AUTHENTICATED
U.S. GOVERNMENT
INFORMATION
GPO

THE STATE OF BANK LENDING IN AMERICA

HEARING

BEFORE THE

SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT

OF THE

COMMITTEE ON FINANCIAL SERVICES

U.S. HOUSE OF REPRESENTATIVES

ONE HUNDRED FIFTEENTH CONGRESS

FIRST SESSION

MARCH 28, 2017

Printed for the use of the Committee on Financial Services

Serial No. 115–11

U.S. GOVERNMENT PUBLISHING OFFICE

27–368 PDF WASHINGTON : 2018

For sale by the Superintendent of Documents, U.S. Government Publishing Office
Internet: bookstore.gpo.gov Phone: toll free (866) 512–1800; DC area (202) 512–1800
Fax: (202) 512–2104 Mail: Stop IDCC, Washington, DC 20402–0001

HOUSE COMMITTEE ON FINANCIAL SERVICES

JEB HENSARLING, Texas, *Chairman*

PATRICK T. MCHENRY, North Carolina, *Vice Chairman*
PETER T. KING, New York
EDWARD R. ROYCE, California
FRANK D. LUCAS, Oklahoma
STEVAN PEARCE, New Mexico
BILL POSEY, Florida
BLAINE LUETKEMEYER, Missouri
BILL HUIZENGA, Michigan
SEAN P. DUFFY, Wisconsin
STEVE STIVERS, Ohio
RANDY HULTGREN, Illinois
DENNIS A. ROSS, Florida
ROBERT PITTENGER, North Carolina
ANN WAGNER, Missouri
ANDY BARR, Kentucky
KEITH J. ROTHFUS, Pennsylvania
LUKE MESSER, Indiana
SCOTT TIPTON, Colorado
ROGER WILLIAMS, Texas
BRUCE POLIQUIN, Maine
MIA LOVE, Utah
FRENCH HILL, Arkansas
TOM EMMER, Minnesota
LEE M. ZELDIN, New York
DAVID A. TROTT, Michigan
BARRY LOUDERMILK, Georgia
ALEXANDER X. MOONEY, West Virginia
THOMAS MacARTHUR, New Jersey
WARREN DAVIDSON, Ohio
TED BUDD, North Carolina
DAVID KUSTOFF, Tennessee
CLAUDIA TENNEY, New York
TREY HOLLINGSWORTH, Indiana

MAXINE WATERS, California, *Ranking Member*
CAROLYN B. MALONEY, New York
NYDIA M. VELÁZQUEZ, New York
BRAD SHERMAN, California
GREGORY W. MEEKS, New York
MICHAEL E. CAPUANO, Massachusetts
WM. LACY CLAY, Missouri
STEPHEN F. LYNCH, Massachusetts
DAVID SCOTT, Georgia
AL GREEN, Texas
EMANUEL CLEAVER, Missouri
GWEN MOORE, Wisconsin
KEITH ELLISON, Minnesota
ED PERLMUTTER, Colorado
JAMES A. HIMES, Connecticut
BILL FOSTER, Illinois
DANIEL T. KILDEE, Michigan
JOHN K. DELANEY, Maryland
KYRSTEN SINEMA, Arizona
JOYCE BEATTY, Ohio
DENNY HECK, Washington
JUAN VARGAS, California
JOSH GOTTHEIMER, New Jersey
VICENTE GONZALEZ, Texas
CHARLIE CRIST, Florida
RUBEN KIHUEN, Nevada

KIRSTEN SUTTON MORK, *Staff Director*

SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT

BLAINE LUETKEMEYER, Missouri, *Chairman*

KEITH J. ROTHFUS, Pennsylvania, *Vice Chairman*
EDWARD R. ROYCE, California
FRANK D. LUCAS, Oklahoma
BILL POSEY, Florida
DENNIS A. ROSS, Florida
ROBERT PITTENGER, North Carolina
ANDY BARR, Kentucky
SCOTT TIPTON, Colorado
ROGER WILLIAMS, Texas
MIA LOVE, Utah
DAVID A. TROTT, Michigan
BARRY LOUDERMILK, Georgia
DAVID KUSTOFF, Tennessee
CLAUDIA TENNEY, New York

WM. LACY CLAY, Missouri, *Ranking Member*
CAROLYN B. MALONEY, New York
GREGORY W. MEEKS, New York
DAVID SCOTT, Georgia
NYDIA M. VELÁZQUEZ, New York
AL GREEN, Texas
KEITH ELLISON, Minnesota
MICHAEL E. CAPUANO, Massachusetts
DENNY HECK, Washington
GWEN MOORE, Wisconsin
CHARLIE CRIST, Florida

CONTENTS

	Page
Hearing held on:	
March 28, 2017	1
Appendix:	
March 28, 2017	39

WITNESSES

TUESDAY, MARCH 28, 2017

Calhoun, Michael D., President, Center for Responsible Lending	9
Heitkamp, R. Scott , President and Chief Executive Officer, ValueBank Texas, on behalf of the Independent Community Bankers of America (ICBA)	4
Motley, J. David, President, Colonial Savings, F.A., on behalf of the Mortgage Bankers Association (MBA)	7
Wade, Holly, Director, Research and Policy Analysis, National Federation of Independent Business (NFIB)	5

APPENDIX

Prepared statements:	
Calhoun, Michael D.	40
Heitkamp, R. Scott	60
Motley, J. David	73
Wade, Holly	86

ADDITIONAL MATERIAL SUBMITTED FOR THE RECORD

Luetkemeyer, Hon. Blaine:	
Written statement of the Credit Union National Association	90
Barr, Hon. Andy:	
Chart entitled, "FACT: Business lending has increased 75% after Dodd-Frank"	92
Hill, Hon. French:	
Article from The Hill entitled, "Why we must base the banking regulation debate on real data," by Paul H. Kupiec of the American Enterprise Institute	93

THE STATE OF BANK LENDING IN AMERICA

Tuesday, March 28, 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 2:02 p.m., in room 2128, Rayburn House Office Building, Hon. Blaine Luetkemeyer [chairman of the subcommittee] presiding.

Members present: Representatives Luetkemeyer, Rothfus, Royce, Lucas, Posey, Ross, Barr, Tipton, Williams, Love, Trott, Loudermilk, Kustoff, Tenney; Clay, Meeks, Green, Heck, and Moore.

Ex officio present: Representative Hensarling,

Also present: Representative Hill.

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. And with regards to that, we are expecting votes around 3:00. I am not sure how long they will be, but it shouldn't probably take much more than an hour, but we will see, give or take some time. But we do anticipate that happening, so we hope everybody will be able to bear with us.

Today's hearing is entitled, "The State of Bank Lending in America."

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 now recognize myself for 5 minutes for an opening statement.

In her testimony before the Senate Banking Committee last month, Chair Yellen painted a rosy picture of economic recovery and widespread credit availability. Chair Yellen supported her assertion by referring to the study conducted by one of our witnesses today, Holly Wade of the National Federation of Independent Businesses (NFIB).

What Chair Yellen neglected to mention was that half of the small businesses surveyed by NFIB said that while they were optimistic about the future, they were still sitting on the credit sidelines. She also failed to highlight the fact that 37 percent of small-business respondents said that taxes, regulations, and red tape were their top business problems. Simply put, the picture she

painted last month doesn't match the reality that small businesses and their employees live every day.

Like so many others in Washington, I don't think she quite gets it. The truth of the matter is that we have what some have referred to as a two-speed economy. Since the 2016 elections, consumer confidence is high, unemployment rates are trending down, and the economy is starting to show signs of life. While the Nation's economic health may be improving, many of her citizens continue to face significant headwinds as they seek to grow their businesses or build a better life for their family.

So today we will scratch beneath the surface to examine what is happening in our economy and how it is impacting American consumers and small businesses. The unfortunate reality is that a significant number of borrowers are, and Ms. Wade's work demonstrates, sitting on the sidelines. And small banks, consumers, and small businesses continue to operate in a stalled economy with limited access to credit.

Data from the Federal Reserve Bank of St. Louis indicates that in the years before passage of the Dodd-Frank Act, small-bank lending was more than 150 percent above large-bank lending. In the 6 years after Dodd-Frank, small-bank lending was almost 80 per cent below large-bank lending. And the reality is that community financial institutions are the primary small-business lenders. Today, nearly half of small businesses and startups don't get the financing they seek. And the situation for consumers who have a less-than-pristine credit history or collateral isn't as bright as it should be.

This week, the New York Fed released a study indicating that one in three Americans couldn't come up with $2,000 if faced with an emergency. So despite seemingly low unemployment rates, people are still living paycheck to paycheck, preventing them from achieving the economic stability all Americans deserve.

Despite the rhetoric fed to us since its passage, consumers and small businesses haven't been protected by Dodd-Frank. Rather, the rules and regulations billed as a pathway to a stable economy have stifled small-business institutions and led to more restricted access and much more expensive credit.

Even the Consumer Financial Protection Bureau (CFPB), which purports to protect consumers, has smothered innovation and financial products that Americans want and need. The result is that consumers and small businesses, the drivers of our economy, are left sitting on the sidelines and struggling to survive.

Today's conversation may be one of the more important ones that we have. It will serve to examine an alarming trend that should be on the front page of every newspaper in America, and to better understand the actual impact the regulatory climate has on banks and their customers.

I thank our witnesses for their time today and look forward to your testimony.

The Chair now recognizes the ranking member of the subcommittee, the gentleman from Missouri, Mr. Clay, for 5 minutes for an opening statement.

Mr. CLAY. Thank you, Mr. Chairman, for calling today's hearing to examine the state of bank lending.

And I thank the witnesses for participating in today's hearing.

Prudent bank lending is key to a sound banking system and a strong economy. Excessive bank lending without appropriate safeguards has proven to lead to a devastating financial crisis. This is why Dodd-Frank focused on restoring reasonable safeguards to better protect consumers from the kind of predatory lending that hurt so many people just a few years ago.

Despite assertions by President Trump and our friends on the other side of the aisle that community banks and lending was crushed because of Dodd-Frank, the data tells a different story. As Joe Friday used to say, "Just the facts, ma'am." And here they are.

Banks have done quite well in the past few years and posted an all-time record in profits in 2016, making more than $171 billion. The number of unprofitable banks has not been this low since 1995, more than 2 decades ago. Very few small-business owners report problems getting access to credit when they want it. And in fact, bank loans to businesses also hit an all-time high after increasing by 75 percent since Dodd-Frank became law.

And how are community banks doing? According to recent FDIC data, community banks are outpacing their larger competitors. Community bank lending increased by more than 8 percent last year and they increased small loans to businesses at more than twice the rate of their peers. Community bank annual profits rose by more than 10 percent over the prior year.

In the words of a Houston Chronicle article for my friend from Texas, "Alternative facts underlie Trump's push to ditch Wall Street regulations." Dodd-Frank isn't making it harder for businesses to get loans.

And I hope with today's hearing we examine the real facts and have a good discussion on sensible, targeted steps, not ideological rollbacks of Dodd-Frank, that we should consider to help small banks continue to lend responsibly to our community.

And, Mr. Chairman, with that, I yield back.

Chairman LUETKEMEYER. The gentleman yields back. And I thank him for his statement.

We will now turn to our witnesses.

First, we welcome the testimony of Mr. Scott Heitkamp, president and chief executive officer of ValueBank Texas, who is testifying on behalf of the Independent Community Bankers of America.

And I understand he needs to leave at about 4:30 to catch a plane, otherwise he is going to be stuck in our beautiful city here for a while, and I don't wish that on anybody, especially if you are not a tourist, and so we will excuse him. So heads up to all the Members, if you do have some questions of Mr. Heitkamp, please make sure you get those out first.

Second, Ms. Holly Wade, who is the director of research and policy analysis at the National Federation of Independent Business. We welcome you.

Third, Mr. David Motley, the president of Colonial Savings, who is testifying on behalf of the Mortgage Bankers Association. Welcome.

And Mr. Michael Calhoun, who is the president of the Center for Responsible Lending. Welcome.

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.

So with that, I recognize Mr. Heitkamp. You are recognized for 5 minutes.

STATEMENT OF R. SCOTT HEITKAMP, PRESIDENT AND CHIEF EXECUTIVE OFFICER, VALUEBANK TEXAS, ON BEHALF OF THE INDEPENDENT COMMUNITY BANKERS OF AMERICA (ICBA)

Mr. HEITKAMP. Thank you, Chairman Luetkemeyer, Ranking Member Clay, and members of the subcommittee. My name is Scott Heitkamp and I am president and CEO of ValueBank Texas in Corpus Christi Texas. I am also chairman of the Independent Community Bankers of America and I am testifying today on behalf of the more than 5,800 community banks we represent.

Thank you for convening today's hearing on the state of bank lending in America. Despite some recent, positive news on the state of bank lending, now is not the time to be complacent. From my viewpoint as a community banker in south Texas, and from my conversations with hundreds of community bankers from around the country, I promise you that the economic recovery is lukewarm, uneven, and fragile. This view is supported by data that when broken down, shows a recovery that is mixed at best with notable regional differences in need of strong solutions.

Today, a customer with a pristine credit score or a large, established business can get a loan. But this isn't the measure of a strong economy. When the credit box is tight, we have subpar economic growth. To break out of this rut and strengthen economic growth, we must expand credit availability to millions of hard-working households and would-be borrowers with less-than-perfect credit scores. Many of these borrowers are in the middle to lower end of the income scale.

Today's regulatory environment has choked off community banks' ability to take on and manage reasonable credit risk. Before I discuss ICBA's recommendations, I would like to give you some background on my bank.

ValueBank Texas was chartered in 1967 and later acquired by my father. I am proud to carry on that legacy. Today, ValueBank Texas is a $213 million bank with 10 offices in Corpus Christi and Houston and 114 employees. We specialize in small-business and residential mortgage lending.

As our name suggests, we are dedicated to creating value for our customers and our community. We are like thousands of community banks across the country with a vested interest in the success of our communities we serve today and for generations to come.

Unfortunately, the number of community banks is rapidly declining. Today, there are some 1,700 fewer community banks than there were in 2010. This historic consolidation will harm competition and leave many small communities stranded without a local community bank. Any review of the health of today's community banking industry must take into account consolidation and a lack of de novo charters.

I believe this consolidation and the lack of charter formation is due to the rise in regulatory burden. Today's banks need a larger scale to amortize the sharply increased costs of compliance. These same costs have a chilling effect on new charters. We need regulatory relief that will slow the consolidation trend, and encourage new charters, creating a more vibrant financial system for the benefit of our customers and small-business owners.

According to a recent Urban Institute study, tight credit killed 1.1 million mortgages in 2015 alone. These would-be borrowers are people with lower credit scores and lower incomes. The study found that tight credit was directly related to regulatory restrictions.

One of the bright spots in today's economy is a surge in optimism among small-business owners as shown in the NFIB survey. This optimism will lead to a growing demand for credit and we must ensure the regulatory environment allows community banks to meet that demand.

The good news is that we have solutions. ICBA's plan for prosperity is a robust regulatory relief agenda with nearly 40 recommendations that will allow Main Street and rural America to prosper. A copy of that plan is attached to my written statement.

This committee's work in the last Congress set the stage for enacting meaningful regulatory relief. I want to highlight the CLEAR Act, soon to be reintroduced by Chairman Luetkemeyer. I also look forward to the reintroduction of Chairman Hensarling's Financial CHOICE Act. These bills, among others before the committee, are all part of the solutions to regulatory burden.

We strongly encourage this committee to complete the work that was started in the last Congress and enact meaningful regulatory relief for community banks.

Thank you again for this opportunity to testify, and I look forward to your questions.

[The prepared statement of Mr. Heitkamp can be found on page 60 of the appendix.]

Chairman LUETKEMEYER. Ms. Wade, you are now recognized for 5 minutes.

STATEMENT OF HOLLY WADE, DIRECTOR, RESEARCH AND POLICY ANALYSIS, NATIONAL FEDERATION OF INDEPENDENT BUSINESS (NFIB)

Ms. WADE. Good afternoon, Chairman Luetkemeyer, Ranking Member Clay, and members of the Subcommittee on Financial Institutions and Consumer Credit. Thank you for the opportunity to testify today on the state of bank lending in America.

Small businesses' ability to access financing is a vital component of a healthy small-business sector. Small businesses rely on financing for general business operations, but also expansion activities and reinvestment.

NFIB regularly studies banking activities and borrowing trends among small-business owners. NFIB's small-business economic trends survey offers a monthly update on borrowing and lending trends among a random sample of NFIB's 325,000 small-business members, a survey NFIB has conducted since 1973.

Since the recession, loan demand has remained historically weak, even with record-low interest rates still available. The percent of

regular borrowers has remained in the low 30s with little pick-up throughout the recovery, whereas previous expansions experienced a level of regular borrowing closer to 40 percent. High numbers of firms remain on the credit sidelines seeing no good reason to borrow.

The survey also asks owners if they were able to satisfy their borrowing needs over the last 3 months. In recent years, about 4 percent report that they were not able to satisfy their borrowing needs, significantly lower than the record high of 11 percent reached in 2010.

These trends are further reflected in NFIB's small-business problems and priorities survey that asks small-business owners to evaluate 75 business-related problems. From 2012 to the current 2016 report, financing has become less of an issue for many owners with fewer interested in borrowing due to slow economic growth, but also due to better balance sheets for those seeking credit.

The ranking for obtaining long-term and short-term business loans both fell precipitously from 2012 to 2016. The former fell 13 positions to its current ranking of 69 out of 75 issues, and the latter 12 positions to the ranking of 70th. The percent of owners finding each a critical issue also fell from about 11 percent to 6 percent in the current report.

But there are a few pockets of small businesses that do have more difficulty accessing credit than the general population: businesses experiencing declining sales of more than 10 percent; and those experiencing rapid growth of 50 percent or more over the last 3 years. The difficulties of the former are generally self-explanatory, but the latter is of significant concern, as those businesses generate jobs and economic growth.

For example, obtaining short-term and long-term loans currently ranks 39th and 42nd, respectively for high-growth firms, roughly 30 positions higher than the ranking for the overall population. And more than twice as many owners find each a critical issue.

The reasons why high-growth small businesses have a more difficult time obtaining credit compared to years past are less obvious. But the decline in the number of small community banks is of particular concern. Small-business owners are far more successful accessing credit through smaller regional banks than larger ones.

A recent Federal Reserve survey found that while 76 percent of small-business applicants were approved for some credit at small banks, only 58 percent were approved at larger banks. The downward trend of commercial banks is not new. But over the last 8 years, the number of commercial banks has dropped from about 7,000 in 2009 to its current level of about 5,000.

The importance of these banks cannot be overstated for small businesses, but also for the banking system itself. NFIB worries that overregulating these smaller community banks will create more bank consolidation and deter new bank formations. Loans to these small businesses are critical to the health of local communities and, collectively, to the health of the small-business sector.

With recent improvements in small-business optimism, owners are in a good position to grow and reinvest in their business. If this occurs, borrowing activities should pick up. Market forces, not regulators in Washington, should manage the supply and price of

banking services and loans so that small-business financing remains available for a potential increase in small-business borrowing.

I appreciate the opportunity to discuss the current state of small-business financing and the challenges that face us going forward, and I look forward to working with the committee to support small businesses and strengthen the U.S. economy.

Thank you.

[The prepared statement of Ms. Wade can be found on page 86 of the appendix.]

Chairman LUETKEMEYER. Thank you, Ms. Wade.

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

STATEMENT OF J. DAVID MOTLEY, PRESIDENT, COLONIAL SAVINGS, F.A., ON BEHALF OF THE MORTGAGE BANKERS ASSOCIATION (MBA)

Mr. MOTLEY. Chairman Luetkemeyer, Ranking Member Clay, and members of the subcommittee, I appreciate the opportunity to testify this afternoon on behalf of the Mortgage Bankers Association.

MBA represents mortgage lenders of all sizes and business models, from small, independent mortgage bankers to community banks like mine, to the Nation's largest financial institutions. Each segment of our industry plays a unique and vital role in the market.

As a 4-decade veteran of the mortgage industry, I can tell you from experience that recently enacted laws have created commendable consumer protections and have made the mortgage market a safer place to do business.

MBA has consistently supported reasonable requirements that will prevent a reemergence of housing and market disruptions. However, we must be mindful that new regulatory demands imposed under Dodd-Frank have also negatively impacted the availability and affordable and sustainable mortgage credit.

MBA's data show that mortgage credit availability remains far below history norms. As a result, many borrowers, too often already underserved populations, have been left on the sidelines. Now that most of Dodd-Frank's mortgage rules have been implemented, it is time to review these regulations and make the necessary adjustments.

Let me highlight some of the key issues we feel would allow lenders to reach more credit-worthy borrowers. There is no better place to start than with the CFPB's ability-to-repay rule. MBA appreciates the work of this committee and that of the CFPB to address some of the flaws in the qualified mortgage definition. We believe that rather than continue to address the rule in a piecemeal fashion, now is the time to examine it holistically, so that all lenders can deliver QM loans to consumers, regardless of size of business model.

To achieve this, we urge Congress and the Bureau to: expand the legal safe harbor to all QM loans; increase the small-loan threshold to fit more smaller-balance loans under the QM umbrella; establish alternatives to the QM underwriting criteria to allow lenders to use other commonly accepted underwriting standards; broaden the abil-

ity for lender-secured defects and technical errors in those loans; pass the Mortgage Choice Act, which would exclude title insurance fees paid to lender-affiliated companies from the calculation of points and fees; and finally, start the process of replacing the so-called QM patch by developing a transparent set of criteria to define QM.

Beyond these QM changes, there are several other areas that should be addressed. First, as a mortgage servicer, I know the cost to service loans has increased dramatically. This is due to new CFPB rules as well as the punishing treatment of mortgage servicing rights under the Basel III framework. Under that rule, banks are required to hold extraordinary amounts of capital to support the MSA asset, making it less likely that banks like mine will retain mortgage servicing.

Amid the backdrop of complicated and conflicting servicing rules, these increased costs directly impact consumer access to credit and make new-loan production less attractive to lenders.

Second, the CFPB should be required to provide authoritative written guidance to accompany its rules. The CFPB's resistance to providing timely written guidance has resulted in confusion, increased costs, and credit overlays by uncertain investors. This is particularly notable in the implementation of the know before-you-owe rule.

Third, regulatory burdens on independent mortgage bankers need to be addressed. For example, State-licensed lenders face frequent and duplicative examinations from the CFPB in each State in which they operate. MBA urges rationalizing this process by requiring the CFPB to adopt formal, risk-based standards for examinations and to better coordinate with the States.

MBA also supports establishing an appeals process for CFPB exams that applies to both banks and nonbanks and adoption of transitional licensing under the SAFE Act.

Fourth, the Justice Department's enforcement action under the False Claims Act continues to have a chilling effect on lender participation in the FHA program. The resulting legal liability for what are oftentimes immaterial defects has forced lenders to impose new credit overlays or limit their involvement in FHA altogether.

So long as the Justice Department continues to impose these draconian penalties on lenders for foot faults, the remaining FHA lenders will continue using overly cautious, defensive underwriting that limits options for borrowers.

In conclusion, the current regulatory environment has increased costs and forced many responsible lenders to limit their lending. This harms consumers, most often low- to moderate-income borrowers, minorities, and first-time home buyers. We urge this subcommittee to do a thorough review of these rules and regulations and make adjustments where necessary. Done properly, we can balance the need for appropriate consumer protections while ensuring access to safe, sustainable mortgage credit.

Thank you.

[The prepared statement of Mr. Motley can be found on page 73 of the appendix.]

Chairman LUETKEMEYER. Mr. Calhoun, we now recognize you for 5 minutes.

STATEMENT OF MICHAEL D. CALHOUN, PRESIDENT, CENTER FOR RESPONSIBLE LENDING

Mr. CALHOUN. Thank you, Mr. Chairman, Ranking Member Clay, and members of the subcommittee for the opportunity to testify today on this important topic.

The state of our banks is critical to our country's economic well-being. In my testimony today, I want to underscore three points, but focusing most on how best we can move our economy forward.

First, as noted, data show that banks and especially our community banks are helping to spearhead our Nation's economic recovery.

My second point is that there are broadly supported steps that can be taken immediately to improve bank regulation and lending. And these should be implemented.

And finally, we must reject those proposals that would thwart the advancement of our economy.

My testimony reflects my experience as president of the Center for Responsible Lending, but also as former general counsel of our lending affiliate, the Self-Help Credit Union. It was established in 1982 to expand access to credit, and in subsequent years has provided over $7 billion of financing for first-time home buyers, small-business loans, and other consumer loans. Today, we serve more than 100,000 account holders with a full range of financial services.

In the early 2000s, the Center for Responsible Lending was established in response to the growing predatory subprime home loans and it works to promote sustainable lending.

On the first point, as noted, after a long and painful recession, our financial institutions and the economy are recovering. And bank and credit union profitability is at near-record level and lending volumes, including commercial and industrial lending, are increasing. Community banks are doing particularly well, as are smaller lenders in general.

This is a healthy sign. And as anyone in the banking industry knows, bank profits are still a very small part of the costs of financial services, usually 2 percent or less. Today's market is a welcome relief from the Great Recession when banks, especially community banks, were hit so hard.

The climb back has been hard. And while some contend that new regulations have depressed that return, numerous studies and data from government and private researchers show otherwise. And those are set out and discussed in my testimony.

I would note, for example, the Urban Institute, cited often, found that the QM rule was not restricting credit access.

Looking first at the areas where we can move forward with the ability-to-repay mortgage rule, that has been a common-sense requirement that has produced a better market, but there are ways that it can be improved. It includes importantly a two-tier approach. There are a number of important provisions where there is additional flexibility for smaller lenders. And in fact, the data as set out in our testimony show that mortgage growth since Dodd-

Frank, mortgage originations, have grown the fastest for smaller lenders as opposed to largest lenders.

As noted by my friend here, the housing area that maybe can be improved most quickly is FHA. The continuing uncertainty of the False Claims Act, as mentioned, is discouraging lending to first-time home buyers, which are a key lagging part of the overall housing market.

In addition, FHA servicing requirements are poorly structured, harming lenders, consumers, and taxpayers alike. They should be reconciled and reformed to match up with other industry standards.

A broader area for reform and one that is often overlooked is the Bank Secrecy Act, and the Anti-Money-Laundering Act. It is essential to prevent terrorists and other criminals from using our financial services system as a vehicle to cause harm. But these Acts place a very heavy regulatory burden on banks and, most particularly, on small banks.

I can tell you, the experience I had at lending programs in our bank, it was one of the toughest regulatory burdens. And the ABA, in fact, in a survey of compliance officers, found it was the costliest regulatory burden.

There is a pretty easy way, though, to substantially improve that, and that is simply to have ownership data collected when businesses are formed rather than placing that burden on the banks. Many groups, including ICBA, The Clearing House, and others have endorsed this, and bipartisan bills have been introduced to implement it. It would be a major advance.

The one thing we need to do is not step backwards, such as by thwarting the work of the CFPB or by creating huge, gaping loopholes in the QM rules, such as having portfolio loans being swept in for all lenders. I look forward to discussing that further with you during our questions.

Thank you again.

[The prepared statement of Mr. Calhoun can be found on page 40 of the appendix.]

Chairman LUETKEMEYER. Thank you, Mr. Calhoun.

And I thank all of our witnesses for their testimony. Good job.

I will recognize himself now for 5 minutes for questions.

The name of our hearing today is, "The State of Bank Lending in America." And I guess the first thing we need to establish is, is there plenty of money to lend?

Mr. Heitkamp, you represent the independent community banks. Is there plenty of money in the community banks to be able to address the needs of the citizens and the businesses of the communities?

Mr. HEITKAMP. Our liquidity is strong. We have plenty of liquidity to lend. We are just looking for a place for it.

Chairman LUETKEMEYER. Mr. Motley, what about you? You are mortgage bankers, are you guys all ready to go, to jump into the market here, with plenty of money to hand out to folks?

Mr. MOTLEY. We have plenty of money to lend. The issue that we have is making sure that we are threading the needle to comply with the regulatory framework that we live with today.

Chairman LUETKEMEYER. That was my next follow-up; it's a nice segue for me here. Once we have established the fact that we have the money, now we have to figure out why it is not getting to the people, or is it getting to the people? And if so, how are we helping people? Or are we not helping people? That is the reason for the hearing today, to find out what kind of lending is going on and what kind of lending is not going on.

So to follow up with you, Mr. Motley, you made a comment that Dodd-Frank regulations are hurting lending, and you advocated a whole lot of different rules and regulation changes that would help implement a lot more lending to continue to allow people to be able to participate in the economy, and I guess do it in a safe way. So would you like to elaborate on just a little bit of that?

Mr. MOTLEY. Sure. The QM rule did establish some basic, prudent underwriting criteria, but it is very, very specific and it relates to the Appendix Q underwriting guidelines that are referenced in the Act.

Appendix Q was lifted from the FHA 4155 handbook, and that 4155 handbook is not particularly applicable to new types of households, to underserved markets, underserved people who are trying to enter the market, who might be trying to use multiple sources of income, there could be multiple households or generational households put into one household, and trying to fit that type of income documentation into the Appendix Q protocol is very difficult to do.

So we believe that Appendix Q needs to be modified, that there needs to be an alternative or an expansion to Appendix Q to allow lenders to react to today's marketplace.

Chairman LUETKEMEYER. Okay, thank you.

Mr. Heitkamp, I had a banker come to me the other day and he told me this story. He said, "I had a customer of mine who came into the bank. He has a half-a-million-dollar home, and he wants to sell it and buy another home, but he needs $250,000 to buy this other home and didn't have that extra amount of cash, but he had less than 30 days to do the deal.

"So he had a half-a-million-dollar asset that he really couldn't take advantage of because of the timing of all of the rules and regulations here. And so, he had to cobble together a bunch of other assets to get to about $200,000, and the bank then made him a loan, but they said they were exposed for the other $50,000 of the $250,000 loan to him.

And so, if regulators would have come walking in that particular day and seen a loan like this that was secured by $200,000 basically with the cash and a $50,000 exposure, what would have happened? And is this a common occurrence in your bank, the situation that the rules and regulators are putting you in?

Mr. HEITKAMP. Yes, sir. I think we find that all the time. I think we have rules that are supposed to help us, but they hurt us from taking care of our borrowers. We have instances all the time where we have borrowers come into the bank asking for us to make them a loan. We want to make the loan, they have plenty of assets, they have plenty of—

Chairman LUETKEMEYER. And these are customers that you are—

Mr. HEITKAMP. These are our customers. I will give you an instance. Last week, we had a lady—we are in a retirement community. Corpus Christi is down in the south of Texas, in the Gulf Coast, and people want to retire down in Corpus, are coming from the Dallas area or the Houston area and want to retire. They have a home still left where they lived. They are moving down, they are deciding either they want to rent that home or they want to sell it.

But they want to come down to Corpus. They have found a home they wanted to buy, they fell in love with the home. They came to the bank and said they would like to buy this home. And through the QM qualifications, the debt-to-income level is 43 percent, so they couldn't qualify.

And our bank made the decision that we are not going to have non-QM loans so we weren't going to take the risk of being sued and figuring out how that is going to work out later on. So a good borrower, with a good capacity, we felt for them, but we just couldn't take that risk.

Chairman LUETKEMEYER. Ms. Wade, very quickly, I am about out of time here, but you made the comment in your testimony that the difference between small banks giving approvals to small businesses and large banks is about a 20, 25 percent difference. Can you explain that difference, why the difference is there? If you had the identical customers, why are small banks doing a better job or being more liberal or more accommodating to small businesses versus large banks?

Ms. WADE. Sure, thank you. From what we have heard from our members, small-business owners, generally the local community banks have a small-business staff, a person in the bank who knows the community, knows the area, and is better able to help them finance their business through lines of credit or traditional bank loans compared to larger banks that might not have the local expertise that is needed.

Chairman LUETKEMEYER. Thank you.

My time has expired. With that, we will recognize Mr. Meeks from New York for 5 minutes.

Mr. MEEKS. Thank you. Thank you, Mr. Chairman.

And I want to thank the witnesses. I think all of you made excellent presentations. And I think that I agree with you in that we have to make sure that the pendulum didn't swing all the way the other way. At one time we had no-doc loans, et cetera, and anybody could get a loan. And now in an effort we have to make sure that pendulum did not swing all the way the other way so that folks don't have access to loans and make sure that they have more available.

And I know and I compliment the smaller community banks and what you have done. I have said often, my parents probably would have never owned a home if it wasn't for a small bank that took a risk on them, that they would be able to buy the home that they purchased.

I know that Mr. Barr has a bill that he is working on. I am not on that bill yet, but I am looking forward to continuing to talk to him, because with his Portfolio Loan and Mortgage Access Act, I think it may be heading in a direction that maybe we can do some-

thing in a bipartisan way. And so, I look forward to continuing to work with him in that vein because I think this is tremendously important that we make sure there is access.

Let me ask, yesterday I was reading in the American Banker an article that touched on how banks of all sizes—actually, I am really focused on the community bankers—are investing in small-business loan funds to meet their CRA economic development goals. And while the funds allow the participating banks to mitigate risk and diversify their small-business lending, the lending seems to be increasing access. And as a result, these funds allow small entrepreneurs to obtain the capital to finance their business ideas.

So, Ms. Wade, would you talk about the impact, if you will, the Community Reinvestment Act has had on increasing small businesses' access to capital? And are there things Congress can do or should do to increase CRA business loaning?

Ms. WADE. Thank you for the question. The members that we survey, I don't know how they are affected by that. But for the most part, they aren't seeing a whole lot of obstacles in gaining access. The problem that we see is that there isn't a lot of optimism or expansion opportunities for them to borrow.

And so the lack of confidence in the economy growing, even if sales are increasing a bit, they aren't confident about expanding their business, reinvesting in their business, given the current state of the economy. And that has been one of their main problems in growing. And that is where we see the low borrowing rates from our members.

Mr. MEEKS. And let me ask Mr. Motley, because here is another reason. Oftentimes, when people say CRA, they may think just urban America. But I think urban America and rural America, in certain areas they have the same problems as far as access and finding and getting loans.

So I would ask Mr. Motley, do you think there is a way to strengthen CRA to incentivize banks to serve small, rural as well as urban areas in these underserved communities? In other words, are there incentives that we can provide through CRA to encourage more reasonable risk-taking by some banks so that the smaller entrepreneurs can get access to capital?

Mr. MOTLEY. Are you referring primarily to rural lending?

Mr. MEEKS. Rural or I think they are similar. CRA reinvests in communities that are underserved. So they help rural areas that are underserved, but also help urban areas that are underserved, so that both have more access to capital.

Mr. MOTLEY. We satisfy our CRA opportunity primarily through low- to moderate-income lending with the FHA program. We do a little bit of lending on a commercial basis throughout our marketplace. And those are underwritten to our personal standards there in town.

But one of the things that we have a tremendous challenge with in the rural areas and outlying areas is the appraisal process. There are very few appraisers available. It is difficult for us to get timely appraisals. And so that is a challenge to us being able to serve that rural neighborhood, both from a residential standpoint and from a commercial standpoint.

Mr. MEEKS. Let me ask you. I have 29 seconds left, and I just wanted to find out, maybe I will ask Mr. Calhoun, CDFIs, I saw that they were being zeroed out under the current budget. Could you tell me the significance of CDFI funding to small-business communities? And are you alarmed at all by zeroing out CDFIs?

Mr. CALHOUN. Very quickly, CDFIs have played a leading role in providing that small-business lending to particularly underserved parts of the market. And historically, the CDFI program has enjoyed strong bipartisan support for that reason.

Mr. MEEKS. Thank you.

I am out of time. I yield back.

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

Mr. ROTHFUS. Thank you, Mr. Chairman.

Mr. Heitkamp, I wanted to ask you a couple of questions. Last week we had a hearing about the lack of de novo activity that we have been seeing, also a striking consolidation that has been going on in the community bank sector.

Now, I am hearing from community banks on a regular basis and their customers about the post-crisis lending environment and the challenges they face in complying with all of the new regulations. Unfortunately, some on the other side of the aisle dismiss these complaints, telling us that bank lending is strong and that profits are high so there cannot be any real problems.

But I think that is a superficial view of the state of bank lending in our economy today. And what we have is a two-speed economy. There is one speed for the largest firms, individuals with the best credit and the biggest banks and there is another speed for everybody else.

As you noted in your testimony, "A customer with a pristine credit score, or a larger, established business can secure a loan. But those with less-than-perfect credit, middle- and lower-income Americans, and those trying to start small businesses are not finding it so easy to access capital.

Community bank consolidation and the de novo drought have surely contributed to this bifurcation since many of these groups would normally turn to community banks for capital. In fact, lending by smaller banks was more than 150 percent higher than large-bank lending before Dodd-Frank, but today it is 80 percent below large-bank lending."

Can you describe how regulatory burdens play a role in creating this two-speed economy?

Mr. HEITKAMP. Yes, sir. I think when you look at it and you see the difference with the regulatory burden and talking about de novo charters, I think that is the reason why we have a lack of de novo charters is the regulatory burden. You are looking at why you would take that risk and getting involved with the regulatory environment today is you are seeing a lot of people saying there are too many regulations and risks to put my money at work to take that risk.

Mr. ROTHFUS. Can you identify or tell us why certain regulations disproportionately disadvantage smaller banks?

Mr. HEITKAMP. Our compliance costs are through the roof. I can give you—in my bank, for instance, in the last 5 to 7 years, I have a compliance person, I have a checker of the compliance person, I have people doing the job day to day. And we are looking at that burden every day to make sure that we don't make a mistake because that mistake will cost us a lot. So the compliance cost is a lot of the burden that we have to deal with.

Mr. ROTHFUS. Now, how has your bank's lending activity changed as a result of Dodd-Frank?

Mr. HEITKAMP. Our loan-to-deposit ratio is about 70 percent. We keep it about 80 percent. It is down about $10 million in the last 5 years. We have been struggling to keep it there. We are trying to hire new people to get it involved, but overall compliance and just the lack of the small- to mid-sized customer not having that flexibility where they can come in, sit across the desk, and say I can take that risk with you, with that regulatory risk that we need to take, we are not willing to do that. So it is forcing some of those customers not to have that credit.

Mr. ROTHFUS. Mr. Motley, if I could ask you a couple of questions. In your testimony, you discussed the tremendous uncertainty about how the CFPB will approach various compliance issues. You wrote, "Despite the extensive liability that can arise from the Truth in Lending Act (TILA) violations, the CFPB has largely forgone providing guidance on TRID, taking the position that such questions will be settled by the courts."

Can you describe how the CFPB's regulation by enforcement impacts consumers?

Mr. MOTLEY. Sure. We can mitigate credit risk, we can mitigate rate risk. We have a very difficult time mitigating regulatory risk because the rules have not been clearly defined in every case. And when we ask for rule clarifications, we get webinars, we get presentations, but at the bottom of every one of those presentations it says you cannot rely on this as being authoritative, you must rely on written guidance, and yet we don't get that written guidance from the CFPB. So it makes it more difficult for us to lend.

And when we are faced with the possibility of a loan being kicked out of a pool or a challenge in court at foreclosure time, if there is a problem with the regulatory issues, with the disclosures, we are going to run into a problem with that. So we are more likely to take a more conservative approach and lend very much within the credit box rather than out to the edge of the credit box. And if we had more regulatory clarity from the CFPB in terms of written guidance, I think that all lenders would be more likely to lend to the edges of that credit box and live within the rules.

Mr. ROTHFUS. Thanks, Mr. Chairman. I yield back.

Chairman LUETKEMEYER. The gentleman's time has expired.

I recognize the gentleman from Texas, Mr. Green, for 5 minutes.

Mr. GREEN. Thank you, Mr. Chairman.

And I thank the witnesses for appearing as well.

And, Mr. Chairman, I want to especially thank you for styling the hearing today. You styled it, "The State of Bank Lending in America." You didn't say, "horrible bank lending." There are so many adjectives that you could have used, and you did not. And I must tell you, I appreciate it. It gives each side an opportunity

to make the case and to hear evidence, if you will, hearkening back to a prior life. So thank you for your balanced approach to styling this hearing.

I am one who believes that community banks, by a given definition, should be aided in every possible way. We do from time to time have difficulty defining community banking. Eighty-nine to 90 percent of all banks are a billion and under, $1 billion and under. We have tried to fashion rules to cover 90 percent of all banks, rounding up, but the problem that we have run into is that when we try to do this, there is a desire to go through the entire additional 10 percent or to some additional portion of the 10 percent that wouldn't be covered.

We tried to do this with H.R. 2642, the Community Lender Regulatory Relief and Consumer Protection Act of 2015, lots of relief for what I call community banks.

My friend from Texas, your bank started in 1967, with $213 million and 114 employees, am I correct?

Mr. HEITKAMP. Yes, sir.

Mr. GREEN. A good bank, by the way. I compliment you. That was not a commercial, but I compliment you. If we could fashion a bill to cover all banks at a billion and under, will your association in Texas support that bill to cover banks at a billion and under as opposed to up to the $50 billion level?

Mr. HEITKAMP. I think you have to look at it in a way of what a community bank is. A billion and under—

Mr. GREEN. Yes, this is where we run into the problem. Go right ahead.

Mr. HEITKAMP. Yes.

Mr. GREEN. This is where we run into the problem.

Mr. HEITKAMP. You can put a threshold out to the billion and under, there are community banks that really serve their community that are—

Mr. GREEN. If I may reclaim my time, we are talking about a bill that would cover 90 percent of all of the banks in the country, most of them are a billion and under, but this is exactly where we go when we try to fashion the bill for the 90 percent. It becomes a question of, how do we get to the $50 billion banks?

I want to help and I believe that we could do something now as opposed to continuing to put it off until we can get the $50 billion banks in. And $50 billion is a number that I am throwing out and most of you know why. That is where the trigger is. What trigger, you ask? The trigger for living wills. The trigger for a SIFI designation.

Those are things that we could debate at a later time. If we could help the 90 percent of all banks that are under a billion dollars, these are the community banks, these are the small banks that you talk about. But when we get ready to legislate, we have to go to $50 billion.

So I am with you on the small-bank issue that you raise. But it is just that when we try to do something for you, it goes to $50 billion. At some point, you are going to have to let them go. You will have to let them go. We will deal with them. You don't have to carry their water. It is good water. Let them carry it.

I yield back.

Chairman LUETKEMEYER. The gentleman yields back.

The gentleman from Kentucky, Mr. Barr, is recognized for 5 minutes.

Mr. BARR. Thank you, Mr. Chairman. Thanks for the great hearing.

And I appreciate the testimony from our witnesses. I am actually asking you all to take a look at a slide that my friends on the other side of the aisle have been displaying during their questioning. And they are citing Federal Reserve statistics and saying that business lending has actually increased after Dodd-Frank, citing commercial industrial bank loans at a record high.

I want to kind of dig deep at this, because as the ranking member of the subcommittee pointed out, just the facts.

This, in my judgment, reading about trends since Dodd-Frank is not just the facts. There are other facts, there is context that I think we have to put into this.

About 25 years ago, small banks under a billion dollars in assets, total industry assets were around 30 percent, $1 billion to $10 billion about 35 percent, and those bigger banks over $10 billion about 35 percent. Today, it is a dramatically different picture. Today, total industry assets for these community banks under a billion dollars is less than 12 percent of all total industry assets, as I look at the statistics. And we know that since Dodd-Frank, we have 1,700 fewer community banks than there were in 2010.

So what the real picture says is that lending from community banks is off, it is much less. And so to the extent there is business lending increasing, it is coming from the larger banks and it is benefiting larger borrowers. So emerging growth companies, small businesses, entrepreneurs, and sole proprietors, the real engine of economic dynamism, the job creators, that is off, that is way down. And that is what that slide doesn't show.

And here is why that matters to me. I represent a district in rural Kentucky. And three-fourths of all lending in rural America come from those small community banks. In fact, the community banks in my district, some of them are less than a hundred million dollars in assets. And that lending is way off. So that is where the concern is, small-bank lending in rural America, small-bank lending where you are talking about half of all small-business lending comes from these community banks.

So, Mr. Heitkamp, as the representative of the community banks here, can you elaborate, is that analysis correct? And is that an explanation for why this slide that my friends on the other side of the aisle—why that slide is totally misleading?

Mr. HEITKAMP. Yes, I think that is definitely a good conclusion, that you are seeing a lot of larger credit unions and larger banks happening, $5-, $10-, $15-, $20 million drive up that data that is just hard data. And when you break down the data, you look at the, like you said, community banks make better than 50 percent of all small-business loans and I believe we do that. It is getting harder for us to do because of the credit box that we are in with the regulatory burdens. We can't take that additional risk.

Years ago, 7 years ago, 10 years ago, 7 out of 10 small businesses came out of the small bank. You look at some of the Dells or you look at some of the big companies, seven of those took the risk,

some community bank took the risk with those guys. And so that is why I think we are having the challenge that we have today with the regulatory box that we are in.

Mr. BARR. We have lost one in five banks in Kentucky since Dodd-Frank. That is a problem. One in five credit unions as well. And I think that is compromising access to credit for the small businesses and for rural America.

I want to switch over to Ms. Wade and Mr. Motley for a minute, especially Mr. Motley on the portfolio lending legislation.

Mr. Calhoun is concerned in his testimony that portfolio lending is dangerous. With all of the exams that occur, and, Mr. Heitkamp, you can weigh in here as well, with all of the scrutiny and the supervision that is happening right now, is Mr. Calhoun right that there is a risk with portfolio lending?

Mr. MOTLEY. I think that there is the potential to put loans in portfolio that might not be prudent over time. And particularly if we are going to define a community bank by size, size varies, asset sizes vary. And so if you set a threshold of a billion dollars, let's say, and then you go above or below and now you have different regimes of rules that you have to comply with, I think that a better approach is to make the QM rule, make a few revisions to the QM rule that would be applicable to all players in the marketplace rather than putting it in just whether or not it is in the portfolio.

Mr. BARR. In my remaining time, we see from HMDA data that there has been a big drop in lending to manufactured housing loans. Based on your knowledge in the marketplace, do you think Congress should act to alleviate the harm to borrowers in the manufactured housing space?

Mr. Heitkamp?

Mr. HEITKAMP. We are in a coastal community, so we don't have a lot of mobile homes because of wind storms rules. So I can't really answer that.

Mr. BARR. Okay. My time has expired. I yield back.

Chairman LUETKEMEYER. The gentleman's time has expired.

The gentleman from Washington, Mr. Heck, is recognized for 5 minutes.

Mr. HECK. Thank you, Mr. Chairman, very much.

I would like to begin just by making an observation about something which Mr. Motley suggested, namely that there can be risk involved in portfolio lending. I am painfully reminded of Washington Mutual, which kept their mortgages or a good percentage of them in portfolio, and it didn't stop them from taking on risks that they thought they could stay ahead of because those homes would be turned at some point and the dance would never end. But of course, it did.

I actually want to ask about mortgages.

Mr. Motley, let me start with you, if I may. There seems to be a new stubborn structural disparity between how many housing units we are creating and what the demand is. And in certain communities where never before have we had this structural difference between supply and demand, we just can't seem to get out ahead of it. Last I read, I think we are at an annual rate of 1.2 million. Demand for that is obviously higher.

And as though I needed proof, and I don't, I have very dear friends who bought a home in Seattle about 30 years ago. And they finally decided to move into a senior-assisted center. They sold their home on—and this was a modest, nice but modest 3-bedroom, cottage kind of home, bungalow kind of home—the first day they listed it for $150,000 more than the asking price. And that is what is happening in a lot of areas in the Seattle market. And I am very concerned about this and about what it is that we could do moving forward.

I am from the school that says that the reasons we have this problem with lending and in fact in providing for housing is almost always more three-dimensional and complex than most people want to give it credit for.

But I am interested as, speaking on behalf of mortgage bankers, what you might have to observe about this new phenomenon of there being structural differences between supply and demand, including in, for example, some Midwestern communities that we had not gone through this quite as we are this time.

So what can you say that might provide insight or help with respect to understanding where we are in the housing market? Fair question of you, Mr. Motley?

Mr. MOTLEY. Okay, let me see if I can answer that or give you my opinion on it. There are significant challenges in the first-time home buyer market in the low-income area of housing where people need to get in, want to get into housing, but because of the cost they just can't do it. And what are some of the issues that are involved in that cost?

Well, local regulations. Land costs, very, very high. Regulations with regard to new construction have been imposed and it makes it very, very difficult for builders these days to build a low-to moderate-income house and make money at it.

Mr. HECK. And make any money at it.

Mr. MOTLEY. Right, right. And so there is that supply issue. But then also from the mortgage side, and this is one of the things that I would ask you to consider about the QM rule, the QM rule says that you cannot—and I am going to defer to my friend Mike here on the exact formulation. There is an APR cap that says that the interest rate or the APR cannot be more than 1½ percent over the average prime offer rate. That is a very narrow range. And what happens when you go over that APOR by 1½, is that it becomes a non-QM loan. Non-QM loans are not liquid. They are not fungible in the marketplace. They are viewed as toxic. And so one of the things that we proposed—

Mr. HECK. Excuse me, Mr. Motley, that is a very interesting point. Thank you. But if I understood you correctly, you are suggesting that in order to be a more liquid market and a more attractive market to lenders that you need to be able to charge more to the people who are on the low-income end of—

Mr. MOTLEY. I am just saying that is the way the calculation works out when you have a low-balance loan because there are fees like title fees that are fixed fees, not a percentage of the loan amount. You have to add those fees into the calculation to get to that APOR. And if you go over that threshold, it becomes a non-QM loan.

Mr. HECK. Mr. Calhoun, would you be supportive of that change as well, sir?

Mr. CALHOUN. We did support that and have for a long time. It is in our written testimony. And the effect of giving that 50 basis points extra of cushion is equivalent in allowing four extra points of closing costs. So it doesn't look like a lot, but since it is an ongoing 50 basis points, that provides a good bit of additional room without creating us one of those places where we can tweak this without creating harm.

I would note, the CFPB has started its review of the whole QM rule, as they are required to do on all their significant rules every 5 years. And this is—

Mr. HECK. Thank you, both.

In my 4 seconds left, let me just say thank you, Mr. Chairman, for the opportunity to use this hearing to say that we ought to be spending a whole lot more time in talking about how to meet housing needs and how to get housing starts up. And it would solve a lot of problems in this economy and for the average American.

And with that, I thank you, sir, and I yield back.

Chairman LUETKEMEYER. The gentleman's time has expired.

They have called votes, but we are going to try and get two more Members in before we leave to vote.

Mr. Williams from Texas is recognized for 5 minutes.

Mr. WILLIAMS. Thank you, Mr. Chairman.

I want to thank all the witnesses for being here today and especially my fellow Texans for coming up here to D.C.

I want to follow through on something Mr. Barr said earlier.

Ms. Wade, you highlight the important role small business plays in economic growth, accounting for about half of the U.S. gross domestic product. Despite this importance, small businesses have struggled to secure credit since the passage of Dodd-Frank. I am a small-business person and I understand every bit of that.

According to research by an analyst at the Federal Reserve Bank of Dallas using FFIEC data, small-business loans at U.S. commercial banks have declined 15 percent since 2008, even while total business loans have increased 33 percent. As a result, small-business loans have shrunk by almost 40 percent of the small-business loans portfolio in 2004 to 20 percent in 2016.

What has been the impact of reduced access to credit on small business? And how will increasing access to capital help small business?

Ms. WADE. Thank you. As I said, one of the problems is that there is just a lack of demand, generally speaking, in the small-business community where they don't have the confidence in seeing opportunities to expand, grow their business or risk not knowing what business conditions will be 6 months, a year down the road. And they are not willing to bet their own money on not a solid economic foundation in many of their communities.

So, the low borrowing levels is one of our main concerns. We did find, however, that there are more difficulties for those who are in high-growth small businesses, so those who have had over 50 percent growth in the last 3 years. Those businesses seem to be finding, on average, a more difficult time in accessing credit. And we are interested in looking into that further.

That might be coming up against some of the regulations that are restricting community and smaller banks in lending to these businesses. And that is where a lot of our concern is focused in these more high-growth businesses that are having a more difficult time accessing credit.

But in creating policies that are more business-friendly, those are the areas that we are focused on in allowing small businesses to grow and improve their business in reinvesting so that there is a strength in borrowing among the small-business community.

Mr. WILLIAMS. All right, thank you.

Mr. Heitkamp, in your testimony, you spoke about bank consolidation. Like many of the small businesses in my district, which you are familiar with, I, too, am a borrower. Can you tell me what these consolidations, these mergers mean to borrowers and communities locally?

Mr. HEITKAMP. Yes, sir. I think the mergers and acquisitions is really hurting the people trying to get credit. You see borrowers out there and today when you lose a merger out of a community bank or it leaves that town, that town doesn't have the access to capital. So a merger is a big issue and the access to capital and those people in those communities are not getting it. And so they are looking for other places to go online and other places, so it is not really driving what we need, real economic growth.

Mr. WILLIAMS. Mr. Motley, what has happened to your banking services since passage of Dodd-Frank? And have you had to reduce some books of business?

Mr. MOTLEY. Have we had to reduce what?

Mr. WILLIAMS. Have you had to reduce some accounts, some books of business?

Mr. MOTLEY. What has happened in our business since Dodd-Frank is that we have increased our staff of compliance personnel dramatically by a factor of probably 10. We spend these days, whereas perhaps prior to the crisis we might have spent $10,000 to $15,000 a month towards compliance issues, we now spend $350,000 a month in compliance, refunding QC, quality control, areas. So it has dramatically increased our cost of business.

In terms of have we had to turn business away, we never were a lender of those no-income, no-asset type loans to any significant extent. So when those products went away, it didn't affect us, we didn't really do those loans.

Mr. WILLIAMS. And all that money that you had spent on compliance could have gone to customers to build a business, to hire people, put people to work, create more taxpayers.

Mr. MOTLEY. It could have reduced the cost to consumers, because when banks incur increased compliance costs or costs generally, those costs are going to get passed on to the consumer one way or the other. So the cost of origination, if I could just take another second, has grown from $1,900 in 2004 for us to over $6,500 in 2016. The cost to originate a loan is dramatically higher than it used to be prior to the recession.

Mr. WILLIAMS. Thank you for your testimony. And I yield back.

Chairman LUETKEMEYER. The gentleman yields back.

We are going to try and get one more Member in here before we recess.

Mr. Loudermilk from Georgia is recognized for 5 minutes.

Mr. LOUDERMILK. Thank you, Mr. Chairman. And I will try to be very brief with this.

Mr. Heitkamp, last year at the end of the year, statistics showed that banks with over $100 million in assets saw a growth in loans, but smaller banks saw a decrease. From a State that has lost a lot of community banks, we have some counties in our State that have no bank branch at all of a smaller community bank. There has been a significant impact on Georgia. And with this, it makes me just wonder, why are we seeing this trend of larger banks are seeing an increase? And what are the challenges of our smaller banks, our community banks?

Mr. HEITKAMP. Yes, I think you are seeing the consolidation that is making the decision if you are a small community, and I think $100 million is even pretty small today. They are saying you need to be half-a-billion dollars to survive the new economic data or the regulatory burden that you need to survive the increase costs.

Mr. LOUDERMILK. So it goes back to the regulatory burden that we are putting on these guys?

Mr. HEITKAMP. Yes, you are looking at our costs have gone up 300 percent in the last 3 years on regulatory costs.

Mr. LOUDERMILK. And what I am getting from our community bankers is, when I am asking about, under the CHOICE Act and Dodd-Frank, what is it that we need to correct? The answer I am getting is death by a thousand cuts. It is not just one thing, it is a death by a thousand cuts. Could you elaborate a little bit more?

Mr. HEITKAMP. I think all these things you are talking about, death by a thousand cuts, every time you turn around you are getting 1,200 pages of regulation or other, you look at HMDA, you look at increased data points there, you are looking at the CFPB, you are looking at TRID, all the new things that Washington is putting out to us. We can't take care of the customer and take care of those costs, so you give to the customer because you have to take care of the other things because of regulations.

Mr. LOUDERMILK. Okay, thank you.

Mr. Motley, one of the things that I have also heard coming from the banks is, tell us what the rules are, just give us what the rules are. I remember when I was in the Air Force, we played a game of softball. But what we weren't told is what the rules are and the rules continually changed, so it was impossible for you to win because every time you went to bat you may be given one pitch, you may be given four pitches.

And I equate what they are saying, especially in the mortgage industry, to we don't know what the rules are that we need to play by because they are evolving. Does that kind of hit where some of the problems are?

Mr. MOTLEY. Yes, sir, it is. And it goes back to my earlier statement. When you don't know what the rules are, you are going to try to take the safest route and you are going to stay away from the edges of the credit box. Because the penalties for making a mistake under the know before you owe rule or really any of the QM rules, the ability to repay rules, all of those rules carry truth in lending liability. And that is significant.

And so when we are not clear on what the rules are, we are going to pull back. We can quantify credit risk, we can quantify rate risk, we cannot quantify regulatory risk. And that is why we need to ask for and I think we should expect to get clear, written, reliable guidance from the CFPB. We get that from the prudential regulators, we should be able to get it from the CFPB.

Mr. CALHOUN. And, Congressman, if I may add just for the record that last year on the so-called TRID or know-before-you-owe, the CFPB did issue a notice that they would engage in formal guidance. They solicited comments, which I know MBA submitted, we did, too, and you should expect in the forthcoming months, if not weeks, that there will be further official TRID guidance to help provide that clarity, because we agree that unnecessary uncertainty has a high cost.

Mr. LOUDERMILK. Mr. Motley, how long have we been asking for this directive?

Mr. MOTLEY. Since the rule came out.

Mr. LOUDERMILK. Okay. So it has been quite a while, very slow going.

I asked one of my lenders or one of our small banks back just a few weeks ago, could you give me some incidences of where you haven't been able to loan money? And they said, we could give you many instances. For instance, there was a guy that we had loaned for a mortgage many times and he paid, has always been current, and he came and asked for a loan for a new home and we had to deny him, but we really couldn't tell him why.

And I believe it was because exactly what you were saying, is they are taking the safe route because they don't know what the rules are. And even though these directions may come out, will they change again?

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

Chairman LUETKEMEYER. The gentleman yields back.

With that, we are going to stand in recess until after votes. I think there are about 4 votes, so we should be back within, oh, 35 to 40 minutes, so sometime between 3:50 and 4:00. So if you will bear with us, we should return.

We stand in recess.

[recess]

Chairman LUETKEMEYER. Let us go back to work. Again, thank you for your indulgence. I apologize for the interruption, but we actually had to go to work a while ago. So thank you so much again for your patience.

The gentleman from Tennessee, Mr. Kustoff, is recognized for 5 minutes.

Mr. KUSTOFF. Thank you, Mr. Chairman.

I am a recovering attorney and a former U.S. attorney, but also a former bank board member for a community bank, so I appreciate the comments and the testimony that many of you have offered.

Mr. Heitkamp, if I can, going back to you, since the implementation of Dodd-Frank, in my opinion, we have seen a one-size-fits-all regulatory regime, regardless of a bank's size, that has had a profound impact on a bank's ability to lend.

Where I am from in west Tennessee, I hear of many instances where long-time customers of their banks or financial institutions are unable to secure a personal or business loan due to the stringent requirements of Dodd-Frank. Problems like these as we have heard today are happening all too often and consumers are finding it more difficult to access credit when they need it the most.

If you could, in your experience, pre-Dodd-Frank and now post-Dodd-Frank, can you talk about the type of individuals that, just subjectively or anecdotally, you could loan to before the implementation of Dodd-Frank and compare that to today?

Mr. HEITKAMP. I will give it a shot, sure. I think looking back, I think I just did this in a talk the other day, talking about what I did 10 years ago. Ten years ago, I took care of my customers, grew my business, and tried to grow my bank.

Today, most of my time is spent trying to deal with new regulations or old regulations and how it is going to affect my bank. So I think that kind of sums up what you are talking about. But from a customer standpoint, we talked about DTI, we talked about the loan requirements that you have to do, the hurdles you have to get over, for good customers, that you are looking for those additional regulatory requirements that have been put on us because of Dodd-Frank.

And I think that is our challenge is trying to help those customers that you want to help and trying to figure out now how to do it. And sometimes you just can't.

Mr. KUSTOFF. In my area of the world, and I talked to some of the bankers around west Tennessee, in rural west Tennessee. I talked to a banker in rural west Tennessee, and I have this in quotes because we took it down verbatim, he told us that a customer of his tried to refinance his primary residential loan. These are his words, "When we requested verification of the income, the customer could not provide it because they had lost their job in the past year. However, for the past 12 months the customer had made regular, timely payments on the loan. He managed to engage in what he called odd jobs and make the payments, but because of the requirements of the ability to repay, our bank was unable to refinance the loan for this specific customer."

And if I could, Mr. Motley, maybe going to you, I believe you had testified that in fact mortgage credit has tightened, and the impact that it is had on customers, your customers, particularly low- to moderate-income borrowers, minorities, and first-time home-buyers. Can you elaborate, if you could, on the various factors that have led to the constriction of credit in general?

Mr. MOTLEY. Was that directed to me? I'm sorry, I couldn't hear you.

Mr. KUSTOFF. Yes, sir.

Mr. MOTLEY. Okay. Particularly in multicultural communities, it is common for families to pool their funds. That is not a standard way of documenting your ability to repay using the Appendix Q. Were it not for the patch, the GSE patch, the temporary patch, we would be very challenged to make the kinds of loans and the number of loans that we have made because the debt-to-income ratio that we have documented based on the information that we have would be well-above 43 percent. And yet we would see people who

have perhaps made that housing payment before, the housing payment that they are proposing to have is equal to or maybe even less than, but it might still be over that 43 percent level.

It is going to be more difficult when that patch goes away in 2021 if we don't make some modifications to what the definition of a QM is. And so we propose some minor modifications, some tweaks that allow lenders to use alternative underwriting decisions and use some other alternative underwriting methods to demonstrate the ability to repay without the very prescriptive rules that are in Appendix Q and specifically the 43 percent debt ratio.

So there are a number of different prototypes, if you will, or borrower types that I could go into, people who are recently out of college, for instance, who are trying to get into their first home, but they don't have a history of earnings, that type of thing is problematic under QM.

Mr. KUSTOFF. Thank you very much.

And I believe my time has expired. Thank you, Mr. Chairman.

Chairman LUETKEMEYER. The gentleman's time has expired.

With that, we recognize the ranking member of the subcommittee, the distinguished gentleman from the "Show Me" State, Mr. Clay, for 5 minutes.

Mr. CLAY. Thank you, Mr. Chairman.

Let me start with a question for both Mr. Heitkamp and Mr. Calhoun.

Some suggest the declining rate of community financial institutions in this country is a recent phenomenon and one that started with the enactment of Dodd-Frank. And yet, the facts once again do not support this.

In the decades leading up to 1980, the total number of commercial banks fluctuated around 13,000 to 14,000. Since that time, there has been a steady decline at a rate of about 300 per year to just under 6,000.

More than 80 percent of banks that exited the market over the past 30 years did not fail, but rather merged or consolidated with another bank utilizing interstate branching laws that were passed long before Dodd-Frank.

And, Mr. Heitkamp, aren't smaller banks being gobbled up by larger banks as a result of the institution's prosperity and success? Is that how you see this?

Mr. HEITKAMP. No, sir, I don't. I see it as kind of the opposite. I think when you start looking at mergers and consolidations, I think the banks that are looking for that are primarily because of regulatory burden that they are putting on. They cannot survive and their costs are going up, so it is driving them to make a decision for viability and for their shareholders to sell their bank. And so you are seeing mergers driven, in my opinion, based upon that decision.

We struggle with it ourselves. We are a $213 million bank. Does it make sense for our shareholders to keep absorbing and seeing our income go down?

Mr. CLAY. Thank you for that response.

Mr. Calhoun, how do you see it?

Mr. CALHOUN. Well, a couple of points here. The biggest impact on community banks has been the fallout of the Great Recession.

We saw almost 500 community banks shuttered. They were the primary banks that got closed for financial difficulties as a result of the Great Recession.

And then I think you have heard from many witnesses here, the two biggest challenges in small-business lending are, first, reduced demand because those businesses are still recovering from the Great Recession, and one that hasn't been mentioned yet, and that is extremely and artificially low interest rates make it extremely difficult for us as small lenders to take deposits and lend and make a living off the difference when interest rates have been depressed so low.

That said, let me be clear, as I said in our written testimony, we both support a two-tier approach to the regulation and an expansion of the existing measures that have been taken in that regard. And there are ways that can be done carefully.

I think the points that Mr. Green was making, don't throw the baby out with the bathwater because, again, the biggest stress was that the housing boom took away so much of our business from the unsustainable lender that the witnesses up here were not willing to engage in. And the reckless lenders took our business away and then crashed the economy, and we took the hit for that and we are still feeling that pain.

And so sustainable, robust growth is what our goal is here. And with some small changes in these places, you can make a measurable impact there.

Mr. CLAY. Thank you for that response.

Mr. Motley, you brought up some interesting scenarios in your testimony about what could help the mortgage industry and our housing industry, in effect. One would be the repay rule that the CFPB has, the qualified mortgage. The Democrats have proposed to exempt community banks from qualified mortgage rules provided that their mortgages are held in portfolio. Would you comment on that?

Mr. MOTLEY. I think that, first of all, we appreciate the idea or the concept that there might be some attempts to stimulate lending. Portfolio lending is an important factor for banks as investments. But I caution the use of portfolios to add loans that are not standard. The QM rule could be adapted for all lenders so that the consumer knows what to expect when they go to a bank, whether it is a small bank, a community bank or a large bank. The rules of the qualified mortgage, I believe, should be the same for everybody.

Mr. CLAY. Thank you so much.

My time is up.

Chairman LUETKEMEYER. The gentleman's time has expired.

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

Mr. POSEY. Thank you, Mr. Chairman.

Mr. Motley, you mentioned in your written testimony that in recent years the Department of Justice has aggressively pursued enforcement actions under the False Claims Act against lenders participating in the FHA insurance programs. I certainly believe that if you defraud the Federal Government, you ought to be held ac-

countable. And in regard to the FHA, we all want to ensure that FHA is protected from risky loans and is on solid financial footing.

But it is my understanding that the Department of Justice has now sued and settled with nearly 30 companies for violations of the False Claims Act. All of these companies were accused of misrepresenting the quality of the loans to the FHA. Those are pretty serious charges.

If the Department of Justice is finding issues this widespread with so many of the program's participants, and I am assuming that these were not intentional acts of crime, shouldn't HUD step in and try to address the problem? In other words, instead of shooting for settlements, it seems like it would make more sense to ensure everyone knows how to comply with the regulations so we can actually prevent real harm from happening in the future.

I think if there were intentional criminal acts, those people ought to go to jail and we ought not be making settlements. That is how you really change behavior for the future, but I'm assuming that is not the case.

Mr. MOTLEY. I think the False Claims Act has been utilized as a sledgehammer to kill a fly in a lot of, in many cases because many of our members have been subjected to false claims acts or errors in calculation of income, perhaps a minor omission, non-intentional omission of a deposit or some credit issue that we were aware of when the loan was made, and yet when that loan, if it goes into default, it does go into default, and then suddenly the lender is being faced with the False Claim Act, and so now not only do you have the loss of the loan and you have to indemnify HUD, but you also have treble damages. So the penalty doesn't fit the crime in a lot of these cases.

Now, we are not advocating, and let me be very clear, if a lender is guilty of fraud or a conspiracy to violate the rules on a regular basis, then that is an appropriate use of the False Claims Act. But for one-offs, for errors in processing, for mistakes that are going to happen, the rules are very, very prescriptive, you start thinking about the loss mitigation protocols that FHA requires, which are not standard, like Mr. Calhoun was talking about earlier, they are different than the agency's protocols for loss mitigation, we need to standardize those loss mitigation protocols.

But if we make a mistake in an FHA loss mitigation process, we haven't experienced it, we have other members who have experienced it, that becomes a false claim when the loan goes into default and they file a claim. And so that sort of mismatch between the crime, the so-called crime, and the punishment needs to be right-sized. And the False Claims Act, we believe, should be used in a very limited, specific when they are egregious activity.

Mr. POSEY. Yes, I was going to ask you what steps HUD can take, and I think you have already said it. Just probably be much clearer and delineate exactly what is and what is not in bounds or out of bounds on the False Claims Act.

Absent HUD providing clarity, how will the DOJ's aggressive enforcement actions affect the lender participation and, more broadly, access to FHA credit? Have you seen a negative impact?

Mr. MOTLEY. We certainly have seen an impact. A number of lenders, one that I am sure you have heard of, Jamie Dimon, has

been very vocal in his concerns about participation in the FHA program. He has said, "We can't be in the FHA program, the risks are too great. And the reason for that is that there is not a good protocol; what we need is a taxonomy of rules and procedures in the FHA guide that will allow lenders to have clarity and certainty in the way that they participate in FHA lending."

Mr. POSEY. Yes. Do you know offhand, when they make these stipulated settlements, do you know where the money goes? Do you have any idea?

Mr. MOTLEY. I'm sorry?

Mr. POSEY. I am curious if you know where the money goes in these stipulated settlements when they make them.

Mr. MOTLEY. I don't know specifically. I think it goes into the coffers of the Federal Government.

Mr. POSEY. Yes, I am wondering if they are making bounty hunters out of DOJ. I just have to wonder about that.

Thank you, Mr. Chairman. I see my time is up.

Chairman LUETKEMEYER. The gentleman's time has expired.

I now recognize Ms. Moore for 5 minutes.

Ms. MOORE. Thank you.

I just wanted to ask the panel—I know that smaller banks were not the cause of our financial meltdown, and excuse me if I ask questions that have already been answered, but we have seen banks become more profitable, including smaller banks.

And so I guess I would want to hear from you all what your thought is about analyses that suggest that part of the problem for smaller banks has been an effort to try to develop growth at a very fast pace. And a lot of the losses were due to aggressive commercial lending because in Dodd-Frank, of course, we exempted these banks from the CFPB, exempted and gave them sort of a tiered structure with regard to regulation.

So I was wondering if you could just share with us what lessons perhaps the smaller banks have learned with regard to rebounding from the crisis, because I am not sure all of it is because of Dodd-Frank.

Mr. HEITKAMP. I will take a stab at that. I am not sure rebounding is the right word, though, because I think earnings are a thing that you can look at and say, okay, does that balance everything but not really, you have regulatory issues that we have been dealt with since Dodd-Frank, too, that is adding in there.

So when you start taking and looking at earnings as a whole, are you looking at larger-bank earnings? Are you looking at community bank earnings? I know they have gone up. But in my case, my earnings have not gone up. I am dealing with a lot more regulation because there is a lot more expense I am having to deal with today than I did before Dodd-Frank.

Ms. MOORE. But you would also stipulate, you would also recognize that a lot of the regulation for larger banks, smaller banks have been excluded from it, and credit unions.

Mr. HEITKAMP. You are saying, "excluded." I am not sure we have been excluded. Maybe there has been a box that we fit in, maybe we get 50 basis points difference or something for exclusion. But really as a whole, we are still subject to HMDA, all the different things that we are having to do in a greater degree.

Ms. MOORE. So the tiering, you don't see that what we have done is adequate enough? Is it the wrong approach totally?

Mr. HEITKAMP. I don't think it is the wrong approach. I just think it is not enough for small community banks and what we are trying to do. I think that we need to push back and say, hey, we need some real regulatory relief that will help us, that doesn't add onto what we are currently doing. All we did is get 1,200 new pages of regulation in each of the different regulations that came out of Dodd-Frank.

Ms. MOORE. I guess what I would like to hear from the panel is whether or not you think that Dodd-Frank had a useful purpose. And obviously, none of you are Wells Fargo or some of the other actors that we have had to fine and there was a tremendous amount of mischief leading up to the financial crisis.

And so we have not wanted to penalize those actors that were not a part of it, but I guess I am concerned about whether or not you all think that there is something in between just sort of jettisoning Dodd-Frank, if there is some concrete improvements that we can make and not just say we don't need a regulatory framework.

Mr. MOTLEY. If I may, the MBA is not proposing that we jettison Dodd-Frank at all. There are a few things that we would like to see happen to make the QM rule a little bit more inclusive for all borrowers, low- to moderate-income borrowers who are stifled in many cases because of the treatment of points and fees and the limited cap on that. So we would like to see an expansion of that. We would like to see some relaxation or some differences in how we interpret the debt-to-income ratio. So we are—

Ms. MOORE. So do you think this has an impact on minority borrowers, who have suffered a lot?

Mr. MOTLEY. It has a definite impact on minority borrowers because of the—and I mentioned earlier before you were here. What we find in multicultural families is that families will go together, they will pool their resources in order to afford a house. That is often very difficult to document and, in many cases, it could be over that 43 percent debt-to-income ratio.

If for some reason that loan is not eligible for Fannie Mae, then we can't go over 43, it will be an illegal loan. So unless we wanted to keep it in portfolio, I suppose you could do that, but then you have the risk of a loan that is not nearly as liquid. It is frowned upon by the regulators. So tweaks to the QM definition would be the thing most helpful, I think, in expanding the credit box.

Ms. MOORE. Thank you so much.

My time has expired. And thank you for your indulgence, Mr. Chairman.

Chairman LUETKEMEYER. The gentlelady's time has expired.

Mr. Heitkamp is going to leave here in a second. Before he leaves, there is one question that hasn't been asked yet. Ms. Moore went to part of it, and I want to sort of jump in here quickly and get a clarification before you do leave, Mr. Heitkamp, and that is with regards to the subject of profitability of the community banks.

I think from the standpoint that you have seen some earnings go up, I think the point that you made a while ago, and we need to clarify it just a little bit further, is the fact that small banks, say

$250 million and under, are the ones that are really, really feeling the pinch of the regulatory costs.

The FDIC did a study a few years ago which showed that they didn't anticipate banks under $250 million even being around in 5 years. And so for clarification purposes, would you agree with that statement or like to expound on it?

Mr. HEITKAMP. Definitely, I think that is really important to talk about today.

Chairman LUETKEMEYER. So you are looking at banks with 750 to a billion, they are doing okay, but the littler guys are the ones that we are talking about.

Mr. HEITKAMP. I would even say $500 million and below, they are really suffering. I think I heard a study that was, like, $350 million, you had to be that size to survive today.

Chairman LUETKEMEYER. Okay, very good. Thank you.

I thank the subcommittee for their indulgence.

Mr. Heitkamp will be leaving here shortly.

But we are going to go to Mr. Tipton next. The gentleman from Colorado is recognized for 5 minutes.

Mr. TIPTON. Thank you, Mr. Chairman, that is a great segue actually to the questions that I had.

I come from a small community. And, Mr. Heitkamp, it certainly captures my attention having participated in a small community bank, when you are talking about a 300 percent increase in terms of some of your regulatory costs.

I had one of our small community banks contact me several months ago and said good news on the employment end, we have made three new hires, the bad news is they are all for compliance. And those are the real challenges really when you say that our small community banks are really facing.

There was a recent Bloomberg News data which showed that loans of a million dollars or less to Main Street-style businesses has fallen to 20 percent of total business credit from 35 percent in 2004. Consumer loans as well?

Mr. HEITKAMP. Yes.

Mr. TIPTON. And have you seen an impact on small-business formation? That is one thing I think that we forget in the mix. Since we have been keeping records for the first time, we are seeing more small businesses shut down than there are new business startups. And as our chairman is often noted as saying, it is hard to have capitalism without capital. You are the liquidity in the marketplace.

Are you seeing that with your small businesses in Texas?

Mr. HEITKAMP. Yes, we are definitely not seeing as many applicants as we have had in the past. I think the people are sitting on the sidelines, seeing what the regulatory issues are and how they are going to impact them before they invest those capital dollars. And so I think that is a deterrent to seeing small business grow.

Mr. TIPTON. When you are seeing some of the difficulties of being able to make a loan that perhaps you would like to be able to make, but regulatorily you are not allowed to make, do you see them turning to alternative financing? And what might that look like?

Mr. HEITKAMP. Yes. I think if they can't get the loan from a commercial bank, they are looking for it in other places. Sometimes they are going online, you see these online lenders, things like that, but it is really not a good alternative for them because at the end of the day it is going to come back to haunt them.

Mr. TIPTON. Higher costs?

Mr. HEITKAMP. Higher costs.

Mr. TIPTON. Higher costs and perhaps more business failure there.

In your testimony you advocated for regulatory reform that would require the Federal financial regulators to conduct a cost/benefit analysis as part of the rulemaking process. How would this improve the final rules, in your opinion?

Mr. HEITKAMP. I think knowing, if you are doing the cost/benefit analysis, to say, okay, does this make sense before you apply a rule or regulation and making sure we talk about it, I think that makes a lot of sense for us to say how the effect will happen to that or what effect will become of that.

Mr. TIPTON. You are probably trying to get out and that is why we are all going to pick on you here in the short term.

[laughter]

Mr. HEITKAMP. That is okay.

Mr. TIPTON. But we recently had Chair Yellen and a variety of regulators testify, and they have always noted the trickle-down effect of regulations, but then they will cite that they are doing everything they can to be able to relieve that regulatory burden that people are facing.

I talked to a couple of community bankers just a few days ago when they were in town and they were talking about the best practices ultimately trickling down. Are you seeing that real impact on you and impacting your ability to maintain that small community bank?

Mr. HEITKAMP. Yes, we are. The best practices are—I am worried about the new ones that is going to come down the road is looking at our small-business customers and the compliance they are wanting to put on small business and gathering data. And everything that you are hearing about that is starting to gear up. We have had regulators start telling us, hey, gear up for this. That is going to be additional costs and additional burden that we are going to have to do if we have to get into small-business lending like that.

Mr. TIPTON. Just one final question from me so that you can leave, if you must. What I think is really important for us to be able to understand is that community bank. When you are talking about the mergers, the acquisitions, it is always with the idea of being able to get the benefit of synergy of a larger entity. But what does a community bank, somebody that you are describing, somebody who lives and works there and understands the people that they are trying to be able to make loans to, what is important about that?

Mr. HEITKAMP. Oh, I think that is the key driver of a community, knowing the people that you deal with, you have the certainty of we have built that relationship over years, you can trust one another, that is hard to get and that is very valuable. And that is my

opinion of community banking. That is why it is so important that we keep these guys.

Mr. TIPTON. Yes. Thank you, Mr. Heitkamp. I appreciate it.

Mr. Motley, I would like to be able to ask just one question of you. You mentioned in your testimony the tightening of mortgage credit availability and the increase in origination and servicing costs.

We have a bank in Westminster, Colorado, that told me their branch had to shut down the majority of their mortgage group, from 15 to 4 people, because the business model simply no longer made sense. According to them, they lost jobs because of the regulatory burden. It was too much.

In your opinion, does the current regulatory framework for mortgage lenders balance safety with access to credit for customers?

Mr. MOTLEY. I think it can be improved upon. I think by making some tweaks in the QM rule, I think by providing clarity, written guidance from the CFPB, we can do a better job of expanding the credit box and allowing more people to qualify for mortgages.

Mr. TIPTON. Thank you.

My time has expired. Thank you, Mr. Chairman.

Chairman LUETKEMEYER. The gentleman's time has expired.

With that, we go to the gentlelady from New York, Ms. Tenney, for 5 minutes.

Ms. TENNEY. Thank you, Mr. Chairman.

And I thank the witnesses for being here to testify.

I had some questions for Mr. Heitkamp, or at least some issues.

I, too, come from a small-business community, in rural upstate New York, where I actually own a small business in the area. And we have had many issues with access to credit. One of the problems we have is so many of our small businesses and smaller banks have been displaced because of regulations and just the huge amount of compliance that we have had to deal with in our business as well.

Coming from New York State, which is one of the highest regulatory States, whether you are in banking, small business, high energy costs, taxes, you name it. If there is an unfunded mandate to send to our local governments or schools and our small-business community, New York will find it.

[laughter]

So part of that, a question I had, and I was going to ask Mr. Heitkamp, but I can put it to the panel or specifically would like to say something to address Ms. Wade because my family's business and dealing with financing. And one of the problems we have had is trying to get access to capital with banks because of the new regulations. And I find that some of the community banks are really not in our league anymore.

And I just wondered if there is any evidence that you have, and I know you may have spoken on this, and I apologize, but I just wanted to hear it again, if there are other avenues that you have cited or indicated in your testimony where small businesses are going for credit if it is not to a banking institution. And if you could just highlight a couple of those that may be other alternative forms of credit as opposed to using a bank.

Ms. WADE. Sure. Their primary source of funding for expansion or reinvestment in their business is the revenue of the business. So personal financing, savings, borrowing from friends and family if they are new, those are the main sources that they are drawing from. And then it is the bank that they have their primary relationship with is where they are looking to access lending.

I think one of the areas that is frustrating for many small businesses in this new banking, regulatory scheme post Dodd-Frank is the area of uncertainty, not knowing why they might not be approved for the full amount that they are asking for and not having a response from their bank representative being able to explain if it is paperwork that they are not filing or why they aren't accessing or why they are not able to access all their credit and not realizing that maybe having a relationship with a secondary bank might be important.

But they certainly draw on credit cards. More are looking at online fintech lending options in accessing credit. But for the most part right now, it is most of their financing is coming from personal savings and revenue from their small business.

Ms. TENNEY. Right. Yes, you just described exactly the circumstance that I myself have been in, maxing out my own personal credit cards and getting a second mortgage just to get past some of the cyclical nature of the businesses that we are in.

On the fintech, that is something that is becoming talked about often in Washington. And can you just tell me any thoughts you might have on regulation in the fintech space and how that would affect our small-business and banking community in your opinion?

Ms. WADE. It is still a very small portion of lending for small businesses. More are becoming interested in accessing or learning more about what products are available through fintech. And one of our concerns is overregulating this area of financing before it develops into something that might be very helpful for the small-business community as they are maybe losing some of the relationships that they have with their small, local banks and are forced to bank with larger banks, that they have a less successful time accessing credit.

So some of that, I think, is spilling over to the fintech arena. And making sure that is still a viable option is important.

Ms. TENNEY. So you are saying that the overregulation of the fintech business could be causing the inability to get credit on that side?

Ms. WADE. We are worried, we are certainly concerned about overregulating of that industry where it wouldn't be a viable option for small businesses to access financing going forward.

Ms. TENNEY. Thank you. I think I am out of time.

Thank you very much, I appreciate it.

Chairman LUETKEMEYER. The gentlelady's time has expired.

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

Mr. ROYCE. Thank you, Mr. Chairman.

If I could just say to the panel here that combating money laundering and combating the financing of terrorism is obviously something we all agree is critical to protecting our citizens, protecting citizens throughout civilization. I am concerned, however, that we

are misaligning our resources and hindering legitimate customers and businesses from accessing capital in some situations, and I thought I would just bring this up.

At least one recent study by The Clearing House concluded that billions in bank resources, billions, are spent on AML/CFT compliance that have limited law enforcement or national security benefit. So clearly, the system as currently designed is outdated and is ineffective.

And so my local banks tell me examiners are more interested in quantitative measurements, like the number of compliance officers that are hired, or the number of suspicious activity reports filed.

And missing in that is a focus on the qualitative side, which would be results-driven risk management which identifies and catches bad actors. And we haven't seen much in the way of that.

And so I was wondering if our remaining bank witness can comment on suspicious activity report filings and other rules and regulations and whether you think they are working. And also, are there ways to better foster cooperation and information sharing among banks or look at the beneficial ownership rules so that we can catch the bad actors while still facilitating access to capital and access to credit for small businesses?

So I would just ask you, Mr. Motley, for your views on that?

Mr. MOTLEY. Thank you. I will try to briefly give you my thoughts on that. We are primarily a residential mortgage lender. We are a depository. We have eight depository branches in the Dallas/Fort Worth area. So we take retail deposits. We do savings accounts. We do traditional banking, but we are primarily a mortgage banking participant.

But the AML rule really requires us to devote a huge amount of resources to managing it. We could probably meet and talk to every customer we have at least once a year and know exactly who our customer is. But this AML rule is pretty onerous. And we have to devote a single compliance person just to that one activity.

We file suspicious activity reports whenever we run across it, we find that more on our mortgage side than we do on the depository side, because really we take great care in knowing who it is that is opening up an account with us.

So for a bank like us, I think that rule is overbearing. And there could be some opportunity for some relief.

Mr. ROYCE. I will ask you another question. Your bank services mortgages, so you are in a unique position to offer, I think, some perspective here on the proposed Basel III increases in the risk-weighting for mortgage servicing rights.

So there would be really two points to you, and the first would be understanding that there is some volatility in these instruments as the interest rates change, do you believe the risk to your balance sheet necessitates higher capital requirements and different capital treatment?

And the second question I would ask you is, what is the impact on your relationship with borrowers if you then are unable to hold onto the servicing rights on the mortgages that you originate? Maybe you can walk us through that.

Mr. MOTLEY. Thank you. To answer your first question, capital is important. Capital supports our business. We are a highly cap-

italized institution. We are at 21 percent of assets is our capital. And so we can support our mortgage lending activity, but Basel III will prevent us from growing that business that we have been in now for 65 years. We have 180,000 customers. We like having those customers. We have a high concentration of mortgage servicing rights to capital. Under the Basel rule, that would be restricted down to 10 percent.

And when that happens, that means we are going to have to—one way to correct it is either grow a whole lot more capital, we are a private entity, that is not so easily done, we are also a family-owned bank. So the alternative is, is to let those mortgages run off or sell the mortgages to somebody else, to sell that relationship down the road to someone else. And one of the things that many of our customers tell is is they came to us because they wanted us to service their loan.

Mr. ROYCE. So that does impact directly your relationship with them in the sense that this becomes the—

Mr. MOTLEY. It absolutely does, yes, sir.

Mr. ROYCE. Yes.

Mr. Chairman, thank you.

Chairman LUETKEMEYER. The gentleman's time has expired.

We have a gentleman here today who is not a member of the subcommittee, but has a phenomenal background in financial services, and serves on the full Financial Services Committee and wants to participate in the hearing.

Without objection, the Chair seeks unanimous consent for the gentleman from Arkansas, Mr. Hill, to be recognized for 5 minutes to question the witnesses. Without objection, it is so ordered.

The gentleman from Arkansas is now recognized. Welcome.

Mr. HILL. I appreciate the chairman and the ranking member's indulgence. Thank you for that. It is always nice to have an interloper drift into your subcommittee, so thanks for letting me participate.

Thank you, panel, for being with us, and sticking with the cause over this long afternoon.

Chair Yellen testified before the Senate and the House in the last couple of weeks and was just emphatic that there is no lending problem in our country, that lending is at an all-time high and that small-business people, Ms. Wade, are not complaining about access to credit. In fact, she says that only less than 4 percent of small businesses say they have no access to credit.

Senator Warren described that was the real facts and that anyone who disagreed with Chair Yellen was in fact proposing alternative facts.

So, Mr. Chairman, I would like to enter in the record some alternative facts, an article entitled, "Why We Must Base the Banking Regulation Debate on Real Data," by Paul Kupiec from AEI.

In that article, it says that the Federal Reserve's own data shows that small-business lending is 14 percent below pre-crisis levels from $700 billion in 2008 to $600 billion today.

The Fed's own research shows that smaller banks play an outsized role in providing small-business credit. And without effect, the largest banks have not filled the lending gap. The dollar vol-

ume of small-business loans made by banks with more than $10 billion in assets declined by 5 percent over the same period.

So I would like the panel's views on commercial paper markets in this country before the crisis were $2 trillion weekly; now it is about $900 billion. So it is my view that one of the biggest contributors to this CNI loan number up there are loans to the biggest companies in our country, our Nation that used to finance themselves through commercial paper.

Does anyone have a view on that?

Ms. Wade?

Ms. WADE. We have certainly seen low borrowing levels. That is the missing component when folks talk about the 4 percent not being able to satisfy their borrowing needs is that there aren't borrowers as we would normally see in an expansion.

The reasons that there aren't as many borrowers, they don't feel it is a good time to expand their business. They aren't optimistic about business conditions in the next 6 months and they are not willing to risk their profits and resources in investing in their business without a full understanding that the economy is going to grow at a rate that they will be able to pay back these loans and use the resources effectively. So I think that is one of the biggest missing components in the conversation for small businesses.

And then, again, for those who are seeking credit and are able to access loans, not understanding what is asked of them from the small-banking community or the small banking community. For the small banks having that level of uncertainty, when there is uncertainty in the small banks and there is uncertainty in the small business, it is a terrible circumstance to facilitate growth in the small-business community and grow their businesses.

Mr. HILL. We have certainly seen that in my district where we only, since the summer of 2007, only have 1,300 more people employed in my congressional district than we did in July of 2007 and only 5,000 more people in the workforce. So it is a very slow growth, as you point out, recovery, so there are not very many prospects.

I want to talk about TILA–RESPA, Mr. Motley. The Urban Institute thinks that there would be about 5 million more mortgages made if we didn't have the combination of TILA–RESPA, QM, ability to repay in that period. And if you look at S&P data, home equity loans since 2011 have declined 3 percent per year in that period of time.

And there is no doubt that one of my constituents in my district reported that just over the last 3 years, his qualified mortgage loans since 2013 have dropped 15 percent a year in eligible credit because of the rules.

What do you think we can do to improve TILA–RESPA? And I know you have already put on the record ability to repay and QM. So what are your thoughts on TILA–RESPA?

Mr. MOTLEY. The penalties of failing to execute the TRID rule disclosures properly can be catastrophic for a small lender because that loan is going to end up being most likely non-salable, not going to be able to be delivered to another investor, private investor.

While Fannie Mae and Freddie Mac don't regulate disclosures, they do expect lenders to follow the rule. And without Fannie Mae and Freddie Mac and the GSE patch that we have right now, lenders would be hurt quite badly because the rules are so specific. Investors are reluctant to buy non-QM loans because of the penalties that are associated with it.

So I think that what we could do to improve upon it, first, is to provide better written guidance that can be relied upon by the CFPB. I think that would be the best thing we could do. And then the second thing we could do is to expand in a moderate way the definition of a QM loan specifically as it impacts low- to moderate-income borrowers.

Mr. HILL. Thank you, Mr. Chairman. Thank you for the time, Mr. Chairman.

Chairman LUETKEMEYER. Thank you for joining our subcommittee today.

And with that, we are at the end of our hearing, and I would certainly like to thank our witnesses. We had a great panel today, with a lot of great information.

One point of clarification, Mr. Motley. In your testimony, you talked about the increased cost of doing a mortgage loan. And my calculations said that it increased about 70 percent in the last 7 years. Would that be pretty close?

Mr. MOTLEY. That would be pretty close, yes, sir.

Chairman LUETKEMEYER. Just rough ballpark figures there. That is breathtaking. If you look at that cost having to be passed on to consumers, it is a significant enough cost that I am sure that it makes a difference to some people's ability to even take out a loan. So I thank you for that information.

Also, I know during the hearing, points were made with regards to the Community Reinvestment Act, the Bank Secrecy Act, and appraisals. A lot of you made points on those three things. And those are going to be items that we are going to talk about in succeeding hearings. They have been brought to my attention by a lot of other banking groups, people in the financial services industry, that there are concerns, problems, issues with those that we need to take a look at.

And so we appreciate your testimony along those lines because, again, it points out that I think your testimony shows that there is an interest and there is a problem there that we need to take a look at. So I thank you for that as well.

But again, thank you for your participation here. It has been great.

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.

And with that, the hearing is adjourned.

[Whereupon, at 4:41 p.m., the hearing was adjourned.]

A P P E N D I X

March 28, 2017

Testimony of Michael D. Calhoun

President,

Center for Responsible Lending

Before the U.S. House Committee on Financial Services'

Subcommittee on Financial Institutions and Consumer Credit

The State of Bank Lending in America

March 28, 2017

Good afternoon Chairman Luetkemeyer, Ranking Member Clay, and Members of the House Committee on Financial Services' Subcommittee on Financial Institutions and Consumer Credit. Thank you for allowing me to testify about the current state of bank lending and the need to ensure that all financial institutions are subjected to responsible, reasonable regulatory oversight that maintains sensible consumer protections.

I am the President of the Center for Responsible Lending (CRL), a nonprofit, non-partisan research and policy organization dedicated to protecting homeownership and family wealth by working to eliminate abusive financial practices. CRL is an affiliate of Self-Help, a nonprofit community development financial institution. For thirty years, Self-Help has focused on creating asset building opportunities for low-income, rural, women-headed, and minority families. In total, Self-Help has provided over $6 billion in financing to 70,000 homebuyers, small businesses, and nonprofits and currently serves more than 80,000 mostly low and moderate income families through 30 retail credit union branches in North Carolina, California, and Illinois. Prior to my leadership of CRL, I headed several of Self-Help's lending divisions, and I also served as General Counsel of Self-Help for more than 10 years.

This important hearing addresses the health of our banks, which provide essential services to consumers and the overall economy. Fortunately, today consumer lending is strong, and bank profitability is at record levels. We are emerging from the shadow of the Great Recession of 2008, including the process of implementing essential protections that ensure such a financial crisis is not repeated, and that consumer financial markets are strong and competitive. In setting and implementing these protections, regulators have utilized a two-tier approach, with numerous measures to lessen compliance costs for smaller institutions. This approach should be continued and expanded. In addition, there are reforms that have broad support that would

benefit all banks, without harming consumers. These should be implemented immediately. However, dismantling essential reforms, such as the mortgage ability to repay standard, or reducing the effectiveness of the Consumer Financial Protection Bureau (CFPB) would harm consumers, banks and the overall economy.

I. History shows that responsible regulations are necessary for a healthy national market and economy.

Recent history has already shown us the consequences of the absence of basic protections and oversight in the financial market. In the years leading up to the financial crisis, mortgage lenders were drawn into competition to offer mortgages with the lowest monthly payment and the least amount of underwriting. Lenders first started offering mortgages that had lower payments that never reduced the principal balance of the loan. This was then surpassed by loans that had "teaser rates" where the monthly payments were even lower for the first several years, but then increased dramatically. Finally, lenders pushed loans that had startling low payments, a few thousand dollars a month for a half million-dollar loan, but the loan balance then *increased* by more than five percent every year. At the same time, lenders competed by reducing underwriting requirements, streamlining the underwriting, and pushing no documentation or "no-doc" loans without any verification of income. It was very difficult for responsible lenders to compete in this environment, and in order to maintain their businesses and some market share, they were forced to join this race to the bottom.

The result is all too well known. In the wake of the financial crisis, 7.8 million American consumers lost their homes through foreclosure.[1] The failure to have a responsible regulatory environment also resulted in taxpayers paying $7 trillion to bail out financial institutions through

[1] CORELOGIC, CORELOGIC REPORTS, UNITED STATES RESIDENTIAL FORECLOSURE CRISIS, TEN YEARS LATER 3, *available at* http://www.corelogic.com/research/foreclosure-report/national-foreclosure-report-10-year.pdf.

loans and according to some reports, an additional $22 trillion through the federal government's purchase of assets.[2] According to the Federal Deposit Insurance Corporation (FDIC), more than 500 banks shuttered their doors and most of those institutions were community banks.[3] In addition, the national economy was undermined and plunged into a severe recession. People lost their jobs, small businesses went under, and many Americans—from small entrepreneurs to families—struggled to make ends meet while being unable to obtain the credit and capital they needed from financial institutions to sustain their position or expand their asset base.

These dynamics and consequences are why the protections of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank)[4] are needed to protect consumers, small businesses, taxpayers, and the nation's economy. All financial institutions, including community banks and credit unions, benefit from the underlying purposes of financial regulation: protecting consumers, ensuring the safety and soundness of institutions, protecting community financial institutions from unfair competition, and defending the nation's financial market from systemic risk.

II. Financial regulations are not slowing economic growth or preventing lending.

Financial institutions, including small banks, continue to recover from the worst financial downturn since the Great Depression. Mortgage lending in particular continues to steadily improve. Small banks are playing an important and growing role in the recovery.

Contrary to theories that the Dodd-Frank Act has stifled growth, the financial sector has had record profits. In 2016 U.S. financial institutions had total annual profits of $171.3 billion, the

---

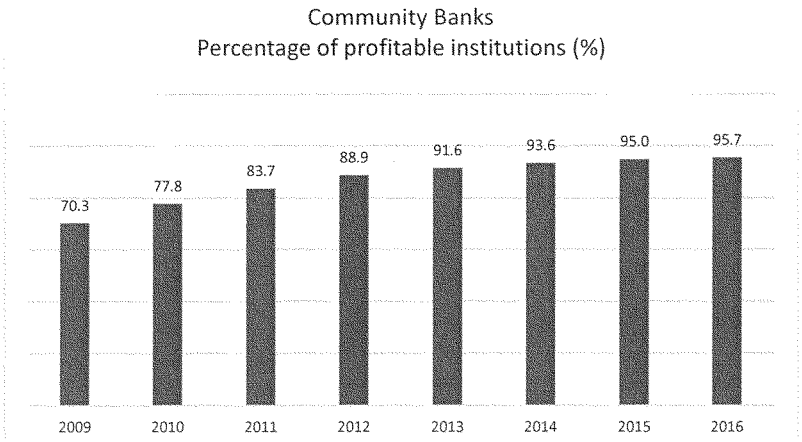
[2] John Carney, The Size of the Bank Bailout: $29 Trillion, *CNBC*, (December 14, 2011), *available at* http://www.cnbc.com/id/45674390#.
[3] FEDERAL DEPOSIT INSURANCE CORPORATION, FAILED BANK LIST, *available at* https://www.fdic.gov/bank/individual/failed/ banklist.html.
[4] Public Law 111-203 (2010).

highest level since 2013.[5] While this profit level is slightly lower than the profit level in the peak of the false housing boom in the years immediately prior to the financial crisis (2004-2006), it remains higher than inflation-adjusted financial sector profits for any other time period since World War II.

Community bank profitability has also rebounded strongly and meets pre-recession levels. In 2010, less than 78 percent of community banks were profitable. By the end of 2015, over 95 percent of community banks were profitable.[6] The most recent FDIC report from the 2016 third quarter notes that the percentage of unprofitable community banks sunk to 4.6 percent, which is the "lowest percentage since the third quarter of 1997."[7] Full year earnings were up 9.7 percent in 2015, which is a higher figure than the overall increase of 7.5 percent for all banks.[8]

---

[5] Wall Street Journal, U.S. Banking Industry Annual Profit Hit Record in 2016 (Feb 28, 2017), *available at*: https://www.wsj.com/articles/u-s-banking-industry-annual-profit-hit-record-in-2016-1488295836.
[6] FEDERAL DEPOSIT INSURANCE CORPORATION, CORE PROFITABILITY OF COMMUNITY BANKS 1985-2015 1 (2016), *available at* https://www.fdic.gov/bank/analytical/quarterly/2016_vol10_4/article1.pdf.
[7] FEDERAL DEPOSIT INSURANCE CORPORATION, QUARTERLY BANKING PROFILE: THIRD QUARTER 2016 1, *available at* https://www.fdic.gov/bank/analytical/quarterly/2016_vol10_4/fdic_v10n4_3q16_quarterly.pdf.
[8] Id.



Federal Deposit Insurance Corporation. Quarterly Banking Profile, Community Bank Performance Section, Table 1-B (2015, 2016), retrieved from: https://www.fdic.gov/bank/analytical/qbp/qbpmenu.html, March 23, 2017.

Credit unions have also continued to grow while recovering from the financial crisis. Credit union membership has been steadily growing in recent years. In 2016, credit unions added 4.7 million new members, which amounted to "the biggest annual increase in credit union history and four times the pace set a decade earlier."[9] Operating costs for credit unions have also fallen in the period since Dodd-Frank was passed and were down to 3.1 percent in 2016 from a high of 3.59 percent in 2008.[10]

While the number of small lenders, including community banks and credit unions has decreased over the years, this cannot be reasonably attributed to Dodd-Frank or CFPB regulations. The number of community banks has declined every single year since 1984.[11] FDIC

[9] CUNA MUTUAL GROUP, CREDIT UNION TRENDS REPORT (2017), *available at* https://www.cunamutual.com/resource-library/publications/credit-union-trends-report.
[10] NATIONAL CREDIT UNION ADMINISTRATION, NCUA CHART PACK (2016), *available at* https://www.ncua.gov/analysis/Pages/industry/fact-sheets.aspx.
[11] FEDERAL DEPOSIT INSURANCE CORPORATION, COMMUNITY BANKING STUDY 1 (2012), *available at* https://www.fdic.gov/regulations/resources/cbi/report/cbi-full.pdf.

research concludes that community bank profitability since 2008 has overwhelmingly been driven by macroeconomic conditions, not regulations.[12] The FDIC study first takes a wide look at regulations that include Dodd-Frank, but also Basel III capital standards. The study states that "regulation is just one among many noneconomic factors that may contribute to structural change in community bank profitability," but conclude that 80 percent of variation in profitability is due to macroeconomic factors, and the other 20 percent includes not just changing regulations, but also "the rise of nonbank lending, competition from larger banks, and changes in loan portfolios and other business practices."[13]

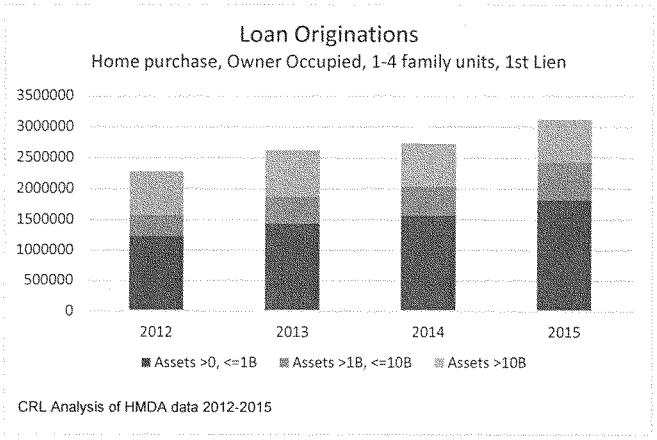
Smaller lenders play an important role in extending access to credit, and it is noteworthy that lending has also rebounded from the depths of the crisis. After falling from June 2008 to November 2010, outstanding consumer loans have steadily increased at $3.7 trillion in December 2016, which well exceeds pre-crisis levels.[14] Small banks have posted increases in commercial lending in all but one quarter compared to levels at the time of passage of Dodd-Frank in 2010.[15] Furthermore, the FDIC's quarterly community bank performance data for the fourth quarter of 2016 shows that community banks hold 43 percent of all small loans to businesses and that they increased lending by $6.4 Billion (2.2 percent) compared to 2015, twice the rate of other banks.[16]

Finally, mortgage lending has also steadily recovered since the crisis. Community banks and small lenders play an important and growing role in the mortgage market in particular. In

---

[12] FDIC, Core Profitability of Community Banks *supra* note 6.
[13] Id at 42.
[14] FEDERAL RESERVE, TOTAL CONSUMER CREDIT OWNED AND SECURITIZED, OUTSTANDING *available at* https://fred.stlouisfed.org/series/TOTALSL.
[15] FEDERAL RESERVE, TOTAL VALUE OF LOANS FOR ALL COMMERCIAL AND INDUSTRY LOANS, SMALL DOMESTIC BANKS *available at* https://fred.stlouisfed.org.
[16] FEDERAL DEPOSIT INSURANCE CORPORATION, QUARTERLY BANKING PROFILE, COMMUNITY BANK PERFORMANCE, FOURTH QUARTER (2016), *available at* https://www.fdic.gov/bank/analytical/qbp/2016dec/qbpcb.html.

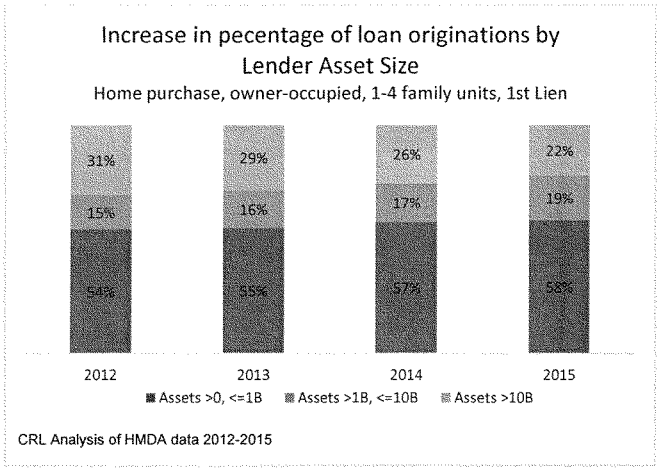
2015, mortgage lenders originated 850,085 more loans[17] than they did in 2012, a 37 percent increase. Loans originated by smaller lenders with assets under $1 billion saw the biggest increase during this period (48 percent) while the largest institutions with assets over $10 billion saw a 1 percent decline. Credit unions alone originated $41.7 billion in first-lien mortgage loans in the third quarter of 2016, an increase of 22 percent over the same period in the previous year.[18]



Small lenders also saw their market share in mortgage lending increase over this time period. The market share of the smallest lenders with assets under $1 billion increased from 54 percent in 2012 to 58 percent in 2015. In contrast, the market share of the largest lenders with assets over $10 billion, decreased from 31 percent in 2012 to 22 percent in 2015.[19]

---

[17] Sarah Wolff, CRL Analysis of HMDA Data 2012-2015. Loan analysis limited to: home purchase, owner-occupied, 1-4 family units, 1st lien loans, *available at* http://www.responsiblelending.org/media/new-hmda-data-shows-mortgage-market-continues-exclude-consumers-color-and-low-wealth-families.
[18] CUNA MUTUAL GROUP, CREDIT UNION TRENDS REPORT (2016), *available at* https://www.cunamutual.com/resource-library/publications/credit-union-trends-report.
[19] CRL Analysis *supra* note 17.



III. Consumer protections put in place by Dodd-Frank, such as the Qualified Mortgage rule have strengthened the housing market.

The CFPB's Qualified Mortgage (QM) rule and the Ability-to-Repay standard set out common sense standards to protect the market and consumers from high-risk, unsustainable loans by ensuring borrowers have an ability to repay the loans they receive. Irresponsible mortgage lending that ignored borrowers' ability to repay their loans resulted in a foreclosure tsunami that disproportionately impacted communities of color—eviscerating a generation of wealth building. Further, Wall Street's appetite for risky mortgages encouraged this lax underwriting, and regulatory inaction failed to address the problem. As a result, unaffordable loans toppled the entire market and nearly destroyed the economy.[20]

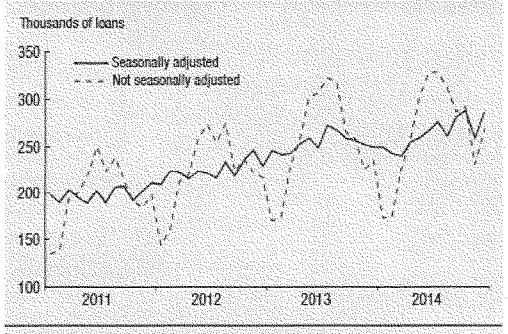
The reforms of Dodd-Frank, including QM and Ability-to-Repay, have not hurt mortgage lending or access to credit. Instead, these reforms support sustainable homeownership and wealth

[20] Testimony of Eric Stein, Center for Responsible Lending, before the US Senate Committee on Banking, Housing, and Urban Affairs, "Turmoil in the US Credit Markets: The Genesis of the Current Economic Crisis," (October 16, 2008) *available at* http://www.banking.senate.gov/public/_cache/files/03d72248-b676-4983-bd3e-0ffec936b509/33A699FF535D59925B69836A6E068FD0.steintestimony101608final.pdf.

building opportunities for lower-wealth households. The QM rule is designed to facilitate the flow of mortgage credit, as lenders will have the confidence in knowing the suitability of loans for borrowers at the time of origination. The same standards in turn reduce the overall likelihood of borrower default. This certainty has benefitted consumers, lenders, and investors alike, leading to a more sustained housing recovery.

Three years have passed since the QM rule was implemented. Reports, including the Home Mortgage Disclosure Act (HMDA) report, show that QM has not negatively impacted mortgage lending or access to credit. In fact, (post QM) HMDA data is very much consistent with market trends immediately preceding the implementation of the QM rule and Ability-to-Repay standard. The Federal Reserve's seasonally adjusted origination numbers, in the chart below, show a slow overall increase in monthly originations from 2011 through 2015 with no discernable decrease when the rules were fully implemented in January 2014. [21]

Figure 3. Volume of home-purchase originations, 2011–14



Note: The data are monthly. Loans are first-lien home-purchase mortgage originations.

[21] FEDERAL RESERVE BULLETIN, THE 2014 HOME MORTGAGE DISCLOSURE ACT DATA (2015), *available at* https://www.federalreserve.gov/pubs/bulletin/2015/pdf/2014_HMDA.pdf.

In addition, HMDA data from 2014-15 shows a modest but steady increase in mortgage lending to low and moderate-income borrowers and African-American and Latino borrowers.[22]

Researchers have looked carefully at mortgage lending after the implementation of QM and found no link to a reduction in credit. For example, researchers at the Urban Institute looked at loans that might reasonably have been affected by the QM standards (interest only or prepayment penalty loans, loans with debt-to-income "DTI" over 43 percent, or adjustable rate mortgages or "ARM" loans) and found no decline in these categories associated with QM.[23] Researchers at the Federal Reserve similarly concluded "The HMDA data provide little indication that the new ATR and QM rules significantly curtailed mortgage credit availability."[24] Researchers at the Federal Reserve also looked at both the origination and securitization of mortgages post-crisis and find that lender asset size has become a less important factor in explaining this lending activity and conclude "smaller banks have not been, on net, deterred from engaging in the sales and securitizations of mortgages, have become a more important part of the market and have profited from their activities."[25]

The Urban Institute likewise found that QM rules had not adversely affected access to credit. While mortgage originations can and should expand, the Urban Institute attributes continued access problems to overcorrections in the post-crises market that has resulted in constrained

---

[22] FEDERAL RESERVE BULLETIN, THE 2015 HOME MORTGAGE DISCLOSURE ACT DATA (2016), *available at* https://www.federalreserve.gov/pubs/bulletin/2016/pdf/2015_HMDA.pdf., see also note 21.
[23] Bing Bai, Laurie Goodman, and Ellen Seidman, Has the QM Rule Made It Harder to Get a Mortgage? (2016), *available at* http://www.urban.org/research/publication/has-qm-rule-made-it-harder-get-mortgage.
[24] FEDERAL RESERVE BULLETIN, THE 2014 HOME MORTGAGE DISCLOSURE ACT DATA, *available at* https://www.federalreserve.gov/pubs/bulletin/2015/pdf/2014_HMDA.pdf.
[25] William F. Basset and John C. Driscoll, Post Crisis Residential Mortgage Lending by Community Banks (2015), *available at* https://www.communitybanking.org/documents/Session3_Paper4_Bassett.pdf.

lending. This environment is most harmful to lower-wealth households with lower FICO scores and fewer resources for a down payment[26]

IV. Large lender portfolio exemptions to the QM rule are unnecessary, do not help small lenders, and are dangerous for the economy.

Some have suggested that expanding QM to include all loans held in portfolio by lenders of any size, would increase lending. However, this would be dangerous for consumers and the market, and unlikely to meaningfully expand lending.

As demonstrated in the housing crisis, holding loans in portfolio alone will not protect borrowers, taxpayers, and the market from the mistakes of the past. In the lead up to the financial crisis, many of the toxic loans, such as negative amortization loans, and "ARMs" underwritten to initial "teaser" rates were held in bank portfolios. Lenders underwrote these loans based upon only this initial, artificially low payment, even though dramatically higher payments commenced after a few years. Many lenders did not document the income of the borrowers, instead making "no-doc" loans. Hundreds of billions of dollars of these loans were made, and many were kept on bank portfolios. These portfolio loans soon crashed, helping to trigger the financial crisis, and devastating banks such as Washington Mutual and Wachovia.[27]

Portfolio loans can still be risky for consumers and taxpayers, and automatic QM status for loans held in portfolio should not be extended to larger institutions. Many homeowners have very substantial equity in their homes and a significant number of those have no current home debt. Current information shows that the average loan-to-value for GSE loans is roughly 74

---

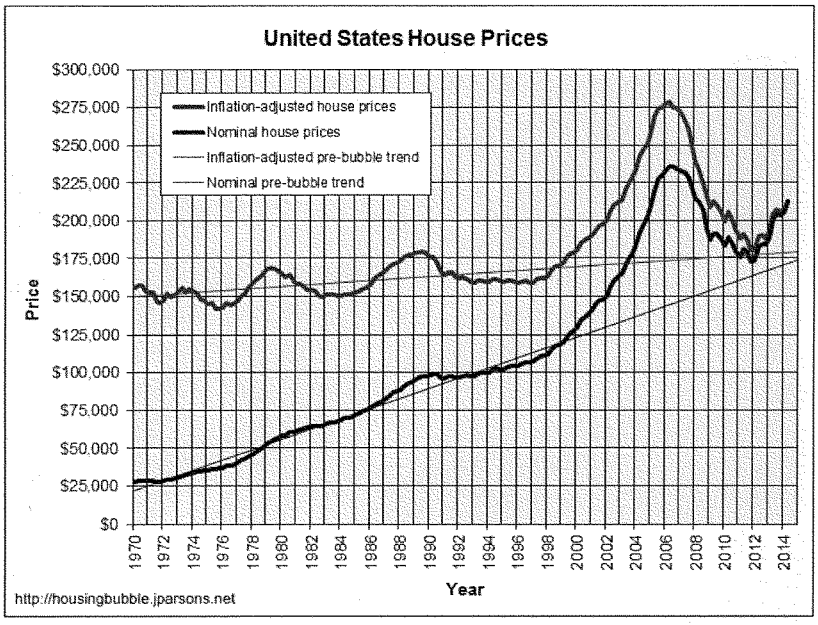
[26] Jim Parrot and Mark Zandi, Opening up the Credit Box 5 (2013), available at http://www.urban.org/UploadedPDF/412910-Opening-the-Credit-Box.pdf., see also LAURIE GOODMAN ET AL., TIGHT CREDIT STANDARDS PREVENTED 5.2 MILLION MORTGAGES BETWEEN 2009 AND 2014, *available at* http://www.urban.org/urban-wire/tight-credit-standards-prevented-52-million-mortgages-between-2009-and-2014.
[27] Ben White and Eric Dash, Wachovia, Looking for Help, Turns to Citigroup, New York Times (September 26, 2008), *available at* http://www.nytimes.com/2008/09/27/business/27bank.html?_r=0.

percent with many loans having much lower levels.[28] With these loans, the borrower's equity absorbs the risk of loss rather than the lender. Therefore, the lender is protected even from very risky loan terms. Furthermore, lenders are also already making and holding loans in portfolio. Portfolio loans accounted for 30.9 percent of all originations in 2016, approximating the pre-crisis share of originations for portfolio loans.[29] Expanding QM to all portfolio loans is unlikely to lead to an increase in volume.

This would be a particularly dangerous time to reduce the Ability-to-Repay/QM mortgage protections. As the economy moves through the business cycle and the recovery improves, the important protections recently put in place will provide new value. Real and nominal house prices now exceed pre-crisis trends and at the same time interest rates are expected to rise. As shown in the chart below, the home market is cyclical with home values rising and falling when measured in real inflation adjusted dollars. There were in fact several substantial price run ups in home values and declines prior to the Great Recession. The difference was that in these prior run ups, the bubble was limited because mortgage payments were not artificially reduced by poor mortgage products without borrower ability to repay. This enabled the market to rebalance without a crash. In contrast in the early 2000's housing prices rose rather than being rebalanced. These unsustainable mortgages further artificially inflated home prices and created a housing bubble of unprecedented height and fall.

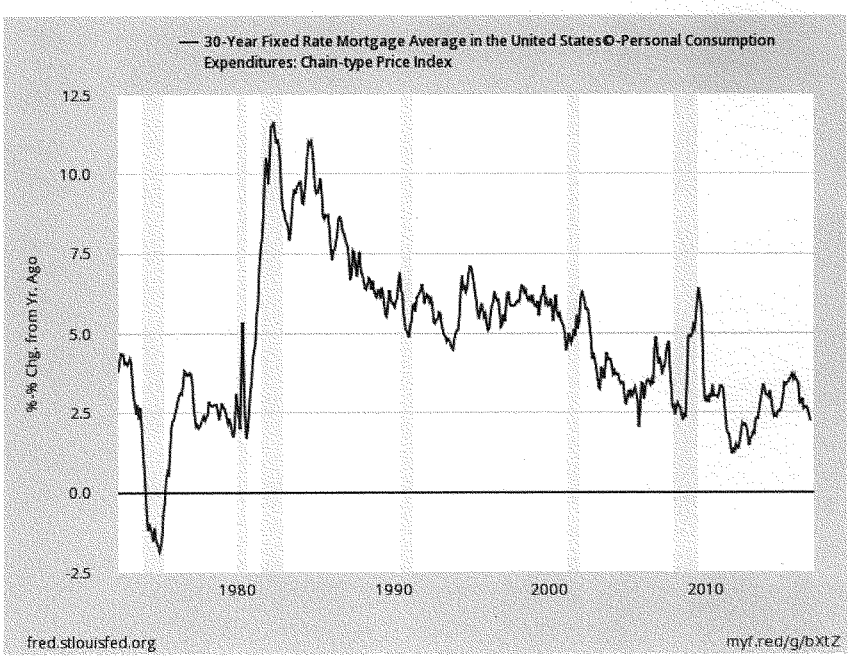
---

[28] FANNIE MAE 2016 CREDIT SUPPLEMENT 6 (2017), *available at* http://www.fanniemae.com/resources/file/ir/pdf/quarterly-annual-results/2016/q42016_credit_summary.pdf.
[29] LAURIE GOODMAN ET AL. HOUSING FINANCE AT A GLANCE: A MONTHLY CHARTBOOK, MARCH 2017 (2017), *available at* http://www.urban.org/research/publication/housing-finance-glance-monthly-chartbook-march-2017/view/full_report.



In the coming years, the monetary market will create pressures for the reintroduction of these unaffordable mortgages. As the following chart shows, we are coming to the end of a decades-long period of declining interest rates, culminating in the current market where there is a negative real interest rate and historically low mortgage rates. A consensus of experts agree that mortgage, and other interest rates will increase in coming years. This will create pressure for lenders to bring back the exotic unaffordable mortgages of the recent past to again artificially reduce monthly mortgage payments. Undercutting the standard that borrowers should have the

ability to repay loans, especially substantial loans made by federally insured institutions would invite a repeat of the recent financial crisis at the cost to the American taxpayer.



Provisions that grant out right legal immunity are extreme and put consumers at great risk. Granting QM status to portfolio loans held by larger financial actors will allow some to use relaxed standards to harm consumers and strip consumer equity, all while being insulated by QM's legal protections.

V. The CFPB is doing its job and must continue its work.

The CFPB has recovered nearly $12 billion for 29 million consumers who have been harmed by illegal practices of credit card companies, banks, debt collectors, mortgage companies, and others. This relief includes monetary compensation to harmed consumers, principal reductions, canceled debts, and other remedies to address these practices. The CFPB has worked hard to end predatory practices by institutions like ITT Tech (a for-profit college that misled borrowers into high-cost private student loans), Wells Fargo, and car-title and payday lenders.

Under the leadership of Director Cordray, the CFPB has issued and proposed rules that make the market safer for consumers and the general economy. In addition to the mortgage rule and standards addressed above, the CFPB has issued a rule to make prepaid cards safer and fairer for consumers who rely on them. The Consumer Bureau has also undertaken enforcement actions that benefit consumers by either shielding them from harm or compensating them for wrong done by illegal financial practices. The Bureau has simplified bank disclosures borrowers receive when taking out a loan, protected military families against illegal foreclosures and abusive student and payday loans, and has guarded seniors from predatory scams. Further, the Bureau has obtained more than a billion dollars in compensation to consumers harmed by misleading credit card add-on products from big banks, and to consumers harmed by the recently uncovered egregious fraudulent acts of Wells Fargo in opening checking accounts without customers' approval. Finally, the CFPB has also provided $160 million in settlements to

consumers harmed by discriminatory auto interest rate mark ups where borrowers ended up with higher-cost auto loans when they qualified for more affordable loans. The Consumer Bureau hears directly from Americans harmed by illegal financial practices through its searchable public complaints database, which has helped people resolve disputes and allowed the Bureau to identify patterns in predatory industry practices. The system has recorded more than one million consumer complaints.[30]

Even though the economy is on a stable path to recovery and much has been done with the robust work of the Consumer Bureau, there remain areas of critical concern that must be addressed. The CFPB must be allowed to continue to do its work on behalf of consumers. For instance, unaffordable payday loans, which are often directly marketed to financially struggling lower wealth families, servicemembers, and communities of color, typically carry annual percentage rates (APR) of at least 300 percent. These high-cost loans are marketed as quick solutions to a financial emergency. Research shows, however, that they typically lead to debt which is hard to escape, and cause a cascade of other financial consequences, such as increased overdraft fees, delinquency on other bills, involuntary loss of bank accounts, and even bankruptcy. For unaffordable car title loans, the result is too often the repossession of a borrower's car, a critical asset for working families. Nationwide, payday and car title loans drain $8 billion in fees every year. [31]

The CFPB is in the process of developing rules to address unaffordable payday and car title loans and egregious arbitration clauses that deny consumers their day in court. There are also

---

[30] Consumer Financial Protection Bureau, CFPB Complaint Snapshot Spotlights Money Transfer Complaints: Bureau Marks Over One Million Consumer Complaints Handled (2016), *available at* https://www.consumerfinance.gov/about-us/newsroom/cfpb-complaint-snapshot-spotlights-money-transfer-complaints/.

[31] Diane Standaert and Delvin Davis, Payday and Car Title Lenders Drain $8 Billion in Fees Every Year (updated 2017), *available at* http://www.responsiblelending.org/sites/default/files/nodes/files/research-publication/crl_statebystate_fee_drain_may2016_0.pdf.

critical areas of reform that the Consumer Bureau must likewise be empowered to continue to address, including excessive and unnecessary overdraft fees, abusive debt collection practices, credit reporting errors, and student loan servicing practices that hinder students' ability to pay back their loans. It is critical to the American people and economy that this work continues.

VI. The two-tier regulatory approach should be continued and expanded. Other consensus reforms should be adopted.

Regulations should take into account the different business models of community banks and credit unions and their cost structure. Much has already been done in this regard and further steps can be taken. In addition, there are other broader reforms that can reduce obstacles and uncertainly without jeopardizing consumers or overall markets.

There are several substantial regulatory provisions that acknowledge and accommodate the special role and circumstances of community banks and credit unions. These include:

- Banks under $10 billion in assets that are exempted from the examination authority of the Consumer Financial Protection Bureau;
- Banks under $10 billion in assets that are exempted from the interchange provisions of the Durbin amendment;
- Banks under $10 billion in assets that are exempted from all of the enhanced bank prudential standards in Title I of Dodd-Frank;
- Regulators that have reduced liquidity and capital requirements based on bank size, with community banks exempted form new liquidity requirements and subject to more flexible capital requirements; and
- The CFPB's more flexible standards for small creditors and small rural lenders for numerous mortgage requirements including: QM status for small rural lender portfolio loans; higher interest rate thresholds for small lender QM safe harbor loans; exemptions from escrow and other servicing requirements; and generous standards for small rural bank balloon loans. This approach works and should be continued.

Other broader proposals that likewise enjoy broad support would provide further relief to all lenders. Further clarification of False Claims Act liability for Federal Housing Administration (FHA) loans is needed to reduce unnecessary uncertainty and protect responsible lenders. Another reform is that the interest rate level for QM safe harbor loans could be increased from

150 basis points over average prime offer rate (APOR) to 200 basis points. This would substantially reduce the number of mortgages that are classified as higher cost mortgages and that are excluded from safe harbor status. Finally, a major area of relief could be provided around the Bank Secrecy Act (BSA) and Anti-Money Laundering (AML) rules compliance.

BSA/AML compliance is a huge regulatory burden, especially for community banks and credit unions. These laws carry out the critical need to prevent our financial institutions from being used by terrorists, drug dealers, and other criminals to facilitate illegal activities. Today, the onerous task of determining the true identity of owners of accounts falls on the financial institution. The American Bankers Association found that this compliance is "the most costly regulatory burden."[32] It further found that this burden was especially costly for smaller banks. The Independent Community Bankers of America (ICBA) and others have asked that "ownership information should be collected and verified at the time a legal entity is formed by either the Internal Revenue Service or other appropriate federal or state agency, rather than by financial institutions. This would provide uniformity and consistency across the United States."[33] Bipartisan bills have supported this solution, and have been endorsed by the Clearing House Association. This important reform should be enacted.

VII. Conclusion.

Financial institutions, especially community banks and credit unions, play an important and essential role in this nation's financial market. CRL understands and supports the need for appropriate regulatory flexibility for small depositories. We oppose, however, any effort to use regulatory relief for community banks and credit unions as a vehicle for non-deposit-taking

---

[32] American Banker, BankThink, (2015) *available at* https://www.americanbanker.com/opinion/how-to-lighten-community-banks-aml-compliance-load.
[33] Independent Community Bankers Association, "2017 Plan for Prosperity," *ICBA* (2017), *available at* http://www.icba.org/docs/default-source/icba/advocacy-documents/priorities/icbaplanforprosperity.

lenders and larger financial institutions to avoid having the regulatory scrutiny and oversight that proved lacking in the build up to the financial crisis. The need for regulatory flexibility must be balanced against the importance of consumer safeguards, the safety and soundness of financial institutions, and the security of America's financial system as a whole. Federal financial regulators like the CFPB must be allowed to both protect the American people and ensure access to a broad, sustainable financial market.

We simply cannot afford another financial crisis. Congress should not roll back the CFPB and consumer protections under Dodd-Frank that have and continue to help millions of people across the country. The CFPB structure and funding should remain as Congress enacted so that the Bureau may continue its work on behalf of America's consumers without gridlock and special interest pressure.

I look forward to continuing to work with this Committee, community banks and credit unions, their associations, and regulators to ensure that all of these objectives are satisfied through laws and responsible regulations. Thank you for the opportunity to testify today, and I look forward to answering your questions.

Testimony of

R. Scott Heitkamp

President & CEO

ValueBank Texas

Corpus Christi, Texas

On behalf of the

Independent Community Bankers of America

Before the

United States House of Representatives

Committee on Financial Services

Subcommittee on Financial Institutions and Consumer Credit

Hearing on

"The State of Bank Lending in America"

March 28, 2017

Washington, D.C.

Chairman Luetkemeyer, Ranking Member Clay, and members of the Subcommittee, my name is Scott Heitkamp, and I am President and CEO of ValueBank Texas in Corpus Christi, Texas. I am also Chairman of the Independent Community Banker of America, and I testify today on behalf of the more than 5,800 community banks we represent. Thank you for convening today's hearing on "The State of Bank Lending in America."

Despite some recent, positive news on the state of bank lending, now is not the time to be complacent. From my vantage point as a community banker in south Texas, and from my conversations with hundreds of community bankers from around the country, I can assure you that the economic recovery is tepid, uneven and fragile. This view is supported by data that, when disaggregated, depict a recovery that is mixed at best and in need of strong remedies. These remedies include ICBA's Plan for Prosperity and several bills that will soon be introduced.

Today, a customer with a pristine credit score, or a larger, established business, can secure a loan, but this isn't the measure of a dynamic economy. When the credit box is tight, we experience subpar economic growth. To break out of this rut and strengthen economic growth, we must expand credit availability to the millions of hardworking households and would-be entrepreneurs with less than pristine credit scores. These potential borrowers, many of whom are at the middle- or lower- end of the income scale, deserve access to credit to purchase a home or to start a small business. Today's regulatory burden has choked off community banks' capacity to take on and manage reasonable credit risk.

Before I discuss proposed remedies, I'd like to give you some background on my bank. ValueBank Texas was chartered in 1967 and later acquired by my father. I'm proud to carry on his legacy as a second-generation community banker. Today, ValueBank Texas is a $213 million-dollar bank with 10 offices in Corpus Christi and suburban Houston with 114 employees. We specialize in small business and residential mortgage lending. As our name suggests, we are dedicated to creating value for our customers and our community. We are typical of thousands of community banks across the country with a vested interest in the success of the communities they serve, today and for generations to come.

Industry Consolidation Reduces Competition and Threatens Small Communities

Unfortunately, the number of community banks is rapidly dwindling. Today there are more than 1,700 fewer community banks than there were in 2010. Since that date, only three de novo community banks have launched operations. We are grateful to this subcommittee for holding a hearing on this critical topic just last week. The effect of industry consolidation is that many small communities are stranded without a local bank. These are the communities likely to be left behind in the recovery. Lack of competition will lead to fewer choices, lower rates on deposits, and higher fees and rates on loans. Any assessment of the health of the community banking industry must account for consolidation and the lack of de novo banks.

What's driving this consolidation and what is discouraging de novo formation? A significant factor is the rise in regulatory burden. Larger banks are much better able to absorb and amortize the sharply increasing cost of compliance. These same costs have a chilling effect on new charters. Meaningful regulatory relief will slow the consolidation trend and encourage new charters, creating a more vibrant financial system to the benefit of consumers and small business borrowers.

The Community Bank-Small Business Partnership

America's community banks are prolific small business lenders. We play an outsized role in funding small businesses and the jobs they create. While community banking organizations represent 17 percent of all U.S. bank assets, we make more than half of all small business loans. Small businesses account for over half of all U.S. employment and nearly two thirds of all employment growth.

What sets community banks apart is their first-hand knowledge of the borrower, the community, and the local economy. Community bank small business lending simply cannot be duplicated by a lender based outside the community. As noted in a recent study by scholars at Harvard's Kennedy School of Government: "In certain lending markets, the technologies larger institutions can deploy have not yet proven effective substitutes for the skills, knowledge, and interpersonal competencies of many traditional banks."[1]

One of the bright spots in today's economy is the surge in optimism among small business owners, as shown in the most recent survey by the National Federation of Independent Businesses.[2] Though credit demand remains weak, as this optimism translates into expansion and hiring, credit demand will grow. We must ensure the regulatory environment allows community banks to leverage their unique underwriting skills to meet that demand for credit and create economic growth.

A Burdensome Regulatory Environment Inhibits Lending

At ValueBank Texas, new, complex rules touch every aspect of our business and have changed the fundamental nature of our business from lending and investing to compliance with ever changing rules and regulations. Before 2008, our bank did not have dedicated compliance staff. We were able to manage our compliance program as part of the duties of our department heads. Today, that is no longer possible and we've been forced to hire dedicated compliance staff to aid our Chief Operating Officer in compliance management. This hiring has more than doubled our salary expenses related to regulatory compliance. On top of that, we've been forced to expand the scopes of our third-party compliance audits. Our cost for these audits have increased by over 150% since 2008. Unfortunately, these escalating compliance expenses are typical of community banks across the country.

As costly and time consuming as it is for us to stay on top of this burden, I want to focus my testimony on the customer impact. Simply put, regulatory overkill is cutting off access to credit for credit-worthy borrowers. The expense and distraction of regulatory compliance divert scarce funding and management resources from community lending – particularly for those marginal borrowers whose applications warrant closer review and a greater capacity for risk. These are the borrowers who get squeezed out by today's regulatory burden. According to a recent Urban Institute study, overly tight credit killed 1.1 million mortgages in 2015 alone.[3] These would-be borrowers are people with lower credit scores and lower income. The study found that tight credit was due in significant part to regulatory restrictions.

In addition to the *indirect* impact of resource diversion, there a number of new rules, particularly in the area of mortgage lending, that *directly* prohibit certain credit-worthy loans from being made by

---

[1] "The State and Fate of Community Banking." Marshall Lux and Robert Greene. Mossavar-Rahmani Center for Business and Government at the Harvard Kennedy School. February 2015.

[2] "Small Business Optimism Remains Near Record High." March 2017 Report: Small Business Optimism Index. National Federation of Independent Businesses.

[3] "Overly tight credit killed 1.1 million mortgages in 2015." Urban Wire. Urban Institute. November 21, 2016.

ValueBank Texas and other community banks around the country. Let me share a few examples that illustrate this point. In each of these cases, creditworthy individuals that would previously have been served are being turned away because new mortgage rules deny community bankers the flexibility to serve them or impose costs that make certain types of loans unprofitable.

- Customers who relocate for a new job often fail to satisfy the income verification requirements of the ability-to-repay rule (also known as the "qualified mortgage," or QM rule). Professionals with decades of experience in their fields – teachers, doctors, pharmacists, and others – who relocate to new areas are denied credit because they cannot produce enough pay stubs in their new job. A credit-worthy borrower shouldn't have to rent, and possibly be forced into a 12-month lease, because they don't have enough paystubs to qualify for a mortgage.
- Community bankers have to deny mortgage credit to small-business owners who cannot comply with the income-documentation requirements under the ability-to-repay rule, despite their excellent credit. The underwriting requirements of QM are inflexible and do not afford the lender discretion to use judgment or to weigh compensating factors such as a high net worth in making credit decisions.
- Low-dollar loans are typical in many parts of the country for purchase or refinance of residential properties. However, the fees on these loans, though low in absolute terms, often exceed the QM rule fee caps. A community banker from Ohio offers the example of a $75,000 loan with an 80 percent loan-to-value ratio and a cash-out feature. The closing fee for a QM loan in this dollar range is capped at $3,000, which is less than the lender's cost of underwriting and processing the loan. This is a credit-worthy loan that will not be made because the lender is not willing to take a loss. Ironically, the loan could be made and transferred to Fannie Mae or Freddie Mac, thereby receiving automatic QM status, but their fee would exceed $4,000, in addition to the originator's fee. QM, far from protecting the customer, causes them to pay significantly more or be denied access to the loan altogether.

I hear these stories again and again from community bankers from Texas and around the country.

Solutions

The good news is that there are readily available legislative solutions to the tepid and uneven economic recovery. Working with community bankers from across the nation, ICBA developed its Plan for Prosperity, a platform of legislative recommendations that will provide meaningful relief for community banks and allow them to thrive by doing what they do best – serving and growing their communities.

While the Plan contains nearly 40 separate legislative recommendations, they are organized around six broad themes:

- Improved access to capital to sustain community bank independence;
- Regulatory relief to promote lending and growth;
- Mortgage reform to strengthen the housing market;
- Reforming oversight and examination practices to better target the true sources of risk;
- Tax reform to restructure, modernize, and simplify our complex and inefficient tax code; and
- Provisions to create and strengthen economic prosperity in rural America.

Each provision of the Plan was crafted to preserve and strengthen consumer protections and safety and soundness. I encourage the members of this committee to review the Plan, which is attached to this statement.

This committee's work in the last Congress set the stage for enacting meaningful regulatory relief in this Congress. I want to highlight the Clear Act, soon to be reintroduced by Chairman Luetkemeyer. Last Congress's version contained provisions addressing mortgage regulatory relief; capital access; and reform of oversight and supervision. The bill was endorsed by 34 state community bank associations. A key provision of the bill, automatic QM status for any mortgage held in portfolio, is also contained in the Portfolio Lending and Mortgage Access Act introduced by Representative Barr. A portfolio lender that holds 100 percent of the credit risk has every incentive to thoroughly assess the borrower's financial condition. This is a simple, easy-to-apply solution to the threat of QM.

We also look forward to the reintroduction of Chairman Hensarling's Financial Choice Act. Last year's bill contained over two dozen community bank regulatory relief provisions from ICBA's Plan for Prosperity.

These bills, among others before the Committee, are all part of the solution to regulatory burden.

We strongly encourage this committee to complete the work that was begun in the last Congress and enact meaningful regulatory relief for community banks.

Thank you again for the opportunity to testify today. I look forward to your questions.

Plan for Prosperity: The Community Bank Agenda for Economic Growth

America's community banks stand ready to join with the 115th Congress and the incoming administration in creating a new era of economic growth and prosperity.

Providing nearly half of all small business loans as well as customized mortgage, consumer, and agricultural loans suited to the unique characteristics of their local communities, America's nearly 6,000 community banks serve a vital role in creating and sustaining economic growth in communities of all sizes and in every region of the country.

To reach their full potential as catalysts for entrepreneurship, economic growth, and job creation, community banks need relief from suffocating regulatory mandates. The exponential growth of these mandates affects nearly every aspect of community banking. The very nature of the industry is shifting away from community investment and community building to paperwork, compliance, and examination. The new Congress has a unique opportunity to simplify, streamline and restructure every aspect of the regulatory and tax environment.

ICBA's Plan for Prosperity ("the Plan") is an agenda for regulatory relief that will allow community banks to thrive by doing what they do best — serving and growing their communities one loan at a time. By reducing unsustainable regulatory burden, the Plan will ensure that scarce capital and labor resources are used productively, not sunk into unnecessary compliance costs, allowing community banks to better focus on lending and investing that will directly improve the quality of life in our communities.

Each provision of the Plan was developed with input from community bankers nationwide and crafted to preserve consumer protections and bank safety and soundness. ICBA and community bankers are committed to working with Congress and the administration to enact the provisions of the Plan with the use of every resource at our disposal. If we act boldly and make fundamental reforms, the American economy will grow and prosper for the benefit of generations to come.

Capital: Simplified Rules and New Options for the Creation and Preservation of Community Bank Capital

The Plan for Prosperity would strengthen community bank viability and independence by enhancing access to capital and simplifying capital regulation. New capital options for community banks would fuel economic growth and prosperity for all Americans.

Basel III Amendments: Restoring the Original Intent of the Rule. Basel III was originally intended to apply only to large, internationally active banks. Non-systemically important financial institutions (non-SIFIs) should be fully exempt from the rule.

In lieu of a full Basel III exemption for all community banks (which is ICBA's strong preference) ICBA proposes the following amendments:

- *Exemption from the capital conservation buffer.* The new buffer provisions impose dividend restrictions that have a chilling effect on potential investors. This is particularly true for Subchapter S banks, whose investors rely on dividends to pay their pro-rata share of the bank's tax. Exempting non-SIFIs from the capital conservation buffer would make it easier for them to raise capital.
- *Full capital recognition of allowance for credit losses.* Provide that the allowance for credit losses is included in tier 1 capital up to 1.25 percent of risk-weighted assets with the remaining amount reported in tier 2 capital. This change would reverse the punitive treatment of the allowance under Basel III. The allowance should be captured in the regulatory capital framework since it is the first line of defense in protecting against future credit losses.
- *Amend risk weighting to promote economic development.* Provide 100 percent risk weighting for acquisition, development, and construction loans. Under Basel III, these loans are classified as high-volatility commercial real estate (HVCRE) loans and risk weighted at 150 percent. ICBA's proposed change would treat these loans the same as other commercial real estate loans and would be consistent with Basel I.
- *Reverse punitive capital treatment of mortgage servicing.* For banks with assets of $50 billion or less, reverse the punitive Basel III capital treatment of mortgage-servicing rights (MSRs) and allow 100 percent of MSRs to be included as common equity tier 1 capital

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

Additional Capital for Small Bank Holding Companies: Modernizing the Federal Reserve's Policy Statement. The Federal Reserve Board should be required to revise the Small Bank Holding Company Policy Statement — a set of capital guidelines that have the force of law. The Policy Statement, which makes it easier for small bank and thrift holding companies to raise additional capital by issuing debt, should be revised to increase the qualifying asset threshold from $1 billion to $10 billion. Qualifying bank and thrift holding companies must not have significant outstanding debt or be engaged in nonbanking activities that involve significant leverage.

Relief from Securities and Exchange Commission Rules. The following SEC rule changes would allow community banks to commit more resources to their communities without putting investors at risk:

- Provide an exemption from internal control audit requirements for banks with a market capitalization of $350 million or less. The current exemption applies to any company with market capitalization of $75 million or less. Because community bank internal control systems are monitored continually by bank examiners, they should not have to sustain the unnecessary annual expense of paying an outside audit firm. This provision would substantially lower the regulatory burden and expense for small, publicly traded banks without creating more risk for investors.
- Regulation D should be reformed so that anyone with a net worth of more than $1 million, including the value of their primary residence, would qualify as an "accredited investor." The number of non-accredited investors that could purchase stock under a private offering should be increased from 35 to 70.

Repeal Collins Amendment for Non-SIFIs. The Collins Amendment to the Dodd-Frank Act (Section 171) was originally intended to equalize large bank and community bank capital treatment. In practice, however, the amendment limits regulators' discretion in implementing Basel III and has proved to be a stumbling block to simpler capital rules for community banks. ICBA supports full repeal of the Collins Amendment for non-systemically important financial institutions (non-SIFIs).

Address Minority Bank Capital Challenges. ICBA will work with Congress to explore options for addressing capital challenges faced by minority banks. These banks serve a critical role in providing credit, capital and financial services to low-to-moderate income and minority communities in urban, rural and suburban areas that are economically distressed.

Regulatory Relief

Community bank regulation, which has steadily increased for decades, is a cumulative, oppressive burden that limits access to credit in our communities and drives industry consolidation that will directly harm consumers and small businesses. Regulatory relief for community banks will promote greater economic growth in our local communities.

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

- The CFPB should be granted additional statutory authority to exempt or tier regulatory requirements for community banks and/or community bank products and services.
- The governance structure of the CFPB should be changed to a five-member commission rather than a single director. This change would strengthen accountability and bring a diversity of views and professional backgrounds to decision-making at the CFPB.
- The Financial Stability Oversight Council's review of CFPB rules should be strengthened by changing the vote required to veto a rule from an unreasonably high two-thirds vote to a simple majority, excluding the CFPB director.

Eliminate Arbitrary "Disparate Impact" Fair Lending Lawsuits. Amend the Equal Credit Opportunity Act and the Fair Housing Act to bar "disparate impact" causes of action and to require discriminatory intent for fair lending violations. Disparate impact describes differential results that arise despite the use of practices that are facially neutral in their treatment of different groups. Lenders must consider factors such as race and national origin in individual credit decisions to protect themselves from fair lending regulatory enforcement actions and lawsuits. Legislation is needed to require discriminatory intent for a finding of fair lending violations. This would ensure lenders that uniformly apply neutral lending standards are not subject to unnecessary regulatory enforcement actions or frivolous and abusive lawsuits under the Equal Credit Opportunity Act or the Fair Housing Act.

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

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

Modernizing the Bank Secrecy Act. ICBA recommends raising the currency transaction report (CTR) threshold from $10,000 to $30,000 and indexing future increases on an annual basis for inflation. The current threshold, set in 1970, is significantly dated and captures far more transactions than originally intended. A higher threshold would produce more targeted, useful information for law enforcement. ICBA also supports the creation of a tax credit to offset the cost of BSA compliance. (See "Tax Relief" below.) In addition, beneficial ownership information should be collected and verified at the time a legal entity is formed by either the Internal Revenue Service or other appropriate federal or state agency, rather than by financial institutions. This would provide uniformity and consistency across the United States.

Cutting the Red Tape in Small Business Lending: Eliminate Burdensome Data Collection. ICBA supports full repeal of the statutory authority (Dodd-Frank Section 1071) for new small business loan data collection requirements. This provision, which will likely require the reporting of information regarding every small business loan application, will fall disproportionately upon smaller banks that lack scale and compliance resources.

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

Preserve Access to Investment Advice for Middle Class Savers. ICBA supports full repeal of the Department of Labor's misguided fiduciary rule, which, if allowed to go into effect, would raise costs, limit choices, and reduce access to sound retirement investment advice for thousands of low and middle income Americans.

Mortgage Reform for Community Banks

Every aspect of mortgage lending is subject to new, complex, and costly regulations that are driving community banks out of this line of business. The Plan for Prosperity would support a robust housing market by providing relief from new mortgage regulations, especially for loans held in portfolio. When a community bank holds a loan in portfolio, it has a direct stake in the loan's performance and every incentive to ensure it is properly underwritten, affordable, and responsibly serviced.

Safe Harbor from Onerous Underwriting. Loans originated and held in portfolio by banks with less than $50 billion in assets, including balloon mortgages, should be granted "qualified mortgage" (QM) safe harbor status from the underwriting requirements of the ability-to-repay rule. In addition, any loan transferred to Fannie Mae, Freddie Mac, or a Federal Home Loan Bank should be automatically granted QM safe harbor status.

HMDA Relief. A recent Home Mortgage Disclosure Act (HMDA) rule more than doubled the number of data fields lenders must report in connection with every loan application, forcing community banks to overhaul their systems and retrain staff at significant cost. ICBA supports repeal of the Dodd-Frank authority for expanded HMDA reporting. In addition, the loan-volume threshold for HMDA reporting should be increased to 1,000 closed-end mortgages and 2,000 open-end lines of credit. The current reporting threshold exempts a maximum of 34,000 loans, according to a CFPB estimate, a minimal fraction of the nearly 10 million annual mortgage applications reported through HMDA last year. ICBA's recommended threshold would provide relief for many more small lenders without significantly impacting the mortgage data available to the CFPB or impairing the purpose of the HMDA statute.

Escrow Relief. Banks with assets of less than $50 billion should be exempt from escrow requirements for loans held in portfolio. Such banks have direct stake in protecting their collateral by ensuring taxes and insurance are paid on a timely basis.

Appraisals. In recent years, appraisal requirements have become more costly, and rural America is experiencing a critical shortage of appraisers. When a mortgage is held in portfolio, a bank should be able to substitute an in-house "property evaluation" for a full residential property appraisal completed by a licensed appraiser.

Preserve Community Bank Mortgage Servicing. Simplified servicing regulation would help preserve the important role of community banks in servicing mortgages and deter further industry consolidation, which is harmful to borrowers. The "small servicer" threshold should be raised from 5,000 loans serviced to the greater of 30,000 loans serviced or $5 billion in unpaid principal balance on loans serviced. To put this proposed threshold in perspective, the average number of loans serviced by each of the five largest servicers subject to the national mortgage settlement is 6.8 million, and each has an unpaid principal balance of more than $300 billion.

Reform of Closing Process and Paperwork. The TILA-RESPA Integrated Disclosure (TRID) rule, which governs the residential mortgage closing process and paperwork, is a uniquely complex rule with unclear liabilities. The rule has caused some community banks to cease offering mortgages and has greatly increased compliance expenditures for others. TRID reform should: (i) make waiting periods waivable at the request of the consumer; (ii) limit liability to violations that cause consumers actual, material harm; (iii) permit creditors to cure errors and make consumers whole before allowing the consumer the right to file a lawsuit; and (iv) exempt loans secured by large, mixed-use properties.

Bank Oversight and Examination

A trend toward oppressive, micromanaged regulatory exams is suffocating community banks' ability to serve their customers and communities. The following reforms would allow community banks to lead an economic revival on Main Streets across America.

Strengthening Accountability in Bank Exams: A Workable Appeals Process. An independent body should be created to receive, investigate, and resolve material complaints from banks in a timely and confidential manner. The goal is to hold examiners accountable and to prevent retribution against banks that file complaints.

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

- A two-year exam cycle for well-rated banks with up to $5 billion in assets would allow examiners to better target their limited resources toward banks that pose systemic risk. It would also provide needed relief to bank management for whom exams are a significant distraction from serving their customers and communities.
- Non-systemically important financial institutions (non-SIFIs) should be exempt from stress test requirements.
- Community banks should be allowed to file a short-form call report in the first and third quarters of each year and file the current, long-form call report only in the second and fourth quarters. The quarterly call report represents a growing burden on community banks without being an effective supervisory tool.
- The Community Reinvestment Act (CRA) asset thresholds should be modernized. The "small bank" and "intermediate small bank" thresholds determine how a bank is assessed. A separate threshold determines how often a bank is assessed. These thresholds do not reflect consolidation in the community banking industry and should be increased. Community banks prosper by reinvesting local deposits and serving all customers in their communities. Too frequent or intrusive CRA exams are unnecessary and force banks to expend resources that could otherwise be dedicated to serving customers.
- All banks with assets of $50 billion or less should be exempt from examination and enforcement by the CFPB and instead be examined and supervised by their prudential regulators for compliance with consumer protection regulation. CFPB backup (or "ride along") authority for compliance exams performed by a bank's primary regulator should be eliminated.

Community Bank Tax Relief

The 115th Congress presents a unique opportunity to restructure, modernize and simplify our complex and inefficient tax code. Tax reform and community bank tax relief, done properly, have the potential to strengthen our economy and spur job creation for a generation or more.

Lower Marginal Rates Needed for Individuals, Corporations, and Businesses. ICBA strongly supports tax rate relief for American individuals, corporations, and businesses. Significant tax relief will provide a much-needed boost to a sluggish economic recovery and possibly help stave off another recession by spurring consumer purchasing, business investment, and hiring. Rate relief must be a part of any tax reform package.

Incentivizing Credit for Low- and Middle-Income Customers and American Agriculture. ICBA supports the creation of new tax credits or deductions for community bank lending to low- and middle-income individuals, businesses, farmers, and ranchers. Such tax credits or deductions would help to sustain and strengthen lending to low- and moderate-income customers and America's farmers and ranchers, and would help offset the competitive advantage enjoyed by tax-exempt credit unions and Farm Credit System lenders.

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

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

Estate Tax Repeal. ICBA supports full, permanent repeal of the estate tax, which jeopardizes the succession of many family-owned community banks from generation to generation. A family estate should never be forced to sell its interest in a community bank to pay a transfer tax. Forced sales of once-family-owned community banks to other community banks or, frequently, to larger regional or national banks, coupled with a recent surge in regulatory burden, accelerate the current trend toward consolidation in the banking sector.

Update Bank Qualified Bond Issuer Limitation. Since 1986, the tax code has provided a special incentive for banks to purchase bonds issued by municipalities, school districts, sanitation districts, and other public entities, provided the issuer expects to issue no more than $10 million of bonds annually. These are known as "bank qualified bonds." Because the $10 million limitation has been severely eroded by inflation, today only a small number of issuers are eligible to take advantage of lower interest rates by issuing bank qualified bonds. The limitation was temporarily increased to $30 million by the American Recovery and Reinvestment Act of 2009. ICBA supports a permanent increase in the limitation to $50 million to be indexed prospectively. A higher limitation would allow local bank deposits to support needed, local public infrastructure investments at a lower interest rate, as originally intended by the 1986 Tax Reform Act.

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

Tax Credit for Bank Secrecy Act Compliance Costs. For community banks, BSA compliance represents a significant expense in terms of both direct and indirect costs. BSA compliance, whatever the benefit to society at large, is a purely governmental, law enforcement function with no direct benefit to the bank or its customers. As such, the costs should be borne by the government. ICBA supports the creation of a tax credit to offset the cost of BSA compliance.

Agriculture & Rural America

A vibrant rural economy is vital to America's prosperity. Community banks, which fund nearly 80 percent of all agricultural loans, serve a critical role in creating and sustaining rural economic prosperity. The following provisions will help rural America thrive by strengthening the community banks that serve agricultural enterprises.

Agricultural Loan Concentration Limits. Regulatory agencies and bank examiners should not treat agency guidance as official agency rule making, particularly with regard to concentration limits that could unnecessarily restrict community bank lending. Many banks in rural areas do not have economic choices beyond agriculture and such guidance, if interpreted as rule making, could dramatically increase their risks as they venture into new lending markets.

Tax Relief for Rural Lending. ICBA supports the creation of tax incentives to support agricultural lending and residential mortgage lending in rural areas. See Community Bank Tax Relief for more information.

Testimony of J. David Motley, CMB

President
Colonial Savings, F.A.

Committee on Financial Services
Subcommittee on Financial Institutions and Consumer Credit

"The State of Bank Lending in America"

March 28, 2017

Chairman Luetkemeyer, Ranking Member Clay, thank you for the opportunity to testify on behalf of the Mortgage Bankers Association (MBA)[1] on the current lending environment and the impediments to credit availability for the American homebuyer in today's market. I am J. David Motley, President of Colonial Savings, F.A. in Fort Worth, Texas, a Certified Mortgage Banker, and Chair-Elect of the Mortgage Bankers Association.

In accordance with the subcommittee's request, my testimony addresses the impact of federal regulation on mortgage lending, the constricted availability of credit in recent years, and how these factors have affected the ability of the mortgage industry to provide financial products or services to consumers and smaller lenders.

The Mortgage Bankers Association represents mortgage lenders of all sizes and business models: from small independent mortgage bankers, community banks, and credit unions to the nation's largest financial institutions. All of MBA's members play their own unique role in helping families all across the country achieve the American dream of homeownership.

Similarly, my community bank, Colonial Savings, serves consumers in all 50 states, originating $1.8 billion in mortgages in 2016 through its retail branches for both the bank's portfolio and for sale to the secondary market, and buying loans from smaller institutions that no longer maintain the capacity or have the desire to engage in mortgage servicing themselves. We are also a servicing outlet under the Federal Home Loan Bank Mortgage Partnership Finance Program and participate as a servicing buyer of the Fannie Mae/Freddie Mac Co-issue execution. Today Colonial services more than $27 billion in residential mortgages.

MBA has consistently supported reasonable requirements that will prevent a reemergence of housing and market disruptions. We believe some aspects of the Dodd-Frank Wall Street Reform and Consumer Protection Act and other statutes have made the mortgage market safer; however, in many other respects the Dodd-Frank rules have reduced the availability and affordability of mortgage credit for many American families.

Today, credit availability is substantially more constrained than it has been historically. Regulatory uncertainty combined with heightened enforcement risk have forced many responsible lenders to reconsider their ability to lend to the full extent of the credit box. These decisions ultimately impact the consumer, and often disproportionately impact low-to-moderate income borrowers, minorities, and first-time homebuyers.

While we believe some of these new regulations were needed, the pendulum has swung too far and certain aspects of the current regulatory regime warrant review and adjustment. These changes need to be considered judiciously to balance the need for appropriate consumer protections while ensuring access to safe, sustainable mortgage credit. In this regard, we strongly urge that particular attention be given to simplifying rules, providing greater clarity and certainty, and mitigating supervisory burdens. These goals are particularly important for smaller, community lenders that may not be able to sustain excessive compliance and legal infrastructures.

---

[1] The Mortgage Bankers Association (MBA) is the national association representing the real estate finance industry, an industry that employs more than 280,000 people in virtually every community in the country. Headquartered in Washington, D.C., the association works to ensure the continued strength of the nation's residential and commercial real estate markets; to expand homeownership and extend access to affordable housing to all Americans. MBA promotes fair and ethical lending practices and fosters professional excellence among real estate finance employees through a wide range of educational programs and a variety of publications. Its membership of over 2,200 companies includes all elements of real estate finance: mortgage companies, mortgage brokers, commercial banks, thrifts, REITs, Wall Street conduits, life insurance companies and others in the mortgage lending field. For additional information, visit MBA's Web site: www.mortgagebankers.org.

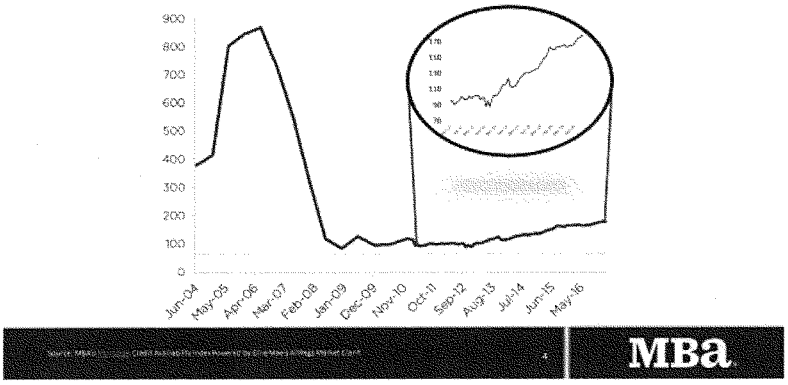
Background

According to MBA's Mortgage Credit Availability Index (MCAI) the availability of affordable mortgage credit is limited for many American homebuyers. The MCAI measures the quantity and quality of mortgage credit over time and for different segments of the market. A decline in the MCAI indicates credit is tightening, while increases in the index are indicative of greater credit availability.

Recent data show that mortgage credit availability increased 0.4 percent in February 2017 and reached its highest level since 2007.[2] However, recent increases in the index are deceptive, and a more detailed analysis shows that while the index reached a high of 869 in mid-2006, today it stands at 177. While no one would suggest a return to the unsustainable lending of the 2006 period, today's index remains less than half the level it was in 2004 (see Chart 1).

Chart 1

Mortgage Credit Availability In Historic Context



In addition to the overall tightening of credit availability, both production and servicing expenses have substantially increased over the past 10 years. MBA's Quarterly Performance Report data – which compiles financial statistics from more than 300 independent mortgage bankers – show that the costs to originate a mortgage loan for a consumer has increased from approximately $4,376 in the third quarter of 2009 to approximately $7,562 by the fourth quarter of 2016 (see Chart 2). Similarly, MBA's servicing data show the fully loaded cost to service a performing loan has gone from $58 in 2008 to $228 by the first half of 2016. For a non-performing loan this increase is even more dramatic, as costs have gone from $482 in 2008 to $2,522 by the first half of 2016 (see Chart 3).

[2] The increase in February was the net result of two countervailing movements. There was an increase in the supply of credit, as more investors offered affordable low down payment mortgages and streamlined documentation for loans guaranteed by the Federal Housing Administration and the Veterans Administration. This increase was partially offset by the first downturn in the availability of jumbo credit in a year, due to the consolidation of some jumbo programs.

Chart 2

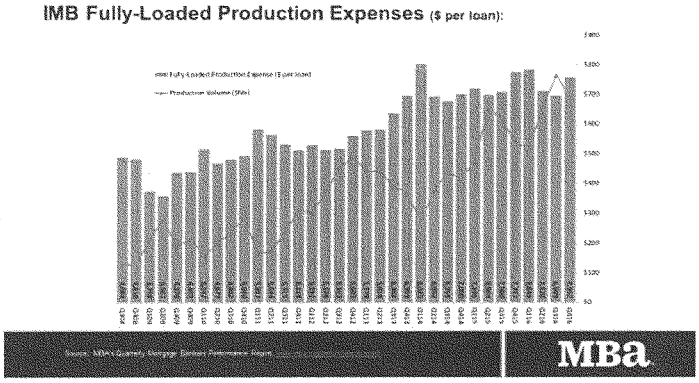
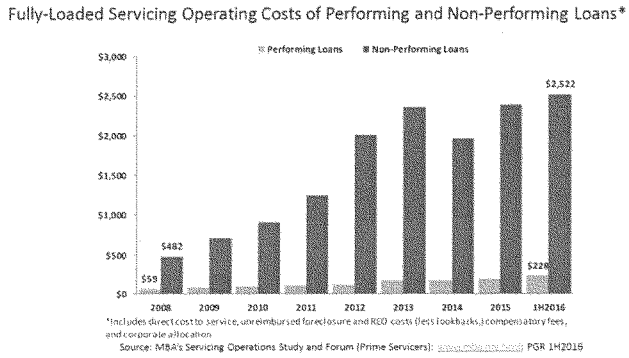


Chart 3



These soaring production and servicing costs are, to a large degree, a consequence of a new legal and regulatory landscape for mortgage lending. The Dodd-Frank Act charged several key regulators with drafting a number of significant and complex rules that impacted almost every facet of the mortgage industry. Most of these rules have already been implemented or are in the process of being implemented. Unfortunately, many of these rules were also drafted and implemented unevenly creating the need for additional clarifying rules and guidance or even considerable revision.

The Dodd-Frank Act also created a new regulator, the Consumer Financial Protection Bureau (CFPB). Although the CFPB is empowered with significant rulemaking authority, the CFPB's approach to redirecting behavior in the marketplace has relied heavily on enforcement actions.

For most financial institutions these actions have resulted in tremendous uncertainty about where and to what extent legal and reputational risks exist. Too often it is unclear how the CFPB interprets a particular statute until an enforcement action, or even multiple enforcement actions, have occurred.[3] Rather than responding proactively to a rule or guidance, financial institutions can only pay for considerably more counsel and compliance advice and hope they are not used to exemplify non-compliant behavior.[4] These costs are particularly burdensome to smaller lenders.

In response to these trends, MBA offers the following views and recommendations that we believe will remove, or at least diminish many of the regulatory impediments that are stifling today's mortgage market and lessening the availability of credit for American consumers.

Many Regulations Are Too Restrictive or Complex

While MBA recognizes the need for clear and reasonable regulations to ensure a safe and transparent mortgage market, we recommend that certain regulations be revisited and revised to encourage lenders to offer a greater degree of sustainable and affordable mortgage credit to consumers.

Ability to Repay and Qualified Mortgages

The Dodd-Frank Act and the CFPB's Ability to Repay (ATR) rule requires lenders to determine that a borrower has a reasonable ability to repay a mortgage before the loan is consummated. The law provides significant penalties and liability for failing to meet this requirement. The ATR rule also provides a presumption of compliance for loans that are originated as Qualified Mortgages (QMs), which provides greater certainty to lenders and mortgage investors regarding potential liability where there has been compliance but a claim is made.

In order for a loan to qualify as a QM, it may not contain certain "risky" features, such as interest only or negative amortization terms, and it must meet specified underwriting standards. These standards include a debt-to-income (DTI) ratio cap of no more than 43 percent, or in the alternative, eligibility for Fannie Mae and Freddie Mac (the GSEs) programs (i.e., the so-called "QM patch"). Borrowers also may not be charged points and fees that exceed three percent of the loan amount for loans in excess of $102,894 (in 2017). Loans below that amount are permitted to have fees in excess of three percent, based on a sliding scale.

The rule establishes a compliance *safe harbor* for QMs only if the Annual Percentage Rate (APR) of the loan does not exceed the average prime offer rate (APOR) for that mortgage by 150 bps or more. Loans to borrowers that exceed the APOR by more than 150 bps receive a *rebuttable presumption* of compliance if the loans otherwise qualify as QMs. Given the legal uncertainties of non-QM and rebuttable presumption lending, safe harbor QMs comprise the vast majority of the mortgage loans available in today's market.

---

[3] In a speech on March 9, 2015 at the Consumer Bankers Association, Director Cordray provided justification for employing agency and court orders instead of rules. He stated, "public enforcement actions have been marked by orders, whether entered by our agency or by a court, which specify the facts and the resulting legal conclusions." These orders provide detailed guidance. Director Cordray stated that "it would be "compliance malpractice" for executives not to take careful bearings from the contents of these orders about how to comply with the law and treat consumers fairly."

[4] One example of this practice is demonstrated in the current treatment of marketing services agreements between settlement services providers. While HUD had generally permitted these arrangements under Section 8(c) of RESPA as long as reasonable compensation was paid for the services, the Bureau asserted these arrangements were likely problematic and violative of RESPA regardless of the compensation. Moreover, the Bureau failed to provide any notice of its changed interpretation to the industry or the public prior to pressing its position in enforcement cases. Instead of issuing rules or guidance, Bureau positions have been articulated through settlements rather than through guidance or rules.

Although the level of additional risk outside the safe harbor has not yet been tested in litigation under Dodd-Frank, most lenders have understandably limited themselves to making only QM safe harbor loans to minimize potential liability and litigation. Non-QM loans have generally been available only to very low risk borrowers. As a result of some of the constraints in the QM definition, many borrowers who should qualify for a QM are unable to access safe, sustainable, and affordable mortgage credit.

MBA believes the ATR rule and QM standards must be improved and we continue to work with policymakers, including the CFPB, to responsibly widen the credit box.

While MBA appreciates some earlier efforts to address flaws in the QM definition, we believe changes to the ATR rule should not be confined to particular types of institutions or business models. The QM definition should be fixed holistically, not revised in piecemeal fashion with special exceptions for certain categories of lenders.

Specifically, MBA has made a number of key recommendations for refining the QM definition to cover additional creditworthy borrowers:

1. **Expand the Safe Harbor**
   All loans satisfying QM requirements should have a legal safe harbor regardless of their rate. The current 150 bps limit is too narrow considering the inclusion of fees in the APR.

2. **Increase the Small Loan Definition**
   The current definition of a smaller loan under the ATR rule – where points and fees may exceed three percent and still qualify as a QM – is set at $102,894 (for 2017). This metric is too low considering the average loan size is approximately $260,000. As a result, too many smaller loans do not qualify as QMs. The points and fees cap should apply only to loans of $200,000 or more, with a sliding scale that permits progressively higher points and fees caps for smaller loans. This change would increase QM lending to moderate-income borrowers who have smaller loan balances.

3. **Establish Alternatives to Appendix Q**
   For those loans not satisfying the QM patch, underwriting of QM loans must be conducted in accordance with Appendix Q of the rule. Unfortunately, Appendix Q is generally viewed as lacking sufficient guidance and flexibility to be used as an underwriting standard. To rectify this problem, MBA supports regulatory or legislative changes to allow the use of other commonly accepted underwriting standards such as those acceptable to the Federal Housing Finance Agency (FHFA), Federal Housing Administration (FHA), the Department of Veterans' Affairs (VA), and the Rural Housing Service (RHS).

4. **Broaden Right to Cure for DTI and other Technical Errors**
   MBA has long advocated for an amendment that would permit the correction of errors where the three percent points and fees limit is exceeded. To encourage lending to the full extent of the QM credit box, MBA also urges that the right to cure or correct errors be extended to DTI miscalculations and other technical errors. There is an existing points and fees cure, but it will apply only to loans closed on or before January 10, 2021. So there needs to be a permanent points and fees cure as well as a DTI cure.

5. **Revise the Points and Fees Definition**
   MBA supports H.R. 1153, the Mortgage Choice Act, which would exclude title insurance fees paid to lender-affiliated companies from the calculation of points and fees under the QM definition. Under the ATR rule, the QM points and fees calculation includes fees paid to lender-affiliated settlement service providers – but not to unaffiliated settlement service providers. Excluding fees paid to affiliates would result in greater competition between providers and benefit consumers. In addition, the treatment of mortgage broker fees results in identical loans being treated differently under the rules.

6. **Replace the Patch and the Default QM**
   The "QM patch" – which allows loans approved by the GSEs' underwriting systems to qualify as QM – is essential at this time, however, it is only a temporary solution while the GSEs are in conservatorship or until 2021. Loans must be consummated on or before January 10, 2021 (unless the conservatorship ends earlier). MBA urges the CFPB to start the process of working with stakeholders to develop a transparent set of criteria, including compensating factors, to define a QM – replacing both the QM patch and the 43 percent DTI standard. Such a standard must provide workable, flexible underwriting standards that are consistent with the Dodd-Frank Act without injecting undue complexity or uncertainty into the process of serving consumers' credit needs.

Servicing Market Regulations

Mortgage servicers currently have to deal with an interconnected and sometimes conflicting landscape of regulatory requirements and government program imperatives. As noted above, in this period of intense regulatory change, MBA data show the cost to service a performing loan has increased by $170 between 2008 and the first half of 2016. For a non-performing loan the jump is even more dramatic, as costs have risen by $2,040 between 2008 and the first half of 2016 (see Chart 3). These additional costs ultimately get passed through to consumers in costs for new loans. Likewise, they directly impact consumer access to credit as defaulted loans cost more than 11 times as much to service as performing loans, consequently causing lenders to reduce their exposure to borrowers that are perceived to pose greater risk.

MBA believes mortgage servicing market regulations would benefit from review under President Trump's recent Executive Order's direction to "make regulation efficient, effective, and appropriately tailored." Coordination among federal agencies and streamlining of existing regulations would go a long way toward lowering costs and increasing the availability of credit.

For example, VA, FHA, and GSEs all have divergent loan modification programs despite a broad consensus on what constitutes a successful program. To stem these differences, MBA strongly urges government insurer and guarantor alignment toward the recently released GSE "Flex modification" program to harmonize these requirements, reduce cost for servicers, and lessen confusion as well as disparities in outcomes based on loan products.

Additional Authoritative Guidance and Clarity is Needed in Key Areas

Notwithstanding the CFPB's preeminent role in consumer regulation, the Bureau has, with limited exceptions, followed a policy of only offering authoritative guidance in the form of formal rules and commentary. Most other guidance in the form of webinars, handbooks or other oral statements is prefaced with the caveat that only formal commentary and rules can be relied upon. While MBA believes that rules and commentary with an opportunity for public comment must remain the primary means of implementing the myriad laws for which the CFPB is responsible, its reluctance

to also offer authoritative written guidance as questions arise – through interpretative rules, FAQs or supervisory memoranda – has made lenders excessively cautious and defensive in their approach to lending.

Absent changes in the CFPB's practices, MBA supports congressional action to require the CFPB to develop an appropriate framework with public comment for its issuance of rules, policies, and supervisory guidance. This would include criteria for issuing rules, commentary, supervisory memoranda or compliance Bulletins to put the industry on notice regarding supervisory expectations on what the CFPB regards as illegal practices. Such legislation should provide that notices from the CFPB of potentially illegal conduct must be provided in sufficient time to permit compliance prior to any CFPB enforcement actions. MBA believes this type of legislation will ensure that consumer credit will not be lessened because of unnecessary confusion or fear regarding the legality of particular actions.

An example of an area where insufficient guidance has been provided is the Truth in Lending Act (TILA) Real Estate Settlement Procedures Act (RESPA) Integrated Disclosure (TRID) or "Know Before You Owe" (KBYO) rule. This CFPB rule requires the use of new, standard disclosure forms to be provided for virtually all mortgage borrowers nationally at the time of mortgage application and settlement, known as the Loan Estimate and the Closing Disclosure, respectively. Significantly, the rule not only changed the disclosure forms but also changed real estate transactions themselves by introducing a three-day waiting period before closing to allow borrowers to review their closing forms. Under the new rule, both lenders and assignees face significant potential liability for failures to comply.

The CFPB produced several webinars and helpful issuances, and participated in numerous conferences and forums leading up to implementation and beyond, and the MBA thanks the Bureau for these efforts. However, many questions regarding this uniquely detailed and complex rule arose and for long periods remained unanswered. Yet the CFPB steadfastly refused to offer timely, accessible FAQs or other authoritative guidance to regulated entities as other regulators do, except on a handful of technical matters.

The absence of timely, authoritative written guidance from the CFPB resulted in confusion and further complicated the implementation process. Most importantly, the lack of such guidance in some areas – such as cures and corrections – seized the market for a time, and other issues deprived some borrowers of timely closings and beneficial features of transactions such as lender and seller credits. Because of the lack of guidance, investors take different positions on issues, and often conservative positions. This results in delays when lenders try to sell loans, and in various cases lenders ultimately cannot sell loans because of perceived technical errors. This is contributing to constraints on the availability of credit to consumers. The provision of clear, written guidance from the CFPB would provide greater certainty to the industry and facilitate the flow of private capital into the mortgage marketplace.

Despite the extensive liability that can arise from TILA violations, the CFPB has largely foregone providing guidance on TRID liability taking the position that such questions will be settled by the courts. This uncertainty can be expected to spawn litigation, increase costs and limit credit to consumers.

Home Mortgage Disclosure Act (HMDA)

The HMDA rule implements provisions of Dodd-Frank that will vastly increase the loan level data collected and reported to the government on applications from and loans to individual borrowers.

The rule's new requirements for data collection and reporting generally go into effect in 2018 and 2019.

While we appreciate that the CFPB has recognized the problem of potential harm to privacy by virtue of the public disclosure of HMDA data and has committed to engaging in a public discussion about these issues, conclusions about the extent this data may be disclosed have not yet been reached. Given this uncertainty, MBA is concerned that if not resolved appropriately, the extent of disclosure may harm individual borrowers and the mortgage market.

We urge Congress to carefully monitor this issue and we support legislation, if necessary, to stop disclosure and possibly reporting of the new data until borrower privacy is adequately considered and protected from harm.

Rules Imposed by International Regulators Need Revision

In certain instances, regulations imposed on U.S. institutions by international regulatory bodies are acting as an impediment to lending and servicing, and should be reconsidered.

Basel III

The punitive treatment of mortgage servicing rights (MSRs) under the Basel III risk-based capital standards threatens to undermine the value of this important asset, with adverse implications for the entire mortgage finance chain. The new Basel III rule increases the risk-weighting of MSRs held by banks from 100 percent to 250 percent. It also decreases the cap on MSRs that a bank may hold on its balance sheet from a 50 percent common equity component of tier one capital to a more stringent 10 percent limit with MSR assets above the limit deducted from regulatory capital. In addition, MSRs, deferred tax assets and equity interests in unconsolidated financial entities are limited, in aggregate, to a 15 percent common equity component of tier one capital before they must be deducted from regulatory capital. This unnecessarily punitive treatment of MSRs makes them one of the most costly asset classes in the entire Basel III framework, despite any clear linkage of MSRs to the financial upheaval that Basel III is intended to address.

MSRs are not widely utilized outside of the United States but are a vital component of the American housing finance system's ability to provide a 30-year fixed-rate mortgage. These negative effects of the Basel III agreement on the mortgage market is an area particularly ripe for reevaluation in light of the President's Executive Order asking agencies to re-evaluate regulations to "enable American companies to be competitive with foreign firms in domestic and foreign markets" and "advance American interests in international financial regulatory negotiations and meetings."

MBA believes that performance, capacity and consumer service quality should be the primary drivers of which servicers gain market share, not excessively high capital standards on a particular segment of the industry. Nor should American banks be handicapped by an international agreement that discriminates against an asset that is uniquely integral to the American mortgage finance system. The current Basel treatment of MSRs, amid the backdrop of complicated and conflicting servicing rules, discourages many community banks from originating mortgage and retaining the servicing, or from acquiring servicing assets. Moreover, it impacts nonbank lenders by removing an important bid for MSR assets from the market.

Small Lender Burdens Need to be Addressed

MBA believes nonbank mortgage lenders play a key role in the mortgage marketplace. MBA supports risk-based supervision of nonbanks, but we are particularly concerned that in addition to dealing with a mountain of sometimes vexing rules, these entities must also deal with frequent and sometimes duplicative examinations from the CFPB and the states in which they operate. This increases costs and unduly strains the resources of these companies.

MBA urges rationalizing this process through either regulatory action by the CFPB or legislation that requires the CFPB to establish by rule a binding written policy of how the CFPB prioritizes the lenders it examines. The CFPB's current approach to "risk focused" examinations is neither codified in a rule nor established in other transparent formal procedural guidance to the industry. A multifactor approach – similar to how the Federal Deposit Insurance Corporation prioritizes exam resources for community banks – could include:

1. Size or market share (without setting a hard cap);
2. Referrals from state regulators;
3. Significant participation or market share in higher risk products;
4. Consumer complaint volume (relative to size, or a high volume of a specific complaint type);

MBA urges that efforts to mitigate examination burdens for nonbank mortgage companies should focus on establishing risk-based supervisory standards that ultimately would provide relief and clarity for *all* lenders.

In addition, MBA supports other efforts to ensure small lender concerns are addressed:

1. Establishment of notice requirements to lenders by CFPB identifying the factors that give rise to a scheduled examination;
2. Establishment of an exam appeals process for smaller lenders, including independent mortgage bankers (IMBs). MBA supports H.R. 1941 from the 114th Congress, and urges IMBs to be added to the bill;
3. Create an IMB Advisory Council at the CFPB, similar to the Bureau's existing Community Bank Advisory Council and Credit Union Advisory Council; and
4. Passage of H.R. 2121 from the 114th Congress, which will provide transitional licensing authority for loan officers moving between bank and nonbank lenders, helping labor mobility and allowing nonbank lenders to compete fairly for talented loan officers.

Other Issues Impeding Credit Access

Given the rising costs to originate and service mortgage loans, lenders must make other important risk management decisions for their businesses that may ultimately lead to increased costs for consumers and affect the availability of credit.

According to MBA data, the United States will see 15.9 million additional households formed over the next decade consisting of 10.3 million additional owner households and 5.6 million new renter households.[5] These households will increase the need for all types of housing over the next decade including the need for affordable financing options for first-time homebuyers and low-to-moderate income borrowers. The following highlights the need for attention to regulatory clarity,

[5] Lynn Fisher and Jamie Woodwell, Housing Demand: Demographics and the Numbers Behind the Coming Multi-Million Increase in Households, Mortgage Bankers Association, July 2015.

efficient and modernized systems, and other areas to help address these homeownership financing needs.

False Claims Act

FHA has played a significant role in helping families become homeowners since 1934 and continues to play a critical role in providing affordable credit access for many first-time and low-to-moderate income borrowers. MBA strongly supports FHA's mission and the need to protect and strengthen the financial viability of government-insured lending programs. In this regard MBA has supported efforts to improve the program and protect it from losses. However, the Department of Justice (DOJ) enforcement actions under the False Claims Act continue to overshadow HUD's certification process and lender participation in the FHA program. This resulting legal liability for participating lenders has caused some lenders to impose new credit overlays and/or limit involvement in FHA lending altogether to minimize risks from program participation. These factors have made FHA credit more expensive and less available.

Notably, on the same day FHA released its final loan-level certification on March 15, 2016, the Justice Department published a statement on its website defending its previous investigations of FHA lenders and the pursuit of certain lenders under the False Claims Act. In this statement, DOJ reaffirmed that "[t]he department will continue [its] enforcement efforts by using the False Claims Act, and will continue to be guided by the language of the act that prohibits the submission of knowing and material false claims."[6] Differing messages from HUD and DOJ have contributed to market uncertainty.

Moreover, despite DOJ's statement that "the False Claims Act requires more than mere negligence or a simple mistake to hold a person liable,"[7] our industry has found little comfort in these words. What is needed is a defined metric to classify various loan defects so lenders can focus their compliance efforts. In the absence of clear and unambiguous metrics for measuring loan defects, participating FHA lenders will continue using cautious, defensive underwriting to mitigate the risk of excessive enforcement actions for minor mistakes.

In order to truly improve and expand access to credit, MBA urges HUD to take all necessary steps to limit the overly broad certification regime that can lead to subjective judgments of what may constitute a "material" false claim under the False Claims Act when these errors may in fact be immaterial. To this end, MBA strongly recommends that HUD adopt a comprehensive, transparent, and predictable Quality Control program in conjunction with the full implementation of the Single Family Loan Quality Assessment Methodology (Defect Taxonomy). Accompanying clear and formal guidance is also needed to specify remedial actions for particular types of underwriting errors. In the absence of an amendment to the False Claims Act, these critical steps could establish a consistent regulatory hierarchy for identifying and classifying material errors to avoid harm to the FHA fund and ultimately its borrowers.

HUD Rules

In addition to False Claims Act liability concerns, a continued lack of clear program guidance paired with conflicting, complex, and antiquated FHA servicing rules has resulted in higher costs for the many smaller lenders that service this segment, the exit from the program of some traditional market participants, and ultimately tighter credit availability standards.

---

[6] Department of Justice, Justice Blogs, The False Claims Act & Federal Housing Administration Lending, March 15, 2016, at https://www.justice.gov/opa/blog/false-claims-act-federal-housing-administration-lending
[7] *Id.*

Complexity and risk in FHA servicing has also influenced decision-making for FHA program participants due to the increased costs associated with the servicing of FHA loans. FHA's conveyance process regulations and bifurcated timelines dramatically increase the risk of loss for FHA servicers and require different processes than those necessary to serve GSE loans. Reforms to FHA servicing are necessary to add cost certainty and reduce operational inefficiencies. Such reforms should include:

1. **Direct conveyance of foreclosed FHA properties**
   FHA should allow lenders to directly convey foreclosed properties to FHA, eliminating costly inspection regimes and delays – consistent with the GSE approach. At the very least, FHA should continue to expand the Distressed Asset Stabilization Program and Claims without Conveyance of Title program since they limit losses to both the FHA fund and servicers by providing an alternative path to the costly conveyance process.

2. **A unified timeline for FHA servicing process rather than three separate milestones**
   Eliminate the current three milestone timeline (first legal action, reasonable diligence, and conveyance) and hold the servicer responsible for compliance with one overall timeline. This is consistent with the GSE approach and incentivizes servicers to "catch up" if issues with the loan result in a slower process initially.

3. **Streamline FHA loss mitigation processes**
   There is widespread consensus that reduced documentation and targeted payment reduction are the factors to consider when designing a successful and accessible loan modification regime. Despite this, FHA persists with a documentation heavy approach that results in greater borrower fallout and higher servicing costs. As mentioned above, FHA should, to the extent possible, align with the recently released GSE "Flex Modification" which reduces borrower documentation burden and results in lower payments. This would help more borrowers stay in their homes and reduce losses to the FHA fund.

Government Housing Resources

Current FHA, VA, and Ginnie Mae program operations require modernization to operate efficiently and handle the volume of these programs. This lack of needed updates is adversely impacting the availability of affordable credit to FHA borrowers. To remedy this, MBA urges Congress to provide FHA, VA, and Ginnie Mae funding for this purpose at requested levels through the regular appropriations process.

Specifically, in order to sustain FHA's current operations and accommodate the work processes of its participating lenders, FHA requires additional funding for effective risk management processes, necessary staffing increases, updates to outdated technology systems, support for new systems (i.e. FHA's new Loan Review System), and the critical maintenance of FHA's program guidance. Notably, the HUD Inspector General has expressed specific concern about the current state of FHA's technology and the lack of its systems capabilities and automation to respond to the changes in business processes and the current IT operating environment. For example, FHA still relies on COBOL programming, while systems like Neighborhood Watch and FHA Connection frequently suffer from system crashes and limited maintenance.

Although MBA recognizes the need for fiscal responsibility in a difficult budget environment, we urge Congress to ensure that the FHA, VA and Ginnie Mae programs operate as 21st Century

programs. Up-to-date resources are critical to risk management functions, effective oversight of issuers and lenders, and protection of the American taxpayer from financial loss. Since their inception, FHA, VA, and in turn Ginnie Mae, have helped over 60 million Americans realize the dream of homeownership and build wealth while stabilizing communities across the nation. To continue this important work, adequate funding levels are vital to the FHA, VA and Ginnie Mae programs.

Conclusion

We commend the efforts of this Subcommittee to examine the regulatory hurdles limiting consumers from accessing affordable mortgage credit. No matter how well-intentioned rules and enforcement may be, we are concerned that key rules and practices are unduly restricting credit opportunities for qualified borrowers.

We thank the Subcommittee for the opportunity to offer our recommendations on these issues and look forward to working closely with you to improve both the affordability and the availability of sound mortgage credit for American families.

TESTIMONY BEFORE THE UNITED STATES CONGRESS
ON BEHALF OF THE

NATIONAL FEDERATION OF INDEPENDENT BUSINESS

NFIB
The Voice of Small Business®

Testimony of

Ms. Holly Wade,
Director of Research and Policy Analysis

before the

Committee on Financial Services Subcommittee on Financial Institutions and Consumer Credit

on the subject of

State of Bank Lending in America

on the date of

March 28, 2017

Good morning Chairman Luetkemeyer, Ranking Member Clay and members of the Subcommittee on Financial Institutions and Consumer Credit. Thank you for the opportunity to testify today on the "State of Bank Lending in America".

My name is Holly Wade, and I serve as the Director of Research and Policy Analysis for the NFIB Research Center. NFIB is the nation's leading small business advocacy association, representing members in Washington, D.C. and all 50 state capitals. Founded in 1943 as a nonprofit, nonpartisan organization, NFIB's mission is to promote and protect the right of its members to own, operate, and grow their businesses.

Small businesses are the bedrock of the U.S. economy with roughly 28 million small firms, of which, 5.8 million are small employers.[1] Small businesses account for about half of U.S. gross domestic output and about half of the private sector employment. Their contribution to the U.S. economy is vital to the creation of a strong foundation for the middle class, offering job opportunities and contributing to their local communities. Small businesses provide goods and services in every market, in every geographic region, and throughout every demographic across the country.

General Small Business Conditions

Over the past nine years, small-business owners have struggled to bounce back from the great recession with the economic recovery being painfully slow for many. NFIB's Small Business Economic Trends survey found small-business owners stuck in a below-average rut, with the survey's headline optimism index exceeding its 43-year average reading on a monthly basis only six times since July 2007, four of those recorded in the last four months.[2] Owners' optimism failed to improve, depressing their hiring and spending, keeping average GDP growth relatively flat at 2 percent over the last eight years. Over this time, government regulations proliferated, increasing the cost of doing business. In response to the combination of policy constraints and anemic GDP growth, few small-business owners found economic conditions and policies supportive of investing in or growing their business. This has translated into below average levels of borrowing among small businesses.

However, post-election, small-business owner sentiment improved dramatically with more owners optimistic about the outlook for business conditions and business expansion. The rosier outlook has translated into more favorable expectations for sales growth and hiring to support expected gains in sales. As owners' confidence in the economy and economic policies rise, they will be more likely to invest in and grow their business. Owners hold high expectations that Congress will now create a friendlier business climate for them to succeed.

Small Business Financing

---

[1] Small Business Administration, Office of Advocacy, Frequently Asked Questions. https://www.sba.gov/sites/default/files/advocacy/SB-FAQ-2016_WEB.pdf

[2] Dunkelberg, William C. and Holly Wade, *NFIB Small Business Economic Trends*, Series, NFIB Research Center.

One area of critical importance in facilitating growth in the small business sector is small-business financing. Small business's ability to access financing is a vital component of a healthy small-business sector. Small businesses rely on financing for general business operations but also expansion activities and reinvestment. NFIB regularly studies banking activities and borrowing trends among small-business owners. NFIB's Small Business Economic Trends survey offers a monthly update on borrowing and lending trends among a random sample of NFIB's 325,000 small-business members, a survey NFIB has conducted since 1973. Since the recession, loan demand has remained historically weak, even with record low interest rates still available. The percent of "regular borrowers" has remained in the low 30s with little pick up throughout the recovery whereas previous expansions experienced a level of "regular borrowing" closer to 40 percent. High numbers of firms remain on the "credit sidelines", seeing no good reason to borrow. The survey also asks owners if they were able to satisfy their borrowing needs over the last three months. While most are not interested in borrowing, the vast majority of borrowers were able to access desired financing. In recent years, about 4 percent report that they were not able to satisfy their borrowing needs each month, but this measure climbed to a record high of 11 percent in 2010.

These trends are further reflected in NFIB Small Business Problems and Priorities survey that asks small-business owners to evaluate 75 business-related problems.[3] Four years ago more small-business owners experienced difficulty obtaining financing due to tougher lending policies including an increased number of distressed borrowers due to the economic slowdown. Since 2012, financing has become a less significant issue for many owners with fewer interested in borrowing due to slow economic growth but also due to better balance sheets for those seeking credit. "Obtaining Long-Term (5 years or more) Business Loans" and "Obtaining Short-Term (less than 12 months or revolving) Business Loans" both fell precipitously from their 2012 rankings. The former fell from a ranking of 56th to 69th and the latter from 58th to its current ranking of 70th. The percent of owners ranking obtaining long-term and short-term loans as critical issues also fell from 2012 to 2016 from about 11 percent reporting each as a critical issue to 6 percent in the 2016 report. Federal Reserve policies continue to flush banks with cheap money to encourage consumer and small-business lending, but small-business owners are not experiencing the type of economic growth to support increased borrowing. And it appears that those who are interested in financing are generally able to access adequate levels of credit.

But there are a few pockets of small businesses that do have more difficulty accessing credit than the general population: businesses experiencing declining sales of more than 10 percent and those experiencing rapid growth of 50 percent or more in the last three years. The difficulties of the former are generally self-explanatory but the latter is of bigger concern as those businesses generate jobs and economic growth. Previous editions of the survey show similar patterns but far less severe than in 2016. For example, obtaining short-term and long-term loans currently ranks 39th and 42nd respectively for high growth firms compared to 70th and 69th for the overall population. Sixteen percent of this group find obtaining short-term loans a critical issue, and 14 percent say the same about obtaining long-term loans, more than double the percent of the

[3] Wade, Holly, *NFIB Small Business Problems and Priorities*, NFIB Research Center, series.

overall population. This disparity is also shown in the 2012 and 2008 issues, but far less pronounced.

The reasons why high growth small businesses are having a more difficult time obtaining credit compared to years past are less obvious, but the decline in the number of small, community banks is of particular concern. Small-business owners are far more successful accessing credit through smaller, regional banks than larger banks.[4] The downward trend is not new but over the last eight years the number of commercial banks has dropped from about 7,000 in 2009 to its current level of about 5,000. The importance of these banks cannot be overstated for small businesses but also for the banking system itself. Five thousand small banks cannot be systemically risky because they invest in local communities and in firms that are not nationally linked. NFIB worries that over regulating these smaller, community banks will create more bank consolidation and deter new bank formations. Loans to these small businesses are critical to the health of local communities and, collectively, to the health of the small-business sector.

Small businesses are in a good position if the positive expectations for real sales and business conditions over the last three months are translated into actual spending on capital equipment, expansion and inventory investment. If this occurs, borrowing activity should pick up. Market forces, not regulators in Washington, should manage the supply and price of banking services and loans so that small business financing remains available for a potential increase in small business borrowing.

Conclusion

NFIB hears from small-business owners year-round about the various challenges they face operating their business, including access to credit. The primary step in developing pro-growth policies is to first, "do no harm", especially when it comes to making it more difficult to operate their business whether due to regulations or creating a more difficult environment for firms to access financing. Small-business owners are in great position to invest in and grow their business given the right set of policies.

I appreciate the opportunity to discuss the current state of the small-business economy and the challenges it faces going forward. I look forward to working with the Committee to support small businesses and strengthen the U.S. economy.

---

[4] Dennis, William Jr., *Small Business, Credit Access, and a Lingering Recession*, NFIB Research Center, January 2012.

Jim Nussle
President & CEO

Phone: 202-508-6745
jnussle@cuna.coop

601 Pennsylvania Avenue NW
South Building, Suite 600
Washington, D.C. 20004-2601

March 28, 2017

The Honorable Blaine Luetkemeyer
Chairman
Subcommittee on Financial Institutions and
Consumer Credit
Committee on Financial Services
United States House of Representatives
Washington, DC 20515

The Honorable William "Lacy" Clay
Ranking Member
Subcommittee on Financial Institutions and
Consumer Credit
Committee on Financial Services
United States House of Representatives
Washington, DC 20515

Dear Chairman Luetkemeyer and Ranking Member Clay:

On behalf of America's credit unions, I am writing regarding today's hearing entitled, "the State of Bank Lending in America." The Credit Union National Association (CUNA) represents America's credit unions and their 110 million members. We respectfully ask you to include this letter for the record of the hearing.

Today's hearing intends to examine recent trends in bank lending and how the current regulatory climate impacts the availability of credit for consumers and small businesses. As you explore this topic, we encourage you to keep in mind that several factors, including compliance burdens from new regulations resulting in increased costs to consumers, should be considered in addition to lending trends.

While loan growth for most loan types has improved since the financial crisis, certain loan types have failed to recover to pre-crisis growth levels. For example, in the years since the enactment of the Dodd-Frank Wall Street Reform and Consumer Protection Act (2011 to 2016), 1-4 family home purchase originations averaged $1.7 trillion annually. That's 16% lower than the annual average in the 15 years prior to 2011. Over the 2011-2016 period, 1-4 family home purchase originations have failed to reach the $2.24 trillion low-water mark experienced in the 2001-2007 expansion. In fact, since 2011, the strongest year for total U.S. 1-4 family home purchase originations experienced $2.04 trillion in originations – which is roughly 10% lower than the previous-cycle low (in 2001) and 46% lower than the previous expansion peak production (in 2003). While lending has been growing year-over-year since the crisis, it has not reached pre-crisis loan growth levels despite near-full-employment, rising incomes and the very low interest rate environment.

One of the reasons that loan growth has not recovered to pre-crisis levels is that federal regulators have imposed more than 200 regulatory changes on credit unions and other lenders. The largest financial institutions, which comprise the greatest share of bank lending, are the least impacted by this increased regulatory burden because they can, for the most part, spread the cost of compliance over large economies of scale. Nevertheless, the impact of these rules is being felt by credit unions and small banks that do not have the scale over which to spread the burden. In this respect, the system created by the Dodd-Frank Act essentially rewards the largest banks and less regulated nonbank lenders – the very institutions that caused the financial crisis –with one-size-fits-all rules that give them a competitive advantage over credit unions and small banks and push more consumers into their products.

It is important for the subcommittee to examine the full scope of how lenders, particularly small lenders, are responding to the new requirements. Earlier this year, we surveyed credit union executives to measure the impact of these rules on credit union members. The findings indicate:

- More than four in 10 credit unions (44%) that have offered mortgages sometime during the past five years have either eliminated certain mortgage products and services (33%) or stopped offering them (11%), primarily due to

burden from CFPB regulations. Credit unions with assets of less than $100 million are the asset group most apt to have dropped their mortgage program altogether.

- TILA-RESPA Integrated Disclosure rules are far and away (80%) the single rule most negatively impacting credit unions that have offered mortgages. This is followed by the Qualified Mortgage rules (43%) and, at more of a distance, Mortgage Servicing (30%) and HMDA rules (19%). TILA-RESPA serves as the most troublesome rule for all asset groups. (Notably, many credit unions have not even yet turned their full attention to the new requirements in the new HMDA rules so this impact is likely understated).

- One in four credit unions (23%) that currently offer HELOCs indicate they plan to either curtail their HELOC offerings or stop offering them in response to the new HMDA rules.

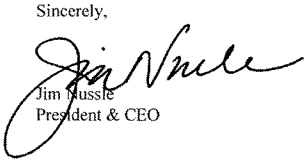
One-size-fits-all regulation robs consumers of lending options from smaller community financial institutions and can often push consumers to use less regulated lenders. The Wall Street banks can afford to comply with these rules and their contribution to overall loan growth will mask slower loan growth or lending contraction by smaller lenders. We have encouraged the CFPB to use its existing exemption authority to shield smaller and less complex financial institutions lenders from the most onerous requirements of its new regulations; however, the CFPB has not used its exemption authority effectively.

As credit unions continue to implement new CFPB mortgage related rules such as the Home Mortgage Disclosure Act, the costs and burdens of one-size-fits-all rules continue to be felt and this disproportion compared to the largest lenders will continue to grow. While handpicked data may paint the market in one light, from a compliance perspective credit unions are continually forced to consider ongoing costs and future potential problems that could result from new rules such as lender liability from the qualified mortgage rule. The result as highlighted in the survey of CUNA members is that they are forced to make difficult decisions to reduce or abandon offerings, which can be a consumers' safest and most affordable option, to protect the resources of the membership as a whole. For smaller and less complex financial institutions, complex rules mean they are spending more time on compliance and less time innovating and working directly with members.

Lastly, we remain concerned that CFPB rules have left credit unions vulnerable to frivolous class action litigation and other unintended consequence that may not be realized until the next economic downturn. The subcommittee should carefully examine the larger picture of the playing field CFPB rules have created for small financial institutions compared to the largest banks and nonbank lenders, and the unintended consequences that may be harming America's consumers.

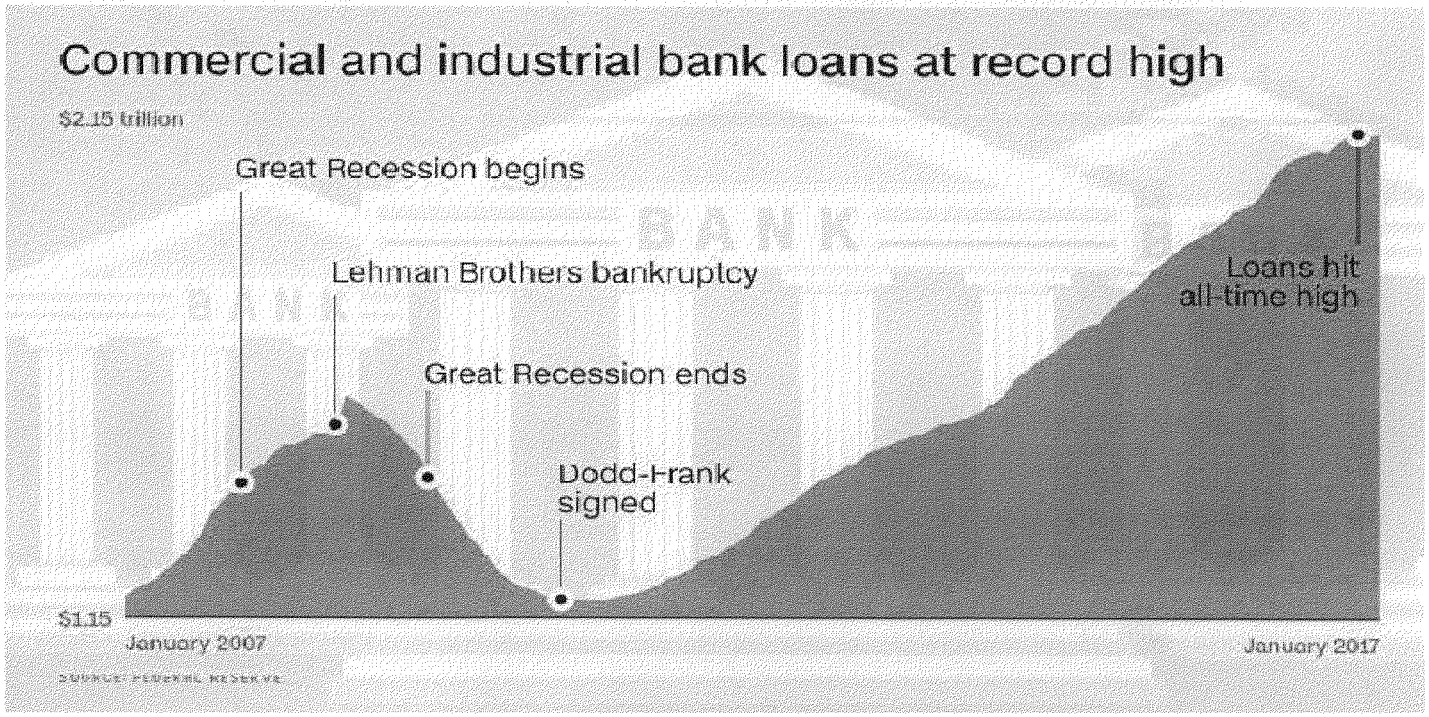
On behalf of America's credit unions and their 110 million members, thank you for your consideration of our views.

Sincerely,



Jim Nussle
President & CEO

FACT: Business lending has increased 75% after Dodd-Frank



Why we must base the banking regulation debate on real data

Paul H. Kupiec

February 28, 2017 10:59 am | *The Hill*

America's financial landscape is changing and not necessarily for the best. Small banks and the credit they provide are disappearing under the Dodd-Frank Act, and yet senators would never know this after listening to the recent Congressional testimony of Federal Reserve Chairman Janet Yellen.

During the hearing, Sens. Sherrod Brown (D-Ohio) and Elizabeth Warren (D-Mass.) led their witness through a series of questions that generated answers to frame a spirited defense of the Dodd-Frank Act. However, independent analysis highlights important inaccuracies in Chairman Yellen answers that undermine the Democrats' defense strategy.

The defense of the Dodd-Frank Act flows from the answers to three basic questions: Hasn't the extra capital required by the Dodd-Frank Act made the system safer? The administration says it's hard to get a bank loan, but isn't credit readily available? Didn't banks just post record earnings?

Affirmative answers to these questions, if true, are designed to support only one conclusion: that the Dodd-Frank Act must stay.

In answering the senators' questions, Chairman Yellen's played her part. That she confirmed the senators' narrative is no surprise. To protect its new Dodd-Frank powers, the Fed must align itself with the fight against Dodd-Frank repeal.

Given the Fed's interest in preserving its powers, committee members must consider independent analysis of the economic data. Once they do, I expect that many will agree that the witness was too quick to agree to with the Brown-Warren Dodd-Frank defense.

One particular issue of concern relates to Yellen's testimony on the availability of small business credit. In response to Sen. Brown's prodding about bank credit availability, Yellen cited a survey by the National Federation of Independent Business that found only 4 percent of small business respondents having difficulty securing "all of the credit they need" and just 2 percent citing credit access as a problem.

Yellen's reference to an association's survey is puzzling since the pace of small business lending can be tracked using regulatory data collected by the Federal Reserve and other federal banking regulators. In fact, the government's own data show remarkable weakness in small business lending.

In June 2008, before the financial crisis took hold, regulatory data indicate total nonagricultural small business lending of $711.5 billion. In June 2016, eight years after the financial crisis, total lending to small business was $613.8 billion. The Federal Reserve's own data show that small business lending is 14 percent below its pre-crisis level.

The Federal Reserve Chairman missed the opportunity to explain a fundamental "supply problem" that is restricting the supply of small business bank credit under Dodd-Frank. The Fed's own research shows that smaller banks play an outsized role in providing small business credit. Moreover, when small banks are acquired by large institutions, lending to small businesses generally suffers. Thus a significant reduction in the number of small banks will likely reduce bank small business credit. This is precisely what is happening under the Dodd-Frank Act.

Regulatory data indicate that, in 2008, the 8,345 banks with less than $10 billion in assets supplied $388.8 billion in small business loans. By 2016, only 5,954 of these banks remained, providing $308.4 billion in small business credit. The demise of nearly 2,400 small banks, along with the the regulatory burden of Dodd-Frank on surviving small institutions, coincides with a 21 percent decline in community bank small business lending. Moreover, the largest banks have not filled the lending gap. The dollar volume of small business loans made by banks with more than $10 billion in assets actually declined by 5.35 percent over this period.

Small business lending aside, the headline numbers on the banking system's capitalization and earnings, cited by Sen. Warren might lead one to believe that banks have become wildly prosperous under the Dodd-Frank Act. One look at the data shows that this interpretation is an illusion — the banking industry is significantly underperforming by historical benchmarks.

The data tell us that, overall, bank lending growth remains anemic. Bank earnings, while at record dollar amounts, are inflated by the record level of assets in the system. On a return basis, industry average return on assets is 20 percent to 40 percent below rates typically recorded in pre-crisis years.

The weakness in banks' current average return on assets is especially notable since banks normally post their strongest asset returns in the mature stages of an economic expansion, before the credit cycle sours. The current economic recovery is already old by historical standards. In other words, current rates of return — as poor as they are — are likely to be as good as they get under Dodd-Frank.

And while the mega-banks must have more capital under the Dodd-Frank Act, the concurrent increase in concentration of assets among the largest institutions may have only increased, and not decreased, systemic risk. Indeed, many senior federal bank regulators remain unconvinced that Dodd-Frank has fixed the too-big-to-fail problem.

A sound case for or against Dodd-Frank reform must be based on real data, and not a false narrative. It is ironic that, in their hearing statements, Sens. Brown and Warren both accused the Trump administration of playing fast and loose with the data. When Senate Banking Committee members reflect on the accuracy of testimony regarding Dodd-Frank reforms, they would be wise to recall the words spoken by their colleague Sen. Brown: "Just because people in high places say it's true doesn't make it so."

Paul Kupiec is a resident scholar at the American Enterprise Institute, where he studies systemic risk and banking regulation. He previously served as director of the Center for Financial Research at the Federal Deposit Insurance Corporation and chairman of the Research Task Force of the Basel Committee on Banking Supervision.

This article was found online at:
https://www.aei.org/publication/why-we-must-base-the-banking-regulation-debate-on-real-data/