.

In my opinion, the reasons for the significant decline of new bank charters is a direct result of the decision made by the FDIC in 2009 to require that applicants for FDIC insurance provide a 7-year business plan, evidence of capital sufficient to maintain a comfortable cushion above that of the required minimums for that entire period of time, and in addition mandated that the initial conditions and enhanced supervisory monitoring imposed on new charters would also be extended from the traditional 3 years to 7 years.

One of the many conditions that the FDIC imposed was requiring prior approval of any change or deviation in the business plan, and the FDIC began imposing similar conditions on just changes in control of existing banks. These had a significantly negative impact.

The regulatory oversight and examination processes post-2008 also created additional capital and regulatory pressures, and informal capital ratios were increased 1 to 2 percent, even for well and good operating banks. Clearly, the enactment of Dodd-Frank unleashed a new plethora of requirements and costs on banks and led to further significant increases in cost.

And in June of 2012, the Federal regulators imposed the Basel III international capital standard on every bank in the United States, sending really another tremor through the industry, and we began to immediately notice a significant shift in our bank clients' attitude. Many began to believe that they would be unable to continue to operate or only do so in a marginally profitable way, if at all.

In response to the chairman's specific request, these added costs occasioned by Dodd-Frank, Basel III, and the discretionary supervisory action significantly impaired existing financial institutions' ability to provide financial services and products to consumers.

In the past few years, we have heard regulators explain the lack of new charters as a result of low interest rates and the expectation that charters would not be viable; however, in my opinion, the 7-year business plan and compliance period was the most significant reason.

At the urging of many in the industry, the FDIC began to change these discretionary regulations. In 2004, they reduced the business plan from a 7- to a 3-year period, but there was still confusion in the marketplace. In April of 2016, the chairman clearly eliminated and returned to the 3-year business plan capital period, and I think that is the reason we see the number of charters beginning to increase.

Thank you very much, Mr. Chairman.

[The prepared statement of Mr. Kennedy can be found on page 70 of the appendix.]

Chairman LUETKEMEYER. Thank you.

Ms. Edelman, you are now recognized for 5 minutes.

STATEMENT OF SARAH EDELMAN, DIRECTOR OF HOUSING FINANCE, CENTER FOR AMERICAN PROGRESS

Ms. EDELMAN. Thank you.

Good afternoon, Chairman Luetkemeyer, Ranking Member Clay, and members of the subcommittee. My name is Sarah Edelman, and I direct the Housing Policy Program at the Center for American Progress. Thanks so much for having me here to testify today. And thank you for your interest in ensuring a robust community banking sector that serves all communities.

A family or a small business should be able to build a strong relationship with their community bank or credit union whether they live in a downtown commercial center, a neighborhood suffering from disinvestment, or a small town. However, watering down the FDIC requirements for new banks is not likely to help Americans better meet their credit needs over the long term.

The decline in de novo banks since the financial crisis has far more to do with macroeconomic conditions than the FDIC application process or higher standards for banks. Researchers at the Federal Reserve found that macroeconomic conditions, including interest rates, account for over two-thirds of the recent decline in de novo applications.

Since the financial crisis, interest rates have been at historic lows. While necessary for helping consumers and businesses and for creating jobs, low interest rates have made it harder for new banks to be profitable. This is because a community bank's primary source of revenue is derived from net interest margin revenue, basically the spread between what a bank pays to fund a loan versus the interest rate the borrower pays to the bank.

Lower interest rates narrow the spread, which means the bank earns less. While existing banks can earn higher profits on loans they originated when interest rates were higher, new banks can't bolster earnings through legacy loans.

It is true that the FDIC made changes to its application process for de novo banks during the financial crisis. In 2009, the FDIC lengthened the period of supervision it requires for new banks from 3 years to 7 years. This change came amid widespread bank failures and hard economic conditions.

By the end of 2009, the FDIC insurance fund had fallen into the red by $20.9 billion. FDIC research shows that during the crisis, newly formed de novo banks failed at twice the rate of existing small banks. It makes sense then that the FDIC would have required additional supervision during a new bank's early years.

However, in 2016, as conditions improved, the FDIC reduced its supervision period back to 3 years. The FDIC is also making the application process more transparent and easier to understand, including through clearer guidelines for applicants and a series of local roundtables.

If we care about making sure that families and businesses have access to credit, we should address factors that have more directly led to the decline in the number of small community banks over the years. For instance, members of the relevant committees in Congress and regulators should make it their full-time job to ensure that the Nation never endures another devastating financial crisis.

According to FDIC data, between 1985 and 2013, over 2,500 banks and thrifts failed. Ninety-seven percent of these failures took place during a financial crisis, either during the savings and loan crisis or during the recent global financial crisis. Put simply, the Nation has lost too many small banks to financial crises caused by the big banks.

In 2010, Congress enacted financial reform to prevent the large banks from taking down community banks and our economy again. Despite the claims of some banking industry representatives, these standards do not appear to be hurting the health of community banks. First, community banks enjoy large exemptions from the new standards. For instance, they aren't subject to CFPB enforcement, stress testing, or many of the new mortgage rules.

Moreover, community bank profits are up, back to where they were before the financial crisis. Business lending has increased since the passage of Dodd-Frank. Small communities banks are doing more mortgage lending than they were before the crisis.

Lowering FDIC standards for new banks, or deregulating Wall Street, as some Members of Congress have proposed, is not likely to help community banks over the long term or aspiring small de novos.

One immediate step Congress can take to strengthen small banks and credit unions is to ensure that community development financial institutions serving their communities are properly funded. I believe my copanelists share my disappointment with the President's proposal last week to eliminate the CDFI Fund, which funds hundreds of CDFIs across the country and generated over $4 billion in lending in 2013. Congress can take an important step towards serving Main Street by making sure CDFIs can continue serving communities often overlooked by larger institutions.

Thank you for your time.

[The prepared statement of Ms. Edelman can be found on page 59 of the appendix.]

Chairman LUETKEMEYER. Thank you.

I will now recognize myself for 5 minutes for questions.

Mr. Kennedy, I want to start with you. You are in the midst right now, I understand, of working with a bank with regards to getting a new charter. Is that correct?

Mr. KENNEDY. Yes, Mr. Chairman.

Chairman LUETKEMEYER. And when you were talking about your testimony there, you had over 30 of these banks that you worked with before, so you have a lot of background, a lot of experience on it. And you are saying that in 2010, I believe it was, there were

30-some that applied for a charter—maybe it was 2009—and none were approved. Can you tell me why none were approved?

Mr. KENNEDY. I don't know. The Chair of the FDIC was testifying in July before the House Oversight Committee, and the FDIC produced the statistics that I drew from. And it just was very clear, you could see a dramatic decline. And I pinpoint that as the change that I referred to in 2009 that the FDIC made to their rules.

Chairman LUETKEMEYER. I think one of the concerns that we have—and this is why the subcommittee is having the hearing today—is we saw prior to 2008 about 150 bank charters and a number of credit union charters as well, and then after that it seemed like it fell off the charts.

And I think, Mr. Burgess, you alluded to the fact that there is a lot of—you made the comment that the economics don't work. So apparently there were a lot of folks who looked at the economics of putting together multimillion-dollar businesses here and it wasn't going to pay back. So can you elaborate a little bit on what you were talking about there?

Mr. BURGESS. I know probably a number of you grew up in small towns like I did. And if you look at a startup organization, in our case we started with $6.5 million, and about 6 employees. I took a large cut in salary from a bigger bank I came from to do that, and I was making less than $100,000.

Today, if I was going to start a new bank, I would have to hire a compliance officer who would make over $100,000, and the economics do not work when you have to put a salary in at that level to get started with a bank that doesn't really have any assets on the books. It also takes probably in the neighborhood of $750,000 in upfront costs to go through the application process before you even have any revenues.

Chairman LUETKEMEYER. So what you are pointing out is that you have a lot of compliance costs, a lot of rules and regulations you have to comply to that cause you to spend more money than had previously been done prior to 2008. Therefore, the economics of it have changed significantly. Is that a fair statement?

Mr. BURGESS. That is a fair statement.

Chairman LUETKEMEYER. And that your business model has changed significantly as a result of all the rules and regulations.

Can you point to a particular rule or regulation or group of rules or regulations that are problematic for you, very costly?

Mr. BURGESS. I can point to a number of rules and regulations that are problematic. But I think it is the accumulation of rule after rule after rule. And if you have a bank that has six or seven employees in it when you start out and they have to get their arms around all of the rules and regulations that were in place before that, and now you have 25,000 pages of new regulations, you can imagine, even if you have a highly experienced compliance person, trying to get your arms around that, number one, training all the employees to make sure that they can meet a zero-tolerance compliance policy in many cases is almost impossible. We are human beings. That is pretty tough.

Chairman LUETKEMEYER. Thank you, Mr. Burgess.

Mr. Stone, you were shaking your head a minute ago when I was talking about rules and regulations.

Mr. STONE. Yes, sir.

Chairman LUETKEMEYER. Do you have a lot of experience with that?

Mr. STONE. Mr. Chairman, I concur with a lot of what Mr. Burgess said. We started with $2 million in capital. We are now a $5 million institution. I was actually speaking yesterday—I was at NASCUS, which are credit union State controllers, and they recommend that you need to start with at least $5 million.

We have the same difficulties. I have a staff of four full-time, and two part-time people. We have the income expense conundrum. We have the regulatory burdens. And I couldn't agree more, my BSA officer is also my compliance officer, and my chief operating officer.

And to be able to keep up with salaries of a small staff—in addition to lack of income right now, because due to certain regulatory concerns we are not allowed to offer certain products right now which would bring in the income which would help grow our credit union.

So it is a catch-22. We want to grow, we want to add services, but we can't because of certain restrictions right now we have on us with a letter of understanding and agreement from the NCUA, and with the regulatory burden, and that is stopping us from growing, from adding these products.

Chairman LUETKEMEYER. You made the comment about relieving the burden of Dodd-Frank. I have almost no time here. Can you just very quickly—

Mr. STONE. That is correct, sir, Dodd-Frank regulations—

Chairman LUETKEMEYER. Okay. My time has expired.

I will recognize the gentleman from Missouri, the ranking member of the subcommittee, Mr. Clay, for 5 minutes.

Mr. CLAY. Thank you, Mr. Chairman.

Let me thank the witnesses for their testimony today and your answers.

Ms. Edelman, your fellow panelists are suggesting that de novo bank and credit union charters are experiencing a current drought as a result of Dodd-Frank protections intended to prevent another financial crisis and harm to consumers. However, I understand the Federal Reserve staff has done research showing that de novo applications tend to closely track interest rates.

You have also done research showing that there has also been considerable consolidation in the banking industry long before Dodd-Frank.

Would you please elaborate on these factors, the role the interest rate environment may play, along with the very long industry consolidation trend, and any other factors and how they affect de novo bank and credit union charters?

Ms. EDELMAN. Sure. Thanks for the question.

Community banks have been having challenges over the past several decades. And most recently what we have been seeing with the lack of de novo charter applications, research from the Federal Reserve has shown that new bank charters are highly correlated to interest rate levels. And so when interest rate levels have been low over the decades, you have seen fewer bank charter applications.

They also found that since the financial crisis, not only have we seen a decline in de novo charters, but we have also seen a decline in the number of new bank branches that are opened by existing banks, pointing out that there is something else going on than just the FDIC de novo process, because those existing banks don't have to go through the de novo process. So there are some macroeconomic factors that seem to have made it less attractive to investors to invest in new banks.

And in terms of consolidation since the mid-1980s, we have seen—as I mentioned in my testimony, most of the small banks that we have lost or seen periods of massive consolidation have happened around the financial crisis, so right after the savings and loan crisis or right after the global financial crisis that was triggered in 2008.

We also saw things like liberalization of interstate banking rules in the 1980s and 1990s that made it far more attractive to consolidate than to open up a new bank.

So there are all sorts of reasons why we have been seeing a decline.

One other thing to point out is that when small banks are doing well, oftentimes they grow into midsized banks, like Mr. Burgess' bank. So 20 percent of the banks that had less than $100 in million assets in 1985 had grown to be midsized community banks by 2011, and some of them even have over $10 billion in assets.

So it is a more complicated picture than simply saying it is the FDIC's fault or it is Dodd-Frank's fault.

Mr. CLAY. And thank you for that.

Mr. Burgess, it is my understanding that your community bank has been in existence for nearly 20 years. You have weathered both the pop of the tech bubble and the financial crisis. As a result of both of those downturns, many community banks, including a large proportion of de novo banks, failed.

It is also my understanding that de novo banks fail in significantly larger proportions than other community banks during a recession, which helps explain why the FDIC imposed additional guardrails around those institutions in 2009. In fact, FDIC researchers found that out of the 1,042 de novo banks chartered between 2000 and 2008, 133 failed or 12.8 percent. In comparison, 4.9 percent of small established banks failed during the same period.

These researchers also noted that de novo banks' higher failure rate is consistent with previous studies which found that they are financially fragile and more susceptible to failure.

My question to you is, when banks fail and the FDIC steps in to make depositors whole, is it not remaining banks, such as your bank, that have to pay additional deposit insurance premiums to recover those losses?

And my time is up.

Mr. BURGESS. Thank you.

Yes, that is true. We do see additional increases in deposit premiums, and we had to rebuild the FDIC fund after the financial crisis.

I am not really familiar with the study that you just discussed, but there were a lot of de novos that started prior to the financial crisis. I would like to see the geographical dispersion of those, because I would assume a lot of those were in the Georgia area and that was hit very heavily during that time. And I would say a lot of those numbers likely came in that area. I am not sure. But you are correct.

Mr. CLAY. Thank you.

Chairman LUETKEMEYER. The gentleman's time has expired.

With that, we go to the vice chairman of the subcommittee, the gentleman from Pennsylvania, Mr. Rothfus, for 5 minutes.

Mr. ROTHFUS. Thank you, Mr. Chairman.

Mr. Burgess, you mentioned in your testimony that you had to raise about $6.5 million in order to start your bank about 19 years ago. And you estimated that a similar effort would require between $20 million and $30 million today. This is certainly in line with what I am hearing from community bankers in my own district. Clearly, having to raise 4 or 5 times more money today than a few years ago—likely from a broader pool of investors—to start a bank is a big hurdle to overcome.

I also wonder whether raising so much capital at the start to satisfy regulators also has the potential to change firm behavior, perhaps inducing banks to make riskier choices. This would seem to be against the spirit of what the regulators are hoping to achieve.

You seem to share this concern. In your testimony you wrote, "If I was in the position of starting a bank today, under today's conditions, I would not do so. Even though, with my experience, I could raise the funds necessary, I would have to grow the bank so quickly to put the capital to work that it would pose undue risk on our shareholders."

Can you elaborate on that statement?

Mr. BURGESS. Yes, thank you for the question.

When an investor looks at where they are going to make an investment, they are looking for a reasonable return. And if they can get a better return somewhere else, that is where that money is going to flow. So if they are going to make an investment in the banking industry, they are going to look for an investment where they know they are going to make a reasonable return.

If you set the capital levels too high and it is going to take 5 to 6 years before they can receive a reasonable return, then they are not going to be very happy with that investment. And when you do get to the point where you need to get more capital, it is unlikely you are going to be able to get those investors to put more in because the return is going to be so low.

Mr. ROTHFUS. Do these higher capital requirements for de novos, would they induce riskier behavior? Are you going to be looking for a return in some way to satisfy the shareholders?

Mr. BURGESS. If you went ahead and started a bank in a community, in a small community especially, and you had to raise $20 million, that means that you would need to have a bank of somewhere around $200 million in assets to support that. A lot of small towns don't have banks that have been there for 100 years that are $200 million in assets.

So it is unlikely you are going to grow a bank to $200 million in a short period of time. If you did, you would have to be looking for alternative ways to bring in deposits, and alternative ways to bring in loans.

More than likely those would have to come in from other markets and other places, which are out of market and are frowned upon by regulators. So it would cause them to use an out-of-the-box plan to try to get to the level to leverage that capital appropriately.

Mr. ROTHFUS. I want to switch to Mr. Kennedy for a second. In your testimony you state that the lack of new charters is not a result of low interest rates. Why do you think that regulators pin the de novo drought partly on low interest rates?

Mr. KENNEDY. I guess the chart that the Federal Reserve produced might be one reason, Congressman. I think it could be one of the reasons, but I do not think it is the only reason. There are examples of banks that were actually chartered and open for business in 2008 just going into the crisis that did very well during that low- interest-rate period.

Mr. ROTHFUS. They were able to make money during those 3 years and they did okay?

Mr. KENNEDY. Yes, sir.

Mr. ROTHFUS. Again, Mr. Kennedy, as you know, the FDIC strongly discourages any deviations from business plans and requires that banks seek their approval before making any changes. While I understand that the FDIC has an interest in making sure that banks stick to their initial plans, we should also be mindful of the fact that economic conditions change and a well-managed institution should be able to respond to change effectively.

Given the FDIC's insistence on sticking to the plan, how can an institution adjust to changing realities quickly enough to succeed?

Mr. KENNEDY. It is a very difficult thing. Thanks for the question.

The good news is that the FDIC did kind of clarify what they mean by adverse or by changes to the plan in April of 2016 and put a 25 percent deviation standard, which provides a little more flexibility than I think they were imposing previously.

Mr. ROTHFUS. Are there any similar requirements that may be an impediment to de novo success?

Mr. KENNEDY. The capital ratios continue to be difficult, particularly on Subchapter S banks, which I think is one of the reasons we have as many community banks in the United States as we do, because they are community banks, largely rural banks that are family owned, like Mr. Burgess', that are able to take advantage of flow-through tax treatment.

But there are caps on the number of shareholders. And so, particularly in the case that we are representing in Florida that I made reference to that is a charter, it is going to begin as a Subchapter S bank, but there are concerns about the number of shareholders being at that 100 shareholder cap. So changing that would be helpful.

Mr. ROTHFUS. I yield back. Thank you, Mr. Chairman.

Chairman LUETKEMEYER. The gentleman's time has expired.

The gentlelady from New York, Mrs. Maloney, is now recognized for 5 minutes.

Mrs. MALONEY. Thank you very much. And thank you, Mr. Chairman and Mr. Ranking Member, for this important hearing.

I agree with the statements of Ms. Edelman that the CDFIs need to be refunded and funded. They provide a critical form of financial services to many communities. And I very strongly agree with Mr. Burgess' statement that often the banks and the credit unions are the key employer, the most important civic leader in these neighborhoods, and are absolutely critical to banking.

And I think we are seeing more and more that larger banks that are involved in the international don't even want to get involved in daily banking of small business loans and mortgages. So community banks really didn't cause the financial crisis; they certainly were the backbone of helping our communities recover and bounce back.

So I just want to thank you, Mr. Burgess, and ask you a little bit more about your statement that banks with less than $100 million in assets have seen by far the steepest drop-off after the crisis. And as you noted in your testimony, more than 43 percent of these smaller banks have disappeared since 2010, which is truly shocking.

And whether the cause of this decline is a higher regulatory burden or economics of scale that make it difficult for small banks to competes with larger rivals or just to survive in general, I think we can all agree that it has become more difficult with a bank with less than $100 million in assets to survive.

So my question, Mr. Burgess, is, does this suggest that new banks will need to be larger when they first start out in order to have a decent chance of surviving? You said you started yours with $20 million, I think you said?

Mr. BURGESS. We started ours with $6.5 million.

Mrs. MALONEY. $6.5 million. So you are saying that can't happen now. Can you elaborate a little more on what this means for starting new banks?

Mr. BURGESS. The first thing it means is in a small community it is unlikely that the community has the resources to even put that amount of money together to start a bank.

But I will give you a story that is a good example of how a small community is impacted. As the chairman of the Texas Bankers Association last year, I traveled all around our State. I remember walking in one morning to a small bank in south Texas and talking to the owner, and he was lamenting the fact that he had lost several of the products that he had been able to do in the past, primarily mortgage lending.

He was the only bank in that community. He quit making mortgage loans because he did not have the staff to get their arms around all of the regulatory requirements for being able to make a mortgage loan. And since there is more or less a zero-tolerance policy for making mistakes, he did not feel like he could take the risk to do that.

So that community is now left with nobody making mortgage loans, and the only people who are going to make mortgage loans in that community would be investors who would come in and buy up those houses and sell those back to people and finance them themselves, which is generally at much higher interest rates.

Mrs. MALONEY. I want to talk to you, Mr. Kennedy, about your testimony. You said that you saw a noted difference after 2012 when it was announced that regulators would impose the international large bank capital standards, known as Basel III, on every bank in the United States.

It seems to me that we have a two-bank system. We have international banks that compete in the international global community, and we have community banks that provide services in communities. And I, for one, have never understood why Basel III capital standards should apply international banking standards when you are not involved in the risky products, you are not involved in the high-risk activities that some of our larger banks are involved in.

So I, for one, would like to explore—and I have raised this in letters and conversations with regulators over and over again—that community banks should not have that same standard. And they say they have a different standard, but I am not hearing that there is a different standard coming from you.

But I would support legislation that would say community banks should not be held to the Basel III capital standards. They should be held to capital standards, but they are not competing in the international market. And that burden seems like an unfair burden, in my belief, on community banks.

And I agree with the statement from Mr. Burgess that community banks provide, I would say, an essential service, really an essential service to America. And if you don't have a bank in your community, you are in big trouble. You can't finance, you can't get things going.

So I really would like to explore that with some of my colleagues on some aspects that we could do, and that seems like a commonsense one to me.

I think the chairman is telling me my time has expired. Thank you.

Chairman LUETKEMEYER. The gentlelady's time has expired.

With that, we go to the gentleman from Florida, Mr. Ross, for 5 minutes.

Mr. ROSS. Thank you, Mr. Chairman.

It is my understanding that the number of community banks that now exist is at the lowest number since prior to the Great Depression in 1928. And as we look at the number of banks and the stagnant growth in the banking industry, I have to speculate that most industries are demand-driven by consumer demand.

And so what effect has the lack of—or is there a lack of—consumer demand for banking services in the industry over the last 10 years?

Mr. Burgess, I will let you start with that.

Mr. BURGESS. No.

Mr. ROSS. There isn't, is there?

Mr. BURGESS. I am not seeing a lack of consumer demand. I am seeing a lack of ability to meet some of the consumers' needs because we created a box that everyone has to fit into.

Mr. ROSS. And so the only way you can stay alive is through acquisition and mergers?

Mr. BURGESS. We can grow our business some. But one of the reasons that I am in the banking business and one of the things I have enjoyed so much since I started was over the years I have been able to sit down with a customer who walked into my office—

Mr. ROSS. Exactly.

Mr. BURGESS. —listen to their story, try to create a custom package for them that meets their needs the way they need their needs to be met.

Mr. ROSS. And since Dodd-Frank, your hands have been tied, have they not?

Mr. BURGESS. In many cases, especially in the mortgage lending area.

Mr. ROSS. And so that consumer demand continues to exist both in the banking and in the credit union industry. Wouldn't you agree, Mr. Stone?

Mr. STONE. I would agree. Currently, we are being restricted due to Dodd-Frank, due to the fact that we are not allowed to offer mortgages, yet because of the size of our institution and the regulatory compliance costs that it would take to offer mortgages.

Mr. ROSS. Such as the qualified mortgage rule?

Mr. STONE. I'm sorry?

Mr. ROSS. Such as the qualified mortgage rule?

Mr. STONE. That is correct.

Mr. ROSS. And so the regulators are telling you how to do your business because they apparently know better. But my concern is that if the consumer demand is there, which it is, in fact, it is probably there more now than it has been in the last 8 years, and yet where are the consumers going to go? Where will they go if they can't go to their credit unions or their community banks?

Mr. STONE. We currently have the demand, and I will give you an example. Currently, we are offering products that no other institution can offer my field of membership, which is all law enforcement officials in the State of New York.

We have a product coming out called "killed in the line of duty" insurance. What that means is one of our members' biggest concerns is not the fact that they need to go to work every day; it's the fact that they might not come home to their families every day. So we have a product coming out that is going to be "killed in the line of duty" insurance, and we will be able to offer loans up to $850,000, and if that member—

Mr. ROSS. You have had to diversify your products, haven't you?

Mr. STONE. That is correct. In addition, we have something called the "uniform loan." So we go out to the new rookies from day one, they could get a loan from us for up to $5,000 for their equipment, to pay off high-interest-rate debt, to help them get started, and they can't walk into Chase Bank right now and get a $5,000 unsecured loan at a very competitive low rate.

Mr. ROSS. But my point is, there is consumer demand out there, and if they can't have their needs met at their community bank or their credit union, they are going to go somewhere else, and that somewhere may not be the safest place; in fact, it may be the most unregulated place.

Mr. STONE. We are hurting our community, we are hurting our field of membership, and we are pushing them to entities like predatory lending.

Mr. ROSS. Mr. Burgess—and maybe Mr. Kennedy might be able to speak on this—because there is also what has been out there is an overregulatory, what I call regulatory intimidation. Take Operation Choke Point, for example, where the DOJ and the Fed come in and say: Because of reputational risks, you can't give loans, we don't recommend that you give loans to these legitimate businesses because we don't like their reputation.

Now, let me ask you this: Has that played any role, do you think, in not only the lack of your ability to expand your bank, but also in the lack of the ability to start de novo banks?

Mr. Burgess, I will let you start, and then Mr. Kennedy.

Mr. BURGESS. I have not seen that, I don't think necessarily, in the area of starting a de novo bank. I know there are a lot of bankers who have certain lines of business where they have felt like they needed to get out of that business because of pressure to—

Mr. ROSS. From the Fed?

Mr. BURGESS. From the regulators.

Mr. ROSS. Yes.

Mr. Kennedy, can you comment?

Mr. KENNEDY. It is interesting. Just people who need loans, businesses that need loans, Ken made reference to the unique requirements of each individual businessman or person or woman, et cetera. And what we are finding is that the bankers have to kind of do what the regulators think is best. And they are getting way down into the weeds rather than being—

Mr. ROSS. And is that more of like an overreaction, because of what happened prior to the 2008 crisis?

Mr. KENNEDY. I believe it is. It has just continued to increase. I have been doing this for 35 years, and it has just continued to increase. When I first started practicing law and representing banks, there was no specific capital standard. You just had to have some prudential capital standards.

Mr. ROSS. I see my time is up. And being from Florida, I am delighted to see that you have clients who are starting a new bank in the State of Florida.

Thank you. I yield back.

Chairman LUETKEMEYER. The gentleman's time has expired.

The gentleman from Georgia, Mr. Scott, is recognized for 5 minutes.

Mr. SCOTT. Thank you, Mr. Chairman.

A priority of mine has always been to help the little guy. And I really mean it when I say it. And if I think a bill will help community banks and credit unions, I am usually the first Democrat to get on board and tirelessly fight to work in a bipartisan way and move legislation across the finish line. My record speaks for that in the 14 years that I have been on the Financial Services Committee. And the reason I do it is so that we can make the lives better for our community banks, for our credit unions.

But when I was preparing for this hearing my staff presented me with some compelling data about why new banks, de novo banks, have just stopped forming. If you recall, on December 16, 2014, the Federal Reserve study that was presented to us found that the biggest contributor to the steep decline in the creation of new banks was the low interest rate environment and the distressed demand for basic banking services.

So with that said, I want to sincerely pose this question to each of you distinguished individuals, and that is, what can we do on the Financial Services Committee to correct this problem? But we should not be focused on weakening Dodd-Frank. We should be focused instead on trends that are happening, such as low interest rates.

Would you all comment and give me an answer on that? Am I correct in stating that the focus should be on what the Fed said was the source of the problem, low interest rate environments and depressed demand, Mr. Burgess?

Mr. BURGESS. Thank you for that question.

Part of our business, and it has been for as long as we have had banks, is riding through interest rate cycles. That is a normal part of what we do. We have to be able to manage that. We always have been able to manage that.

But what is different this time is that when you have all these new costs that are being placed on you to meet regulatory demands, you have increasing cost, you have decreasing revenue, and the two of those things working together makes it very difficult to maintain profitability to allow you to grow and serve your community.

One thing you mentioned too that I would like to talk about is the small person or the people who have less resources to work with. The huge amount of regulation that has been placed on the mortgage lending side has hurt those small borrowers more than anybody else, because it makes it so costly to make a small loan that some banks have walked away from the smaller loans, and those are the ones that we specifically need for the group of people who are trying to buy the lower-cost houses. We have to be able to reduce those costs so we can meet that segment of the population.

Mr. SCOTT. Okay.

Mr. Stone?

Mr. STONE. Thank you for the question, Congressman.

In the credit union world our process, starting up a credit union, chartering it is a 17-step process. What we would appreciate is if Congress could help us reduce the amount of inefficiency and miscommunication in the chartering process starting up.

In addition, we feel possibly, pre-Dodd-Frank, I believe—and I have worked in the credit union world prior to 2003—the NCUA had sufficient restrictions and governance on credit unions. I feel even though we fall a bit under the umbrella of the current CFPB guidelines, I think it would be great for the credit union world right now if some of those were restricted and the credit unions didn't have to be under that umbrella.

Mr. SCOTT. Okay. I have 20 seconds, but I did want to get an answer just as a matter of fact. Do each of you agree when the Federal Reserve says that there is a depressed demand for basic banking services in this country?

Mr. BURGESS. I do not agree with that.

Mr. KENNEDY. I do not agree with that either.

Mr. STONE. I do not agree.

Mr. SCOTT. Why do you think the Fed came up with this? Because you all in the banking industry ought to know the answer to whether the demand is increasing.

Mr. BURGESS. We see it every day. I don't know where they came up with those numbers.

Mr. SCOTT. All right. I am glad I asked that question to clear it up. Thank you.

Chairman LUETKEMEYER. The gentleman's time has expired.

The gentleman from North Carolina, Mr. Pittenger, is now recognized for 5 minutes.

Mr. PITTENGER. Thank you, Mr. Chairman.

And I thank each of you for being here today. As a former bank board member of a small community bank, I have great interest in your testimony and what you have offered for us today. It has been very helpful and confirming to me of my experience in the banking business.

I was at our bank from the time we chartered until the time that we sold the bank some 11 years later. We sold it at maybe a little over 2½ times book value. It was a good return, and we were pleased with what we did.

But the interesting thing about our experience was we knew who was creditworthy, and there was a box to check for character, and know your customer. That is what it was all about. And we enjoyed a great experience. I think our loan losses were never over 2 percent, but usually less than 1 percent. It was a great accomplishment, a great experience for me.

And so, to that end, I recognize the impediments that have been placed upon the banking industry today—in North Carolina alone we have lost 40 percent of our banks—and truly restricting credit and capital, particularly in the rural communities which I serve. I serve eight counties, six of which are very rural, and they are impeded. That small farmer, that small-business guy doesn't have access to capital.

Ms. Edelman, I would like to ask you a question or two with the little time we have. I have read some about your background. You graduated, I believe, from the University of Maryland?

Ms. EDELMAN. That is right.

Mr. PITTENGER. And also from George Washington University.

Ms. EDELMAN. Correct. And I am originally from Pennsylvania.

Mr. PITTENGER. From where?

Ms. EDELMAN. Pennsylvania.

Mr. PITTENGER. Welcome.

Ms. EDELMAN. Thank you.

Mr. PITTENGER. You served in the Peace Corps.

Ms. EDELMAN. That is right.

Mr. PITTENGER. You served in AmeriCorps.

Ms. EDELMAN. Correct.

Mr. PITTENGER. You have been a community organizer, worked on community legal services, many other efforts of social intent. I am certain we would have much to learn from you of your experience, since you have been throughout the world in your public service, and I commend you for it.

I would say to you and inquire, have you ever worked in a bank?

Ms. EDELMAN. I have never worked in a bank. I worked on small economic development projects, and so community banks were part of—

Mr. PITTENGER. You have never worked at a bank. Have you ever been on a bank board?

Ms. EDELMAN. No.

Mr. PITTENGER. So you have never been involved in the loan process, never been involved in a bank and what it takes in terms of credit and establishing credit and what they do to—

Ms. EDELMAN. No. I am here today because I focus on working families and their ability to get a mortgage.

Mr. PITTENGER. And I appreciate that.

Ms. EDELMAN. So the issues that—

Mr. PITTENGER. What I am inquiring, Ms. Edelman, today—

Ms. EDELMAN. Yes.

Mr. Pittenger. —is understanding the realities of the real world. I would learn much from you, I think, I do believe, from your experiences of what you have achieved and accomplished through the Peace Corps and AmeriCorps. But I would just commend to you that these gentlemen, they validate by personal experience, they validate a statement that I heard from a man out in the hall earlier, about 30 minutes ago, that they sold their bank because of the compliance requirements. They had to consolidate. And these requirements, through Basel requirements, through the FDIC, have imposed enormous impediments on the growth of banks and the access to capital.

And with all due respect to you, while it is good to see academically what could be the concerns, what I hear back in my district is that small guy, that small entrepreneur who doesn't qualify, and that bank who can't issue credit to that small guy. And, frankly, they have been the lifeblood of our economy.

Ms. EDELMAN. Sure.

Mr. PITTENGER. While we can say—you can say, well, the economy is bad so the banks didn't do well—the reality is, would you accept the fact that perhaps these rules, these regulations, these compliance requirements imposed upon the financial institutions, the credit unions, the small banks, the inability to loan to people who could really be the dynamic in our economy?

Ms. EDELMAN. Here is what I think. I believe it is very important that regulators take the challenges that community banks and credit unions are facing very seriously.

Mr. PITTENGER. But I asked you a question.

Ms. EDELMAN. And it is partly why they have given the exemptions. But let me just—

Mr. PITTENGER. Reclaiming my time, excuse me, ma'am.

I would like to ask you this: Do you believe that these impediments, these rules, these regulations, these compliance requirements, do you think that they had an impact on what these men are talking about? Do you see the merit in what they have been trying to say?

Ms. EDELMAN. I believe that there has been an adjustment period. I also worry that the focus on repealing Dodd-Frank, that if you got rid of Dodd-Frank tomorrow, we are still going to have 300 small banks failing per year. This has been a trend we have seen since 1985. And I worry we are missing the ball.

Mr. PITTENGER. Reclaiming my time, I yield back.

I would just say real-life experience, I would commend to you, would make a different statement upon that.

Thank you. I yield back.

Chairman LUETKEMEYER. The gentleman's time has expired.

Ms. Velazquez from New York is now recognized for 5 minutes.

Ms. VELAZQUEZ. Puerto Rican from New York.

Mr. Burgess, in your testimony, you indicated that the ability of consumer banks to engage in small-business lending is being threatened by FinTech nonbank lenders, who often make loans without the same obligations and oversight as community banks.

How would you recommend regulating nonbank lenders in this space?

Mr. BURGESS. The first thing I would like to say is I am glad we have the FinTech area, because I think that is where the creativity and the innovation is coming from. The only thing we would want is we would want a level playing field so they don't have an unfair advantage in the same markets we are in.

So I am all for the FinTech area. I think they bring a level of innovation that is going to make us better down the road. We embrace a lot of what they are doing. We just want to make sure that we are playing on the same playing field they are.

Ms. VELAZQUEZ. I do, too. And one area of concern for me is transparency, so that borrowers know what they are getting, what type of fees. So that is why I asked the question.

Mr. Burgess, you also discussed how complex and the cost involved for de novo bank applicants when they are dealing with the business plan section of the application. So can you share with us how can we streamline the application process for new banks?

Mr. BURGESS. Yes. And one thing, while I am answering that—I would like to respond to one thing Ms. Edelman said earlier—is part of the process you go through when you decide you are going to charter a new bank is you go talk to the licensing person with whichever regulator you are going to go through, and they tell you what the hurdles are. If you decide those hurdles are too high, you don't fill out the application.

But a specific answer to your question is, you generally are going to be hiring two or three professional people to work with you, to fill out the application, to go through all the legal requirements that you have to do to make sure you are in line or the application will never happen. And the cost for most banks—Pat could probably answer that better than me—but I know that a lot of banks I have seen are going to spend between $750,000 to a million dollars in startup costs before they ever open the doors to start turning a dollar of revenue.

Ms. VELAZQUEZ. Thank you.

Mr. Stone, credit unions in New York recently informed me that it is becoming increasingly difficult to provide overseas remittances due to the escalating cost of complying with the associated rules and regulations.

How would you recommend we try and reduce the compliance costs for credit unions in this area?

Mr. STONE. Congresswoman, thank you for asking that question. While we have only provided a limited amount of remittances so far at The Finest, it is an area where we could expand our services if our members request it. However, with limited staff and resources, we would have to weigh the benefit of expanding against the staff and resources needed to comply if we went over the hundred-exemption limit.

So currently, we are way under the hundred. Being a brand new credit union, we have only done really two per month maybe we average.

Ms. VELAZQUEZ. Okay.

Ms. Edelman, last January, you wrote an article in which you argued that the decline of community banks is largely due to changes in the underlying market. You also offer a number of recommendations that you think could revive this important institution. Can you walk through some of those recommendations?

Ms. EDELMAN. Sure. I think it is important that instead of focusing on the Dodd-Frank regulations, we focus on some of the causes of the 30-year decline in small banks. Larger banks have lots of advantages over small banks, and that is partly why we have given small banks a number of carve-outs and flexibilities from the Dodd-Frank rules. But larger banks also have the ability to offer products that smaller banks can't because of the overhead required, like credit cards, for instance, which are often very profitable for large banks but require marketing and a call center and enormous overhead.

And so I think it is important that we look for ways to help small banks be more competitive. They clearly come with some innate competitive advantages. They serve the local community very well. They can get information from customers that larger banks just don't—just completely miss. But we need to be thinking about how to bring down administrative costs, how to help them leverage technology more. We need to be having a conversation about how the Federal Government can support them in the years to come.

Ms. VELAZQUEZ. Thank you.

Thank you, Mr. Chairman. I yield back.

Chairman LUETKEMEYER. The gentlelady's time has expired.

The gentleman from Texas, Mr. Williams, is recognized for 5 minutes.

Mr. WILLIAMS. Thank you, Mr. Chairman.

And thanks to all the witnesses today. We appreciate you being here.

It is an understatement to say that the current regulatory environment isn't working. It isn't working for Main Street America, of which I am a member, and it isn't working for the American taxpayers. As of this month, in Texas alone, 358 State- or Federally-chartered banks, credit unions, or thrifts have either closed or merged since 2010. According to our Texas State Banking Commission, the last bank or credit union chartered in Texas was in 2009. And in the Austin metro area, which is one of the fastest growing populations in the country and in my district—that has been an explosion of growth—can claim just 16 locally-chartered banks, down from almost 60 at its height in the 1980s.

So where does this leave us? Fortunately, it looks like Texas will get its first new State-chartered bank in almost 8 years. The Bank of Austin, which would primarily serve central Texas, has begun the long process of chartering in the Austin area.

Now, Mr. Burgess, to you, let me begin. In your testimony, you indicated that when you started FirstCapital Bank in 1998, you capitalized for $6.5 million. You go on to say it is the current expectation in the banking community that approximately $20 million to

$30 million would be needed to start a new bank. The Bank of Austin has reportedly raised $40 million.

So please walk the subcommittee through some of the challenges you think the Bank of Austin will face that FirstCapital did not when it was chartered 20 years ago.

Mr. BURGESS. Number one, they are in Austin. That helps, because there are enough assets in Austin that if they have good businesspeople in the bank that can grow business quickly, they can probably get to that number. But it is going to take a bank of a little over $400 million to put that capital to work and provide a reasonable return to the shareholders so that they will be able to keep going and growing.

Mr. WILLIAMS. So let me ask you this: Do you believe the Bank of Austin is a product of market opportunity or regulatory changes?

Mr. BURGESS. I think that they are starting a bank in a market where they can make it work, because a bank of $400 million can probably put the regulatory expertise in place to be able to meet the guidelines or meet the expectations.

Mr. WILLIAMS. Assuming the Bank of Austin is approved, the regulatory expectations are still very high for new entrants, with the FDIC micromanaging their operations for the first few years with little or no flexibility. It is hard for new entrants to find experienced compliance officers that will make sure that they keep up with the regulations. And I think you would agree with that, in that you have talked about that.

Mr. BURGESS. I do.

Mr. WILLIAMS. Mr. Stone, we have had some State-chartered and one Federally-chartered credit union in Texas since 2010, and after 76 mergers, we are now under 500 Statewide. I think you would agree that one way to improve the environment and viability for community financial institutions is to reduce the often complicated and burdensome regulations coming out of the CFPB, with which many credit unions and banks must comply.

So from your perspective, how do you think the current regulatory environment impacts or discourages new institutions from forming?

Mr. STONE. Currently, we support the comprehensive relief proposed in the Financial CHOICE Act. NAFCU believes credit unions should be exempt from the CFPB's authority, with credit unions' regulation directly handled by NCUA, as pre-Dodd-Frank.

Mr. WILLIAMS. Okay. Let me ask you another question. Cost of operations and new technology, economic risk, capital requirements, and the need for immediate results are all challenges faced when chartering a new credit union or bank.

How have these challenges been magnified under a post-Dodd-Frank regulatory environment?

Mr. STONE. It is a tremendous burden. So taking into account the $2 million that we started with, which is very little, then we have the regulatory burdens, the challenges of having a regulatory officer, a compliance officer, on top of new technology, equipment, phone systems, all of the entities that we need to operate and run a credit union, the math doesn't add up. And it is a challenge every day that causes me problems when I go to sleep at night.

Mr. WILLIAMS. I would ask you, Mr. Kennedy, also, from your perspective—you have a very knowledgeable one—how do you think the current regulatory environment impacts or discourages these new institutions?

Mr. KENNEDY. Not only the new institutions, but existing institutions, Congressman. Over the last 8 or so years, it is just continuing at a snowballing pace. And I hope that the new Administration and the focus on lifting regulation will make some big difference here. And clearly, in the de novo charter area, I think it will, and particularly the steps that the FDIC has taken.

It is a big deal to reduce that 7-year compliance period and a capital requirement back down to 3. That is a big change. But I think a lot of people still are skeptical about their ability to get approval.

Mr. WILLIAMS. I thank all of you for your testimony.

Mr. Chairman, I yield back.

Chairman LUETKEMEYER. The gentleman yields back his time.

The gentleman from Texas, Mr. Green, is recognized for 5 minutes.

Mr. GREEN. Thank you, Mr. Chairman. I thank the ranking member as well. And I would like to compliment you, Mr. Chairman and Mr. Ranking Member, for holding this hearing, because it has been very beneficial.

It is beneficial because we have heard, of course, about the legacy loans, which can be beneficial if you are already in business, low interest rates, which can be a detriment to you if you are not already in business.

But what is really important, as I see it, is you have all agreed that compliance cost is a significant part of your problem, if I may call it a problem. I am sure that there may be some other words that might be more appropriate for you, but let's call it a problem.

And in concluding that compliance cost is a problem, you have also identified yourselves as community banks that are small. This is important, because we have had testimony of community banks being capitalized at the $50 billion level. That is a pretty big community bank, $50 billion.

I think the gentleman from the credit union, Mr. Stone, you indicated that 90 percent of your credit unions are under a billion dollars. Is that what you said?

Mr. STONE. That is correct, Congressman.

Mr. GREEN. And about 90 percent of all banks, maybe 89 percent I think it is, are a billion or under.

So the question that I have for you is really not complicated, and it becomes complicated when the bankers get to my office, but it is not a complicated question. It is this: Can we construct legislation for community banks that won't reach the $50 billion level?

Why do I ask? Because I have community bankers who will visit with me, and they make the argument that you are making today, but the solutions go to the $50 billion level. That makes it a heavy lift.

Is it possible, in your minds, especially my Texas banker, can we fashion legislation, that would probably be bipartisan, that doesn't have to go to the $50 billion level? You are talking about small banks. In your mind, what is a community bank capitalization?

Mr. BURGESS. Thank you, Congressman.

I think we could sit down and come up with a list of product lines that a community bank is typically in. And a community bank generally deals within its geographic region instead of in big, wide swathes. I have a little bit of concern about setting everything based on thresholds, because I just crossed over from 900-some odd million to just over a billion, and now I have to follow a whole different set of rules and I am really the same bank today that I was a month ago.

Mr. GREEN. Listen, you are my friend, but we are getting back to the point that I was making earlier. We start talking about small banks and doing something to help them, but when we get to the remedy, it reaches $50 billion. There has to be a way for us to do something for the banks that are 10 and under without going to $50 billion.

There are people here who really want to do something for small community banks. They all identify with small community banks. But the remedy takes us to $50 billion, it will take us to eliminating sometimes the living wills, all of the things that were put in place for larger banks, because they are really not the megabanks, but larger banks.

Again, how do we do this so that we stay with the smaller community banks?

Mr. Kennedy?

Mr. KENNEDY. It is an interesting question, but I think you can. I think you can draw the line, whether it is total assets or whether it is types of products and types of business, although I hate to constrain creativity. I heard our Texas savings and loan commissioner describe her definition of community banks as being those that had a relationship with their customers.

Mr. GREEN. Let me share this with you quickly, Mr. Kennedy. The $50 billion threshold brings in a trigger, and you are familiar with that trigger. So when we do this, it becomes more than helping small community banks that we all want to help.

I understand that my time is beyond what I have been allotted. So thank you, Mr. Chairman, and I yield back.

Chairman LUETKEMEYER. The gentleman's time has expired.

We now go to the gentlelady from Utah, Mrs. Love, for 5 minutes.

Mrs. LOVE. Thank you, Mr. Chairman.

I would like to ask the panel about the effects of the de novo drought on small businesses and access to capital. This is a tremendous issue and it is certainly important to the State of Utah, which has seen its banking sector shrink due to the exit of certain banks on account of the regulatory environment, compounded by the inability to charter new institutions.

This has been particularly damaging in the industrial bank sector, which has been a very stable segment of our banking sector, and yet it has suffered from the inability to get FDIC approval for new banks in the years since the financial crisis.

So I have just a quick question for Ms. Edelman. Do you have any evidence that industrial loan companies were part of or contributed to the financial crisis?

Ms. EDELMAN. I can't give you a definitive answer that no industrial loan company did anything wrong, but, no, they were not the driving force behind the crisis.

Mrs. LOVE. Okay. Yet—and I am making a point here—we haven't seen any approval of industrial banks. So I have to question the FDIC's requirements and the soundness of their decision-making not to approve new banks for FDIC insurance.

Banks of all sizes play roles in the economy while delivering safety and convenience. If you look at some of the things that they offer, safeguards, $12.7 trillion in deposits, $2.4 trillion in home loans originated by banks, $380 billion in loans to small businesses, $175 billion in loans to farmers and ranchers.

Mr. Burgess, you mentioned in your testimony, you cited that since Dodd-Frank, more than 43 percent of banks under $100 million in assets have disappeared, as have 17 percent of banks between $100 million and $1 billion. Those are a lot of assets that have been lost to the banking sector. I look at the numbers that I cited here. To me, it would seem that fewer bank options would mean fewer of these numbers going into the economy, fewer people getting the ability to have access to credit, and job losses.

Can you talk to me a little bit more about what your thoughts are on that?

Mr. BURGESS. Thank you, Congresswoman.

A lot of the banks that have gone away have not failed. So those assets haven't left the system, but they have been consolidated with other banks, bigger banks. And when you do that, number one, one of the things you do is you reduce competition. There is less competition. And by less competition, you have less options, less pricing options for the customers.

And in some cases, if those banks are in small communities, like I would assume you have a lot of in your State, you have a large bank with just a branch in that community rather than a community bank with local ownership and local leadership that really has a focused interest on making that community better. So you lose a little bit of that value of a community bank when that becomes a branch rather than a community bank.

Mrs. LOVE. Let me just talk about what I have experienced as a mayor in Saratoga Springs, Utah. We have a City that is just starting up, and a lot of our constituents, our residents, wanted to have a library. As you all know, libraries are all expenditure. They don't get incomes from libraries. And we didn't have the base to sustain a library.

So the people who came through for us were the banks that were actually in our community. You have the Bank of American Fork that donated thousands and thousands of dollars, actually sponsored the children's section in our library. We had communities that were coming together that were volunteering their time. And these were all donations from the banks that were really wanting to infuse themselves in our community.

So I just want to say that, to me, this is not about trying to save banks' hides. This is not about me taking your side. This is about the people who need access to the services that you offer. This is about the farmer who is trying to get access to credit to purchase a tractor so he can plow his fields so we can have food to eat. This is about the young women in my neighborhoods who are trying to make a little bit of extra money while staying with their children by trying to expand their homes, to teach kids how to read.

These are the people who need access to credit, and when we are not allowing more banks, not allowing more resources and options out there, we lose competition, and the people end up losing their ability to reach their dreams.

Thank you. I yield back.

Chairman LUETKEMEYER. The gentleman from Washington, Mr. Heck, is recognized for 5 minutes—no, Mr. Ellison, you guys decide how you want to go.

Mr. HECK. I am glad to go before him. Am I before him? Am I senior? I am, because I arrived earlier, didn't I? Don't start the clock yet.

Chairman LUETKEMEYER. We won't start the clock. We want to get this straight. We were told it was Mr. Heck, then Mr. Ellison. Is that not correct?

Mr. ELLISON. I defer to the gentleman from Missouri.

Mr. HECK. It is the new rule, and I love this new rule. Thank you, Mr. Chairman.

Chairman LUETKEMEYER. Okay. Mr. Heck is recognized for 5 minutes. Make a decision. Go.

Mr. HECK. Ms. Edelman, thank you so much for being here. Is it essentially your position that when interest rates normalize, de novo startups will?

Is it your position that when interest rates normalize through the Fed's increasing of rates, that de novo startups will as well?

Ms. EDELMAN. Yes. We should see an increase in de novos when the interest rates rise for sure, and if we don't, we can revisit.

Mr. HECK. So let me say a couple of things to you. I am really glad you are here. I actually largely accept your macro frame for this, that interest rates and overall status of the economy are much more correlative to this than regulatory burden per se. But I do want to make a couple of comments that I hope you will just consider.

Number one, you have 75 to 80 percent associated with those 2 factors. That means there are 25 to 30 that are—or 20 to 25 that are not.

Secondly, I spent a good part of my life over the last year going from credit union to community bank to actually large banks as well and asking to sit down with their compliance officers and show me, in concrete terms, what their compliance requirements were today versus pre-Dodd-Frank and it is measurable in terms of the thickness of the paper stack.

So, look, I am not going to lecture you about your real-life experiences, because actually I think you have had a stellar career and I compliment you for it. But I am going to suggest to you that while it may not be purely correlative or causative, here is one thing that we can know: It still makes it harder going forward, because the truth is that compliance burden costs go straight off the lower right-hand number. And to the degree that lower right-hand number has shrunk makes it that more difficult to operate a small community bank or continue to operate a credit union.

So I would hope that we don't buy into, can't touch a hair on the head of Dodd-Frank, can't touch a hair on the FDIC. And let me tell you why I am especially concerned about this, because it is part of the larger frame that I have tried—and I hope that maybe the chairman is listening as he looks forward to future scheduling—and that is the issue of small-business loans and access to capital by small businesses.

We know some things here that are pretty disturbing. We know that the percent of businesses that are startups has almost been cut in half from the late 1970s to the last year for which we have good data, 2011, actually. We also know that small-business failure rates are up. We know that access to capital by small businesses has been impeded.

We also know, thanks to the incredibly enterprising work of a postdoc student at MIT, that when branches close—and, again, there are lots of causes for that. I would turn to you first to say, what are some of those causes, like technology. I had one of my colleagues on this committee indicate here recently that he has a regional bank headquartered in his district that in the last, I can't remember the exact number, it is like 6 or 8 years, branch visits have been cut in half by the customers. That is one of the reasons why branches are closing. We know that. But branches are closing also, in part, for a variety of reasons.

And here is what happens. This postdoc student's work reveals consumer loans don't suffer. Mortgages don't suffer. Small-business loans suffer. And that is very disconcerting to me, especially when you consider that it is startup small businesses that are such an important contributor to productivity growth.

Now, you and I, you are from CAP, you and I could have a cup of coffee and have a good long mutually supportive conversation about how we are way overdue on America getting a raise and real wage increases. There is no small part of the failure of that to happen—some of it is policy, some of it is macroeconomic—there is no small part of that—that is, we have not experience of late productivity increases that we used to. In fact, the whole measurement of productivity has been drawn into question. But I think intuitively, we know fewer small-business startups, lesser growth on the productivity side.

And I also want to finish on this cautionary note. I have raised this in committee before, Mr. Chairman, and it is this: There is a part of Dodd-Frank that requires the CFPB to begin collecting business data. They don't have a rule yet to do that. But once they start collecting data on businesses, that might lead to another layer of regulation that I am personally concerned about, even somebody who sits on this side of the aisle, sir. And I will tell you why.

Mortgage products have become standardized. They are subject to computer algorithms and processes. You cannot standardize small-business loans. That is judgment and subjectivity and relationship. And to the degree that we go down that track, as we have—you like hearing this, you are going to give me 2 more seconds—like we have mortgages, which I support, is dangerous for even more access to capital by small businesses. And we don't want to go there.

And I am really glad you are here, Ms. Edelman, because that data was really important in this speech.

Mr. Chairman, you are so indulgent. Thank you, sir.

Chairman LUETKEMEYER. The gentleman's time has expired.

The Fed has done a study on small-business lending, for the gentleman's information, and the SBA has a lot of information with regards to small-business lending. So there is some data out there if you want to go after that, Mr. Heck. I appreciate your comments, though.

With that, we will recognize the gentleman from Tennessee, Mr. Kustoff, for 5 minutes.

Mr. KUSTOFF. Thank you, Mr. Chairman. At this time, I would like to yield to my colleague, Mrs. Love.

Mrs. LOVE. Mr. Chairman, I would like to ask unanimous consent to enter into the record a letter from the National Association of Industrial Bankers, the Nevada Bankers Association, and the Utah Bankers Association on the topic of de novo.

Chairman LUETKEMEYER. Without objection, it is so ordered.

Mrs. LOVE. Thank you. I yield back.

Chairman LUETKEMEYER. Mr. Kustoff is again recognized.

Mr. KUSTOFF. Thank you, Mr. Chairman.

Mr. Burgess, if we could, going back to your experience chartering the bank in 1998, do you have an opinion, examining the time it takes to create a de novo bank to become chartered in this post-crisis environment, in your best estimate, how long does it take for a de novo to become profitable now as opposed to back in 1998? And if you could compare the two.

Mr. BURGESS. I can really only speak to my experience. I started putting the application together and started raising money in about January of 1998, and we opened the bank in November of 1998. So it took us about 11 months.

The only example I have heard recently—because there have not been any de novo banks to speak of, so it is kind of hard to measure that. I do know of an instance in Texas where a bank that has been in existence for many, many years had some branches in another State, and they chartered a new bank to fold those branches into a new charter in that State, so that they would have a charter in Texas and they would have a charter in that other State. It look them 14 months. Keeping in mind that they had been examined for years and years by their regulator, it took 14 months to get approved for a new charter, just to roll the branches together and put them under a separate bank in that State. That is the only example I have.

Mr. KUSTOFF. Thank you, Mr. Burgess.

Mr. Kennedy, we have heard testimony today surrounding the regulatory burdens that have discouraged capital formation around de novo banks. Today, as a matter of fact, I met with members from my State, the Tennessee Bankers Association, who said that for each dollar spent on compliance, that results in $10 that can't be lent into the community. And I have a community banking background. I served on a bank board in my part of Tennessee, west Tennessee, for 6 years before becoming a Member of Congress.

But my point is that it must create a burden on small community banks. And while some question the effect of Dodd-Frank on the ability of smaller institutions to operate, I believe you said or you testified earlier that there wasn't a question that regulatory compliance costs have increased significantly and sometimes suggesting operating costs by almost a third.

And so my question is, how do those increased costs affect the ability of institutions to provide products and services to the communities that they serve?

Mr. KENNEDY. Combined with the increased capital levels and just the compliance costs, it makes it difficult to operate. You have to continue to hire additional staff. It is a much more complex environment to be operating in. And so that takes away the ability to deliver financial services and products to consumers.

Mr. KUSTOFF. Thank you, Mr. Kennedy.

I yield the balance of my time.

Chairman LUETKEMEYER. The gentleman from Minnesota, Mr. Ellison, is recognized for 5 minutes.

Mr. ELLISON. Mr. Burgess, the day before the President sent to Congress his initial budget proposal last week, the organization you represent, the American Bankers Association, along with other bank associations, wrote to Congress. And an excerpt of your letter is on the screen. I would direct you to take a look at it if you like.

These banking organizations wrote, "We are gravely concerned that the Administration's forthcoming fiscal year 2018 budget may propose cuts to the CDFI Fund. We strongly urge you to maintain strong funding levels. During the 2016 Presidential campaign, the need to create jobs and revitalize the economies of disenfranchised rural communities and neglected inner cities was a key theme. CDFI banks work in the exact communities that were the focus of this conversation. Community-based financial institutions are uniquely positioned to understand local credit needs, which is why there is historic bipartisan support for the CDFI Fund."

And yet the President's budget, which I am sure you know, in contradiction to the campaign talk to help the forgotten women and men, has proposed not only cuts, but a complete defunding of CDFI.

Does ABA have a position and does it stand by its letter or is there a new position?

Mr. BURGESS. I don't really know the thought processes that went into the whole budget process, because I am not involved in that. But we definitely support anything that will help communities develop and that will give us more tools to work with to help small businesses survive and do better.

Mr. ELLISON. So that is your letter. Do you stand by that letter?

Mr. BURGESS. That is not my letter.

Mr. ELLISON. It is a bank that ABA joined, and you are still with it, right?

Mr. BURGESS. Yes, we support that.

Mr. ELLISON. Okay. Thank you.

Mr. Stone?

Mr. STONE. Yes, Congressman.

Mr. ELLISON. Thank you for being here today, sir.

In your testimony, you note that your credit union was recently certified as a CDFI, and you are currently drafting your grant request. You also note that, "The CDFI Fund can be an important tool for small and de novo institutions."

So if the Congress, following the President's budget, decides to eliminate the CDFI fund, what would be the impact on your institution and the community you represent?

Mr. STONE. Great question. Thank you, Congressman.

This year was the first year. We were certified in a short period of time, so we are a CDFI institution. And just let me preface that by saying the limited resources we have even to complete the grants and the grant requests. So we are working with a third party, which costs a certain amount of dollars which we don't have to spend, but we have to be willing to take the chance to possibly obtain those CDFI funds by paying the money we don't have, because we need to help our members and that money is available.

We are a low-income designated credit union. We have specific needs, including things like EMV cards. We currently have magnetic stripe debit cards; and moving it within compliance, moving into the future, we need the EMV cards. The process could cost $40,000 to $50,000 of funds we don't have. So we are expending funds we don't have to try to get a chance at the CDFI funds. So the answer is, those funds are very important to us.

Mr. ELLISON. Thanks a lot for mentioning that. And if you have any other examples of what the elimination of the CDFI might mean to you, please forward that information, because we really want to fight for that program.

Mr. STONE. Yes, sir.

Mr. ELLISON. Ms. Edelman, do you agree with the recent Forbes article headline that reads, "Why Trump's plan to defund CDFIs would be disastrous for small businesses?" See it up there on the screen?

Ms. EDELMAN. Yes. So CDFI funds have stepped into many communities that larger banks have forgotten about a long time ago. They make loans that aren't as profitable. They are really important sources for small-business lending. In 2013, the CDFI Fund helped generate over $4 billion in lending. It played an incredibly important role in our communities. It was appalling for someone to run on creating jobs, on economic development, and then slashing the very resources that are needed to do this work.

Mr. ELLISON. I would like to agree with that. But let me remind Members that I have a CDFI bill, and it would expand the secondary market for small business and community development loans made by CDFIs. I hope that you guys take a look at it, and perhaps support it. And my bill, the Small Business and Community Investments Expansion Act, H.R. 704, is led with Mr. Stivers, Mr. Pittenger, Mrs. Maloney, and other members of the committee. It is a bipartisan effort.

And let me tell you, I don't know how you say you are going to help working people across America and want to eliminate the CDFI Fund.

I think that is about how much time I have. Thank you for your time.

Chairman LUETKEMEYER. The gentleman's time has expired.

The gentleman from Colorado, Mr. Tipton, is now recognized for 5 minutes.

Mr. TIPTON. Thank you, Mr. Chairman.

And I would like to thank all of our panelists for taking the time to be here today.

I think listening on both sides of the aisle, we are hearing testimony about the importance of our community banks' concern that we are not getting access to capital at those local areas. I particularly appreciated Mr. Heck's comments when it came to talking about the importance of those small-business loans.

And I have been struck by the report that came out which cited that for the first time in our history, we are seeing more small businesses shut down in this country than there are new business startups.

Mr. Burgess, have you had difficulty in terms of being able to make some of those small-business loans that Mr. Heck and myself are concerned about, and I believe many others?

Mr. BURGESS. Thank you, Congressman, for that question.

Our whole business—our bank is primarily a small-business lending bank. So we spend most of our time trying to find small-business loans. We are definitely under more scrutiny from various different places for how we make loans in the small-business arena. So it slowed us down. Like I spoke to earlier, there is a little more of a box that we have to fit people into.

What I also said is one of the most satisfying things to me in my job is being able to sit down with a small-business owner, listen to what he is trying to do, and try to custom tailor a plan that is going to best fit his or her situation. And I am less able to do that now than I have been able to do in earlier parts of my career.

Mr. TIPTON. How about even with existing customers? I am struck by a story we had out of Pueblo, Colorado, about regulations basically killing a small business, a small construction company. It was doing reasonably well, had paid off its line of credit. And I came from a construction family, so I understood this. The pipeline ran dry.

They are trying to be able to bid new jobs to be able to keep their people employed, to be able to keep their equipment moving. When they went back to the bank, a local bank in Pueblo, to be able to re-up that line of credit, they were informed that the bank would have liked to have made that loan, but regulatorily they could not. As a result, the small construction company lined up their equipment, auctioned it off, and laid off their 23 core employees.

Have you had that kind of an example down in Texas as well?

Mr. BURGESS. I don't have a specific example in mind right now, but I have had that happen in the past. And it is very unfortunate when that does happen. It hurts.

Mr. TIPTON. I find it curious, we have had Chair Yellen before our committee, and she has spoken to what is the reality, I think, that we are feeling at many of our community banks, what is called that trickle-down effect.

As we look at the chart that has been up on the board, it would look very reasonable that community banks are exempt from so much of Dodd-Frank. But are we seeing that trickle-down regulatory effect that is increasing cost, making it harder to be able to make loans and harder to be able to actually support those small businesses that are helping our communities grow?

Mr. BURGESS. Yes, we are seeing trickle down. Just one example would be stress testing. That is really not supposed to apply, but it is being pushed toward us. It is being suggested to us that we do stress testing, which we have started doing. That is not supposed to be something the smaller banks are required to do, but that is just one example.

Mr. TIPTON. I also appreciate some of our colleagues, again, on both sides of the aisle, who are trying to be solutions-oriented. It is something I think we have had the opportunity to be able to visit about. We have introduced legislation called the TAILOR Act, to be able to actually have rules and regulations that are going to be sculpted to be able to meet the risk portfolio, the model of the bank.

Is that a sensible way forward to actually address what I think I am hearing we all seem to be having in common, let's open up that market once again for community banks, not only to be started, but to be able to loan once again to our communities?

Mr. BURGESS. Absolutely. And we thank you for that, for sponsoring that bill. We feel that banks should be regulated based on the complexity of their business model, not based on necessarily an absolute size. And I heard the comments before, but we feel that the smaller banks especially are much less complicated, and we need to figure out how to have a less stressful environmental program over those banks so that they can operate and meet the needs of their customers.

Mr. TIPTON. Thank you.

And, Mr. Chairman, my time is about to expire. I yield back.

Chairman LUETKEMEYER. I now recognize the gentlelady from New York, Ms. Tenney, for 5 minutes.

Ms. TENNEY. Thank you, Mr. Chairman.

And thank you, panel. I appreciate you being here.

I am from New York, where I live in a very rural area where we have few small community banks and credit unions left. We have seen a lot of consolidations and a lot less access to credit. We have a lot of rural areas, farming, and also have small cities, where we have people in urban poor zones who have a hard time getting access to credit for even basic items.

And it seems to me, and I would argue just as someone who was a bank attorney in my past, it was a huge problem to deal with regulations, especially smaller banks. And I am the owner of a small business as well. And so trying to comply with the regulations is actually more onerous on a small community institution, including a bank, which to me has caused us to have less banks, in my estimation.

I was just wondering—I think I would address this to Mr. Kennedy first—do you think the cost of attaining the actual de novo charter affects interested candidates?

Mr. KENNEDY. I apologize, but I couldn't understand.

Ms. TENNEY. Do you think that the cost of actually trying to obtain a de novo charter affects candidates or discourages them from being able to get into the market?

Mr. KENNEDY. I don't think so. And I again want to underscore, there has been a dramatic shift in the way the FDIC has viewed this in the last 12 to 18 months. And I think they are actively promoting. The OCC is doing the same thing. That is our personal experience. They are being as accommodating as they can through this chartering process. They are, frankly, enthusiastic about it.

And I don't think the actual cost—clearly, there is additional scrutiny, business plan analysis. We are living in a much more complex time now because of the compliance costs and all those requirements. So there is a little increased cost, but if I think about the 30 charters over the years that we have been involved in, I wouldn't say it is dramatic.

Ms. TENNEY. I come from an area where I can walk into my local community bank and hand the teller my checking account. They balance it for me, and I can go back and talk to the bank president. There is about one bank left in our area like that. There used to be so many small banks, and they now just can't afford the compliance costs in many cases. Whether they have had to cut branches or consolidate, I have found it seems to be an issue.

Mr. Stone, I just want to ask you if you could identify any areas where we can streamline the process and allow more financial institutions like the ones I described, in a small community with a farm-based economy, how we can actually bring them in without resorting to regulations.

Mr. STONE. Congresswoman, thank you for this opportunity.

I think a very important step that we didn't touch upon here regarding your question is, in order to secure funds to charter our credit union, it takes an altruistic effort from an entity to start the credit union. So it is not a loan. It is not an investment. Whoever gives that money, it is a gift. They are not getting it back. They are not getting interest on it. It is very different than shareholders in a bank, very, very different.

That being said, to secure those funds is—in today's market, you have to find a group that has an affinity, some kind of special bond to the field of membership that you are starting with because otherwise why would they give those funds to start with, getting nothing in return.

There is a 17-step process under the NCUA for chartering a credit union. I have been through it not that long ago. So it wasn't 10 years ago. It wasn't 20 years ago. It was less than 3 years ago we went through this process. It is difficult at times and it is inefficient. So if we could have Congress improve the efficiency of the process, that would greatly help the process of starting a credit union, in addition to securing the funding, which is very difficult.

Ms. TENNEY. Thank you. We do have less and less credit unions. I used to represent a credit union in my district as an attorney.

We touch on just that the Community Reinvestment Act is underserved, underbank communities would have less access to financial services. That is sometimes the case, especially in an area like mine that is fairly economically depressed.

I would argue that, again, increasing the number of institutions, small institutions that don't have to be burdened with some of the regulations, that we certainly want to regulate, especially whether it is a bank or a small credit union, but can't we have more banks? Would you argue that there are more banks, more credit unions, to have competition and drive down the costs and increase the access to services, especially in some of our urban areas, where they really just don't have a place to go? Is that something that you would support?

Mr. STONE. We are a proponent of exactly what you said. So we are able to give—our average rookie who comes into the academy makes $42,000 a year, and they might have a family, a small family. And living in New York City, that is not a lot of money. They don't have access. A lot them had predatory loans at very high interest rates.

So we were able to offer from the get-go a very low unsecured interest rate for personal loans up to $5,000, which would help them either pay off high-interest-rate credit cards, help them buy equipment, or help them build up credit if they didn't have credit.

Ms. TENNEY. I think my time is about to expire, but I want to say thank you to all of you for testifying on this important issue.

And hopefully, we can thank the chairman because—

Chairman LUETKEMEYER. The gentleman from Georgia, Mr. Loudermilk, is recognized for 5 minutes.

Mr. LOUDERMILK. Thank you, Mr. Chairman. And I appreciate the panel being here today.

The lack of de novo banks in Georgia is especially concerning to me, seeing that Georgia lost more banks than any other State during the crisis, and we have had a difficulty of seeing new banks open up. In fact, of Georgia's counties, we have 3 that have absolutely no bank branch at all now, and we have 47 Georgia counties that don't have a community bank headquartered in the counties.

As a small-business owner, I relied heavily on my small community bank because I served with the bank president on the chamber of commerce board and they knew the needs of the community.

So it is actually really concerning that we haven't seen these. And even though large banks are important, there is a specific need, especially in rural communities, for these small community banks.

And so, Mr. Burgess, how can we increase, just in the rural area, how are we going to be able to bring these underserved areas some new banking?

Mr. BURGESS. I think some of the things we can do is reduce the upfront capital threshold somewhat: $20 million to $30 million is not going to work in the communities that you are talking about; probably $10 million would be a more reasonable number because that would take about a $100 million bank, and that is probably a doable number that they can get to in a reasonable period of time.

Probably reduce the minimum capital ratios for maybe the first 3 years to let them get on their feet to 6 or 7 percent instead of maybe this 10 percent number we are kind of talking about right now.

Create possibly a fast-track application process to make it a little bit easier for them to navigate that and move toward a quicker application process to get them in business.

Possibly reduce that penalty box from 3 years to a little bit shorter so that there are not so many restrictions, like he talked about a minute ago, to get that business off the ground. If you have too many restrictions, you can't get going very fast.

And there are probably some more, but I will let some other people talk.

Mr. LOUDERMILK. Okay. I do have another question. We have seen a trend of financial institutions switching from Federal charters to State charters, mainly because it seems that the State regulatory environment is more favorable. What is the primary difference that you see between the State charters and the Federal or the regulator?

Mr. BURGESS. I am a little different. I am a national charter, and I like being a national charter, but it is a choice. The State charter is a little bit less expensive to the bank. One of the things I prefer with the national charter is that I have one regulator as opposed to, if you are a State charter, you have the State and the FDIC coming in at different times. I just don't like it that way. It is a choice.

Mr. LOUDERMILK. Now, I am glad to see the credit unions and the banks sitting next to each other and getting along very well. That is unique in some cases, at least in Georgia.

I have seen more credit unions popping up in some of these communities. Are we seeing a growth in credit unions nationally or are they filling in some of the voids that we have seen from small community banks?

Mr. STONE. Congressman, we feel the credit unions are being reduced. The credit unions are being absorbed into larger credit unions. We found that it is very difficult to survive being a small credit union. As much as we try to help our field of membership, with all of the products they want, the more that we—if we increase products, increase services, we need to put another person on member services and create those products. This takes away from the regulatory compliance. We have to put someone back on regulatory compliance and then it takes away from member service. So it is difficult for small credit unions to survive.

Mr. LOUDERMILK. If we were to remove some of what I feel is an overregulated environment, would that stimulate de novo banks, new credit unions coming into these—

Mr. STONE. I think 100 percent, if that also included in the chartering process to reduce the inefficiencies that are there and improve the communication with the chartering entity, with the supervisor—in our case it is the NCUA—and the chartering the institution.

Mr. LOUDERMILK. Mr. Burgess, cutting back on some regulations would—

Mr. BURGESS. I definitely think if we could tailor the regulation a little bit more for the startup banks, maybe the regulators stay closer to them for a while and have more communication. But if we could relax that a little bit so they can not have to spend so much money on personnel to get off the ground.

Mr. LOUDERMILK. All right. Mr. Chairman, thank you. I yield back.

Chairman LUETKEMEYER. The gentleman's time has expired.

The gentleman from Michigan, Mr. Trott, is recognized for 5 minutes.

Mr. TROTT. Thank you, Mr. Chairman.

I want to thank the panel for their time and insight today. And I apologize, I missed your opening statements. I ducked out to speak to the Michigan Bankers Association. And I am glad I did because they gave me this hat. You can't read it from there probably, but it says, "Make Banking Great Again." And if they had given me four more, I would give one to each of you to thank you for your time today.

But I want to start with Ms. Edelman at kind of a high level before we dive into the de novo drought. What do you think caused the financial crisis in 2008?

Ms. EDELMAN. The financial crisis in 2008 was caused primarily by—it was triggered by predatory mortgage lending, mortgages that were packaged up and sold through the private label security market, and folks buying, investors buying things that they didn't really know the quality of.

Mr. TROTT. What do you think caused all those predatory mortgages and subprime loans to be made? What was the impetus there?

Ms. EDELMAN. Maybe I can save you some time. It was largely not small community banks that were making these loans.

Mr. TROTT. Do you think it was the responsibility of the private sector or the responsibility of the Federal Government—the role of the Federal Government that caused it?

Ms. EDELMAN. Oh, I think it was the private sector. The regulation at the time was inadequate.

Mr. TROTT. So it wasn't the change in direction with respect to housing policies promulgated by Presidents Clinton and Bush insofar as they relaxed the underwriting standards at FHA for Fannie Mae and Freddie Mac and who should receive mortgages, that didn't have a role in loans being made to people who really shouldn't have them?

Ms. EDELMAN. FHA had less than 5 percent of the mortgage market share in the lead-up to the crisis. Fannie and Freddie's market share had also dropped significantly. Most of the mortgages that were made that were predatory in the leadup to the crisis had nothing to do with the Federal Government.

Mr. TROTT. Okay. We probably can just agree to disagree on that.

Let's talk about a little bank in Birmingham, Michigan, the Bank of Birmingham. I was at their holiday party in December, and the CEO pulled me in his office, and he said, "Dave, I don't want to have to tell you this, but we have sold." And I said, "Oh, I am surprised by that. The bank is doing well, it is a successful little bank in my town."

And he said, "Yes, we sold it to the Bank of Ann Arbor, and we just could not handle the regulatory burden. We had to sell."

And I wish I had brought a picture to throw up on the screen. This is much too small. But this is just the regulations that have been promulgated since 2010. It only lists 15 of the many different bodies that regulate the financial institutions. And when I saw this, I really had a keen understanding of why the Bank of Birmingham had to sell, because they couldn't afford to exist in this environment.

You talked earlier about kind of defending Dodd-Frank and suggesting that really Dodd-Frank is not the cause of the de novo crisis. And I had a chart that I brought. This one you probably can see. It talks about the number of banks that had disappeared over the last 25 years.

And so when I looked at this chart earlier today, I thought, in response to your testimony, well, maybe you are right, maybe Dodd-Frank really is not the cause. I don't think it has helped, but we can argue about that. But maybe it is not the cause. Maybe it is just a factor.

But then I realized, for the last 25 or 30 years, wouldn't you agree that the regulations generally on banks have increased tremendously, hence, that is the explanation for this chart?

Ms. EDELMAN. I think there were—particularly in the lead-up to the crisis, we went through over a decade of major deregulation. So I don't know that—I am not sure that is correct.

Mr. TROTT. Mrs. Love from Utah brought up a small business in her district. So if I am an automotive supplier in southeast Michigan, and I have maybe $2 million a year in revenue, and I want to spend $100,000 on a piece of equipment, and I need to get a loan, do you think Citi or Bank of America or Chase would even talk to me? I know from your response to Mr. Pittenger that you haven't been a loan officer, so just speculate for me.

Ms. EDELMAN. I have met a loan officer. I have gotten a mortgage.

Mr. TROTT. No, no, but you told him you hadn't been a loan officer.

Ms. EDELMAN. No, I have never been a loan officer.

I completely agree with you that small businesses need small community banks in order to get credit. These are the banks that stay when the times get tough. These are the banks that make it possible for small businesses to do business. What I am concerned about is focusing on Dodd-Frank when we have had 30 years of decline, and I am worried we are missing the bigger picture.

Mr. TROTT. My time is about to expire.

Mr. Burgess, I want to ask you a question.

And maybe if there is a second for you to comment on his answer, Ms. Edelman, that would be great.

So if we relax the regulations, streamline the approval process, what is going to be the consequence of that succinctly?

And then, Ms. Edelman, if you have any concerns about that, I would love to hear them.

Mr. BURGESS. Number one, I think it will allow us, as community banks, to go back to what we have been able to do in the past, as I have stated already, that we can more easily tailor specific packages for people based on their individual circumstances.

Mr. TROTT. And my time has expired. You would agree that is all good, Ms. Edelman?

Ms. EDELMAN. If we are talking about finding ways to make it easier for small community banks, I think we have a lot to talk about.

Mr. TROTT. Thank you. I yield back.

Chairman LUETKEMEYER. The gentleman's time has expired.

With that, we go to the gentleman from Kentucky, the chairman of our Monetary Policy and Trade Subcommittee, Mr. Barr, for 5 minutes.

Mr. BARR. Thank you, Mr. Chairman. Thanks for hosting this very important hearing about the de novo charter drought in the aftermath of the Dodd-Frank law.

According to the Kentucky Bankers Association, which I represent, the number of banks in the Commonwealth of Kentucky has dropped from 198 to 164 since the enactment of Dodd-Frank. That means that roughly one in five banks that existed prior to Dodd-Frank has closed its doors.

And contrary to Ms. Edelman's testimony, at least in Kentucky, I can tell you that most of this decline occurred not in the immediate aftermath of the financial crisis, but instead in 2013, 2014, 2015, and 2016, well into the implementation of the qualified mortgage rule, the TRID rules, and implementation of Dodd-Frank regulations.

Now, we know from Mr. Burgess' testimony earlier today that Kentucky isn't the only State that has this problem in terms of the decline in community banks in this country. Ms. Edelman and my friends on the other side of the aisle, with reference to their slide that is on display here, they are blaming this decline in new banks—they are blaming low interest rates on this, monetary policy. Ms. Edelman's testimony is that 75 or 80 percent of the decline in new banks can be explained by low interest rates and weak macroeconomic factors.

I just have to note, as the chairman of the Monetary Policy Subcommittee, that my friends on the other side of the aisle are blaming unconventional monetary policy for macroeconomic trends in this hearing. But in the other hearing, in my subcommittee, they credit unconventional monetary policy for positive economic developments. So I don't know which one it is. I don't know what their narrative is.

But here is what my community bankers tell me. What my community bankers tell me about this chart, and Ms. Edelman's testimony, is that if you are a good banker, you know how to work in a low-interest-rate environment, you know how to adjust your rates to reach the margin and the spread that you need to be profitable.

What is different, though, now that coincides with this trend from 2008 to 2013 with the decline in new bank formation is the Dodd-Frank law. The low interest rate environment is not to blame. A community banker who was in my office today from central Kentucky told me that his bank—his net income, the profits of his bank are down $8 million a year, year after year, since the Dodd-Frank law.

So this idea that low interest rates are the cause of the decline in new charters, the decline in banks just doesn't hold water. This trend coincides not just with low rates, which good bankers can deal with, it coincides with the Dodd-Frank law.

So I will just ask Mr. Burgess to respond to that. Do you agree with that analysis?

Mr. BURGESS. Yes, I do agree with that. We, as bankers, always go through different interest rate cycles, and we have to manage our balance sheets in a way that we can appropriately deal with that. The difference this time is that our regulatory cost is significantly higher. It makes it much harder to reduce the cost side of the income statement to be able to adjust to those changes in interest rates.

Mr. BARR. Now, my friends on the other side of the aisle also—and Ms. Edelman makes a big deal about the fact that Dodd-Frank law is tailored, and they say that there are exemptions from some of these regulations for small banks. According to Kentucky banks, what they say is the most time-consuming and burdensome regulations are the real estate disclosure rules, fair lending regulations, ability to repay, QM rule, and TRID, and that these regulations are doubling the amount of time required to close a mortgage even assuming the disclosure contains no errors.

Ms. Edelman makes the argument that there is a small creditor exemption on QM. Tell me why the small creditor exemption is insufficient to deliver the relief to a community bank, Mr. Burgess?

Mr. BURGESS. Let me just tell you our experience. Before we started implementing the Dodd-Frank rules, our bank was making about $220 million a year at our peak in the four markets that we serve. We had to go back and retool our entire mortgage lending process. We are just now getting back up to about $80 million a year. So we are less than half in mortgage loan volume than where we were before we started implementing all the new rules.

Mr. BARR. Thank you for your testimony. My time has expired. I yield back.

Chairman LUETKEMEYER. The gentleman's time has expired.

The gentleman from California, Mr. Royce, is now recognized for 5 minutes.

Mr. ROYCE. Thank you, Mr. Chairman. Thanks for holding this hearing as well.

Mr. Burgess made a comment earlier that I was going to go back to, and that was your declaration this morning that you would not start a new bank in this regulatory climate. And I think if you are saying it, a lot of other people are thinking it, which could be what explains exactly the challenge we see and the lack of formation across the country.

And then you go to the issues of why. And I think the gentleman from Kentucky raised the point about why we are not seeing the small-business loans, the mortgage loans, the financing of the local economic growth, why we didn't see the traditional function played at the local level that would have gotten the country moving out of the recession. And it goes to this issue—this is why I am a cosponsor of the TAILOR Act—it goes to this issue where I don't think that Friendly Hills Bank in Whittier, California, should be regulated like a Wall Street firm.

I think what has happened here is that the overleverage of the systemically risky institutions brought about a flood tide of regulation that came down like a ton of bricks on the community banks that could least be capable with handling, given economies of scale, this ever-changing, ever-morphing regulatory environment in which they did nothing to bring this on. They were not the systemically risky institutions that created the crisis.

So there was no excuse, in my opinion, for the way the legislation created the atrophy that exists today where, as you say, you and your friends and colleagues wouldn't really consider walking into this kind of environment. It just doesn't make sense.

You are trying to keep your heads above water now. You are trying to support your local communities and stay alive in an environment where your best talent has to be spent trying to keep up with these ever-changing regulations instead of reaching out into the marketplace and doing what you have traditionally done commercially and with home loans and so forth.

But I was hoping that you could also address a case where this tailored approach was promised and where that promise hasn't been delivered, and that is on the Durbin amendment. And I will give you my thoughts on that.

I was a conferee for the Dodd-Frank Act, and I was very concerned about—and I laid out the arguments—what the impact was going to be on financial institutions with respect to this Durbin amendment.

But one of the arguments that was thrown back was that the exemption for low asset institutions would protect community banks. It would protect community banks and credit unions. I remember that argument being made in retort. Even though, by the way, we had never heard this in committee. It came out of nowhere, if you remember the markup. And there we were with this Durbin amendment.

So this hasn't come to fruition from any evidence I have seen. The Durbin amendment was passed without debate in the House, and the cost in the payments to the ecosystem were passed along to whom? To the small financial institutions.

So how has the Durbin amendment impacted the calculus when it comes to starting new community financial institutions? That is the question I would ask. And did the exemption do what it promised to do? And what products or services have consumers lost out on in the aftermath of this passage? Because I guarantee you there were tradeoffs there as well. So those are the three questions I would ask.

Yes, sir. Thank you.

Mr. BURGESS. Thank you for the question.

The first thing is the Durbin amendment, in my mind, is fixing the price on our industry for a product that we created. And the amount that has been taken away has been given to another industry, and they had nothing to do with creating that product.

Mr. ROYCE. And I haven't seen any real evidence that the beneficiary of that is the consumer either, by the way.

Mr. BURGESS. None that we can see.

So as to how that would impact new startups, it really is part of the overall picture. You are taking income away from the industry, you are increasing the cost of the industry, you are increasing the bar to get into the industry. And all of those things working together is what would have an impact on startups.

Mr. ROYCE. And what about that promise that was made that smaller financial institutions would not be impacted by this?

Mr. BURGESS. In our particular case, we fall under the threshold to where it is supposed to impact us. But if you look at the net income that we derive from that particular line of business, it has been declining ever since that happened.

Mr. ROYCE. And what products, what services, in your opinion, maybe have consumers lost out on in the aftermath as you faced this consequence as well as the—

Mr. BURGESS. We have had to look at other products and services and figure out where we can make up that difference so that it doesn't impact our bottom line. We either have to increase pricing or eliminate certain products.

Mr. ROYCE. I thank you very much.

And, Mr. Chairman, thank you again.

Chairman LUETKEMEYER. The gentleman's time has expired.

And with that, we are at the end of the hearing. They have actually called votes, so we are all going to—as you can see, most of the folks have already rushed out. I apologize for that, but we are trying to get done here for the day.

I would like to thank the witnesses for your testimony today. You have been great, you really have answered a lot of very good questions, and your testimony has confirmed some of our suspicions of some of the problems with de novo situations in some circumstance, and also raised other ones.

That is what we hoped to accomplish today, to be able to get a handle on what is going on in the financial services world so we can basically lay the predicate for what we need to do over the next couple of years with regards to looking into different rules, regulations, and situations that are affecting the financial services community as well, particularly with regards to the competitiveness and operation of those financial institutions.

The Chair notes that some Members may have additional questions for this panel, which they may wish to submit in writing. Without objection, the hearing record will remain open for 5 legislative days for Members to submit written questions to these witnesses and to place their responses in the record. Also, without objection, Members will have 5 legislative days to submit extraneous materials to the Chair for inclusion in the record.

With that, this hearing is adjourned.

[Whereupon, at 4:25 p.m., the hearing was adjourned.]

A P P E N D I X

March 21, 2017

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Testimony of

Kenneth L. Burgess

On behalf of the

American Bankers Association

before the

Subcommittee on Financial Institutions and Consumer Credit

Of the

Financial Services Committee

United States House of Representatives

American Bankers Association

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March 21, 2017

Chairman Luetkemeyer and Ranking Member Clay, my name is Ken Burgess and I am the Chairman of FirstCapital Bank of Texas in Midland, Texas. I appreciate the opportunity to be here to present the views of the American Bankers Association (ABA) on ending the drought of new bank charters. The ABA is the voice of the nation's $16 trillion banking industry, which is composed of small, mid-size, regional and large banks that together employ more than 2 million people, safeguard $12 trillion in deposits and extend more than $9 trillion in loans.

FirstCapital Bank was chartered in 1998. In less than 20 years, we have grown our assets to just over $1 billion and serve the Midland, Lubbock and Amarillo markets in West Texas as well as a new market in Central Texas near Austin. We are primarily a commercial bank lending to small businesses and we also have a mortgage lending arm.

ABA appreciates the opportunity to testify on the nearly complete lack of new banks being started (de novo banks). New entrants into any industry are a sign of growth potential and economic opportunity. New banks help fill gaps in the provision of banking services, increases competition, and ultimately strengthen the community banking sector. Consumers and businesses have more choices of competitive products and services which translates into greater economic activity and growth in local communities.

The lack of de novo activity is concerning to our industry and sadly reflects the same forces that are driving consolidation—excessive and complex regulations that are not tailored to the risks of specific institutions. This—not the local economic conditions—is often the tipping point that drives small banks to merge with banks typically many times larger and is a barrier to entry for new banks.

Since the Dodd-Frank Act was enacted in 2010, community banks have shown great resilience and have endeavored to provide the financial services critical to the success of their communities.

They are in the business of lending and have worked to provide credit in spite of the onslaught of new regulations. The fact that they continue to lend and strive for profitability in no way suggests that the Dodd-Frank Act—and its 25,000 pages of proposed and final rules—has not had a negative impact on banks' customers and communities. It has had an impact: since Dodd-Frank was enacted ***1,917 banks*** (or 24% of the industry) have disappeared. Contrast that with only ***six*** de novo banks since Dodd-Frank.[1]

Consolidation Accelerates After Dodd-Frank Act

Asset	2004-2010	2010-2016
< $100m	-36.1%	-43.9%
$100m – 1b	4.4%	-17.8%
$1b - 10b	19.4%	11.9%
>$10b	-7.1%	8.6%
All Banks	-14.1%	-24.5%

Certainly, consolidation would have occurred without Dodd-Frank, but the increased pace of that consolidation since it was enacted has been extraordinary. Since Dodd-Frank, more than 43% of banks under $100 million in assets have disappeared, as has 17% of banks between $100 million and $1 billion (see Table).

The fact is that the thousands of new regulations that have been imposed on community banks are an enormous driver of decisions to sell to a larger bank. The median sized bank in this country has only 44 employees. These are small businesses themselves. There is simply not enough capacity to read and understand what rules apply (especially as rules are modified); implement, train, and test for compliance with those that do; and still have the time and resources to meet with individuals and businesses about their financial needs.

The FDIC has acknowledged the vital importance of community banks and the need for changes to encourage de novo formations. The agency noted that community banks account for 43 percent of small loans (less than $1 million) to businesses and in one out of every five counties in the U.S., the only physical banking offices are those of community banks. Without a banking presence, any economic vitality will quickly disappear.

To help prospective de novos, the FDIC in April 2016 announced welcome supervisory changes, including community outreach, establishing a team of people to guide prospective de novos through every stage of the process, refreshing its answers to key questions, and developing a guide to the deposit insurance application process to increase transparency. In addition, the period

[1] There were 14 insured institutions established after July 31, 2010. The six true de novos are those charters that are "from scratch" and have no predecessor charters. Two of the six de novos began operation in January and have yet to file a Call Report. Excluded are 7 charters established to absorb or liquidate a failed bank and one credit union that converted to a mutual savings bank charter.

of heightened de novo supervision and strict adherence to the bank's original business plan—what some have referred to as the "penalty box"—was shortened from seven years to three years.

Addressing gaps in knowledge and resources is very important, but it doesn't address the underlying issues that create the barriers to entry: capital hurdles, unreasonable regulatory expectations on directors, funding constraints, an inflexible regulatory infrastructure, technology investments, and tax-favored competition from credit unions and the Farm Credit System. The 3-year penalty box, while better, still acts as a deterrent. If it does not make economic sense, no one will start a new bank. Look no further than the lack of new charters for proof of this. Fix the underlying problems and new charters will result.

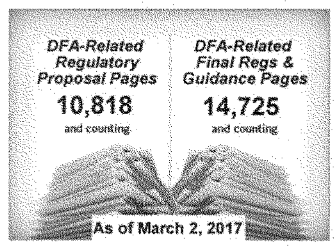
Each and every bank in this country helps fuel the U.S. economy. Each has a direct impact on job creation, economic growth and prosperity. Community banks have always prided themselves on being flexible in order to meet the unique circumstances of each customer. This is why it is imperative that Congress take steps to ensure and enhance the banking industry's capacity to serve their customers, thereby facilitating job creation and economic growth. When a bank disappears everyone in the community is affected.

We thank this subcommittee for its willingness to shed light on these problems and we thank Chairman Hensarling and the committee for the work they have undertaken to provide much needed relief. We urge Congress to work together— Senate and House—to pass legislation that will enhance the ability of community banks to serve our customers and help grow our economy.

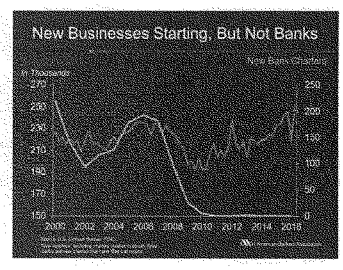
In the remainder of my testimony, I would like to focus on the following key points:

- Lack of de novos has its roots in excessive regulation;
- Constraints on assets, liabilities and capital all conspire to make new charters uneconomical; and
- To assure the broadest possible financial options for our communities, we must think creatively to find solutions that stimulate new bank entrants.

1. Lack of De Novo Banks Has Its Roots in Excessive Regulation



The forces that challenge banks every day are the same as those that make starting a new bank nearly impossible. Certainly, economic conditions have had an impact. The near zero-interest-rate policy is challenging enough for existing banks and it makes starting a new bank that much more difficult. But new banks have been started in all phases of the economic cycle. For example, in the middle of the so-called "S&L Crisis" in 1990 and at the beginning of a severe recession, 191 de novos began operation. Over the next 10 years, 1,500 new banks started! There were opportunities to be found and investors willing to risk their own money to capitalize a new bank.



Contrast that with the latest cycle: it started similarly with 181 new charters in 2007 (the start of the recession) but fell off very quickly over the next two years. Since the Dodd-Frank Act was enacted in 2010, there have only been ***six*** true de novos. Two of those de novos began operation just this January, eight months after the FDIC's announcement of changes. Even more starkly is the contrast between lack of de novo bank formations and the recovery of new business formations across all industries since the recession.

Not only has the regulation been piled on, but more telling is the regulatory approach that a bank should never fail. This is not only an impossible standard, but it is too risk averse and limits new activities and growth. The first chapter in every book on entrepreneurship or economics says that capitalism is built on investors putting ideas and money to work, accepting the very real risk that they will fail in the process.

When my bank was started, we raised $6.5 million to capitalize the bank. This was an amount we felt we could grow into in a reasonable period of time, which would allow us to provide a reasonable return to our shareholders. As we grew, we raised additional capital to keep the bank adequately capitalize, but careful not to overcapitalize. We have raised capital 6 different times since our inception to support our growth. Had we raised it all in the beginning, shareholders would have been unhappy and would not have been willing to invest more when it was needed.

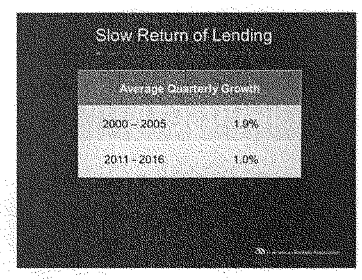
If I was in the position of starting a bank under today's conditions, I would not do so. Even though, with my experience, I could likely raise the funds necessary, I would have to grow the bank so quickly to put the capital to work that it would pose undue risk on our shareholders. Starting a new bank in a small community would be extremely difficult. It would be extremely challenging to raise capital and impossible to grow the bank quickly enough to utilize it. Moreover, I would also be very concerned about running a profitable bank as I would need to hire a highly experienced compliance officer to assure compliance with all the regulations. Good compliance officers now easily make six figures. In many small banks, that is more than the highest paid staff member is paid.

2. **Constraints on Assets, Liabilities and Capital All Conspire to Make New Charters Uneconomical**

On both sides of the balance sheet—assets on one side and liability plus capital on the other—there are constraints that limit the economic potential of any new bank. These are detailed below:

Earning Assets are Under Stress

Some have argued that bank lending continues and therefore, there has been no impact of Dodd-Frank. Banks continue to lend even with the shackles that bind them. However, in the five years since DFA was enacted, the ***pace of lending was half*** of what it was several years before the financial crisis.



Some banks have stopped offering certain products altogether, such as mortgage and other consumer loans. The October 2015 RESPA/TILA integration rules have raised mortgage costs, delayed closings and have limited access to home loans to many potential new buyers. <u>TRID Survey Results</u> As a result, consumers now pay more, wait longer, and have incentives not to shop among lenders because of the delays it is likely to create. The result is fewer options for consumers as many community banks abandon mortgage lending altogether due to the added risks and costs that make it uneconomical.

Moreover, in April 2016, 72 percent of community banks reported that the 2014 rules on ability to repay and qualified mortgages have restricted their ability to extend credit, even after over two years of adjustment and adaptation. Mortgage Survey Results

For residential mortgage and home equity lending, new requirements from the Consumer Financial Protection Bureau with help from the other regulators has made this type of lending more risky. The risk comes from an aggressive compliance culture combined with an inflexible definition of qualified mortgages. This means fewer banks will offer these loans, limiting choices and options for consumers.

The last area of profitability for consumer banks is small business lending. This continues to be profitable, but it is now under assault from the tax-free credit unions and Fintech non-bank lenders who make loans without the same obligations and oversight as community banks.

Every earning asset held by community banks is now less profitable than it was in years past. Some of this erosion is caused by regulations, some by the interest rate environment, some by unregulated competitors, and some by untaxed and lightly supervised competitors. For those considering starting a new bank, these stresses combine to limit potential profitability and discourage any investment. Banks compete with all other capital options, and if returns from making good asset decisions are not sufficient to generate a reasonable return, money flows elsewhere.

Funding Constraints Limit Asset Growth

Even when there are good opportunities to lend, funding those loans is the perhaps the biggest hurdle for potential de novos. Banks are funded with deposits. Recent regulations aimed at the largest banks, which take a narrow view of "stable" funding, coupled with the FDIC's aggressive definition of what constitutes a brokered deposit, have steered the industry into insured retail and small business deposits. While these deposits offer low cost funding, this narrow view of stable funding constrains banks, which incur a regulatory cost as compared to other types of funding. The limited array of acceptable funding sources hits de novo banks acutely as it takes time to build the customer relationships necessary to gather these deposits—and de novos can't compete on convenience (with few branch locations) or pay high rates.

There are many other sources of funding available that have proven to be stable and cost effective. For example, as de novo institutions build their deposit base, they may need to look for funding outside of their local market by using the internet-based deposit services or partnering with a third party to help market their products and generate deposits. Unfortunately, all these are considered "brokered" by the FDIC and, as such are unlikely to be approved in the de novo's new business plan. The bottom line is that unlike most new businesses that can work every available option to gain customers and gain market share, new banks are extremely limited in their funding and product options, further detracting from the desirability of a new bank charter.

Capital Thresholds are Too High

As I state before, we started our bank with about $6.5 million. The expectation now in banking circles is that it would take $20-$30 million to start a bank. This is many multiples beyond what ***successful*** banks needed in the past. Can a bank today earn enough to cover the cost of that capital? Great investment options don't exist in today's abnormally low-rate environment. But even with more normal rates and a steeper yield curve, a new bank probably cannot grow fast enough to cover investor expectations. Without adequate yields to investors, capital will flow to better investment alternatives removing capital from the banking industry.

The key point is that investors cannot justify illiquid investments at low yields. If de novos were a good investment that made economic sense, today there would be a lot more new banks started. Besides the enormous regulatory infrastructure that must be covered by capital (with no return, of course), the technology investment required in today's banking world is also large. Moreover, while a strong business plan for the new bank is required, there is strong resistance by the regulators to any change in that plan. Any new business must adjust quickly to the rapidly changing reality of their market, but unlike most new businesses, de novo banks must jump through regulatory hoops to chart a new course. With the 3-year penalty box and strong resistance by the regulators to any change in the business plans of a new bank, it can be nearly impossible to make the necessary adjustments quick enough to be successful. For investors, it raises questions about success and timing of their potential returns.

The pressure to increase capital levels—including requirements of the Basel Capital Standards—increase the hurdle rate for any return to investors. A well-capitalized bank used to operate with 6% leverage capital; now they are being pushed to maintain 9% capital. The simple math is that earnings must increase by 50% to maintain the same return on equity. These high capital requirements mean that new banks are unlikely to make a reasonable return on equity in any reasonable time frame.

So we are back to the beginning. If investors can't see a way to make a reasonable return on investment, they won't invest. No investment means fewer new banks and slower growth for the U. S. economy.

Unreasonable Regulatory Expectations for Directors is Also an Impediment

Typically investors in a de novo institution become the first directors of the newly formed bank. This is because the capital often comes from pooled funding from leaders in the community that see a niche that could be filled by the new bank.

The significant regulatory requirements of directors in banks today—which can impose personal legal liabilities for them—make it difficult for any bank to find a good director and near-impossible for new bank. Directors are now expected to know more than they can, including maturity matching, hedging strategies, derivative accounting, complex asset-liability strategies, and cybersecurity risks and mitigations, to name just a few. They must then tell management how to address each of these. Given the potential liability, the lawyers to these investors most certainly would advise against being a bank director.

3. A Creative Approach is Needed to Encourage New Bank Formations

The changes the FDIC has made are a good beginning, but more can and needs to be done. It's time to think differently to encourage new banks—by requiring less capital, reducing regulatory burden, permitting greater flexibility in business plans, and lifting funding restrictions. Some modest ideas to consider include:

- Create a fast track for new banks.
- Reduce the minimum initial capital level (e.g., to $10 million) and reduce the required capital ratio for the first three years (e.g., to 6%). The goal is enable the new bank to generate earnings and grow quickly enough to become profitable and sustainable.
- Further reduce the "penalty box" and enable changes in the bank's business plan.

- Allow a new bank to fund itself in the least-cost most efficient way without regard to source.
- Define any mortgage loan held by the bank on its own balance sheet as a Qualified Mortgage.
- Address the unfair competition from tax-favored providers such as credit unions and the Farm Credit System.

Simply put, Congress can help by eliminating unnecessary impediments which negatively impacts every community across the United States. This will help stem the tide of community bank consolidation and create an environment conducive to new bank charters. The key to changing the consolidation trend is to stop treating all banks as if they were the largest and most complex institutions. All too often, regulations intended for the largest institutions become the standard that is applied to every bank—Basel III capital requirements being the most egregious. Such an approach 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 customers ultimately bear. A better approach to regulation is ***tailored*** bank supervision that is responsive to 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. By facilitating new bank charters, new capital will flow into the entire banking system as it would signal the potential for growth and success.

Conclusion

I grew up in a banking family. My father managed three small banks in three small communities in West Texas. From childhood, I watched the impact that a small town community bank has on its community. They are involved in or behind almost every initiative. They support almost every non-profit and they support the small businesses in those communities like no other bank can. When a small community loses its bank, it quickly begins to die.

The lack of de novos banks is strong evidence that the economics do not add up. Investors have plenty of choices about where to invest, and if the impediments to starting a new bank are too great, they will quickly move money to opportunities with greater promise. The forces that have acted to stop new de novos are the same ones that have led to the dramatic consolidation of the banking industry. Fix the underlying problems and the future will be brighter for both new and existing banks.

Our nation's diverse banking structure is the envy of the world, yet we are letting it slowly dissolve away. Please help us stem this trend before it is too late. We urge Congress to act now and pass legislation to help turn the tide of community bank consolidation, create an economic environment that encourages new bank charters, and protect communities from losing a key partner supporting economic growth.

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"Ending the De Novo Drought: Examining the Application Process for De Novo Financial Institutions"

Testimony before the House Subcommittee on Financial Institutions and Consumer Credit

Sarah Edelman
Center for American Progress
March 21, 2017

Good afternoon Chairman Luetkemeyer, Ranking Member Clay, and members of the subcommittee. My name is Sarah Edelman, and I direct the housing finance team at the Center for American Progress, a nonpartisan think tank dedicated to improving the lives of Americans through progressive ideas and action. Thank you for inviting me to testify on this important topic.

The number of new bank applications to the FDIC has declined substantially since the global financial crisis. This decline is largely the result of macroeconomic factors, including, historically low interest rates reducing the profitability of new banks, as well as investors being able to purchase failing banks at a discount following the financial crisis.

It is true that the financial crisis also severely damaged the FDIC insurance fund, which drove the FDIC to enact temporary measures, including greater oversight of new banks, to protect its insurance system. Additionally, the application process has occasionally been a challenge for *de novo* financial institutions. However, the FDIC has worked to improve the process significantly, and most of the obstacles facing new small bank entrants are not related to the FDIC application process or bank regulations. Thus, gutting FDIC oversight is not likely to address the shortage of new bank applications.

In this testimony, I will describe the challenges facing new bank entrants and what the FDIC has done to date to make the application process more transparent and easier to navigate. I will also provide an overview of the current health of the community banking sector and steps Congress and regulators can take to help level the playing field for the smallest community banks.

Shortage of new bank applications largely caused by macroeconomic factors

While some of the conversation about the shortage of new bank entrants has centered on increased compliance costs and a difficult application process, the research shows that other factors are far more significant. A 2014 Federal Reserve study showed that 75-80 percent of the decline in new banks can be explained by low interest rates and weak macroeconomic factors.[1]

Moreover, the study found that the declining trend is not unique to new banks entrants – bank branches opened by existing banks have experienced a similar decline. The authors explain that "since both expansion and *de novo* entry have declined, regulations that affect only *de novo* banks are likely not the main cause of the entry void."[2]

Low interest rates are a significant factor discouraging new bank entrants. While low interest rates have helped to stimulate economic growth and demand for business and consumer loans, they reduce net interest margin for new banks.[3] Low interest rates make it less expensive for a consumer or business to take out a loan, which is good for the economy and housing market but a challenge to new bank profitability. While existing banks can earn profits on loans they originated when interest rates were higher, new banks cannot bolster earnings through existing loans.

According to Federal Reserve research, new bank formation is closely correlated with interest rates. When rates are low, fewer new banks enter the market and when they are higher, more new banks are created.

New investment in the banking sector has also taken different forms in recent years. While few new banks have formed, between 2008 and 2012 four hundred and sixty-five failing banks had their assets purchased through the FDIC bank resolution process.[4] Purchasing a failing bank at a discount from the FDIC can be a less expensive way to start a bank.

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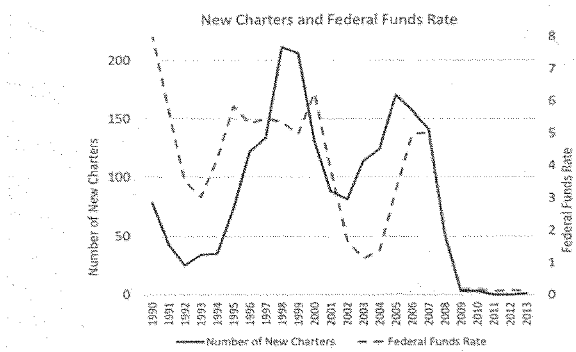
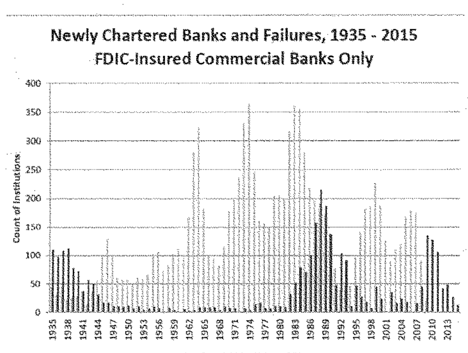
[1] Robert Adams and Jacob Gramlich, "Where Are All the New Banks? The Role of Regulatory Burden in New Charter Creation," (Washington: Federal Reserve Board, 2014), available at https://www.federalreserve.gov/econresdata/feds/2014/files/2014113pap.pdf.
[2] Ibid.
[3] Ibid, net interest margin refers to interest revenue minus interest costs divided by total assets.
[4] CAP calculations of data from FDIC "Annual Reports," available at https://www.fdic.gov/about/strategic/report/ (last accessed March, 2017).



Source: Robert Adams and Jacob Gramlich, "Where Are All the New Banks? The Role of Regulatory Burden in New Charter Creation."



Source: FDIC[5]

[5] Martin Gruenberg, Statement of FDIC Chairman before the House Committee on Oversight and Government Reform, "*De Novo* Banks and Industrial Loan Companies," July 13, 2016, available at https://www.fdic.gov/news/news/speeches/spjul1316.html.

The FDIC is taking steps to improve the *de novo* bank application process

In 2009, when the nation was experiencing widespread bank failures and the FDIC insurance fund was approaching negative levels, the FDIC put additional safeguards in place to prevent more bank failures.[6]

FDIC research shows that during the crisis, newly-formed *de novo* banks failed at twice the rate of existing small community banks.[7] To lower the risk of more new bank failures, the FDIC lengthened its period of enhanced supervision for new banks from three to seven years.[8] This policy change made sense, especially during a time when economic conditions were deteriorating and new banks were failing in large numbers.

Research has found that new banks' higher failure rates are the result of them having less portfolio diversity, riskier investments, and greater reliance on irregular funding; making them significantly more susceptible to failure, especially when business cycle conditions deteriorate.[9] There are many examples from the crisis, including Haven Trust which was reported on as a case study of such failures in *The New York Times* – it was a small bank based in Georgia founded in 2000 that failed in 2008 because of its lax lending standards, poor risk controls and excessive portfolio of risky construction loans.[10] It simply did not have the diversification necessary to weather difficult economic conditions or offset its poor lending.[11]

In 2016, after the FDIC fund had recovered and bank failures had declined, the FDIC returned the enhanced supervision period to 3 years.[12] The FDIC has also taken steps to make the application process more transparent and efficient. For instance, the agency published a detailed question and answer document about FDIC's criteria for approving new banks to help applicants submit stronger proposals.[13] The agency also hosted a

[6] Ibid.
[7] Yan Lee and Chiwon Yom, "The Entry, Performance and Risk Profile of De Novo Banks," Working Paper 2016-03 (FDIC CFR, 2016), available at https://www.fdic.gov/bank/analytical/CFR/2016/WP_2016/WP2016_03.pdf.
[8] Martin Gruenberg, "De Novo Banks and Industrial Loan Companies."
[9] Yan Lee and Chiwon Yom, "The Entry, Performance and Risk Profile of De Novo Banks."
[10] Eric Dash, "Post-Mortems Reveal Obvious Risk at Banks," *The New York Times*, November 18, 2009, available at http://www.nytimes.com/2009/11/19/business/19risk.html.
[11] Federal Deposit Insurance Corporation, "Material Loss Review of Haven Trust Bank, Duluth, Georgia," Report No. AUD-09-017 (August, 2009), available at https://www.fdicig.gov/reports09/09-017-508.shtml.
[12] Federal Deposit Insurance Corporation, "De Novo Banks: Economic Trends and Supervisory Framework," *FDIC Supervisory Highlights*, 13(1)(Summer, 2016), available at https://www.fdic.gov/regulations/examinations/supervisory/insights/sisum16/SI_Summer16.pdf.
[13] Ibid.

training about the application process for state and federal regulators to encourage more communication among the regulators who approve new bank charters and have hosted multiple *de novo* roundtables with stakeholders across different regions.[14] The FDIC also released a proposed handbook for *de novo* applicants for comment at the end of 2016 and is currently in the process of incorporating the feedback and finalizing the handbook.

While the FDIC should continue to improve the application process, it should not lower its standards for approving new banks for FDIC insurance. As economist Simon Johnson explained during his testimony before the House Committee on Oversight and Government Reform, bank failures that occur as a result of lower standards could force the FDIC to increase deposit insurance costs across the banking sector to keep the insurance fund healthy.[15] While some new bank failures are to be expected, the FDIC should not approve new banks that it does not believe can be profitable and serve the banking needs of their communities over the long term.

The U.S. community banking sector is strong, but a long-term decline in the number of small community banks persists

By most measures, the community banking sector is strong and profitable.
In terms of profitability, the core return on assets (ROA) for community banks has been relatively stable between 1985 and 2015. Core profitability rose sharply from a low in the late 1980s during the S&L crisis to a high in the early 1990s, then trended down slowly through the mid-2000s before falling sharply to a low during the financial crisis in 2008, and has now returned to pre-crisis levels. [16]

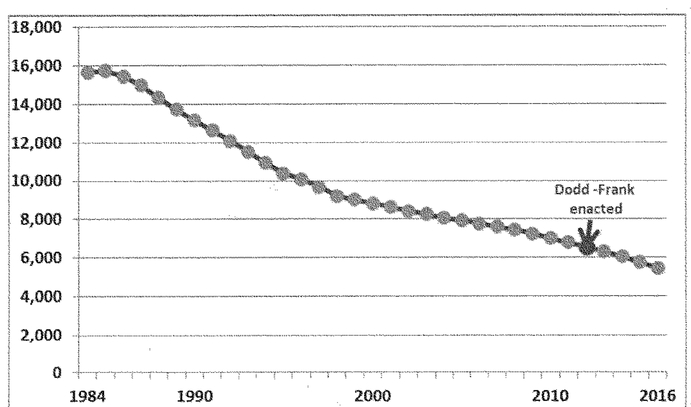
According to the FDIC, there are now more banks with assets between $100 million and $10 billion than in 1985. Specifically, they report that "[t]he number of banks with assets between $100 million and $1 billion increased by 7 percent between 1985 and 2013, while the number of banks with assets between $1 billion and $10 billion increased by 5

[14] Ibid; FDIC Community Banking Initiative, "De Novo Outreach Meetings,:" available at https://www.fdic.gov/news/conferences/communitybanking/2017/denovo/index.html (last accessed March 2017); https://www.fdic.gov/news/conferences/communitybanking/2017/denovo/index.html; https://www.fdic.gov/news/news/press/2016/pr16110.html; FDIC Press Release, "FDIC Seeking Comment on New Handbook for De Novo Organizers Applying for Deposit Insurance," (December, 2016), available at https://www.fdic.gov/news/news/press/2016/pr16110.html (last accessed March 2017).
[15] Simon Johnson, Testimony submitted to the House Committee on Oversight and Government Reform, "Oversight of the FDIC Application Process," July 13, 2016, available at https://oversight.house.gov/wp-content/uploads/2016/07/Johnson-Statement-Statement-FDIC-7-13.pdf.
[16] Division of Insurance and Research of the FDIC, *FDIC Quarterly*, 10(4) (2016), available at https://www.fdic.gov/bank/analytical/quarterly/2016_vol10_4/fdic_v10n4_3q16_quarterly.pdf.

percent."[17] Many of these banks are community banks, and the FDIC also reports that during the same period these institutions saw significant asset growth.[18] These banks also experienced growth in terms of total assets.

In spite of the relative stability in the community bank share of banking charters, the community bank shares of offices and assets have steadily declined since 1985. While some have blamed this decline on the recent costs of complying with the Dodd-Frank Act, the decline predated financial reform by decades. As a share of total banking offices, community
banks have declined from 53 percent in 1985 to 35 percent in 2013.[19]

Number of U.S. Community Banks



Source: Federal Deposit Insurance Corporation, Historical Community Banking Reference Data

It's the smallest banks that have experienced the most challenges. The number of small community banks, those with assets below $100 million, declined by 85 percent between

[17] Division of Insurance and Research of the FDIC, "Community Banks Remain Resilient Amid Industry Consolidation."
[18] Ibid.
[19] Ibid.

1985 and 2013, while the number of community banks with assets between $100 million and $10 billion increased during the same time period.[20]

Small community banks play an important role in communities across the country. They help businesses create jobs and help families pursue their dreams of buying a home or sending a child to college. Their decline is worrying to local and national policymakers alike. However, as is the case with respect to *de novo* charters, it does not appear that the Dodd-Frank Act is responsible for the decline in small banks.

The factors that have contributed to this decline in the number of small community banks are as follows: First, in the 1980s and 1990s, the banking industry lobbied for and achieved regulatory changes that paved the way for interstate banking.[21] Prior to these regulatory changes, banks could not open branches across state lines and, in some cases, not even across county lines.[22] These changes led to massive consolidation within the banking industry, which among other things, reduced the number of small community banks.[23]

Second, while many new banks start as small community banks with assets below $100 million, if they are successful and their assets grow over time, many become mid-sized community banks. According to an FDIC study, out of nearly 14,000 banks that in 1984 that had less than $100 million in assets, 2,774 or 20 percent of the total expanded to hold more than $250 million in assets by 2011. A number also grew dramatically, with 11 of them holding over $10 billion in assets in 2011. [24]

Third, the majority of small community banks consolidated or disappeared after the savings and loan crisis in the 1980s and the financial crisis in 2008.[25] This massive loss

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[20] Council of Economic Advisers, "The Performance of Community Banks Over Time," (August, 2016), available at https://obamawhitehouse.archives.gov/sites/default/files/page/files/20160810_cea_community_banks.pdf.
[21] Division of Insurance and Research of the FDIC, "Community Banks Remain Resilient Amid Industry Consolidation."
[22] Erin Davis and Tara Rice, "The Branch Banking Boom in Illinois: A Byproduct of Restrictive Branching Laws," *Chicago Fed Letter*, No. 238, Federal Reserve Bank of Chicago, (May, 2007), available at https://www.chicagofed.org/publications/chicago-fed-letter/2007/may-238.
[23] Council of Economic Advisers" The Performance of Community Banks Over Time."
[24] Federal Deposit Insurance Corporation, "Community Banking Study Chapter 2: Structural Change Among Community and Noncommunity Banks," (2012), available at https://www.fdic.gov/regulations/resources/cbi/report/CBSI-2.pdf.
[25] *Division of Insurance and Research of the FDIC, "Community Banks Remain Resilient Amid Industry Consolidation."*

of community banks following turmoil in the financial system underscores the importance of a well-regulated financial sector.

Finally, larger banks benefit from economies of scale typically not available to small banks. For instance, as Adam Levitin explained during his testimony before the Committee on Financial Services, there are some consumer financial products like credit cards that are hugely profitable for larger banks and harder for small banks to offer because of the steep overhead costs.[26] Larger firms can also spread general operation costs across a larger number of bank branches. These difficulties are not unique to the banking sector. Small businesses across sectors in the U.S. economy are struggling to keep up with larger firms.

Leveling the playing field for small community banks

Congress and regulators have recognized the unique role that small community banks play in our communities and the unique challenges associated with their business model. As a result, they have taken steps to level the playing field for small community banks competing against larger banks and non-bank financial institutions.

When Congress passed the Dodd Frank Wall Street Reform and Consumer Protection Act in 2010 to help ensure that Wall Street could never again crash the financial system, Congress and regulators carved out small community banks from many of the new Dodd Frank bank compliance requirements. Some of these carve-outs and flexibilities are listed below:

- Underwriting flexibility: Small banks have greater underwriting flexibility when making Qualified Mortgage, or QM, loans—those that are eligible for the highest level of protection from legal challenges—because if small banks hold the loans on portfolio, they are not bound to the fixed debt-to-income ratio limit that applies to larger lenders.[27]Small institutions serving rural or underserved areas also can get QM protection for loans that require a balloon payment, although the general QM definition bans balloon loans.[28]

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[26] Adam J. Levitin, Written Testimony before the House Committee on Financial Services, "Preserving Consumer Choice and Financial Independence," March 18, 2015, available at http://financialservices.house.gov/uploadedfiles/hhrg-114-ba00-wstate-alevitin-20150318.pdf.
[27] Consumer Financial Protection Bureau, "Ability-to-Repay and Qualified Mortgage Rule: Small Entity Compliance Guide" (2013), Section 4.3, available at http://files.consumerfinance.gov/f/201308_cfpb_atrqm-implementation-guide_final.pdf.
[28] Consumer Financial Protection Bureau, "Ability-to-Repay and Qualified Mortgage Rule: Small Entity Compliance Guide," Section 4.6.2.11

- Mortgage servicing flexibility: Small creditors are exempt from most mortgage-servicing rules.[29]
- Capital: Global Systemically Important Bank (G-SIBs) capital surcharge applies only to the 8 U.S. G-SIBs and the countercyclical capital buffer will only apply to banks above $250B[30]
- Liquidity: Liquidity coverage ratio applies only to banks above $250B
- Leverage: supplementary leverage ratio applies only to banks over $250B[31]
- Living wills: only applies to banks above $50B
- Stress testing: only applies to banks above $10B
- Enhanced risk management standards: applies only to banks above $50B
- Long term debt: TLAC/LTD requirements are for G-SIBS only
- Examinations: Banks and credit unions with less than $10B in net assets are examined by one single regulator. Large banks are examined by their prudential regulator and the CFPB [32]
- CFPB enforcement: CFPB enforcement only applies for financial institutions above $10B[33]

There are also various opportunities for small banks to weigh in with regulators about the regulatory process. The CFPB, the FDIC and the Federal Reserve have all formed community bank advisory councils since the financial crisis.[34] Moreover, the CFPB has to permit small businesses, including community banks, to weigh in on rulemaking efforts before proposed rules are released for public comment.[35] The voices of community banks are well represented and regulators continue to be responsive to their concerns.

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[29] Consumer Financial Protection Bureau, "2013 Real Estate Settlement Procedures Act (Regulation X) and Truth in Lending Act (Regulation Z) Mortgage Servicing Final Rules: Small Entity Compliance Guide"(2013), Section 3, available at http://files.consumerfinance.gov/f/201306_cfpb_compliance-guide_2013-mortgage-servicing-rules.pdf.
[30] *Also includes banks with more than $10bn in on balance sheet foreign exposure
[31] *Also includes banks with more than $10bn in on balance sheet foreign exposure
[32] 12 U.S.C. § 5515 (Section 1025 of the Dodd-Frank Act).
[33] 12 U.S.C. § 5516 (Section 1026 of the Dodd-Frank Act).
[34] Consumer Financial Protection Bureau, "Advisory groups," available at http://www.consumerfinance.gov/advisory-groups/ (last accessed March 2017); Government Accountability Office, "Community Banks and Credit Unions: Impact of the Dodd-Frank Act Depends Largely on Future Rule Makings," GAO-12-881, Report to Congressional Requesters, September 2012, available at http://www.gao.gov/assets/650/648210.pdf.
[35] Consumer Financial Protection Bureau, "Fact Sheet: Small Business Review Panel Process," available at http://files.consumerfinance.gov/f/201503_cfpb_factsheet-small-business-review-panel-process.pdf (last accessed March 2017).

The FDIC also implemented Dodd Frank requirements that have shifted costs away from small banks and toward larger financial institutions. First, the FDIC changed the way it calculates a bank's assessment base for deposit insurance in a way that largely favors small banks. The FDIC estimated that this change reduced FDIC premiums charges for community banks by about one third.[36] The FDIC also raised the amount of deposit insurance it provides to $250,000 from $100,000, which allows small banks to be more competitive for consumer deposits.[37]

Finally, Congress now requires regulators to oversee non-bank financial institutions, which helps to level the playing field for community banks.[38] In the lead up to the crisis, some non-bank financial institutions offered profitable, but predatory, products that stripped wealth from communities.[39] It was often difficult for a small banks offering safe products to consumers to compete with these unregulated institutions. Federal supervision of nonbank institutions helps prevent non-bank financial institutions from leading a race to the bottom.

Instead of deregulating Wall Street, Congress and regulators should build on their work to level the playing field for small banks and to ensure that all markets are well served by banks.

Deregulating the financial sector, as proposed by the Financial CHOICE Act, would only put community banks at a greater economic disadvantage. Providing the big banks with carve outs and exemptions currently only available to community banks would do nothing to help community banks. Moreover, reducing the rules that constrain excessive risk taking by large banks can allows them to boost their short-term profits, as they did in

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[36] Doreen R. Eberley, Testimony before the House Subcommittee on Financial Institutions and Consumer Credit, "Examining Regulatory Burdens," April 23, 2015, available at https://www.fdic.gov/news/news/speeches/archives/2015/spapril2315.html.

[37] Ibid.

[38] Edward V. Murphy, "Who Regulates Whom and How? An Overview of U.S. Financial Regulatory Policy for Banking and Securities Markets," Congressional Research Service (January, 30, 2015), available at https://fas.org/sgp/crs/misc/R43087.pdf.

[39] James H. Caar, "Wealth Stripping: Why It Costs So Much to Be Poor," *Democracy Journal* 26 (Fall, 2012), available at http://democracyjournal.org/magazine/26/wealth-stripping-why-it-costs-so-much-to-be-poor/; Charles L. Nier, III and Maureen R. St. Cyr, "A Racial Financial Crisis: Rethinking The Theory Of Reverse Redlining To Combat Predatory Lending Under The Fair Housing Act," *Temple Law Review* 83 (Summer 2011), available at https://www.templelawreview.org/lawreview/assets/uploads/2012/02/83.4_Nier_St.Cyr_.pdf; Debbie Bocian, Delvin Davis, Sonia Garrison and Bill Sermon, "The State of Lending in America & its Impact on U.S. Households," Center for Responsible Lending, (December 2012), available at http://staging.community-wealth.org/sites/clone.community-wealth.org/files/downloads/report-bocian-et-al.pdf.

the run up to the financial crisis. Ending the restraints on predatory finance can crowd out sound lending and safer financial products.

Moreover, the FCA is a huge step backward in the effort to limit financial instability which during the crisis was generated by the large banks and the shadow banking system. This instability put community banks at a heightened risk of failure and led to the Great Recession.

The FCA allows Wall Street megabanks to opt out of vital financial stability protections including stress testing, liquidity rules, and risk management standards in exchange for a modest increase in capital. Moreover, it eliminates the Orderly Liquidation Authority (OLA) a new tool established by Dodd-Frank that enables regulators to wind down a complex financial firm in an orderly manner. Without OLA, in a crisis regulators will be stuck with the two same terrible options they had in 2008: Lehman-style bankruptcies or AIG-style bailouts. If implemented, the Financial CHOICE Act would put us squarely back in the vicious cycle of unchecked financial sector risk, financial crises, and bailouts. Too many workers lost their jobs, too many people lost their homes, and too many families lost their wealth to make the same mistakes again.

If Congress is serious about leveling the playing field for community banks, it will provide small banks with more support and ensure strong oversight of too big to fail banks. Pressuring the FDIC to lower standards for new banks or taking steps to deregulate the financial sector is unlikely to address the core challenges facing new banks.

Written Testimony of Patrick J. Kennedy, Jr.
Managing Partner of Kennedy Sutherland LLP
President of the Subchapter S Bank Association
Before the Subcommittee on Financial Institutions and Consumer Credit,
Committee on Financial Services of the House of Representatives

March 21, 2017

Mr. Chairman, Ranking Member Clay and Members of the Subcommittee, thank you for inviting me to appear at this hearing and to submit written testimony. I have been a practicing lawyer for over thirty years and during those years have represented community banks, their shareholders, directors, officers and related entities on a wide range of corporate, regulatory and tax matters. Over those years and together with my various law partners, our firm has represented over 30 de novo charter groups. We are honored to be representing a group of Florida businessmen who have filed the first national bank charter in the US since 2008.

I also am President and founder of the Subchapter S Bank Association, which is primarily an educational organization, which provides substantive advice and content to shareholders and directors and officers of banks that have elected or are considering subchapter S tax treatment under the Internal Revenue Code (IRC). There are approximately 2,100 banks in the US which maintain an S election – accounting for approximately one third of the bank charters in the US. Ninety percent of these Sub S banks are under $1 billion in total assets and 90% of that number are located in rural communities across the US.

In 2008 there were 101 applications for new bank insurance filed with the FDIC of which 28 were approved; 33 were filed in 2009 but none were approved. The filings dropped to 6 in 2010 and a total of 10 from 2011 through June 30, 2016, with only 3 charters being approved during that time. In my opinion, the reasons for the significant decline of new bank charters is a direct result of a decision made by the FDIC in 2009 to require that applicants for FDIC insurance provide a 7 year business plan and evidence of capital sufficient to maintain a comfortable cushion over and above the required minimum capital ratios for that period of time. In addition to this application requirement, the FDIC also mandated that the initial conditions and enhanced supervisory monitoring imposed on new banks would also extend from the previous 3 to 7 years. One of the many conditions required the new bank to avoid deviations from its business plan including financial projections and required the bank to obtain prior approval of any change or deviation. The FDIC also began imposing similar conditions on banks that had recently undergone a change in control, and we witnessed the difficult experience of those banks in complying with these conditions and obtaining approval for deviations in business plans, many times requiring such banks to increase their capital ratios significantly above well capitalized minimums as an additional condition for approval of the change.

In addition, the significant increase in bank regulatory oversight and examination practices post 2008 created additional capital and regulatory pressures on most banks during this period. Capital ratios began to be informally increased 1 to 2% even though banks were operating at or above the regulatory minimums for well capitalized banks.

In addition to this discretionary increase in regulation, Congress enacted Dodd Frank which unleashed a plethora of new requirements and restrictions on banks and led to further significant increased costs. Many in the industry began to wonder whether they could survive these heavy costs and regulatory burden, and it became commonly discussed at banking conferences that to survive banks would have to be at least $500MM in total assets. While I personally do not believe that is the case, there is no question that regulatory compliance costs have increased significantly, some suggesting that it increased operating costs by one third.

The announcement by the three federal bank regulatory agencies in June 2012 that they intended to impose the international large bank capital standard known as Basel III on every bank in the US regardless of size sent a tremor through the industry, and we immediately noticed a significant shift in our community bank clients' attitudes. Many began to believe that continuing to operate their community banks would be marginally profitable, if at all, and with the lack of capital access to meet these new requirements and costs, many began to look for an exit through merger or sale. Thus began the current decline in the number of banks.

In response to the Chairman's specific request, these added costs occasioned by Dodd Frank, Basel III and discretionary supervisory action significantly impaired existing financial institution's ability to provide financial services and products to consumers in the communities they serve. Many banks exited the mortgage loan business because of the complexity and uncertainty resulting from Dodd Frank, the CFPB and related rulemaking. The costs are significant and it is generally known in the industry that the cost of making a loan of less than $100,000.00 is not covered by the interest earned, including the cost of capital and loan reserves required to support such a loan, unless the bank has some very unique processes that can be employed to lower costs.

Over the past few years, we have heard regulators explain the lack of new charters being the result of low interest rates and the expectation that a new charter would not be viable; however, in my opinion, the 7 year business plan and compliance period as well as the significant increase in regulation have been the primary reasons. We observed banks which were chartered at the beginning of the financial crisis in 2008 which managed to grow and become profitable within the three year timeframe that was the norm for many years.

At the urging of many in the industry, the FDIC issued revised Questions and Answers to its Insurance Application, required of de novo banks in November of 2014 which returned the business plan requirement back to 3 years from 7; however, the FDIC did not change its 7 year conditional period of enhanced supervision until April of 2016, when it specifically reverted back to the pre-2009 three year period. Despite these changes and Chairman Gruenberg's public remarks in April of 2016 announcing that increasing de novo charters was one of FDIC's top three priorities, widespread skepticism abounds throughout the industry, including many industry experts who advance the often discussed theory that the regulatory agencies would prefer to do away with community banks and concentrate banking in the US in the hands of a few. While I have personally held meeting with each of the three agencies together with bank clients and colleagues over the past several years and have always had this question about community banks answered in the negative – meaning there is no agency policy or plan to reduce the number of community banks, these theories continue to be discussed.

Mr. Chairman, while we represent larger community banks with multi-billions in assets, we have a long history of representing many smaller and rural based community banks and can firmly testify to the value of such community banks and the importance of doing everything we can to provide access to capital, reduce regulation and promote new bank charters and new bank ownership. This is particularly true in rural America where the large banks simply do not wish to locate or provide services. As you well understand, we are very fortunate to have as many community banks in the US as we do and in my view we should do everything we can to encourage new bank formation and entry.

I would be remiss not to highlight the importance of the ability of banks to elect subchapter S tax treatment which was granted by Congress 20 years ago through an amendment to the IRC. While it is anecdotal, I believe that the availability of flow through tax treatment for banks is one of the reasons we have as many community banks today as we do. Before banks could elect Sub S, an owner had to sell the bank in order to get value from it; whereas Sub S tax treatment is an efficient form of business organization which permits current cash flow to be received by owners without double taxation. Indeed the most popular form of new business organization in the US today is the limited liability company; but banks cannot be organized in this fashion as a result of IRS regulations, though the FDIC has authorized banks to be organized as LLCs. Banks must use the S election in order to achieve pass through taxation; however, the current limits on number and type of shareholder constrains banks which are by nature capital intensive businesses, especially in this regulatory environment. During the last Congress, Representative Marchant joined by Chairman Luetkemeyer and others in introducing HB 2789 to increase the number of bank Sub S shareholders from 100 to 500 and permit the issuance of preferred stock, a popular means for banks to raise capital. Congressman Marchant also introduced HR 3287 to permit banks to organize as limited liability companies which would create significantly greater organizational flexibility and opportunities to raise bank capital. We anticipate similar bills being introduced in both the House and Senate this Congress. Indeed, we have held detailed discussions with Chairman Brady and most of the members and staff of the Ways and Means Committee and have heard no opposition to these proposals. Similar discussions have been taking place recently with members of the Senate Finance committee and staff.

These bills are also a means of promoting more new bank charters since they would provide the opportunity for flow through tax treatment. As I mentioned before, our firm is privileged to represent the first new national bank charter filed since 2008, and it is being organized as an S corporation for purposes of enhancing shareholder value without the need to sell the bank. And while the organizers of this bank are confident in their ability to raise the necessary capital, they would prefer not to be constrained by the 100 shareholder limit.

While the charter application is still under review by the FDIC and the Office of the Comptroller of the Currency (OCC), I can testify that both agencies have been very welcoming and helpful during the entire process, from the first introductory meetings we held in Washington with senior officials at the OCC and the FDIC through our current stage in the process. Each agency has been very responsive and encouraging and have expressed genuine interest in seeing our client's application succeed.

I would also note that the OCC issued new and updated bank charter licensing guidance in September of 2016 which provides clear and current information on the new national bank charter requirements and process. In December 2016, the FDIC issued a publication for comment entitled *Applying for Deposit Insurance – A Handbook for Organizers of De Novo Institutions* which is a very readable and "user-friendly" guide to potential new bank organizers. Both of these publications provide current and useful information are clear evidence of regulator's desire to see more new bank charters.

I applaud the Chairman and members of the committee for holding this hearing and hope that my testimony has given the committee some additional insight and will also promote new bank charter activity. We also encourage Congress to adopt the above referenced bills to increase capital access for community banks and to continue to encourage less regulation so that shareholders can cause their banks to be managed efficiently and effectively. One further specific suggestion would be to permit Subchapter S banks, and if authorized limited liability company banks, to pay dividends to their shareholders in an amount equal to the personal taxable income derived from bank earnings. The regulatory authorities have prohibited this and demanded that no dividends be paid to shareholders even in the face of taxable income being recognized by shareholders of S corp banks and bank holding companies. I thank the Chairman for his leadership in encouraging the regulatory authorities to eliminate this inequality.

Testimony of

Keith Stone
President & CEO of The Finest Federal Credit Union

On behalf of
The National Association of Federally-Insured Credit Unions

"Ending the De Novo Drought: Examining the Application Process for De Novo Financial Institutions"

Before the
House Financial Services Subcommittee on Financial Institutions and Consumer Credit

March 21, 2017

Introduction

Good afternoon, Chairman Luetkemeyer, Ranking Member Clay and Members of the Subcommittee. My name is Keith Stone and I am testifying today on behalf of the National Association of Federally-Insured Credit Unions (NAFCU). Thank you for holding this important hearing today. I appreciate the opportunity to share with you my experience with chartering a new credit union.

I currently serve as the President and CEO of The Finest Federal Credit Union (FCU), headquartered in New York, New York, a role I assumed in February 2015, just after the credit union was chartered. I have over 25 years of experience in financial services, including time as a Vice President of a Federal Savings Bank and spending over eight years as the Vice President and CFO of another credit union.

The Finest FCU's charter was approved in January of 2015 to serve the needs of New York State's law enforcement departments, agencies, bureaus and offices. We currently have just over $5 million in assets and serve over 2,400 members.

As you may know, NAFCU is the only national organization that exclusively represents the interests of the nation's federally-insured credit unions at the federal level. NAFCU is celebrating its 50th anniversary this year. The association is comprised of roughly 800 member-owned and operated federally-insured credit unions. NAFCU member credit unions collectively account for approximately 70 percent of the assets of federally-insured credit unions. NAFCU and the entire credit union community appreciate the opportunity to participate in this discussion regarding the many difficulties associated with starting a credit union.

Background on Credit Unions

Historically, credit unions have served a unique function in the delivery of essential financial services to American consumers. Established by an Act of Congress in 1934, the federal credit union system was created, and has been recognized, as a way to promote thrift and to make financial services available to all Americans, many of whom may otherwise have limited access to financial services. Congress established credit unions as an alternative to banks and to meet a precise public need – a niche that credit unions still fill today.

Every credit union, regardless of size, is a cooperative institution organized "for the purpose of promoting thrift among its members and creating a source of credit for provident or productive purposes." (12 USC 1752(1)). While over 80 years have passed since the *Federal Credit Union Act* (FCUA) was signed into law, two fundamental principles regarding the operation of credit unions remain every bit as important today as in 1934:

- credit unions remain wholly committed to providing their members with efficient, low-cost, personal financial service; and,
- credit unions continue to emphasize traditional cooperative values such as democracy and volunteerism.

Credit unions are not banks. The nation's approximately 6,000 federally-insured credit unions serve a different purpose and have a fundamentally different structure than banks. Credit unions exist solely for the purpose of providing financial services to their members, while banks aim to make a profit for a limited number of shareholders. As owners of cooperative financial institutions united by a common bond, all credit union members have an equal say in the operation of their credit union—"one member, one vote"—regardless of the dollar amount they have on account. Furthermore, unlike their counterparts at banks and thrifts, federal credit union directors generally serve without remuneration—a fact epitomizing the true "volunteer spirit" permeating the credit union community.

Credit unions have always been some of the most highly regulated of all financial institutions, facing restrictions on who they can serve and their ability to raise capital. There are many consumer protections built into the *Federal Credit Union Act*, such as the only federal usury ceiling on financial institutions and the prohibition on prepayment penalties that other institutions have often used to bait and trap consumers into high cost products.

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 the *Dodd-Frank Act*, 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 shouldn't 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 regulations and compliance costs is a chief priority of NAFCU members.

Unfortunately, the number of credit unions has decreased by 20% since the implementation of Dodd-Frank, and 96% of the credit unions that have disappeared had total assets of under $100 million. This is largely due to the drastic increase in regulation—mostly stemming from the new CFPB—that many smaller credit unions simply can't keep up with. Small and mid-sized credit unions often cannot afford the staff needed to comply with redundant regulations from multiple agencies outside of NCUA, the principle regulator for credit unions.

The Lack of De Novo Credit Unions

The relentless rising cost of compliance deters many would-be de novo credit unions. Additionally, the initial capital infusion and cash outlays are often too great for many communities and associations, and there is practically no return on investment. Starting a new credit union is essentially an altruistic endeavor, as there is no ultimate financial incentive for those who are successful. Furthermore, the complex chartering process may seem relatively easy and straightforward when compared to what a de novo credit union will face once it is chartered and operating. The industry has seen a significant decline in the pace of de novo credit unions post Dodd-Frank enactment.

The table below outlines the number of de novo federally-insured credit unions chartered since the year 2000.

New FICU Charters since 2000

	Federal Charters	State Charters	Total
2000	8	4	12
2001	7	3	10
2002	4	2	6
2003	11	4	15
2004	2	3	5
2005	5	4	9
2006	7	1	8
2007	3	0	3
2008	4	3	7
2009	2	0	2
2010	1	0	1
2011	1	0	1
2012	4	1	5
2013	1	0	1
2014	3	0	3
2015	4	0	4
2016	0	1	1
Total (2000-2016)	67	26	93
Pre Dodd-Frank (2000-2009) Annual Average	5.3	2.4	7.7
Post Dodd-Frank (2010-2016) Annual Average	2.0	0.3	2.3

Sources: NCUA annual reports, Insurance Reports of Activity

Summation of the Steps Necessary to Charter a Credit Union

Chartering a credit union is not quick, nor easy. NCUA's chartering process involves 17 steps that can be broken into 4 categories. The first three steps are research or plenary based, the next 4 steps cover identifying initial capital sources and outlays as well as determining the field of membership (FOM) and finding potential subscribers. The next eight steps relate to development of a business plan, hiring or appointing staff and the board of directors, and the development of financial, operational, and strategic plans. All of these steps of course include the completion of numerous NCUA forms and documents. The final steps cover NCUA's evaluations and requests for follow-up information.

NCUA's Office of Small Credit Union Initiatives (OSCUI) offers free consulting services once the applicant receives preliminary FOM approval. However, it can still take up to three years to receive a charter depending on the complexity of the credit union's business model. This startup time can be even longer if there are delays in obtaining the funding (grants/donations) necessary to cover the start-up costs—including the absorption of any net operating losses and cash necessary to maintain adequate levels of capitalization. The general guidance for start-up costs is 10 percent of expected assets.

I outline the seventeen steps for establishing a federal credit union in Appendix A.

Chartering Process at The Finest FCU

The idea for The Finest Federal Credit Union came from Mr. Paul McCormack, a retired NYPD Deputy Inspector. In his travels, he was introduced to officials from St Raphael Garda Credit Union, the largest credit union in Ireland. Mr. McCormack was intrigued and amazed at the services offered by this cooperative and led him to ask the question, "why doesn't the world's largest police force (NYPD) have their own credit union tailor-made to fill their own unique needs?" In 2007, Paul and several other organizers went to work trying to find a way to fund the venture. After more than a year of research and organizing, it became apparent that the financial crisis of 2008 scared away the would-be capital sources. A few years later, the project was re-started with new inspiration from the original organizers, specifically Mr. McCormack, when Amtrust Financial Services, a New York based property and casualty insurer, announced its interest in assisting our credit union launch. Once funding was secured, we went to work drafting the application, business plan and pro-formas, and finally submitted our application to NCUA with requests for amendments. This process lasted over eighteen months.

Currently, The Finest FCU has $5 million in assets, serves more than 2,400 members, and offers checking and savings accounts, revolving lines of credit, and personal loans. We will soon be able to offer auto, mortgage, and boat loans, as well as a host of wealth management services.

Why was The Finest FCU able to succeed?

During the process of researching, chartering and starting operations for the organization, The Finest FCU benefitted from a number of factors, below including:

- The organizers and subscribers cooperation and commitment helped to keep the underlying goal in focus – providing specific help and services to the officers of the NYPD through all stages of life.
- The support and financial backing of Amtrust Financial Services. Securing a supporter who was willing to help fund the chartering effort was key.
- NCUA was helpful, especially towards the end of the chartering process and as The Finest began operation. NCUA's Office of Consumer Financial Protection and Office of Small Credit Union Initiatives worked to provide us answers as questions arose in the process.

- The NCUA website provided a comprehensive guide on how to charter a federal credit union.

What Challenges Has The Finest FCU Faced?

Of course, starting any new enterprise is challenging, but starting a new enterprise within the framework of the heavily and increasingly regulated financial services industry offers some particularly daunting challenges, including:

- The biggest hurdle was securing funding for the project. Without the support of Amtrust Financial Services, we would probably not be here today.
- The costs of running day-to-day operations and keeping up with the ever-changing post Dodd-Frank regulatory environment consume significant resources. New credit unions get no breaks, and were it not for a tremendous amount of volunteered legal and organizational help from AmTrust Financial and Reed & Jolly PLLC, we could not have made it across the finish line.
- Selecting a core processor and other service providers is a daunting task that has a fair share of risk.
- Our current charter powers limit us to small loans and deny us the powers necessary to fully serve our member needs. While we fully understand the safety and soundness concerns usually faced by new credit unions, we have significant capital, including deposits from other credit unions. Unfortunately, even though we have been able to consistently grow since initial operations, we are still seeking authority to offer mortgages, as well as personal loans in excess of $5,000.

- While the NCUA was extremely helpful throughout the chartering process, there were periods of uncertainty due to their delayed responses (there is no requirement for a timely response) and even ambiguity in their responses when they did respond.
- The current requirement for monthly board meetings, with copies of all materials to the NCUA, consumes considerable resources and may be an outdated feature of credit union bylaws.
- It is challenging to retain experienced and competent employees to help manage/run a full-service banking institution. We all wear many hats and need the ability to multi-task and think "outside the box".

Steps to Improve the Chartering Process

NCUA takes an active role to help new credit unions form and provides support as an agency. Still, de novo credit unions could benefit from NCUA rules that do more to provide structure and flexibility for the unique challenges that new credit unions face. NAFCU believes that the agency and its examiners should establish timetables for responses at various stages of the chartering process and have some limited authority to provide flexibility on a case-by-case basis with new credit unions, such as additional time to build capital requirements or meet certain requirements.

We would also urge Congress to adopt more flexibility in the *Federal Credit Union Act* when it comes to prompt corrective action capital requirements for de novo credit unions. While the *Federal Credit Union Act* gives NCUA some PCA flexibility for new credit unions, allowing more flexibility, including giving NCUA the power to approve forms of supplemental capital for all credit unions, including de novo institutions, would help.

One way that Congress could enable more flexibility is by passing the *Capital Access for Small Businesses and Jobs Act*, H.R. 1244, which would authorize all credit unions to issue supplemental capital, so long as it does not alter the cooperative ownership structure of credit unions. NAFCU urges Congress to pass this legislation as it would better enable credit unions to meet capital requirements.

An additional flexibility that Congress should consider is whether field-of-membership (FOM) restrictions could be more accommodating for new credit unions. Economic and market realities often hamper opportunities for new credit unions to grow and gain solid footing; often, a lack of a sizeable membership base is a lead cause of this burden. Flexible FOMs for new credit unions would expand the potential market and make it easier to quickly grow the membership to a sustainable size.

Another step NCUA could take is to ensure its examiners who are in the field and working with new credit unions, are carrying out the mission of OSCUI, have the ability and flexibility to work with new credit unions, and have the experience to understand business plans adopted by new credit unions. The agency should take steps to ensure that there are not disconnects between headquarters and regional offices, such as assigning a specific contact at NCUA for the de nov credit union during the chartering process. Often de novo credit unions find initial approval for some things is ultimately reversed down the line, adding to the challenges and frustrations of the process.

Along the same lines, rules and regulations that not only protect member deposits and the share insurance fund, but also allow for different models of forming and operating credit unions may be worth consideration. NCUA should seek to modernize outdated governance provisions in the Federal Credit Union Act and its rules and regulations, including taking steps to reform its standard credit union bylaws. In essence, we would encourage NCUA to think outside the box when it comes to new credit union charters and we stand ready to work with them on those efforts.

Finally, we have recently been certified as a Community Development Financial Institution (CDFI) and we are currently drafting our grant request. We believe that it is our responsibility to our membership (owners) to apply for any funding that may be available. The funds we may receive would be used to offset certain expenses including some regulatory/compliance burdens. The CDFI fund can be an important tool for small and de novo institutions.

Regulatory Hurdles/Burden After Chartering

Should a credit union make it through the application and chartering process, the hard part is likely just beginning as they now face a tidal wave of regulation. Since enactment of the *Dodd-Frank Act*, we have witnessed large banks grow and small banks and credit unions disappear. Approximately one-third of credit union charters established in recent years have not survived.

During the consideration of financial reform, NAFCU was concerned about the possibility of overregulation of good actors such as credit unions, and this is why NAFCU was the only credit union trade association to oppose the new CFPB having rulemaking 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 it is true that credit unions under $10 billion are exempt from the examination and enforcement from the CFPB, all credit unions are subject to the rulemakings of the agency and are feeling this burden. While the CFPB has the authority to exempt certain institutions, such as credit unions, from agency rules, they have unfortunately been reluctant to use this authority on a broad scale.

The impact of this growing compliance burden is evident as the overall number of credit unions continues to decline. Since the second quarter of 2010, we have lost over 1,500 federally-insured credit unions – over 20% of the industry. The overwhelming majority (96%) of these were smaller institutions below $100 million in assets. 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 merge out of business or be taken over. There is an urgent need for Congress to enact meaningful regulatory relief.

Additionally, since the financial crisis and the passage of Dodd-Frank, the number of new credit unions seeking charters has decreased by nearly 70% per year, with an average of 7.7 new charters annually in the 10 years before Dodd-Frank and only 2.3 annually since the passage of Dodd-Frank.

This growing demand on credit unions is demonstrated by a recent NAFCU survey of our membership that found that nearly 97% of respondents were spending more time on regulatory compliance issues than they did in 2009. In addition to hiring new compliance personnel, many credit unions have reported that non-compliance staff is regularly called upon to help with the compliance workload. In fact, another recent survey found that over 70% of respondents have had non-compliance staff members take on compliance-related duties due to the increasing regulatory burden. This highlights the fact that many non-compliance staff is forced to take time away from serving members to spend time on compliance issues. A new credit union often has limited staff to tackle many challenges, and often finds itself in this situation where compliance, not service, becomes the main focus. Every dollar, or hour, spent on compliance, is time or money taken away from member service, additional loans, or better rates.

Additionally, cyber and data security is an important issue for all credit unions, but especially de novo charters. While we have to take steps to protect our members' financial data, a major data breach at a retailer that allows criminals access to consumers' financial accounts could prove costly to financial institutions, such as credit unions, as they try to protect their members. Smaller and de novo credit unions have a harder time absorbing these costs. We would urge Congress to enact a national data security standard to require those that hold consumer financial data have protections in place akin to what financial institutions have to do under the *Gramm-Leach-Bliley Act*.

Credit Unions Need Regulatory Relief

Regulatory burden is the top challenge facing credit unions today. Finding ways to cut-down on burdensome and unnecessary regulatory compliance costs is the only way for credit unions to thrive and continue to provide their member-owners with basic financial services and the exemplary service they need and deserve. NAFCU continues the fight and looks forward to working with Congress to address the many legislative and regulatory challenges faced by the credit union industry today.

It is with that in mind that we would like to reiterate our support for comprehensive regulatory relief for community institutions, such as the *Financial CHOICE Act* proposed in the last Congress. This legislation contained key elements of regulatory relief including repeal of the Durbin Amendment, reforms to structure, power and rules of the CFPB, greater cost-benefit analysis of new regulations, and improvements to the examination process for credit unions.

In order to ensure that this relief best benefits de novo credit unions, we would urge you to go further and fully exempt all credit unions from CFPB authority. Having to worry about rules from multiple regulators is a daunting challenge for all credit unions, and is especially hard on de novo charters – who are often so focused on getting established that they don't see the CFPB tidal wave coming. Returning credit unions to the sole jurisdiction of NCUA, is a key step Congress can take to help reverse the declining de novo trend.

We also urge you to take action to help modernize and update the *Federal Credit Union Act*, such as removing outdated governance provisions from the statute, allowing all credit unions to add underserved areas to their field of membership, and modernizing capital requirements to create a true risk-based system capital system for credit unions.

Conclusion

NCUA provides a number of important resources for de novo credit unions. We would urge the agency to do more to aid new credit unions by providing more flexibility with its rules and examiners on a case by case basis to not make the process so onerous. NCUA should also provide de novo credit unions with timely responses. This could be aided by the agency creating a key contact for each de novo credit union. Additionally, we would also encourage the agency to look at it from a business perspective and think outside the box in how it can help de novo credit unions.

Unfortunately, new credit unions like The Finest FCU are not being created due not only to the hurdles posed by initial start-up time and costs, but also the daunting over-regulation facing the credit union once its charter is granted. Many smaller credit unions are saying "enough is enough" when it comes to the overregulation of the industry. The compliance requirements in a post-Dodd-Frank environment have grown to a tipping point where it is nearly impossible for many smaller institutions to survive, much less start from scratch. Credit unions want to continue to aid in the economic recovery, but are being stymied by this overregulation. We need regulatory relief – both legislatively and from the regulators.

We would urge this Subcommittee to support regulatory relief for credit unions and support modernizing and updating the *Federal Credit Union Act*. Finally, the subcommittee should encourage regulators to act to provide relief where they can without additional Congressional action.

We thank you for the opportunity to share our thoughts with you today. I welcome any questions you might have.

Appendix A – Steps to Charter a Federal Credit Union

Step 1 – Research the Federal Charter
An applicant must research and review what a federal credit union is, detail the regulatory and consumer compliance requirements of a federal credit union (FCU), and describe the operational requirements involved in running a federal credit union.
Documentation Requirement: Subscriber must submit a signed letter, acknowledging research and review is complete.

Step 2 – Select a Credit Union Name
Select a name that is not already being officially used by, or would be confused with another credit union name.
Documentation Requirement: Send a letter to NCUA with requested credit union name.

Step 3 – Establish a Field of Membership (FOM)
Potential members must qualify for membership by belonging to a specific group with a common bond. NCUA will provide preliminary approval on a proposed FOM upon applicant satisfying documentation requirements.
Documentation Requirement: varies depending on common bond:

- **Single common bond** - a letter identifying the FOM type, the proposed FOM wording, and:
    - For occupational common bond:
      Enclose a letter from the entity (on its letterhead) stating it is interested in sponsoring and being a part of the FCU. The letter must be signed by an individual authorized to represent the entity and must include the following:
        - Entity's name;
        - Physical address;
        - Telephone number; and
        - Number of employees
    - For Trade-Industry-Profession (TIP) common bond:
      Enclose a letter identifying the following:
        - Name of proposed trade, industry, or profession;
        - Number of employees in TIP and independent documentation to support the number;
        - Geographic area to be served;
        - Discussion of previously approved TIP by NCUA, if applicable; and
        - Description of how membership eligibility will be verified (i.e., pay stub, employment badge, HR department, etc.).
    - For associational common bond:
      Enclose a letter from the association entity stating it is interested in sponsoring and being a part of the applicant. The letter must be signed by an individual authorized to represent the entity and must include the following:
        - Entity's name, physical address, and telephone number;
        - Number of members in the association; and
        - Number of employees in the association, if any

Also, the applicant should enclose a copy of the association's Bylaws, Articles of Incorporation, Constitution, Charter or any other equivalent documentation supporting that it is a recognized entity.

- **Multiple common bond** – a letter identifying the FOM type, the proposed FOM wording, and:
  - For multiple occupational common bond:
    Identify each entity by name, city and state, and include number of current employees. Also, enclose a letter from an authorized representative of each entity stating it is interested in sponsoring and being a part of the applicant's FOM. The letter must also include:
    - Number of current employees;
    - Distance (# of miles) the entity's physical address is located from the applicant's office facility;
    - Physical address and telephone number of the entity;
    - If any single group being included has more than 3,000 members,
      - Explanation why the group cannot form its own credit union; and
      - Statement whether the group has other credit union service. If the group has other credit union service, submit a letter from any overlapped credit union indicating whether or not it objects to the overlap, unless the overlapped credit union is a community charter or non-federally insured.
  - For multiple associational common bond:
    Identify each entity by name, city and state, and include the number of current employees and members. Also, enclose a letter from an authorized representative of each entity stating it is interested in sponsoring and being a part of the applicant's FOM. The letter must also include:
    - Number of current members and the association's employees;
    - Distance (# of miles) the association's physical address is located from the applicant's office facility;
    - Physical address and telephone number of the association;
    - If any single group being included has more than 3,000 members, provide
      - Explanation why the group cannot form its own credit union; and
      - Statement whether the group has other credit union service. If the group has other credit union service, submit a letter from the overlapped credit union indicating whether or not it objects to the overlap, unless the overlapped credit union is a community charter or non-federally insured.

    The letter must also include a copy of the association's Bylaws, Articles of Incorporation, Constitution, Charter, or any other equivalent documentation supporting that it is a recognized entity.
- **Community common bond** - A letter identifying the FOM type the applicant wishes to serve, proposed FOM wording, and:
  - For single political jurisdictions, submit the following:
    - Name of the single political jurisdiction;
    - Map of the political jurisdiction(s) with the proposed area outlined; and
    - Population of the community

- For multiple contiguous political jurisdictions or rural districts, submit the following:
  - Name of the multiple contiguous political jurisdictions or rural district;
  - Map of the community with the proposed area outlined; and Population of the community

Step 4 – Identify Subscribers
Subscribers are any seven or more natural persons who desire to form a FCU, and they are responsible for preparing the charter application. A primary point of contact needs to be identified for NCUA. Subscribers need to undergo an "appropriate investigation" to determine "the general character and fitness of the subscribers thereto."
Documentation Requirement:

- A letter identifying the subscribers and their anticipated involvement and contribution to the chartering process, including time commitment (number of hours per month);
- Name and telephone number of the contact person; and
- An original Report of Official and Agreement to Serve (NCUA 4012) Form and a resume for each individual who desires to be a subscriber of the new FCU.

Step 5 – Secure Funding to Cover Start-Up Costs
NCUA provides guidance material on typical start up and operating costs for newly chartered credit unions. Typically, subscribers must seek monetary donations or subsidies to cover start up and operating costs for the initial years of operation. All commitments pledged must be placed in writing from their source and include the specific commitment and its terms. The commitment letters must be supported by the donor's clear ability to provide the pledged support. This can be accomplished with a copy of the donor's audited financial statements or equivalent documentation.
Documentation Requirement:

- In a letter addressed to NCUA, describe the source of your funding and the actions and steps taken by the subscribers to obtain the necessary funds to cover the applicant's start-up costs and operations until the FCU can become profitable.
- Obtain the commitment in writing from the funding source and ensure the letter contains the following details regarding the commitment:
  - Name of the person making the commitment;
  - Name of organization affiliated with donor;
  - Address of person/organization;
  - Telephone number of person/organization;
  - Type and amount of commitment;
  - Start date of commitment;
  - End date of commitment; and
  - Description of terms and conditions of commitment.
- Submit copies of bank statements and/or donors' most recent audited financial statements or equivalent documentation to NCUA.

Step 6 – Identify a Physical Location
Each credit union must have at least one physical location, including applicants that are anticipating most transactions via the internet or other electronic means.

Document Requirement: In a letter, inform NCUA of the applicant's anticipated physical address of its main office and any branches to be opened at inception.

Step 7 – Survey Potential Membership
Data gathered from the survey will reveal the level of interest and support for the applicant FCU. The results of the membership survey drive the business plan and financial projections, and support the reasonableness and achievability of the projected outcomes. The results must clearly indicate support for a new FCU and its desired services.
Each organizing group must design a membership survey form that gathers enough information to aid in developing and supporting the products and services set forth in the business plan along with pro-forma financial projections and related assumptions. NCUA provides applicants with a sample membership survey that applicants can customize to meet their needs. If surveying the all persons within a FOM is not feasible, NCUA requires either a statistically valid sample, or a targeted sample, survey. The number of required survey responses will vary depending on the size of the population. Applicant FCUs should develop a business plan based on the survey results and the most likely future scenario.
Documentation Requirement: Upon completion of the membership survey, the applicant is required to submit the following:

- Tally of the membership survey results;
- Written analysis of the membership survey results;
- Blank copy of the membership survey form;
- Written explanation of how the membership survey form was distributed; and
- Written explanation of the random sample process used to select who received a survey form.

Step 8 – Find a Mentor and Other Resources
NCUA strongly recommends subscribers/organizers establish mentor relationships with one or more existing credit unions and also to seek out other assistance in and outside the credit union industry. NCUA provides a recommended resource list for applicants to use.
Document Requirement: Applicants must notify NCUA in writing of all mentor relationships established and include copies of the written acknowledgement letters. The written letters should:

- Identify the steps, actions, or services the mentor will provide to assist the subscribers or the new federal credit union once chartered;
- Specify how the mentor will provide the specified actions or services;
- Discuss the length of time the actions or services will be provided;
- Explain any conditions for continued involvement with the applicant;
- Identify the name and contact information of the specific individual(s) providing the assistance, and
- Include any other pertinent information.

Step 9 – Identify Officials and Management
Applicants must identify individuals that will serve as directors, supervisory committee members, and credit committee members. When selecting directors, applicants must be sure that they can carry out the duties in good faith, administer the affairs of the credit union fairly, and have a working familiarity with basic finance and accounting practices. NCUA will evaluate a

prospective credit union applicant's competence, experience, character, and integrity to ensure his or her association with a newly chartered credit union is in the best interests of the credit union's members or of the public.

Document Requirement: The applicant must submit an original Report of Official and Agreement to Serve (NCUA 4012) Form and a resume for each individual who desires to serve as an official and/or employee.

Step 10 – Create a Business Plan

The applicant must create a plan that must support the applicant via survey results and commitment letters reflecting sponsor support. It should also detail the subscribers' goals and objectives, and demonstrate that the goals are realistic and achievable based on the assumptions provided.

Document Requirement: The business plan must contain the following sections:

- **Mission statement**: brief statement describing the purpose of the proposed FCU
- **Market analysis**: analyze market conditions, including geographic, demographic.
    - Consider what financial service providers are already available to the proposed membership.
- **Evidence of member support**: Describe and summarize the membership survey results and analyses performed by the subscribers and organizer, and detail the financial services needed/desired by the membership.
- **Products and services**: Identify the products and services that the proposed FCU will provide in the first two years, justified by the results of the membership survey.
    - The plan should discuss in detail the terms and conditions of products (ie., interest rates, and per transaction and aggregate maximum dollar limitation), use of third party vendors offered in the first two years, and the diligence conducted on such vendors.
- **Goals for shares, loans, and number of members:** Provide projections for the dollar amount and number of loans and shares, and the number of members for the first two years of operation, which will serve as benchmarks to measure the success.
- **Management and staffing:** Discuss the number of employees, their titles, and the anticipated compensation and benefits. Staff should have experience or expertise in offering and managing the products and services to be offered. All management and third-party agreements must be in writing and reviewed by an attorney.
- **Operating facility:** Identify the location and cost of the proposed FCU office and discuss why the location was selected. The applicant should submit a copy of the draft agreement and attorney review to NCUA.
- **Recordkeeping and Processing System**: Identify the data processing system(s) selected for use by the credit union. Discuss why the system(s) were selected and the cost of the system(s).
- **Surety Bond Coverage:** NCUA regulations require certain minimum bond coverages.
- **Source of funds and other support**: Subscribers must ensure the level of funding and support is sufficient to operate the credit union for providing the services deemed important by the members, as reflected in the membership survey.
- **Plans for Operating Independently**: Subscribers need to explain and support how the proposed FCU will continue operations after Year 2 while remaining solvent.

- **Continuity Plan for Director, Committee Members, Management and Staff:** Discuss the number of directors and members for each committee, including a supervisory committee, and credit committee if being used. Detail out the terms of each official and the training to be provided prior to, and after opening the proposed FCU.

Step 11 – Create Pro-Forma Financial Statement Projections and Assumptions
Detailed pro-forma financial statements consist of a balance sheet and income statement for the first two years of operations, as well as membership, delinquency, and net charge off projections. NCUA requires applicants to submit such information. The agency provides a sample pro-form statement.
Document Requirement: The applicant must submit semi-annual pro-forma balance sheet and income statement projections and corresponding assumptions for at least the first two full years of operation. Additionally, the annual pro-forma financial projections through the year the proposed FCU will be profitable absent grant money to demonstrate its ability to operate independently.

Step 12 – Develop a Marketing Plan
Describe how the proposed FCU will market the credit union to potential members. Specifically identify the advertising venues and methods to be used and include the cost for each.
Document Requirement: Submit a formal written marketing plan including costs associated with each marketing initiative.

Step 13 – Complete Required NCUA Forms
The Appendix of the Chartering Manual contains the required chartering forms. These forms can only be completed and signed by the appropriate individuals after receiving preliminary field of membership approval from NCUA.
Document Requirement: Applicant must submit Forms 4001, 4008, 9500, and 9501.

Step 14 – Establish Credit Union Bylaws
The applicant should customize NCUA's standard bylaws to fit their unique membership needs.
Document Requirement: Submit the adopted draft credit union bylaws to NCUA.

Step 15 – Draft Written Policies and Procedures
Policies and procedures should specifically address the impact on the credit union's operation and should be reviewed and adjusted as necessary, but at least annually. The specific policies and procedures required for a new federal credit union will depend on its particular offerings, membership, and environment.
Document Requirement: Applicant should develop policies that generally take account of the following:

- Fair Lending Policy and Loan Policy
- Collection Policy
- Loan Charge-Off Policy
- Allowance for Loan and Lease Losses (ALLL) Policy
- Investment Policy
- Cash Policy

- Bank Secrecy Act (BSA)/Customer Identification Program (CIP)
- Office of Foreign Assets Control (OFAC) Policy
- Truth-in-Savings (TIS)
- Director Fiduciary Duties
- Reimbursement Policy
- Asset Liability Management (ALM) Policy
- Liquidity Policy
- Vendor Management/Third Party Relationships
- E-Commerce Policy
- Security Program
- Disaster Recovery and Business Continuity/Resumption Policy
- Privacy Policy
- Identity Theft Red Flags, Credit Report Address Discrepancies, and Records Disposal
- Procedures for Major Operational Areas
- Policies for Advanced Services

Step 16 – Meet with NCUA Staff
Upon satisfactory completion of a charter application demonstrating the organization certificate conforms to the requirements of the Federal Credit Union Act, the proposed FCU business model has the potential of demonstrating economic viability, along with the subscribers and officials being of good character and fitness, NCUA staff will meet with the proposed subscribers, officials, and management to finalize a Letter of Understanding and Agreement (LUA). An LUA outlines the parameters in which the new federal credit union will operate and is based substantially on the PFCU's approved business plan and financial projections.

Step 17 – Charter Issued
Upon successful completion of NCUA's onsite review and execution of the Letter of Understanding and Agreement, NCUA will issue a Charter and Certificate of Insurance to establish the new federal credit union. NCUA will forward these documents and necessary pamphlets, forms, and instructional manuals to the credit union office.

AFSA
Protecting Credit Since 1916
American Financial Services Association

March 20, 2017

Hon. Blaine Luetkemeyer	Hon. Wm. Lacy Clay
Chairman	Ranking Member
Subcommittee on Financial Institutions	Subcommittee on Financial Institutions
& Consumer Credit	& Consumer Credit
House Financial Services Committee	House Financial Services Committee
Washington, DC 20515	Washington, DC 20515

Dear Chairman Luetkemeyer and Ranking Member Clay:

The American Financial Services Association (AFSA)[1] respectfully requests that this statement be made part of the record for the March 21, 2017 hearing entitled *"Ending the De Novo Drought: Examining the Application Process for De Novo Financial Institutions."*

The Federal Deposit Insurance Corporation (FDIC) should return to chartering new banks to help our economy. Your subcommittee's hearing is especially timely in light of the differing attitudes about new charters shown by the federal banking agencies. While the Office of the Comptroller of the Currency embraces new charters, the FDIC refuses to process insurance approvals for existing types of bank charters.

Industrial banks, known in some states as industrial loan companies, thrift and loan companies or Morris Plan banks, are among the types of applications for new charters which languish at the FDIC. (For more information, please see the appendix.) AFSA has a keen interest in the outcome of this hearing. We are grateful to you both for holding this hearing and we hope our statement is helpful.

For the past 40 years, industrial banks, many owned by commercial parents, have compiled the best record of capitalization and profitability of any group of banks in the nation. There is no evidence that states have inadequately regulated the industrial banks they chartered. Yet, for a decade, the FDIC failed to process any industrial bank application. During most of this time, the moratorium was imposed by administrative fiat without any legal authorization, public announcement, statement of reasons, or opportunity for public input on this critical and damaging policy.

This *de facto* moratorium on new charters is particularly harmful to Nevada and Utah, which permit the chartering of industrial banks, only to find their banking law preempted by a regulatory agency operating with no statutory or policy basis. These states serve their role as laboratories for change and have demonstrated beyond any reasonable and objective doubt that industrial banks operate as safe, sound, responsible and beneficial providers of credit.

Chartering a bank is, properly, a rigorous process that follows requirements found in Sections 4, 5 and 6 of the Federal Deposit Insurance Act. In the case of state-chartered banks, applications are reviewed by both the FDIC and the state banking regulator. However, a rigorous process

[1] AFSA is the national trade association for the consumer credit industry, protecting access to credit and consumer choice. In 1971, AFSA merged with the American Industrial Bankers Association, an organization of industrial banks, thrift and loan companies, and sales finance companies and we are proud to continue to represent a number of these banks.

need not be an endless process. The FDIC is required to process applications on a timely basis. Section 343 (a) of the Riegle Community Development and Regulatory Improvement Act of 1994 requires federal banking agencies— including the FDIC—to take action on an application within one year of the day upon which a complete application is received.

While Congress created this timely and efficient application process, the FDIC peppers applicants with requests for data and additional information to prevent an application from being deemed completed. While the *FDIC Case Manager Manual (April 2004)* states "it is expected that processing time frames approaching the one-year time limit and/or needing a waiver will occur in rare and unusual circumstances," one pending application, filed by a publicly traded company with global operations and already owning a domestic bank and international bank, has been slow-walked by FDIC bureaucrats since November 2009. Another AFSA member—an iconic, global brand with experience in financial services was discouraged from pursuing a charter.

In reality, the one-year approval period is a hollow requirement as the FDIC has the discretion to determine when an application is considered "complete" and has repeatedly delayed this decision on industrial bank applications by never deeming applications as completed.

The FDIC should be encouraged to charter new banks to improve the American economy. To supplement our statement, we commend to the subcommittee the thorough testimony presented by the National Association of Industrial Bankers and the Utah Bankers Association before the July 13, 2016 United States House of Representatives Committee on Oversight & Government Reform hearing, entitled *Oversight of the FDIC Application Process.*

*

Thank you for the opportunity to share our views. If you have any questions, please contact AFSA's Executive Vice President Bill Himpler at 202-466-8616 or bhimpler@afsamail.org.

APPENDIX

What is an industrial bank?

Industrial banks are state-chartered banking institutions that may be owned by a commercial entity. First chartered in 1910, industrial banks predate the Federal Deposit Insurance Act by 23 years. Industrial banks are FDIC-regulated depository institutions chartered under the laws of California, Colorado, Hawaii, Indiana, Minnesota, Nevada, and Utah. Today, they principally operate in Nevada and Utah.

Industrial banks engage in consumer and commercial lending on both a secured and unsecured basis. They accept time deposits, money market accounts, savings accounts and deposits that may be withdrawn through negotiable orders of withdrawal.

Industrial banks are subject to the same banking laws and are regulated in the same manner as other depository institutions. Though not required to be regulated as federal bank holding companies, owners of industrial banks are not unregulated. Like any other state bank, they are supervised and examined both by the states that charter them and by the FDIC. They are subject to the same safety and soundness, consumer protection, deposit insurance, Community Reinvestment Act, and other requirements as any other FDIC-insured depository institutions.

Industrial banks evolved from early twentieth century Morris Plan Banks, consumer lending institutions organized at a time when commercial banks rarely made consumer loans or offered deposit accounts to individuals. The word "industrial" in their names stems from the original mission of providing credit to industrial workers, not to the industries themselves.

In the past four decades, industrial banks have compiled among the best record of capitalization and profitability of any group of banks in the nation and represent a sector of the financial services industry that should be encouraged to grow.

When did the moratorium on industrial bank charters start and when did it end?

In the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), Congress placed a temporary moratorium on commercial firms chartering or acquiring industrial banks to allow Congress time to study the merits of allowing commercial firms to own these banks. Congress decided *not* to renew the moratorium when it expired in July 2013, meaning that federal law continues to allow commercial firms to charter and acquire industrial banks.

Even though Congress did not renew the moratorium, the FDIC has failed to process any new industrial bank applications, thereby blocking states' rights to grant new charters and providing additional credit to consumers and small businesses. This decision disregards the preexisting federal law that requires the processing of applications within a reasonable time frame and ignores Congress' intent to maintain a dual banking system in the United States. In fact, even former FDIC Chair Sheila Bair agreed the agency has a legal obligation under current statute to process these applications.

Despite federal law, Congress' intent, and the safety and soundness of industrial banks, the FDIC has continued a *de facto* moratorium on granting industrial bank charters. There has been no legal authorization, public announcement, statement of reasons, or opportunity for public input to this policy. Industrial banks formerly were subject to two moratoria on new charters both of which ended after a GAO study found *no* need for additional legislation.

Below is a timeline of the moratorium over the last decade.

- **7/28/06:** In response to an application filed by Walmart, FDIC Chair Sheila Bair imposes a six-month moratorium on applications for deposit insurance by industrial banks and notices of change in bank control of existing industrial banks.
- **1/31/07:** The FDIC votes to extend the moratorium until 1/31/08. Oddly, Chairman Bair noted, "Industrial banks have a history of strength and innovation. *Today's action ensures that industrial banks will continue to remain safe and important participants in the financial system and that the parent company will be a source of strength and not a source of risk."*
- **11/28/07:** FDIC Chair Bair announces she will lift the moratorium saying, *"We've extended it for 18 months already, and I think if we go much longer, we expose ourselves to litigation. We have a legal obligation under current statute to process these applications."*
- **6/25/10:** The Dodd-Frank conference report includes section 603 which imposed a three-year moratorium on the ability of *"commercial firms"* to acquire FDIC-insured industrial banks and credit card banks and directing the GAO to study issues arising from commercial ownership of industrial banks.
- **7/21/10:** The Dodd-Frank Act is signed into law.
- **5/9/11:** FDIC Chair Bair resigns.
- **7/9/11:** Martin Gruenberg becomes Acting FDIC Chair and is later confirmed.
- **1/19/12:** The GAO Report is published making no recommendations for additional legislation.
- **7/22/13:** The Dodd-Frank Act Moratorium expires.
- **Today:** The last new industrial bank charter was approved in 2008.

ICBA
INDEPENDENT COMMUNITY
BANKERS *of* AMERICA®

March 21, 2017

De Novo Community Bank Formation Needed to Support a Competitive U.S. Financial System

On behalf of the more than 5,800 community banks represented by ICBA, we thank Chairman Luetkemeyer, Ranking Member Clay, and members of the subcommittee for convening today's hearing entitled "Ending the De Novo Drought: Examining the Application Process for De Novo Financial Institutions." ICBA is a leading advocate for regulatory policies that will foster the creation of much needed de novo banks. We are pleased to offer this statement for the record.

A vibrant financial services industry that meets the credit and banking needs of consumers and small businesses in all regions of the country requires a steady influx of de novo charters. Unfortunately, de novo charters have come to a virtual halt. Only three new banks have opened for business since the financial crisis. Meanwhile, the pace of consolidation has accelerated, the number of community banks has dwindled, and more American communities have been stranded without a local bank.

This is a dramatic shift from prior years during which de novo bank formation averaged over 170 per year. Even in the depths of the savings and loan crisis in the 1980s, when 1,800 banks and savings institutions failed, an average of 196 de novo banks and savings institutions were formed annually from 1984 through 1992.

ICBA believes that it is imperative that the FDIC establish an application process and tailored regulatory environment that encourages and facilitates the formation of de novo banks. ICBA advocated for and ultimately won a significant and favorable change in FDIC policy. De novo bank applicants are no longer required to provide upfront capitalization sufficient to maintain a Tier 1 leverage capital ratio of at least 8 percent for the first *seven* years of operation – which had been a significant deterrent to applications. The FDIC agreed to reduce the initial capitalization period to the first *three* years, with an accompanying reduction in the amount of upfront capital required. Also, the business plan submitted with the application can cover the first three years of operation, not the first seven years.

The FDIC also conducted a series of four outreach meetings during 2016 in different regions of the country on the topic de novo charters. ICBA participated in these meetings. ICBA applauds the FDIC for changes to the application process and requirements and for hosting outreach meetings.

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Because restarting the influx of de novo banks is so important to our financial system, ICBA is pressing the FDIC for additional changes to the application process. In particular, the FDIC should streamline the voluminous financial projections and marketing plan that an applicant must submit as part of their business plan. Not only is the business plan requirement overly detailed and burdensome, but if an application is approved and begins operations, it is not permitted to deviate from its business plan without regulatory approval. A de novo banker at the FDIC outreach meeting in New York described how his bank funded itself with CDARS reciprocal deposits only to find out that the FDIC considered them to be brokered deposits as well as a deviation from the banks' business plan. The FDIC nearly forced the bank to unravel all of its deposit transactions. The prospect of three years of intense scrutiny over a new bank's business practices and capital levels – significantly more intense than the scrutiny applied to an established bank – is an additional deterrent to de novo applicants.

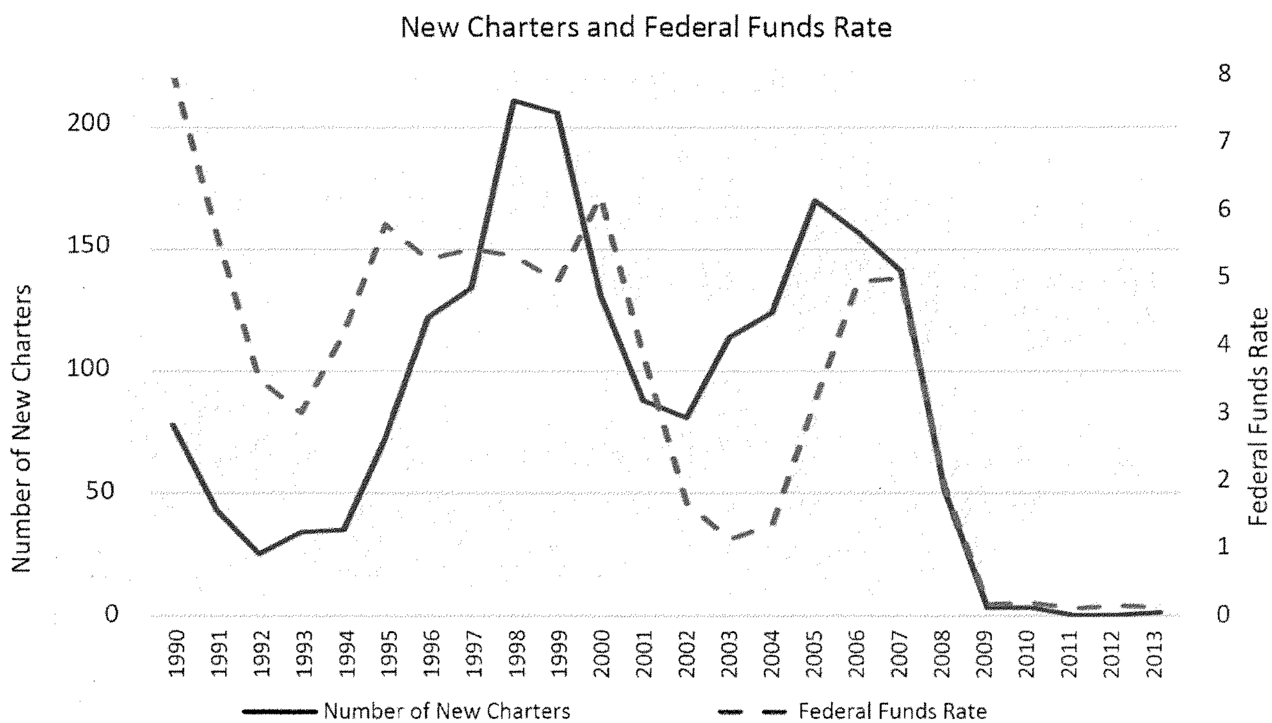
Of course, reform of the application process and the initial period of regulatory scrutiny is not sufficient to jump start de novo applications. The current regulatory and tax environment for community banks, new and established, is daunting and acts as a strong deterrent to potential de novo applicants. That is why ICBA has been working closely with Congress to advance the 2017 Plan for Prosperity: The Community Bank Agenda for Economic Growth.

ICBA thanks this committee for its support for meaningful regulatory and tax relief for community banks to spur de novo applications and to increase the flow of credit among established community banks. This relief will create a more competitive financial system and spur economic growth and job creation. ICBA's recommendations for regulatory and tax relief are set forth in our Plan for Prosperity, a copy of which is attached to this statement.

Closing

Thank you again for convening this hearing and raising the profile of a critical issue for the financial system and for the American economy. ICBA looks forward to continuing to work with the committee to promote de novo banks and to enact regulatory relief for existing and prospective community banks.

Correlation of *De Novo* Bank Formation and Interest Rates



Source: Federal Reserve Board research - https://www.federalreserve.gov/econresdata/feds/2014/files/2014113pap.pdf

American Bankers Association | CDBA Community Development Bankers Association | ICBA Independent Community Bankers of America | National Bankers Association The Voice of Minority Banking Since 1927

March 14, 2017

"We are gravely concerned that the Administration's forthcoming FY 2018 budget may propose cuts to the CDFI Fund. We strongly urge you to maintain strong funding levels....

During the 2016 Presidential campaign, the need to create jobs and revitalize the economies of disenfranchised rural communities and neglected inner cities was a key theme. CDFI banks work in the exact communities that were the focus of this conversation. Community based financial institutions are uniquely positioned to understand local credit needs which is why there is historic bipartisan support for the CDFI Fund."

Rep. Keith Ellison Slide

Forbes

MAR 17, 2017 @ 12:02 PM 227,756 VIEWS The Little Black Book of Billi

Why Trump's Plan To Defund CDFIs Would Be Disastrous For America's Small Businesses

…Say goodbye to affordable small-dollar loans

…The CDFI program…has offered small businesses the opportunity to secure affordable, responsible capital from traditional sources. If the program were to be eliminated, banks would dramatically pull back when it comes to their small business lending platforms."

Rep. Keith Ellison Slide

American Bankers Association | CDBA Community Development Bankers Association | ICBA Independent Community Bankers of America | National Bankers Association The Voice of Minority Banking Since 1927

March 14, 2017

The Honorable Shelly Moore Capito
Chairman
Subcommittee on Financial Services & General Government Appropriations
United States Senate
172 Russell Senate Office Building
Washington, DC 20510

The Honorable Tom Graves
Chairman
Subcommittee on Financial Services & General Government Appropriations
United States House of Representatives
2000 Rayburn House Office Building
Washington DC 20515

The Honorable Christopher Coons
Ranking Member
Subcommittee on Financial Services & General Government Appropriations
United States Senate
127A Russell Senate Office Building
Washington, DC 20510

The Honorable Mike Quigley
Ranking Member
Subcommittee on Financial Services & General Government Appropriations
United States House of Representatives
2459 Rayburn House Office Building
Washington, DC 20515

Dear Chairman Moore Capito, Chairman Graves, Ranking Member Coons and Ranking Member Quigley:

On behalf of the undersigned banking trade associations, we urge you to support FY 2017 and FY 2018 funding for the Community Development Financial Institutions (CDFI) Fund of the U.S. Department of the Treasury.

With regard to the outstanding FY 2017 FSGG appropriations that are operating under a Continuing Resolution, we urge you to support $250 million[1] for the CDFI Fund, including a $23 million allocation for the Bank Enterprise Award (BEA) Program[2]. We are gravely concerned that the Administration's forthcoming FY 2018 budget may propose cuts to the CDFI Fund. We strongly urge you to maintain strong funding levels. Specifically, we ask you to support $250 million in FY 2018 for the CDFI Fund, including a $35 million allocation for the Bank Enterprise Award (BEA) Program.

Both requests are generally consistent with funding provided by Congress in FY 2016 and in the pending FY 2017 bills passed by the Senate and House Appropriations Committees during the 114th Congress.

The justification for increasing the BEA Program allocation within the CDFI Fund's overall appropriations is based on strong demand, high private sector leverage, and impact. The dollar amount of BEA requests has increased 200% since 2012 – from $88.5 million in 2012 to $179 million in 2015. In that time, the BEA Program allocation has risen by just $1 million – a 5% increase. In 2015, only $1 in funding was available for every $10.40 in requests – the highest of all CDFI Fund program. In 2015, the program received 106 applications – the most in

[1] $250 million is amount passed in HR 5485 (House FY 2017 Financial Services appropriation bill).
[2] $23 million is amount passed in S 3067 (Senate FY 2017 Financial Services appropriations bills).

its history; yet, the program had only $18.7 million available to award. An analysis by the CDFI Fund found that 90% of all BEA monies go to the lowest income census tracts (30% poverty, 1.5 times the national unemployment rate). Since 1996, the BEA Program has made $429 million in awards and helped facilitate billions in new investments that benefit the most difficult to serve markets.

During the 2016 Presidential campaign, the need to create jobs and revitalize the economies of disenfranchised rural communities and neglected inner cities was a key theme. CDFI banks work in the exact communities that were the focus of this conversation. Community based financial institutions are uniquely positioned to understand local credit needs which is why there is historic bipartisan support for the CDFI Fund.

Collectively our organizations represent thousands of FDIC-insured depository institutions across the United States. Since 1996, hundreds of banks have participated in the programs of the CDFI Fund. The programs of the CDFI Fund have a proven, documented track record of creating impact and have become invaluable in helping banks find ways to serve credit markets and communities that otherwise might not be served. It is one of the Federal Government's best market-based strategies for leveraging and channeling needed resources to our most challenged communities.

In the interests of creating new jobs and creating economic opportunity in the most distressed communities, we urge you to support: (1) $250 million for the CDFI Fund with $23 million for BEA in FY 2017; and (2) $250 million for the CDFI Fund with $35 million for BEA in FY 2018.

Sincerely,

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National Association of Industrial Bankers

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- SINCE 1908 -

UNITED STATES HOUSE OF REPRESENTATIVES

FINANCIAL SERVICES SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT

Hearing On

Ending the De Novo Drought: Examining the Application Process for De Novo Financial Institutions

Tuesday, March 21, 2017

STATEMENT FOR THE RECORD

On Behalf of

National Association of Industrial Bankers

Nevada Bankers Association

Utah Bankers Association

On behalf of the National Association of Industrial Bankers (NAIB), the Nevada Bankers Association (NBA), and the Utah Bankers Association (UBA), thank you for holding this important hearing reviewing the recent trends in de novo entry, the current regulatory framework surrounding the formation of new banks and credit unions and its impact on the banking system and our nation's economy.

NAIB is the voice of the industrial banking industry. First chartered in 1910, industrial banks operate under a number of titles; industrial loan banks, industrial loan corporations, or thrift and loan companies. These banks engage in consumer and commercial lending on both a secured and unsecured basis. They do not offer demand checking accounts but do accept time deposits, savings deposit money market accounts and NOW accounts. Industrial banks provide a broad array of products and services to customers and small businesses nationwide, including some of the most underserved segments of the US economy.

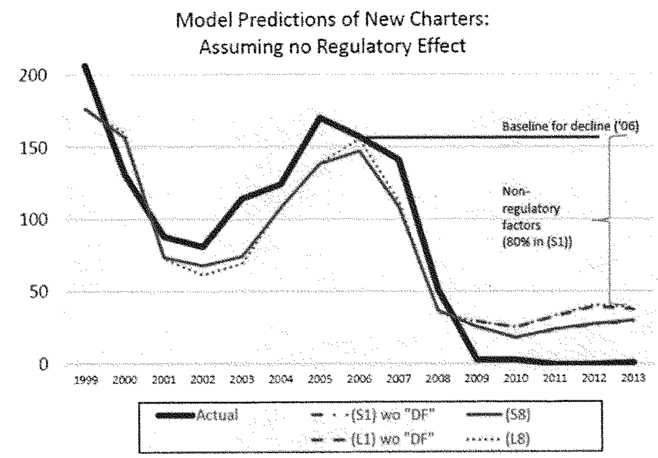
The Utah Bankers Association and the Nevada Bankers Association are professional trade associations for commercial banks, savings banks and industrial banks. Both established in 1908, the NBA and UBA serve, represent and advocate for the interests of their members.

We believe the lack of new banks is an especially important subject for Congressional review because of its effect on access to a stable supply of credit on fair terms. All providers of credit are important to the economy, but none have been more important to consumers and small businesses than banks and credit unions. Throughout our nation's history, banks and credit unions have proven their ability to operate in all economic conditions, and they are unquestionably the best regulated.

In recent years, however, banks' role as providers of credit has declined, and the absence of new bank approvals is one element of that decline. History suggests that banks have formed a core of credit providers in times of critical need, and we believe that studies would show these depository institutions are still best equipped to provide credit in times of downturn. Our regulatory policies and practices should reflect this central role of banks in our economy.

A model developed by economists at the Federal Reserve Board of Governors that predicts an average of 30 new banks should have been chartered between 2009 and 2014.

Figure 8B



"We use the model to predict the level of new bank formation that would have occurred absent any regulatory changes post-crisis, and compare the model's predicted levels of bank formation to the actual level of bank formation." (Adams and Gramlich, 2014: 4)

A recent article in *The Economist* magazine described the current climate for bank startups as "barren, dry, desolate."[1] This is not dramatic overstatement, but harsh reality.

CHARTERING A NEW BANK

The Federal Deposit Insurance Corporation, as you may know, does not charter financial institutions. Banks are chartered by the individual states or, in the case of national banks, by the Office of the Comptroller of the Currency (OCC). The FDIC decides whether to grant newly chartered banks federal deposit insurance, a requirement for any institution that collects deposits from individuals. The FDIC also serves as federal regulator for state-chartered banks, exercising further supervisory authority over those institutions.

If the organizers of a new bank choose a state charter, the FDIC is the primary federal regulator responsible for processing the application. If the application is approved, the FDIC shares responsibility with the state regulator for examining the bank and ensuring that it operates in a safe and sound manner, in compliance with all applicable federal laws and regulations. If the organizers choose a federal charter, the FDIC must still review the application and consult with the relevant federal regulator. In all cases, a new bank *cannot* begin operating until the FDIC approves its application or does not object to another federal regulator approving the application.

[1] "Bank Free or Die; Small Banks in America." *Economist (US)* 25 July 2015: n. pag. Web.

This approval process for new banks is written into law as Sections 4, 5 and 6 of the Federal Deposit Insurance Act. In these sections, Congress clearly articulated the statutory requirements for applicants and the criteria regulators must consider when considering those applications. The law requires applicants to present a detailed business plan, show financial and staff resources, and demonstrate an ability to operate a profitable and legally compliant institution.

Concerned that this process could prevent the timely consideration and approval of new banks, Congress enacted Section 343(a) of the Riegle Community Development and Regulatory Improvement Act of 1994, which "requires" federal banking agencies — including the FDIC — to take action on an application within one year of the day upon which "a complete application is received." According to the FDIC's own *Case Manager Manual*, "it is expected that processing time frames approaching the one-year time limit and/or needing a waiver will occur in rare and unusual circumstances."[2]

Unfortunately, the FDIC ignores both Congress and its own internal processes by using the simple expedient of not finding an application "complete," asking endless questions interspersed between long periods of silence. Potential applicants, even existing banks seeking routine approvals for organizational and operational changes, view the FDIC applications process as a black hole designed to deny changes through inaction in service of a no-growth policy.

All of this poses a question: Why is the FDIC not approving any charters? Their own answers are unpersuasive.

On several occasions FDIC officials have blamed the dearth of new bank applications on economic conditions, which likely did play a role during the Great Recession. But if that were the only factor we would expect to see new bank applications surging as the economy recovers, and that is not happening. Indeed, studies have shown that in all prior recessions bank applications declined during the downturn, but never went to zero, and quickly returned to normal numbers of applications after the recession ended. The lack of new bank applications, even now, is anomalous and cannot be explained by current economic conditions or increased regulatory costs since 2008. A careful review of the existing data shows that the only credible explanation for the lack of new applications is a *de facto* moratorium imposed by the FDIC.

A paper issued by the Federal Reserve Bank of Richmond in 2015 clearly shows that bank profitability has recovered to near normal levels since the recession, and if we were following historical trends, new banks would have been formed at normal rates for the past few years.[3] Thus, factors other than economic conditions are blocking the organization of new banks. We believe the array of new requirements imposed by the FDIC on new bank applicants and the FDIC's stonewalling of pending applications is the real barriers to opening new banks. The chartering of new community banks and specialty banks has always been an engine of innovation in our nation's banking services and credit markets. This engine has stopped.

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[3] McCord, Roisin, and Edward Simpson Prescott. "The Financial Crisis, the Collapse of Bank Entry, and Changes in the Size Distribution of Banks." *Federal Reserve Bank of Richmond Economic Quarterly* 100.1 (2014): 23-50. Print.

The lack of new charters has helped to fuel continued growth among the nation's largest banks. By not allowing a natural renewal through new charters, the FDIC is enshrining a more concentrated, less dynamic banking sector.

Beyond the drive toward consolidation, however, the FDIC has shown a strong hostility toward new bank models since 2008. This is short-sighted. Technology has transformed the overall structure of the financial services markets. Technological advances such as ATMs, credit and debit cards, and mobile-based applications have made branches increasingly less important, and changed the basic relationship between banks and many of their customers, especially younger ones, from geographically based to product-based. Banks must become technology leaders if they want to remain in business tomorrow. If the FDIC continues to block change and growth, banks will become increasingly insignificant as suppliers of credit to the economy.

This is unacceptable. A healthy economy requires a healthy banking system. A vibrant and innovative banking system is critical for job growth and economic expansion. It appears that the FDIC has failed to take broader economic needs into account when fashioning the unilateral policies it has followed for the past decade.

The nation needs new banks, and the time is overdue to allow banks of every kind to resume playing their natural role in the economy. Given the rapid development of technology, it is also essential for regulators to allow banks to adapt to the changing economy and develop new ways to deliver products and services designed to serve the needs and demands of more tech-savvy generations.

THE FDIC'S CONDUCT SHOWS A PATTERN OF ERECTING ROADBLOCKS TO NEW ENTRANTS

Along with endless processing times, and constantly evolving, ambiguous requirements, FDIC policies designed to block new banks include:

- A new highly constricted, novel definition of "serving public needs and convenience"
- Prohibiting branchless banks
- Prohibiting applications that rely on brokered deposits
- Prohibiting specialty banks, which often have monoline or tailored business plans

The FDIC has unilaterally adopted these new policies, without public notice and request for comment, and has concealed what it was doing to avoid oversight. The FDIC's practice of using "non-denial denials" to avoid oversight and accountability for blocking growth of a vital sector of the economy is improper and dangerous. The agency has adopted these policies without a clear understanding of the needs of the economy, or of its own proper role in facilitating the development of a thriving and stable economy.

WHO GETS HURT?

When the FDIC "balks," it particularly affects three types of banks, each of which brings vital economic benefits to the customers they serve:

- Community banks
- Minority banks
- Specialty banks, such as industrial banks

COMMUNITY BANKS

While community banks are small in relation to total bank assets, they make a disproportionate number of agricultural and small business loans. As Federal Reserve Governor Lael Brainard has noted, "Community banks have long been a primary source of credit for small businesses and today may continue to have the best business model for fulfilling many small business credit needs." She also pointed out that "community banks continue to hold about 50 percent of outstanding small business loans at commercial banks, far in excess of their 20 percent share of commercial banking assets and deposits."[4]

While much of the nation has enjoyed an economic recovery since 2008, rural America has not participated. A May 2016 study by the Economic Innovation Group found that only 20 counties generated half the country's net new business startups.[5] None of these 20 counties are in rural areas.

As the number of banks declines, it is unlikely that large institutions will fill this void. Community banks compete on service more than on rates. As banks grow, they typically focus more on efficient delivery of a high volume of standardized products and services. This can leave smaller customers and communities by the wayside.

As the Federal Reserve Bank of Richmond points out, the formation of new banks is vitally important to fill the voids created as existing banks grow, merge, and leave their smaller niches unserved. Between 2007 and 2014, the number of small banks in the U.S. declined by an astonishing 41%. The Richmond Federal Reserve Bank study found this was largely the result of "a striking decline in new bank entry not seen in previous periods. **From 2009 through 2013, entry falls to almost zero."** (emphasis added)

This trend is alarming because community banks disproportionately serve small businesses and rural American communities. In 2011, community banks held the majority of deposits in rural and "micropolitan" counties — areas surrounding an urban center between 10,000 and 50,000 people — according to the FDIC. The FDIC also found that community banks were four times more likely than non-community banks to locate their offices in rural areas.

[4] Brainard, Lael. "Community Banks, Small Business Credit, and Online Lending." Community Banking Research and Policy Conference, Cosponsored by the Federal Reserve System and Conference of State Bank Supervisors, Federal Reserve Bank of St. Louis, St. Louis, Missouri. 30 Sept. 2015. https://www.federalreserve.gov/newsevents/speech/brainard20150930a.htm.

Community banks also serve small businesses, providing approximately 50% of all small business finance. Some observers suggest the decline in small business formation, especially in small towns and rural areas, is the direct result of the disappearance of community banks.[6]

Agricultural communities are also seeing a marked decline in the availability of banking services. Community banks provide 50% to 77% of agricultural loans. While estimates vary, all agree that community banks are an important source of agricultural finance, and are disappearing in rural America. Some communities have no local financial services, and individuals may have to travel up to two hours to reach a banking location.

This creates "financial deserts" in rural America, exacerbated by the fact that many of these communities lack the Internet services that may offer alternative means of banking. This growing gap in outlying communities' access to vital financial services highlights the profound flaw in the FDIC's unilateral no-growth, no new competition policy. New competition from banks that focus initially on those underserved communities is the best way to fill these gaps.

MINORITY BANKS

Of the nation's 6,110 FDIC-insured institutions, only 162 are Minority Depository Institutions (MDIs). In fact, FDIC data show that only 22 MDIs are African American-owned, and only 30 are Hispanic American-owned.[7] These institutions make up less than one percent of the nation's banks.

The FDIC's December 2015 Minority Depository Institutions report explains the need for these banks:

> *Having offices in minority communities is also important to providing access to mainstream financial services. A 2011 FDIC survey shows that 10 million "unbanked" U.S. households did not have bank accounts while another 14 million households could be considered "underbanked."*[8]

That survey found that 21.4% of African American and 20.1% of Hispanic American households were unbanked, compared with 4% of white households. The FDIC noted that

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[6] DeYoung, Robert, et al., "Small Business Lending and Social Capital: Are Rural Relationships Different?" (paper presented at the Community Banking in the 21st Century conference, Federal Reserve System & Conference of State Bank Supervisors, St. Louis, Mo., October 2-3, 2013); Berger, Allen N., Seth D. Bonime, Lawrence G. Goldberg, and Lawrence J. White. "The Dynamics of Market Entry: The Effects of Mergers and Acquisitions on Entry in the Banking Industry." *Journal of Business, University of Chicago* 77.4 (2004): 797-834. Web.; McCord, Roisin, and Edward Simpson Prescott. "The Financial Crisis, the Collapse of Bank Entry, and Changes in the Size Distribution of Banks." *Federal Reserve Bank of Richmond Economic Quarterly* 100.1 (2014): 23-50. Print.

[7] FDIC Minority Depository Institutions Report, Dec. 2015,https://www.fdic.gov/regulations/resources/minority/mdi.html.

[8] 2011 FDIC National Survey of Unbanked and Underbanked Households, http://www.fdic.gov/householdssurvey/.

"MDIs are important service providers to minority populations, which tend to have higher percentages of unbanked households than other population groups."[9]

Minority banks are, by and large, community banks. The challenges and opportunities that apply to community banks apply to minority banks as well. Community banking has also traditionally served lower income individuals, and low-income communities are often left without any financial services beyond the transactional services provided by ATMs.

FDIC Chairman Martin Gruenberg acknowledged this last summer in remarks to the Urban Financial Services Coalition. After noting that "[m]any consumers — minorities in particular — remain unserved by the banking system," he went on to say that "the number of MDIs has declined since the onset of the financial crisis and has continued to decrease in recent years." He made no mention of the obvious solution: chartering new minority banks.

SPECIALTY BANKS

Specialized institutions, such as industrial banks, have long been part of the fabric of the financial system. Industrial banks have existed for more than a century and operate under a number of titles: industrial banks, industrial loan banks, industrial loan corporations, thrift and loan companies, and more recently federal savings banks.

Industrial banks provide a broad array of products and services to customers nationwide, including some of the most under-served segments of the U.S. economy. Banks under this charter serve truckers, taxi drivers and postage buyers, while others use the charter to provide services for some of the largest credit card and commercial finance companies in the nation.

Specialty banks, which might also be called branchless banks, are leaders in the development of new technologies to deliver financial services. This is one of the strongest and clearest trends in banking and financial services today. Younger generations increasingly rely on banking services delivered through their mobile devices. Growing numbers of people no longer visit a bank branch. Instead they bank from home, using online systems that can be accessed from anywhere, which is easier than driving to a branch.

Although the existing specialty banks have been the strongest and safest banks in the nation for many years, the market's widely held perception is that the FDIC will not approve any new application for an industrial bank, or for any other kind of branchless bank that would offer specialized products and services nationwide. This is a dangerous policy, driving innovations crucial to the future of banking to less regulated and less stable providers.

Two states, Nevada and Utah, currently offer these charters. Despite state laws that enable new charters, the FDIC has refused to approve or consider new applications. In fact, the agency actively discourages these applications.

[9] United States. Federal Deposit Insurance Corporation. "Minority Depository Institutions: Structure, Performance, and Social Impact." FDIC Quarterly. 3rd ed. Vol. 8. N.p.: n.p., n.d. Print.

The Nevada and Utah legislatures chose to permit these longstanding charters, and Congress has reaffirmed their authority on three occasions: in 1987 (Competitive Equality Banking Act), 1999 (Graham-Leach-Bliley Act), and 2010 (Dodd-Frank Wall Street Reform and Consumer Protection Act). Now the states — and by extension, Congress — find their public policy preempted, without any legal process, by the unilateral actions of the FDIC.

A GLIMMER OF HOPE?

On April 6, 2016, Chairman Gruenberg announced that the FDIC was rescinding a policy that required heightened scrutiny of *de novo* banks during their first seven years of existence, and was returning to the prior policy, which subjected new banks to regulatory micromanagement for three years.[10] The announcement also stated that "the FDIC welcomes applications for deposit insurance, and we clearly have a role to play in facilitating the establishment of new institutions."

From an applicant perspective, the three-year or seven-year duration of the *de novo* scrutiny is not a determinant in whether to apply. In fact, the common perception among potential applicants is that the FDIC's claim to welcome new applications is mere public relations.

This perception exists because the FDIC's decade-long conduct contradicts this announcement. Potential applicants will not commit the substantial time and money needed to prepare an application until they see the FDIC changing its practices of enforcing a unilateral no-growth policy while avoiding accountability to Congress.

Is the FDIC serious about approving new charters? It seems unlikely. In recent remarks about the impact of post-financial crisis banking reforms on the financial system and the economy, Chairman Gruenberg did not seem aware of any problems. He told Washington, DC's Exchequer Club last month that he believes "the reforms put in place since the crisis have been largely consistent with, and supportive of, the ability of banks to serve the U.S. economy."[11]

He made no mention of new charters or underserved markets.

ONLY CONGRESS SHOULD DECIDE IF THERE ARE ENOUGH BANKS

While the FDIC should have broad discretion over approving new bank applications, it does not have the discretion to shut down the formation of new banks altogether, or to refuse to process applications for types of banks authorized by Congress to access deposit insurance. Congress, which enacted the Federal Deposit Insurance Act and numerous banking bills, did ask for this. The states, which have chartered banks since 1780, are finding their 236 years of prudential regulatory experience ignored. [12]

[10] Gruenberg, Martin. "Strategies for Long-Term Success." FDIC Community Banking Conference. Arlington, VA. 6 Apr. 2016. Speech.
[11] Gruenberg, Martin. "The Impact of Post-Crisis Reforms on the U.S. Financial System and Economy." Exchequer Club; Washington, D.C. 15 June 2016. Speech.
[12] States chartered banks from 1780 until 1933 without the aid of the FDIC.

In evaluating deposit insurance applications, the FDIC should gather and use information that identifies:

- the kinds and amounts of financial services needed to support a thriving and stable economy;
- the best ways to provide these services;
- the optimal numbers and types of banks to support the economy;
- the best regulatory policies to support the development of these banks and other financial services providers; and
- the best regulatory policies to control risks and address potential crises.

We found no studies conducted by the FDIC or any other entity addressing these questions. We found no announcement by the FDIC that it is adopting new standards that would reduce or block new bank applications, no description of studies or reasoning for changes to its long-articulated standards for applicants, and no requests for comment or input on these new policies.

We believe that policymaking must be transparent, and that regulators must not create policy without a clear understanding of its effect on the economy, a thorough assessment of the nation's best interests, and an open process seeking input from all interested parties.

Thank you for the opportunity to share our views.

Sincerely,

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