EXAMINING COMMUNITY BANK REGULATORY BURDENS

HEARING

BEFORE THE

SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT

OF THE

COMMITTEE ON FINANCIAL SERVICES

U.S. HOUSE OF REPRESENTATIVES

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EXAMINING COMMUNITY BANK REGULATORY BURDENS

Tuesday, April 16, 2013

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 10:03 a.m., in room 2128, Rayburn House Office Building, Hon. Shelley Moore Capito [chairwoman of the subcommittee] presiding.

Members present: Representatives Capito, McHenry, Pearce, Posey, Fitzpatrick, Luetkemeyer, Duffy, Stutzman, Pittenger, Barr, Cotton; Meeks, Maloney, Watt, McCarthy of New York, Scott, Green, Ellison, Velazquez, Murphy, Delaney, and Heck.

Ex officio present: Representatives Hensarling and Waters.

Chairwoman CAPITO. The subcommittee will come to order.

Without objection, the Chair is authorized to declare a recess of the committee at any time. Luckily, I don't think we are expecting votes until 1 p.m., so we will have a good stretch of time here.

This morning's hearing is the second installment in a series of hearings focused on regulatory relief for community financial institutions.

Last week, we heard from a panel of credit union representatives. Today, we will hear from community bankers. These hearings are an opportunity for our Members to further examine proposals for regulatory relief from community financial institutions.

The challenges facing community banks across this Nation are not new. Every time our Nation experiences a financial crisis, Congress responds with new regulations, and in some cases new agencies, rather than identifying outdated, unnecessary, or overly burdensome regulations. While formulating these new policies, too often the response is just to pile new regulations on top of the old. We are now seeing this as the Dodd-Frank Act is implemented by the Federal regulatory agencies.

Unfortunately, the growing regulatory burden is having a real effect on communities across the Nation. The more time and resources community bankers devote to compliance, the less time they have to work with their communities to drive innovation and economic growth.

This is especially troubling given that the community banks provide 46 percent of the industry's small denomination loans to farms and businesses.

These types of loans are often labor-intensive, and the strong relationships community bankers have with their clients allows them to provide tailor-made products.

One of our witnesses today will discuss the adverse effects the regulatory burden is having on consumers and their access to financial products.

We must find a way for policymakers, regulators, and financial institutions to develop better ways to track the cumulative burden regulations place on financial institutions.

If we do not, we will continue to see further consolidation in the industry which will have a profound effect on the world communities, like the State I represent, West Virginia.

In many of these areas, community banks are the only banks that serve the needs of their communities. Their local knowledge and connection to families and businesses they support is a critical aspect of our Nation's diverse financial system.

One area that I will continue to focus on is the examination process for financial institutions. Last night, Representative Maloney and I reintroduced the Financial Institutions Examination Fairness and Reform Act. This bipartisan legislation has support from Members across the geographic and political spectrum.

We need to ensure that regulators have the tools to maintain a safe and sound financial system, but we also need to ensure the community banks and credit unions have an impartial avenue to appeal materials, supervisory decisions, and ensure consistency in examinations.

Today's witnesses will provide the subcommittee with recommendations on ways to improve the regulatory environment for community banks.

I would like to thank you all for your willingness to share your thoughts. I am especially pleased that my constituent, Bill Loving, from Pendleton Community Bank is able to join us here today.

Bill is a wonderful advocate for community banks and understands rural communities and the banks that serve them.

I now yield to the ranking member of the subcommittee, the gentleman from New York, Mr. Meeks, 2 minutes for the purpose of making an opening statement.

Mr. MEEKS. Thank you, Madam Chairwoman.

Thank you for holding this hearing today. This is, as you said, the second hearing we have held in the last month on examining regulatory relief for smaller institutions, whether they are credit unions or community banks, and I can't think of a more worthy topic to consider in this subcommittee.

Community-based institutions play a vital role in every district in this country and I hope that this is something that we can agree upon on a bipartisan manner and look at reforms that will help these small banks. I will ask about Basel III and its potential impact on the industry.

As I mentioned in our first hearing, I worry that Basel III is too complicated and does not offer the appropriate risk weightings to different classes of assets. For example, it would apply a discount to any asset that isn't sovereign debt in the U.S. Treasuries or cash.

This means a bank that specializes in mortgages, for example, may have to hold a lot more capital against those mortgages to satisfy the minimum capital requirements; however, it would make sense to me to not have capital requirements that jeopardize the worthy economic activities spurred by lending firms from smaller and medium-sized or regional banks, institutions that don't engage in the exotic activities that some of the larger institutions do.

As we learned in the FDIC's recently released community banking study, smaller and regional institutions are the engines of economic growth in this country because they lend to their neighbors and their communities to keep their farms or their small businesses going or to hire employees.

In fact, as you have indicated, the study noted that although community banks hold only 14 percent of the banking industry's assets, they make 46 percent of the smaller denomination loans to farms and small businesses.

They are often the sole source of mortgage financing, and therefore the lifeline of the housing industry in our communities. It was not their activity that blew up the global banking system, and I think the capital requirements we have placed on banks should recognize that.

I want to work with all my colleagues, the Republicans and regulators and Democrats, on that issue to make sure that we do not stifle the economy through well-intentioned but ultimately inappropriate rules.

Last week, I ended my opening statement at the hearing on credit unions by including a plea for credit unions to cooperate with community banks on regulatory reform. So what is good for the goose is good for the gander. I hope that the community banks represented here today will come together with credit unions to help advance commonsense reforms for both groups so we can make the changes necessary to decisively move the economy in the right direction.

I thank you, Madam Chairwoman, and I look forward to hearing the testimony of the witnesses.

Chairwoman CAPITO. Thank you.

Mr. Duffy for 2 minutes.

Mr. DUFFY. Thank you, Chairwoman Capito, for holding this very important hearing. As you mentioned, last week we focused on credit union regulatory burdens. This week, we are focused on community bank regulatory burdens.

My district is dotted with both types of lenders, and if our community banks can't get dollars out the door then it is not just the banks that suffer: it is the family who is trying to buy a home; it is the entrepreneur who is trying to start or expand their business; or it is the farmer who is trying to purchase a new piece of equipment who suffers. It is our local economies that these community banks serve that suffer when they are not well-functioning.

In the past few years, we have seen banks consolidate, and tighten credit, consumer product options have diminished, and compliance costs have skyrocketed. While we have a strong community bank presence in Wisconsin, I wish I could say the sector is expanding, but unfortunately it is the opposite. The number of community banks in Wisconsin has decreased over the past years as the number of employees has also shrunk.

On the other hand, the banking regulators are on a hiring frenzy. From 2010 to 2014, the CFPB has grown from zero employees to 1,500 employees. That is more employees than the Department of the Treasury.

The Dodd-Frank Act promulgated more than 400 new rules and only about half of them have been finalized. The tide is still rising and the paperwork is piling up.

Today, I look forward to hearing from our witnesses on how we can stop these negative trends and alleviate these burdens. I have strongly opposed a one-size-fits-all approach to many of these new regulations.

There are 253 FDIC-insured banks in Wisconsin with under $1 billion of assets. These are not the guys who caused the financial crisis, but they are being roped into the new regulations as if they were the bad actors.

Today, I am interested in hearing more about your concerns with Basel III, QM, and how other rules are seriously affecting the way community banks lend and operate.

My concern is that homeowners and small businesses back home in central, northern, and western Wisconsin are the ones getting hurt by many of these new regulations.

With that, I yield back, Madam Chairwoman.

Chairwoman CAPITO. The gentleman yields back.

Mrs. Maloney for 3 minutes.

Mrs. MALONEY. Thank you, Chairwoman Capito and Ranking Member Meeks, for calling this hearing, and I also thank all of the panelists. We really look forward to what you have to say.

First of all, Madam Chairwoman, I would like to remember Charlie Wilson, who passed away this past Sunday. He was a member of this body, a member of this committee for two Congresses, and he was himself a community banker and he brought that understanding and passion to the committee.

He played a very forceful role particularly in financial institutions and community banks and also housing, and I wanted to remember him at the beginning of this hearing and the contribution that he made to Ohio and to our country.

This hearing is the second in a two-part hearing on smaller financial institutions, community banks, credit unions, and regional banks and identifying ways that we can make sure that they keep doing what they do best: providing financial services to communities, neighborhoods, and their customers.

These community banks, in the last financial crisis—which took $17 trillion out of our economy—were truly, I believe, the unsung heroes and heroines: the regional banks; credit unions; and community banks.

I speak for the community that I represent. They were the financial institutions that kept providing the traditional loan opportunities for small businesses, home purchases, and refinancing. Those services were provided by the community banks and helped us revive.

They are unique in many ways to the American financial system and we need to make sure that their services are there, that we understand their needs, and that the regulatory burden is not so great that it forces them to either close their doors or to merge.

In response to this, the Chairlady and I have written a letter to the Federal Reserve that calls upon them to be uniquely aware of the capital requirements that are required under Basel III.

Basel III was written for global commerce. If community banks are not involved in global commerce, then we should not have those standards on them.

I ask permission to place this letter in the record. I have met with the Federal Reserve as I am sure the Chairlady has—

Chairwoman CAPITO. Without objection, it is so ordered.

Mrs. MALONEY. —and I am getting very positive indications back that they are going to be sensitive to the dual responsibilities, and I have had such interest in this letter, Madam Chairwoman, that I want to circulate another one that other Members can sign because they keep asking me, "Can I go on the Capito letter you did?" And I said, "We have already sent it." But they want to show their concern for fair treatment to these institutions.

In response to the financial crisis that according to Christina Romer was 3 times stronger than the Great Depression, the community banks, along with the whole banking system, were under tremendous pressure.

And during this time, Chairlady Capito and I authored the Financial Institution Examination Fairness and Reform Act to make sure that they had the strength to respond.

In examinations, they often felt like they couldn't speak up, and this bill generated over 190 co-sponsors in the last Congress and has been introduced yesterday by Senators Manchin and Moran. I do hope that this is one area where we can reach across the aisle and have strong bipartisan support.

And in closing, we have the need for both very large institutions that are necessary to compete in the global marketplace, but we don't need to have that standard then put on community banks that the regulation is so overwhelmingly burdensome. But we have to respect the role that each of these institutions plays in our financial system.

I look forward to your testimony. Thank you.

Chairwoman CAPITO. Thank you.

Mr. Pittenger for 1½ minutes.

Mr. PITTENGER. Thank you, Chairwoman Capito, for holding this important hearing and allowing me the time to make an opening statement.

We have seen in the wake of the financial crisis the only prescription from D.C. was to regulate away the problem. Unfortunately, this has had a severe impact on smaller financial institutions, especially community banks, and it has also led it to an anemic economic growth and a persistent high unemployment.

One of the first district events I held was to sit down with a number of community bank presidents and listen to their concerns regarding the amount of regulations pouring out of Washington.

The same concerns were voiced time and again, "We didn't cause the crisis, and our banks didn't take bailout money, but yet we are the ones suffering the consequences."

All we need to look at is the consolidation of these banks for the past several years. Even the FDIC's community banking study found that the number of federally-insured banks decreased from nearly 18,000 in 1984 to 7,000 in 2011. We are witnessing the devastating loss of community banks throughout the country.

After sitting on a community bank board for over 10 years, I have seen firsthand how these institutions have a positive impact in the community and the types of services they provide to their customers.

Failure to listen to their concerns and adopt a new regulatory approach will only lead to further consolidation of these banks, and less options for Americans, and will impede our Nation's economic recovery.

Today's testimony provides a great opportunity to hear from community banks about regulatory and compliance issues, and I look forward to hearing their concerns.

I yield back my time.

Chairwoman CAPITO. Thank you.

The ranking member of the full Financial Services Committee, Ms. Waters, is recognized for 2 minutes.

Ms. WATERS. Thank you very much. Madam Chairwoman, I would like to thank you for holding this hearing. This may be one of the most important ones that we will be involved with anytime soon.

I want to thank the witnesses for taking time to come talk to us today, and I would like to personally thank Mr. Pinkett for agreeing to testify in front of the committee today.

He is the CEO of City National Bank of New Jersey and serves on the Office of the Comptroller of the Currency's Minority Depository Institution Advisory Committee.

Thank you very much, Mr. Pinkett.

I know it is still a challenging time for community-sized institutions such as yourselves, and it can't be easy to take time away from your businesses, so I want to get you all back home as soon as possible because we really need you to be out there lending in your communities to help get this country back on track.

That is exactly why we are here today. We want to know what we can do to help. We understand there is quite a bit of regulation that you are responsible for complying with in your day-to-day operations, and that burden falls particularly hard on smaller institutions such as yours.

There is not a one-size-fits-all solution to regulation, and I have been encouraged by the Consumer Financial Protection Bureau's (CFPB) recognition of that fact.

I understand that Director Cordray has been aggressive in his outreach to community banks and that the CFPB takes your input very seriously. This was recently evident by the community bank exceptions in the Qualified Mortgage rule. That dialogue is leading to results, and I hope it continues.

Other regulators have taken note of the importance of community banks to our economy as well. In December, the FDIC released a thorough and enlightening study on community banking that has been quite helpful to our Members, and Governor Duke of the Federal Reserve recently highlighted how the Dodd-Frank Wall Street

Reform Act is being implemented in ways that consider the size and the complexity of the institutions it impacts.

Reading through your testimony, I am reminded that appropriately regulating the larger banks is just as important to your survival as reducing your regulatory burden.

There are a lot of advantages to being a large institution, and I have heard many times that the small banks feel they are held to a higher standard, that regulators pay much more attention to their books even though community banks were not responsible for the financial crisis.

I will continue to support the regulators in the implementation of the Wall Street Reform Act to ensure that our financial system is a stable one where small institutions like yours can thrive, but regulators are only tasked with enforcing the laws that Congress has passed.

So it is appropriate for us as lawmakers to turn our attention to a discussion of what is and isn't working right now and what we might do to streamline these laws so we can get you back to your communities creating jobs.

As you know, the House has already gotten to work on that by passing the Eliminate Privacy Notice Confusion Act. Our Members have received letters from your trade organizations, and over the recess, visited you in your home districts in order to gather information on other sensible reforms we might pursue that will help you put more of your capital to work.

My staff and I have been reviewing these requests closely, and I look forward to a productive discussion today. This has been an area of strong bipartisan agreement, and I want to commend Chairwoman Capito and Ranking Member Meeks on working together to make this hearing possible.

I yield back the balance of my time.

Chairwoman CAPITO. Thank you.

Mr. Fitzpatrick for 1½ minutes.

Mr. FITZPATRICK. Thank you, Madam Chairwoman.

And I want to thank the witnesses for your testimony to the committee here today. I have been meeting on a fairly regular basis with community bankers back in my district and I consistently hear about examinations and regulations.

More recently, I am hearing a lot of anxiety with respect to CFPB and also the Qualified Mortgage rule, and what I have been telling them is that I believe that there is a broad acknowledgement that Congress needs to do more to relieve community financial institutions from the regulatory burdens that they are facing, and I believe this recognition has been borne out from hearings like this and from meetings like the meetings that I am having and other Members of Congress across the country are having with their community bankers in their districts.

Community bankers are vital to the economy and I want to thank you for what you do for our economy. I and my colleagues on the Financial Services Committee will continue to look at how we can help community banks, help Main Street, and I believe that we will produce some meaningful legislation to that effect.

I know that I am committed to that and will continue to work with the community bankers in our districts to that end.

I thank the chairwoman.

Chairwoman CAPITO. Thank you.

Mr. Scott for 2 minutes.

Mr. SCOTT. Thank you very much, Madam Chairwoman.

I believe we all agree that regulatory reform is indeed necessary; however, as we work forward with these issues revolving around community banking, we must be sure the regulations meant to address too-big-to-fail do not wind up placing a disproportionate burden on the relative little guy of community banking.

A disproportionate burden of say compliance costs due to simple economics of scale. We look at our industry, you have the smaller banks, you have community banks, you have a regional bank. What is the difference?

We have medium-sized banks. We have credit unions. We have pawn brokers. We have loan companies. All have an impact when we do regulations. In my State of Georgia, we have led the Nation in bank failures. My colleague Lynn Westmoreland and I have looked at that and so far, there is a determination that in some cases, there has been too much regulation, and in other cases, there has not been enough regulation.

So I assure all of you who are here to testify that this committee, our committee, understands your concerns and I am hopeful that as financial regulatory reform is implemented, we can work to come to a consensus and indeed ensure that loopholes, where they are, are closed, that transparency is emphasized, and those institutions which contributed to the financial crisis are indeed held accountable without harming smaller institutions, which is the heart and soul of our lending system.

They are the ones that make the loans to the small business community. They are the ones that make the loans to entrepreneurs, to farmers, and to homeowners.

And so I think it is important, in closing, that we underscore that we must not be afraid to make what I call smart adjustments to the regulatory responses to the financial crisis, be it Dodd-Frank or otherwise, where such adjustment is warranted, particularly to portions that may not work as we intended or may have unintended negative consequences.

Thank you, Madam Chairwoman.

Chairwoman CAPITO. Thank you.

Mr. Barr for 1½ minutes.

Mr. BARR. Thank you, Chairwoman Capito, for holding this very important hearing to examine the regulatory burdens on community banks.

As I have travelled around the 6th Congressional District of Kentucky and talked with community and regional bankers, whether in Lexington or in more rural parts of my district, I have consistently heard the same themes: that the regulations coming out of Washington are too burdensome, too complex, and oftentimes, flat out counterproductive.

I am frequently told by my community bankers that they feel like they are no longer working for their communities, but instead that they are working for the regulators.

I regularly hear that overregulation has effectively prohibited reputational relationship and character-based lending which deprives reputable entrepreneurs and small businesses of the ability to access the capital needed to create jobs.

Why do we continue to suffer from persistent high unemployment in this country? Why is this the most anemic economic recovery since the Great Depression?

I submit that this is one of the reasons, and the worst part is that while regulatory costs are most directly seen firsthand by the community banks, the consequences ripple right out into businesses on Main Street seeking credit to expand, the farmers seeking agricultural loans, and families working to purchase a home.

I look forward to hearing from the witnesses about improvements that can be made to cost-benefit analysis, about contradictory signals they receive from Washington, and about whether the current regulatory environment is really protecting consumers.

Chairwoman CAPITO. Thank you.

And finally, Mr. Luetkemeyer for 1½ minutes.

Mr. LUETKEMEYER. Thank you, Madam Chairwoman.

I want to thank Chuck Kim this morning. He is a banker from the St. Louis area with Commerce Bank. He is a nice addition to the panel. I am sure he is going to have some great insights to offer today with regards to our discussion.

Regulatory requirements disproportionately burden community banks that do not have the resources necessary to comply. That is why in the coming weeks, I will introduce legislation to reduce some of the burdens facing community banks.

As in the 112th Congress, this legislation will seek to give community banks the ability to attract capital, support the needs of the customers, and contribute to the local economies.

It is time for Washington to work with community banks instead of against them. I now look forward to working with the community leadership as well on initiatives to enable our community banks to help the communities they serve.

And with that, Madam Chairwoman, I yield back.

Chairwoman CAPITO. I thank the gentleman.

And that concludes our opening statements, so I would like to welcome our panel of distinguished witnesses.

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.

Our first witness is Mr. Ken L. Burgess, chairman, First Bancshares of Texas, Inc., on behalf of the American Bankers Association. Welcome, Mr. Burgess.

I would ask all of the witnesses to pull the microphones close, so we are able to hear you. Thank you.

STATEMENT OF KENNETH L. BURGESS, JR., CHAIRMAN, FIRST BANCSHARES OF TEXAS, INC., ON BEHALF OF THE AMERICAN BANKERS ASSOCIATION (ABA)

Mr. BURGESS. Thank you, Chairwoman Capito. Chairwoman Capito, Ranking Member Meeks, my name is Ken Burgess, and I am the chairman of FirstCapital Bank of Texas, a community bank located in Midland, Texas.

FirstCapital was formed in 1998 and has since expanded to $713 million in assets serving Midland as well as Amarillo and Lubbock.

I appreciate the opportunity to be here to present the views of the ABA. Hearings like today's are very important. It is an opportunity to change the dialogue from just talking about the importance of community banks to what can be done to stop the rapid decline in the number of small banks and start taking action to assure we have a healthy and vibrant community banking sector.

Many actions since the financial crisis have hurt, not helped, community banks. For example, at the same time that banks were trying to serve their local communities, new rules meant more compliance officers and fewer customer-facing employees.

Just when regulators want to see banks grow, they raise capital standards and now are proposing new Basel III standards that will surely force banks of all sizes, but particularly small banks, to reduce lending.

Just when the housing market most needs mortgage loans, new rules are imposing costs so high that many community banks will likely scale back their mortgage operations. These concerns may even force my bank and others like it out of the mortgage lending business altogether.

Make no mistake about it, this burden is keenly felt by all banks. For my bank, we spend nearly $1 million on compliance every year and we added 10 new members to our staff to meet compliance requirements just this past year.

As a $713 million bank, we are better able to absorb the compliance costs. For the medium-sized bank with $168 million in assets and only 39 employees, this burden is nearly overwhelming.

Some would say this is simply the cost of doing business, but every dollar used for compliance costs is a dollar not used to lend in our communities, and unfortunately the costs are going up every year, and as they do, small banks disappear.

In fact, there are 1,500 fewer community banks from a decade ago. Today, it is not unusual to hear bankers from strong healthy banks say they are ready to sell because the regulatory burden is simply too much.

It is time to make changes that have tangible results. ABA applauds Congress on recent additions such as the ATM placard and privacy notice bill. More can and should be done. Let me highlight just a few.

First, the financial services examination process should be improved. Our bank has been fortunate in that our exams have continued to be thorough and fair. This is how it should be for all banks; however, I have heard a much different story from many community bankers.

We need an exam process that provides consistent, timely exam reports as well as an appeals process free from threat of retaliation. We thank Chairwoman Capito and Representative Maloney for introducing H.R. 1553, which addresses the many important concerns.

Second, Basel III should be reformed so that capital rules enhance not inhibit the role of any bank, but particularly community banks.

Current proposals would introduce significant volatility into bank capital levels and force many banks to change their core business model due to unfair risk weightings.

Third, mortgage rules should be simplified and consistent. The new mortgage rules are creating severe legal risks. Our bank and many others will not make loans outside the narrow regulatory box, and many banks will likely be forced to exit mortgage and retail lending altogether due to higher risks.

Fourth, clarify that banks are exempt from municipal advisor registration requirements and ensure that banks can buy and sell municipal bonds. We urge this committee to adopt a bill similar to S. 710, the Municipal Advisors Relief Act of 2013, which was recently introduced in the Senate.

In summary, community banks face an uphill battle against excessive regulatory burden. Congress has the power to lift some of this burden and to turn the tide in favor of our Nation's community banks.

In order to do this, we need to move beyond simple good intentions and take decisive action. The ABA stands ready to assist this subcommittee in those efforts.

Thank you very much.

[The prepared statement of Mr. Burgess can be found on page 46 of the appendix.]

Chairwoman CAPITO. Thank you.

Our second witness is Mr. Charles G. Kim, executive vice president and chief financial officer, Commerce Bancshares, Inc., on behalf of the Consumer Bankers Association.

Welcome.

STATEMENT OF CHARLES G. KIM, EXECUTIVE VICE PRESIDENT AND CHIEF FINANCIAL OFFICER, COMMERCE BANCSHARES, INC., ON BEHALF OF THE CONSUMER BANKERS ASSOCIATION (CBA)

Mr. KIM. Thank you.

Chairwoman Capito, Ranking Member Meeks, and members of the subcommittee, my name is Chuck Kim, and I am executive vice president and chief financial officer of Commerce Bancshares. Commerce was founded in 1865 and serves customers in Missouri, Kansas, Illinois, Oklahoma, and Colorado.

Our engaged and passionate workforce is guided by our customer promise: we ask; listen; and solve. Commerce is also a member of the Consumer Bankers Association, which has been the recognized voice on retail banking in the Nation's capital for more than 90 years.

On behalf of both Commerce and the CBA, I appreciate the opportunity to be here today. CBA has long been a proponent of reducing regulatory burden and is enthusiastic about working with the subcommittee to achieve our shared goals.

First, we applaud Chairwoman Capito and others for highlighting how the CARD Act is unfairly impacting spouses' ability to access credit. This unintended consequence is a great example of how regulations can impact a bank's ability to provide financial products to consumers. We await the CFPB's final rule to correct this.

I would also like to thank Congressman Luetkemeyer and others for their leadership in removing the unnecessary requirement of duplicative ATM fee disclosures and for their efforts this Congress on privacy issues.

We have seen significant regulatory changes with the passage of the Dodd-Frank Act, the creation of the CFPB, and other new rules. The rules promulgated by our regulators were needed to protect consumers and ensure a healthy baking industry. As we adjust to this new landscape, unintended consequences will surely arise throughout the process.

As we go forward with helping customers and small businesses meet their financial needs, regulators should consider not only the one-time cost and the annual cost of compliance, but also the impact on innovation, new product development, and the overall diversion of resources from meeting customer needs.

Regulatory agencies should also consider how the various regulations overlap and interact. While one regulation might not be a problem, the issuance of numerous regulations at the same time can be very challenging.

For example, we have seen a tremendous amount of change in the market space. New regulations on appraisals, servicing, loan officer compensation, and underwriting will impact the mortgage market as banks work towards compliance while seeking guidance on the new rules.

One area where we find ourselves seeking answers is the Qualified Mortgage rule. As we prepare for the January 2014 compliance date, we face some difficulty waiting for guidance from the CFPB. We need more clarity and enough time to comply.

While we continue to move forward with the implementation of the CFPB's mortgage rules, we anticipate additional impacts from the Qualified Residential Mortgage (QRM) rule and Basel III, both of which also affect mortgages.

The impact of Basel III on home equity lines may also harm small business owners who use them to start, fund, and expand their businesses.

We are hopeful that regulators will provide the industry with a coordinated final QM rule to provide the clarity we as an industry constantly seek during any period of regulatory change.

The absence of regulatory clarity is a difficult cost to quantify and may hinder a bank's ability to fully comply by a rule's specified effective date. Our systems are complex, they are intertwined, and they are very costly to change.

When rules are not clear or there is uncertainty about future rules, financial institutions will minimize risk by delaying or eliminating new products and services.

One way this can occur is when enforcement actions are used by regulators as a proxy for industry guidance instead of using the formal regulatory process. Enforcement actions that are not grounded in clear rules provide little clarity for the industry.

Exams are the hallmark way in which consumer protection and safety and soundness are maintained by regulators; however, supervision can become unnecessarily burdensome if the examination process is inefficient, if the rules are too complex, if there are multiple regulatory agencies covering the same examination territory, or if the process is unnecessarily slow.

We applaud this subcommittee for its work to improve the exam process and CBA looks forward to working with the subcommittee in the future.

We would also suggest the subcommittee review inefficiencies in both the ESIGN Act and the CARD Act's rate increase review requirement to further reduce regulatory burden.

In conclusion, we expect the regulatory environment to remain challenging as the CFPB and the prudential regulators issue more rules including QRM, Basel III, and others.

It is important to understand how excessive and unnecessary regulations are costly are to consumers. The more clarity, coordination, and cost-benefit analysis we see, the better we can serve our communities and prevent unintended consequences. Thank you.

[The prepared statement of Mr. Kim can be found on page 65 of the appendix.]

Chairwoman CAPITO. Thank you.

Our next witness is Mr. William A. Loving, president and CEO of Pendleton Community Bank, on behalf of the Independent Community Bankers of America.

Welcome.

STATEMENT OF WILLIAM A. LOVING, JR., PRESIDENT AND CHIEF EXECUTIVE OFFICER, PENDLETON COMMUNITY BANK, ON BEHALF OF THE INDEPENDENT COMMUNITY BANKERS OF AMERICA (ICBA)

Mr. LOVING. Chairwoman Capito, Ranking Member Meeks, and members of the subcommittee, my name is William A. Loving, Jr., and I am president and CEO of Pendleton Community Bank, a $260 million bank in Franklin, West Virginia. I am also chairman of the Independent Community Bankers of America, and I testify today on its behalf.

America's 7,000 community banks, including those located in rural and small towns, are dedicated to lending in their communities and supporting their broad-based economic recovery.

Unfortunately, in addition to the existing regulatory burden, a glut of new rules that are not proportional to our size, business model, or risk is stunting our potential to do so.

Sensible, targeted, regulatory relief will allow community banks to realize their full potential as catalysts for entrepreneurship, job creation, and economic growth.

To that end, ICBA has developed a package of legislative recommendations known as the Plan for Prosperity that will go a long way in rebalancing our regulatory burden and will allow us to invest more of our private capital and labor resources in serving our communities.

Because my time is limited, I will focus on the mortgage provisions of the plan. We believe that portfolio lending, because it provides an overriding incentive for lenders to ensure a loan's affordability and performance, should be the principal criteria for protecting community banks from heightened litigation risk and exemption from costly new requirements.

Such protections and exemptions are essential to preserving a private capital lending model. This model has worked well for decades, experienced a low default rate, and is often the only source of credit for many customers and communities.

In the rural areas I serve, many loans are ineligible for sale into the secondary market because of stringent appraisal requirements, because the house sits on an irregular or mixed-use property, or because the borrower has a nontraditional income.

I am happy to hold these loans in my portfolio; however, the only way I can manage interest rate risk is to structure the transaction as an ARM loan or a ballooned loan which is re-priced and renewed at maturity; typically 3 to 7 years.

Because these loans cannot be securitized, they must be funded through retail deposits which include higher cost CDs. For this reason, the required pricing often triggers the regulatory definition of higher-priced mortgage loans, which is based on an unrelated secondary market index.

But this lending model is at risk. New CFPB rules would only provide Safe Harbor litigation protections to balloon loans made by lenders that operate predominantly in rural counties. Applying the narrowly defined rule designation at the county level produces arbitrary results.

Many community banks that have all the characteristics of rule lenders will fail the test. To illustrate the problem, attached to my written testimony is a State-by-State map of rural county designations based upon the criteria that CFPB will use. I urge you to look at your own State. You may be surprised at the results.

In my State of West Virginia, arguably a rural State in its entirety, 26 of 55 counties fail the CFPB's rule test. Similarly, higher-priced loans, even when that pricing is aligned with the lender's cost of funds, risks, and other factors, are excluded from the Safe Harbor and will be subject to an escrow requirement for taxes and insurance.

For low-volume lenders in particular, an escrow requirement is expensive and impractical. Our recommended solution avoids the torturous analysis required by the CFPB. It is clean, straightforward, and easy to apply: provide QM Safe Harbor status and an exemption from the escrow requirement for all community bank mortgage loans held in the portfolio.

Additionally, the escrow requirement is unnecessary for portfolio lenders like Pendleton who have every incentive to ensure that the borrower can make tax and insurance payments.

These burdens will simply curtail prudent lending to qualified borrowers who have no other sources of credit.

Before closing, I would like to thank Chairwoman Capito and Congresswoman Maloney for introducing H.R. 1553 yesterday, which will provide for needed examination reforms called for in the plan to prosperity.

I would also like to thank this committee and the House for quickly passing the Privacy Notice Confusion Elimination Act, another key provision of the plan introduced by Congressman Luetkemeyer.

Finally, we are grateful to the members of this committee who have introduced additional provisions for the plan for prosperity. Thank you again for the opportunity to testify.

[The prepared statement of Mr. Loving can be found on page 76 of the appendix.]

Chairwoman CAPITO. Thank you.

Our final witness is Mr. Preston D. Pinkett, III, president and chief executive officer, City National Bank of New Jersey.

Welcome.

STATEMENT OF PRESTON PINKETT, III, PRESIDENT AND CHIEF EXECUTIVE OFFICER, CITY NATIONAL BANK OF NEW JERSEY

Mr. PINKETT. Thank you, and good morning.

I am president of City National Bank of New Jersey. We are a $350 million African-American-owned and operated bank headquartered in Newark, New Jersey.

At $350 million, that makes us the 7th largest African-American bank in the country, and so I would like to talk a little bit about the difficulty minority banks are having as they deal with, sort of, all of the regulation and the business challenges we face.

We are regulated by the Office of the Comptroller of the Currency. We are also regulated by the Federal Reserve because we have a holding company, and we are regulated by the FDIC, of course. And I could go on.

And so, the regulations continue to pile up. As Ranking Member Waters mentioned—thank you very much—I am on the advisory board for the Office of the Comptroller of the Currency's Minority Depository Institutions Advisory Committee which is focused on trying to figure out what the regulators can do to improve access and support minority institutions.

It is an effort that is focused on trying to make a difference in the communities where minority institutions function, and I think there is a lot of work that is happening and we are very pleased to be part of that.

I accepted the job focused on minority institutions because I think it matters. I think this work is really important. There are a small number of minority depository institutions and an even smaller number of African-American institutions focused in America and we need to preserve those institutions.

The largest challenge we face, I think, is that there is regulation in FIRREA Section 308 that speaks to the need for the regulators to preserve minority institutions, support minority institutions.

What I hear from the regulators is that they don't have guidance from this body on what that means. So they have no specific authority or no specific guidance on how to make life a little more bearable for minority institutions.

They understand the struggles we face. We are in high-risk markets engaged in high-risk business but they don't have levers or opportunities to, or even direction as to what it means to preserve and protect those institutions to support them.

I really would like to applaud the work—the intention of this committee because I think that there is a lot to be done and it is important of course to continue to focus on securing the safety and soundness of the economy as well as of these institutions.

We want to be fair. We want to be responsive to community needs. The banks that I work with in the National Bankers Association are all interested in the communities that they serve and no one wants to take advantage of consumers, and I think that is a fair assessment of all of the community banks that I know.

It is important that this body understand that access to financial services through low- and moderate-income communities is essential and that it be through regulated institutions.

If we were to fail, if we were unable to serve our customers, they would be forced to use alternative service providers and those service providers would charge much more and have much less compassion and understanding about how to do business with our customers.

We understand that there is a commitment to consumers and we share that commitment. The degree to which there can be some flexibility in business models so as to ensure the products and services we offer are reflective of that which the community needs is important to us.

Let me just touch on some of the things that haven't been mentioned. A lot of what I have prepared has already been said, so I don't want to repeat that over again. But there are some things with which those in our industry are struggling.

We have TARP funds and the TARP redemption process is one in which it is unclear and for our institutions which are minority-owned because they are 51 percent minority-owned, the ability to raise capital is not quite as easy as it is for larger institutions or even non-minority institutions, and so the TARP redemption process being made clear and giving us sufficient time to align the resources we need would be helpful.

We have gone through the process with the Capital Purchase Program. And next, that will be the Community Development Capital Initiative, the CDCI funding. Those institutions have not yet, in most instances, plan for how they will deal with that redemption.

Tax policy: we have deferred tax excesses due to losses. To the extent that we could work out a solution for minority institutions so that the change of control provisions in investments don't adversely affect them when they raise capital, that would be helpful in sustaining the institutions and allowing them to survive.

And on the last, I would just like to ask you to please encourage the Community Development Financial Institutions fund in Treasury to continue to support minority banks and minority institutions as they reach out to the communities to do the business of helping to turn the most needy areas of this country around. Thank you.

[The prepared statement of Mr. Pinkett can be found on page 144 of the appendix.]

Chairwoman CAPITO. Thank you.

I thank all of the witnesses, and we will now begin the question portion of the hearing. I will recognize myself for 5 minutes.

Several of you mentioned the costs of compliance but you mentioned that there was a 2001 survey which found that nearly half of the banks surveyed point towards compliance as the reason for not offering a new product, no longer offering certain accounts, or market expansion.

I am interested in the effect this is having not only on the institution, but the consumer, and I think Mr. Kim and Mr. Burgess, you mentioned this in your testimony. What types of new products or new accounts are you talking about when you are talking about that?

Mr. KIM. One thing that comes to mind are prepaid cards. Those are popular with a lot of consumers now whether they are gift cards or payroll cards or a general purpose reloadable card, and there has been a lot of regulation recently around those products that probably make the business case for them just kind of completely go away. And so, we would—

Chairwoman CAPITO. For a community bank?

Mr. KIM. Right. For a community bank and maybe for anybody. A bad regulation can hurt everybody in that case.

Chairwoman CAPITO. Right.

Mr. KIM. So, that is one area where we have seen some real problems and that is a product we issue. For instance, there were some regulations in a Q&A format that were put out recently which caused us to stop selling gift cards in our branches for a period of time until we get some clarity on the regulation.

And so, customers are just not getting those products and others will shy away from those kinds of products because we have regulatory ambiguity.

Chairwoman CAPITO. Right.

Mr. Burgess, did you have any other suggested products, or where you are limiting your market expansion because of this?

Mr. BURGESS. Madam Chairwoman, I wouldn't say that it has limited us yet, but the two major concerns I have would be on the mortgage side because we are a relatively large mortgage lender for our size bank, and with some of the things that are coming out in the QM rules and a few of the other things that are coming out, we have a concern that the box is becoming so small for people to fit into and the risks are becoming so high to be outside that box from our standpoint, depending on how all of this comes out, we will have to make a decision as to whether we stay in the mortgage lending business.

We are not as big of a retail lender outside of the mortgage business, but retail lending has some of the same concerns with some of the compliance issues that are arising.

Chairwoman CAPITO. All right. Let's talk about Qualified Mortgages. It came up in everybody's testimony. This is my concern—as you mentioned the narrow box—you folks are in business obviously for your shareholders and to do the right thing.

What kind of consumer do you envision that once these rules become—even if they are—let say that they lack the clarity because they are not going to be clear. Let's face it; it is a new world out there. And so, it is going to be more difficult.

So you are going to err on the side of caution, I would imagine. Instead of saying, "I will take the risk on this," you are going to pull back.

What kind of consumer is the one who is going to be most hurt? I would imagine Mr. Pinkett might have a—because you dealt with higher risk. What kind of concerns do you have about your consumers in this new, Qualified Mortgage world?

Are you just going to write less mortgages or—

Mr. PINKETT. I'm sorry. It certainly becomes difficult to write as many mortgages. It becomes more of a factory as opposed to a customized consumer product. So the challenge of all the regulations that dictate what the product should look like is that they also dictate what the customer should look like—

Chairwoman CAPITO. Right.

Mr. PINKETT. —and it leaves less flexibility. I think the direction of ensuring that the consumer has choices and ensuring that the consumer is well-served is important, but I would offer that the regulators could ask us to justify how the product works in a way that is supportive of the customer as opposed to telling us what the product should look like.

Chairwoman CAPITO. Excellent suggestion.

Mr. Loving?

Mr. LOVING. As indicated, the QM rule has a narrow definition as it relates to the rule designation. That is a problem for us simply because of the high price mortgage, but you also will find farmers who have seasonal or nontraditional income. They fall outside of the income requirement.

They may have high-wealth individuals who have substantial assets that historically we have made loans based upon their financial history, the financial net worth, but all of a sudden their income doesn't meet the criteria and so they fall outside the guidelines.

So unfortunately, this rule will carve out a lot of good borrowers for mortgages.

Chairwoman CAPITO. Okay.

Mr. Kim, I have 10 seconds.

Mr. KIM. I think also physicians, new physicians for instance is another area where we tend to be accommodating. They are people who are going to make a lot of money at some point in the future and they probably wouldn't fit a QM the way that we would underwrite them.

Chairwoman CAPITO. Oh, actually I did hear that from one of my community bankers in West Virginia who sort of specializes in that product.

All right. Mr. Meeks for 5 minutes.

Mr. MEEKS. Thank you, Madam Chairwoman.

As legislators, one of the challenges we have is that many definitions exist for a community bank. And in February, Federal Reserve Chairman Ben Bernanke gave a speech on the importance of community banking to the economy.

In that speech, he noted that although community banks provide a wide range of services for their customers, their primary activities revolve around the traditional banking models, specifically taking short-term deposits to fund longer-term investments such as small business, agricultural, or commercial real estate loans.

So my question, Mr. Burgess, is do you think it is more appropriate to define a community bank by its activities rather than the size of its balance sheet?

Mr. BURGESS. I would say that would be true because I think what should be done is we should look at the risks that a bank is taking to determine how much regulation needs to be there and not necessarily the size.

Because there can be some fairly large regional banks that are just plain vanilla, providing plain-vanilla products and they are not taking a lot of risks that would create a lot of risk in the balance sheet, and I think the regulations are to be focused on risk and not on size.

Mr. MEEKS. Mr. Loving, would you support reforms that are targeted towards community banks that focus on providing services in "traditional" banking?

Mr. LOVING. I believe community banks are those that have operated and operate in the traditional banking model except, as you said it, short-term deposits and fund long-term investments.

I think the risk model and the risk matrix that they employ is the definition of the community bank. They lend locally. They are relationship lenders. They know their customers. They are operated locally, and so I would agree.

Mr. MEEKS. Mr. Pinkett, could you tell us, have your interactions with regulators suggested that they are concerned about the preservation of MDIs?

Mr. PINKETT. It has suggested that they are concerned. I think it has also suggested that they don't know how that concern translates to action.

Mr. MEEKS. What do you think would help preserve the MDI status? For example, CPP and raising capital?

Mr. PINKETT. I think the—in dealing with the TARP issue and how that capital has flowed to the institutions and then how it gets paid out is a challenge.

I think that part of the challenge is that we have to reflect the value of the institutions today as we redeem those shares and that is a challenge for Treasury, because in some sense, I would say Treasury sees this as more debt than equity in those institutions.

But I think that the ability to raise capital really is reflective of the ability to manage getting new capital in without changing the nature of the institution.

So focusing on the minority depository institution's activities and the fact that it remains focused on minority communities and remains managed by minorities and overseen by a minority board regardless of the makeup of the shareholders, I think would be a big step in allowing them to raise the capital they need to be stable and secure.

Mr. MEEKS. Mr. Kim, to what extent if any are compliance costs a driver for consolidation in the community banking sector? And do you know of any banks that have merged with each other perhaps or shut down entirely because they couldn't keep up with the compliance costs?

Mr. KIM. We are very aware of what is going on in the community banking market both in banks smaller than us and our same size and truly that is a driving factor.

I heard a story—it is interesting you ask this—last week I was sitting with a young man whose family had been in the banking business in Kansas.

He said he made it through the Depression, made it through the Dust Bowl, and now he has a cousin who is in his 60s and is running a $70 million bank in Kansas and he said, "They don't make a whole lot of profit. What profit that they made, they were going to have to invest in hiring compliance officers.''

And his family, after all those years of being in the banking business—he actually said his cousin said, ''I don't want to burden my family with continuing to run the bank.''

Mr. MEEKS. Let me just also say though, when we talk about the QM rule, I wouldn't be here if the QM rule as proposed today was in place when my parents bought a house.

They would have never qualified for a house under the QM. And had they not been able to buy that house, I wouldn't have been able to go to college because it was because of that house that they were able to finance my education.

So what we will be doing with the QM rule as it is proposed is locking out a whole segment of Americans who want the American dream of owning a home, who can then help their children get the quality education that they need so that we can all prosper in this place—so I am with you 100 percent when—if you looked at some of these rules, there were all unintended consequences. Some of them just don't make any sense to me. The QM rule as proposed is one of them.

I yield back.

Chairwoman CAPITO. Thank you.

Mr. Duffy for 5 minutes.

Mr. DUFFY. Thank you, Madam Chairwoman.

You can see that all the news reporting about congressional gridlock has been wrong. We all get along and a great hearing of bipartisanship and I think it underscores the fact that this issue we are talking about today is not an urban versus rural, Democrat versus Republican, liberal versus conservative issue. This is an issue that is affecting our country as a whole, and I think it is really important that we have more light shed on it and we get some congressional action.

I want to talk about Basel III a little bit because many of my Wisconsin bankers, some of whom are here today, continually bring this up to me and its impact on their ability to perform.

We all want to have strong capital requirements. We all want to have safe and sound banks. We want to make sure we don't have taxpayers bail out the banking industry again.

So when we look at Basel III and its proposals, why wouldn't you all agree with it? And if you don't agree with it, what negative impact will it have on your bank's ability to do its important job?

Mr. Loving?

Mr. LOVING. There are several provisions of Basel III that concern community banks and concern me personally. The AOCI provision will certainly distort capital as interest rates move.

And also the risk weights that are assigned to mortgage loans; if you take the Basel III provision and you take the QM requirement that is being proposed, that is a significant process on mortgage lending that will curtail mortgage lending and balloon loans in particular. Just because it is a balloon loan, by definition, it will receive a higher risk classification although it is not a riskier asset.

Mr. DUFFY. Mr. Burgess?

Mr. BURGESS. I am not even sure where to start on it because there are so many provisions in Basel III that could have a negative impact, but just to mention a few: eliminating trust preferred securities, which were grandfathered under the Dodd-Frank Act. We don't have a lot of that, but we have about $3 million of it and we have been able to use that as capital to help our bank grow and provide more loans within our communities and if that is taken away, we are going to have to find a place to replace that.

The complexity of the weightings on each type of loan: in the past, we have risk-weighted pools and so you could go into the call report and you could figure out what the risk-weighted assets were by looking at the call report. You have to do that loan by loan, so there is complexity.

And on the mortgage side, as he just mentioned, as I said, we are fairly large in the mortgage business, there are several provisions there that in our case, our mortgage loans are probably the safest loans that we have on our books. We have never foreclosed on a mortgage loan in 15 years. So we are now talking about significantly increasing the risk weightings on probably the safest part of our portfolio.

I will stop now for others, but there are a number of other things.

Mr. KIM. I would just say in general, as Chairwoman Capito pointed out, the rule was written for the world's banks and it makes sense for those systemically important institutions and there needs to be some sort of level playing field. It wasn't written for us.

It really does not work for us. Now, the Federal Reserve and the way that it interprets the rules maybe will make it easier for banks of various sizes to comply by throwing some things out but we are not sure. There is no clarity.

We don't know where that is going, and there have been calls from a couple of the FDIC Board Members, Tom Hoenig and other gentlemen, suggesting that there is a much simpler way to do this, especially for banks in our weight classes.

Mr. PINKETT. Mr. Duffy, I feel like I should stand up for this since no one else has, but I really can't come up with a reason why a $350 million bank would want to go through the brain damage and difficulty of being—that this legislation was set up for, for trillion dollar institutions. It is just not appropriate for us.

Mr. DUFFY. And I wanted to make sure everyone had a chance to answer the question. I only have 45 seconds left. Does Basel III have an impact on a smaller bank's ability to compete with the larger bank? Is the cost imposed on a smaller bank greater than—

Mr. PINKETT. Yes.

Mr. LOVING. Yes. It certainly does, and when you add to it the competitive advantage that the larger institutions have in cost of funding, it just complicates the competitive issue.

Mr. DUFFY. If you had a recommendation, would it be for an exemption or would it be for delays? What is the recommendation that you would give us?

Mr. LOVING. Exemption.

Mr. PINKETT. Exemption.

Mr. BURGESS. Exemption. I would say we need to reduce the complexity of the rules so that it is much easier to determine what the capital needs are. It is so hard to figure that out right now.

Mr. KIM. Neither. And if there is an exemption, it needs to be at the level of systemically important institutions, not banks like us.

Mr. DUFFY. I yield back.

Chairwoman CAPITO. Mrs. McCarthy for 5 minutes.

Mrs. MCCARTHY OF NEW YORK. Thank you very much, and again, thank you for having a second hearing on what we can do.

Mr. Kim, when you were speaking, the only thing I could think of is one size does not fit all. Unfortunately, down here in Congress, sometimes when the rules go by it is for everybody, and it just doesn't work out, and most of us here agree with that.

I wanted to ask you, the alternative products that help move the underbanked and the unbanked into the financial system are of great interest to me and to my constituents out on Long Island, New York.

It is important that there are safe, regulated products available to people that allow them to build their confidence and trust in the banking system while providing Main Street banking which many of us grew up with and we happen to like our local bankers to go in.

So I guess in your testimony you were discussing conflicting regulatory requirements that make offering short-term, small-dollar products very difficult, as well as inconsistency on certain regulatory requirements that make it difficult for banks to offer products that provide consumers access to funds to fill short-term gaps. You explained that a little bit, but could you go into that a little bit more detail?

Mr. KIM. Sure. There is a need for short-term liquidity products. You can see it; little offices spring up in various areas of town for payday loans or title lending or any of those kinds of things. Some people do use the overdraft method to finance their short-term cash needs, which is not a very prudent way to do that.

And I think to the extent that we can move those loans into the banking system and there is some sort of a Safe Harbor that we can operate under to offer those kind of products and we have to be able to offer them profitably.

Frequently what happens and what kind of scares many bankers away from providing products to lower-income consumers is there is regulatory risk and there is also a lack of a business model and a lot of times people are willing to pay for things that maybe we don't think they should.

How many of us have adult children who are willing to pay $5 to get cash out of an ATM despite the fact that we say, "Don't do that." They do that. They want the convenience. That is what they want.

So I would say that if there was a Safe Harbor, a clear definition of how those products could work, we would all be better off if the banking system provided those as opposed to the nonbanks.

Mrs. MCCARTHY OF NEW YORK. Just a follow up, and this is going to be general to those who want to answer it, I had read the GAO report from 208 to 211 and we learned that many of the small bank failures during the financial crisis were attributed to high concentration in commercial real estate loans associated with poor underwriting in management in the institution itself.

I am interested in hearing how you would propose to address these issues so that small banks may continue to lend while maintaining the safety and soundness of the institution.

We do know that a lot of banks did fail and most of the areas that I was looking at on the map were probably areas that had high concentrations of large construction loans. How do we handle that? How would you all handle that?

Mr. BURGESS. I think in our particular case, we actually do make quite a few CRE-type loans, but we manage our concentrations and we make sure that we stay within the safe concentration levels that we should.

And I think the regulators are doing a really good job of looking at that now and making sure that everybody has strong concentration policies in place to make sure that you are not putting all of your eggs in one basket.

Mrs. MCCARTHY OF NEW YORK. So you basically agree with those regulations, to keep that stronger so the banks don't fail?

Mr. BURGESS. I think that is one of the risk mechanisms which need to be there. If you put all your eggs in one basket, you are taking the risk that if things go bad in that area, it can take the bank down.

Mrs. MCCARTHY OF NEW YORK. Mr. Pinkett?

Mr. PINKETT. Yes. I am in one of those banks that was overconcentrated in commercial real estate. That is how I got my job. I think the solution is to have—the regulatory solution, I mean, there is a management solution, which is better management. The regulatory solution would be to identify where there is poor management and actually to encourage management changes and to look at the bank not from a "gotcha" point of view but from how a, "Can I help you survive and move forward point of view?"

That is guidance the regulators just don't have at this moment, but we are seeing more of it, I would say at least from my primary regulator, and having more productive conversations, which I think will help the banks succeed.

I don't think there is anything this body or any other body can do if management is poor and continues to make bad decisions, but what we can do and what we ought to do for the taxpayers is to identify poor management and do as much as we can to move them out as quickly as possible.

Mrs. MCCARTHY OF NEW YORK. Thank you.

Thank you for all your testimony.

I yield back.

Chairwoman CAPITO. Thank you.

Mr. McHenry for 5 minutes.

Mr. MCHENRY. Thank you, Chairwoman Capito.

Thank you all for testifying, and thank you for making loans in our communities. I want to follow the chairwoman's questions about the Qualified Mortgage, the QM rule that the CFPB issued.

Now, let me just go across-the-board, each one of you, yes or no, do you make mortgage loans?

Mr. Burgess?

Mr. BURGESS. Yes.

Mr. KIM. Yes.

Mr. LOVING. Yes.

Mr. PINKETT. Yes.

Mr. MCHENRY. Fantastic. We have seen from the CFPB the QM rule. I don't know if it is quite as thick as the Bible, but let's just say it is a little long and very complex.

How many of you intend to make mortgages outside of that QM box?

Mr. BURGESS. Under no circumstances.

Mr. KIM. We are still evaluating that.

Mr. LOVING. We are evaluating the implication as well of making mortgages outside of the designation because of the risk potential that is possible.

Mr. PINKETT. We are also, the risks, but also the need that we see in the communities that we serve.

Mr. MCHENRY. So there is a give-and-take and you would like to make mortgages outside of the QM rule and you are trying to figure out how to do that?

Mr. PINKETT. We would like to service our customers if we can, yes.

Mr. MCHENRY. And so the implication there is that the QM does limit your ability to do so?

Mr. PINKETT. I believe it does.

Mr. MCHENRY. Okay. Now, it is interesting because Richard Cordray, who under some reports has a position at the CFPB, and under other reports is unconfirmed—anyway, we will get into that issue at some other point, I would hope.

But anyway, Mr. Cordray gave a speech at the Credit Union National Association—I don't think any of you on the panel were invited to that, but needless to say, I think some of you might have seen his comments that he wanted to encourage institutions to lend outside of the Qualified Mortgage rule.

Let me just ask again. Mr. Burgess, any interest in doing that?

Mr. BURGESS. In our mind, we make about 1,000 loans or so a year and to have that much unmeasured risk out there that we cannot evaluate on an ongoing basis for the life of the loan is something that we just don't feel we can do.

Mr. MCHENRY. Okay. So no interest.

Mr. BURGESS. No.

Mr. MCHENRY. All right. Last week, it was reported that the White House is "encouraging lenders to use more subjective judgment in determining whether to offer a loan."

Now of course, this contradicts Dodd-Frank. It also contradicts the rule put in place by the CFPB and what I am hearing from the industry is that runs counter to the encouragement of all their regulators.

I am not asking you to testify against your regulators; I certainly want all of you to live happy and productive lives, and that is probably not the easiest way to make that happen, but just give me a little word about the conflicting messages you are receiving on this matter in particular.

Mr. Kim?

Mr. KIM. There is a continual friction between safety and soundness, the regulation and then the need to make loans in underserved markets and in fact the QM rule probably makes it harder to make loans in underserved markets.

And so, if we comply with QM, we will make fewer loans there and they will rap us on the knuckles for not making the loans.

So that is an example of where the lack of clarity or the conflict in the regulation is a problem.

Mr. MCHENRY. Mr. Pinkett?

Mr. PINKETT. We have not had any issues with our regulators on this topic. In general, I think it is a matter of, we both have the same interest, which is exactly as you phrased it, which is, how do you service customers and how do you run a safe and sound institution?

Those two things sometimes are in competition and the test should not be a hard and fast rule. The test should be, are we using good quality judgment in making a decision?

For us, it is a little different. We are not as large so we don't—we wouldn't set it up as a line of business, non-QM loans. What we would do is we would have to look at it on a one-by-one basis and make intelligent decisions with the information we have about our customers.

Mr. MCHENRY. So you would like to be able to make those subjective decisions to give community lending?

Mr. PINKETT. I think it is really the only way we can do the work that is really needed in this country. There are enough big banks that are underwriting to scores and numbers.

The customers come to us because they say, "We can't get anyone to listen to our story." When we talk to small business owners who say, "I haven't been in business for 3 years and so therefore I can't get a banker to even come visit me because I don't have 3 years of financials," and they say, "Thank God you can, because this is the only chance I have to get the money I need to grow my small business," that is what community banks do, and we just happen to do it in a community where there is even less opportunity for that kind of conversation.

Mr. MCHENRY. Thank you.

Chairwoman CAPITO. Thank you.

Mrs. Maloney for 5 minutes.

Mrs. MALONEY. First of all, I want to thank all the panelists for their contributions today, but I particularly want to thank Mr. Kim for raising a concern about how spouses are treated in access to credit under the Credit Card Bill of Rights, which I authored, and it certainly was not my intent in any way, shape, or form to hurt women in our economy.

I do want to say that with the work of Mrs. Capito and others, and we have met with Mr. Cordray and I believe he will be coming out with a rule that completely addresses that so there will be equality of treatment and equality of access.

But I wanted to thank you for your attention to that and sensitivity to it. I appreciate it.

I would like to start by asking Kenneth Burgess and then each one of you for a response to H.R. 1553, which was reintroduced yesterday in both the House and the Senate.

This bill was written during the throes of the economic crisis. We were in the process of losing $18 trillion of wealth in our country and our phones were ringing off the hook with community bankers under tremendous stress: enforced mergers; being threatened with closure; and a feeling that their point of view was not being heard.

And we wrote this to respond to this deep concern because we knew the value that the community banks were offering in our neighborhoods; oftentimes, the only access to credit during this period for mortgages and small business loans.

Now, in the past 3 years, I don't believe I have gotten one community bank complaint. During the crisis, they were calling every day. They were frantic. They felt like the regulators weren't listening to them, and I am wondering, have the regulators changed their processes in any way to be more sensitive to the community bank concerns?

Do you think this bill is still needed given the fact that the economy has improved and apparently they have made some different assessments of being more respectful and allowing the Bozeman role to be heard in the agency? Do you think the bill is needed and why, and what do you think is the most important aspect of it to help community banks in our overall economy?

Mr. BURGESS. Yes, I do. And as I mentioned in my testimony, we have not been in a situation, we have been in a little bit better economy where we are so we haven't seen the pendulum swing quite so far in our area.

But that is kind of what happens when you have a crisis and a lot of the rulings or a lot of the decisions that are made by regulators when they come to a bank are subjective and a lot of it comes from the perception that regulator has; if they are looking at a lot of problem banks before they come in, they take a little bit harder line view in making some of the subjective decisions that they make.

So I think it helps if we have an opportunity for an independent review of some of those decisions to make sure that those are being applied consistently across-the-board.

And I did experience the 1980s in Texas, and so I did see the same types of things at that time and I know how that can happen. Fortunately, I am not having to deal with it at this time.

Mrs. MALONEY. Mr. Kim?

Mr. KIM. Yes, I would echo Mr. Burgess' comments that we have had a very good relationship with our regulators. It has really not been a problem we have experienced. That said, I have heard a lot of my colleagues, and as you note, more so a few years back, lamenting what has gone on with the regulators.

And even though perhaps it is not as big a problem now, the pendulum will swing back and if there are some independent rules and some appeals process, I am certain that the industry will appreciate that and it will be well-founded.

Mr. LOVING. Yes, I would agree and although the pendulum has swung—things are better in West Virginia—we never went through the crisis.

We have always been fairly stable from an economic perspective, but I, like Mr. Kim, heard from colleagues across the country that they were under a severe and harsh exam environment and I think that the Act as presented will provide for the proper method to have a separate review and process for the banker to go through if there is an issue.

And as Mr. Kim indicated, the pendulum will swing back. We will go through another crisis of some sort sometime in the future, and so this plan in place will be helpful.

Mrs. MALONEY. Mr. Pinkett?

Mr. PINKETT. I have not had a problem with regulators. We have great relationships, I would say, with our regulators. They listen; we talk. They talk; we listen. We communicate well.

I don't know—it is so far back I will just say this: historically, regulators have not been bankers and bankers have not been regulators. The regulators don't understand the operations of the institution and the bankers have never thought about all of the systemic risks associated with running an institution.

So we have to communicate better. I think that what I have seen with my regulators is, and I was at the Federal Reserve in New York last week, and we were talking about the fact that they were hiring people from industry who understand how to run a bank. So I think encouragement on how to be a better regulator is really what is important.

I have not had an issue that I would need to take to an ombudsman, but I think having that encouragement and having a framework where they understand what it means to be a regulator and what their challenge is and making sure that is clear, I think would be very helpful. If this legislation could do that, that would be great.

Mrs. MALONEY. Thank you.

My time has expired. Thank you.

Chairwoman CAPITO. Thank you.

Mr. Pearce for 5 minutes.

Mr. PEARCE. Thank you, Madam Chairwoman.

I thank each one of you as individuals for participating today.

This is the same story that we hear as we go around my district. I represent the southern district of New Mexico. Our per capita income is about $30,000 to $35,000, in small communities, and so your story is exactly the one that we hear.

I will kind of start where Mr. Meeks was discussing that he went to college because his parents could get one of those nonstandard loans that Mr. McHenry was talking about, and in fact, that is my story, too. There were six kids and I was signing notes at the bank at age 13 and 14 all the way through high school; $2,000 a year we would buy a pig, show him at a local county fair, and we funded six educations—six college educations, and yet these stories are going to discontinue because of the CFPB.

So when the CFPB is putting regulations in place that should apply to the trillion dollar banks, what they are going to do is choke off the small local banks and choke off access to capital and for people who would never qualify for a loan at one of the big institutions. We just wouldn't. The rates of return are not there.

They are going to fall outside the box. I am hearing you all say you are not going to set up products and so this hearing is extraordinarily valuable. I look at it as the CFPB has a de facto war on the poor because it is the poor who are going to suffer when we don't have nonstandard mortgages.

I was pretty interested in Mr. Pinkett's discussion on—and one of my concerns—we talk about GSE reform and privatizing GSE's.

I guarantee, as a small State with $31,000 per capita income, I worry that the rates of return are not going to be there because Mr. Pinkett says the mainstream investors seeking higher rates of return would have us alter our decades-long focus on the most needy.

And that is, I think, what is going to happen to the small rural areas if we have the GSE's that are totally, totally free market. We are never going to have a rate of return in Mr. Pinkett's neighborhood or my neighborhood, and so what you will do is you will take away those 30-year loans for that part of the market and again starve us for capital.

But you mentioned also, Mr. Pinkett, about the unregulated nonprofit institutions that you compete with. Could you expand on that just a bit?

Mr. PINKETT. In addition to the large banks and credit unions, we also have nonprofit organizations that operate in the communities that are able to access capital from the large institutions because it is debt capital, because they are unregulated, because they have a business model that allows them to repay that capital back in a much easier way than we would ever be able to do it given the fact that in order for me to make a payment back to a bondholder, I would have to get approval from at least two of my three regulators.

Mr. PEARCE. I appreciate that, and it is something that we don't see much in—that is a viewpoint I think is extraordinarily valuable for me today.

Also, I think you all have adequately stated the same concerns our bankers are talking about in Basel III, that you weren't involved in any of the risky processes but you are getting nailed with the same responsibilities and your lending—your portfolios don't look like those large institutions, but you are still having to have the same capital requirements, the increased risk weighting. We hear that constantly.

I guess not many of you mentioned the appraisal situation. That is one thing I hear a lot in New Mexico, that the appraisals under CFPB have suddenly gotten very difficult. Is that something you all are experiencing? Just a yes or no is fine.

Mr. LOVING. Yes, it is something we are experiencing. As a matter of fact, we just went to an appraisal management company to try to comply with the regulation, which added to time and cost of the appraisal.

And we found cases where we knew the value of the property better than the appraiser because they are out of the area, or better yet, the appraiser cannot find the needed comps to fulfill the requirements and as a result, the loan doesn't qualify for the secondary market.

Mr. PEARCE. I would hope to get some comments from everyone, but I am going to squeeze one more question in, and that is on the flood insurance.

Again, we are getting tremendous complaints on flood insurance. The last flood we had was back there when Noah was having his problems and we are getting stuck for what happened in Hurricane Katrina and so 1,000-year floodplains.

Mr. Burgess, you had mentioned flood insurance in your written statement. I don't know if you would like to expand on that just a bit, the problems you are facing.

Mr. BURGESS. I think right now we are still trying to get our arms around the new rules, but I think one of the concerns that we have is that the penalties for a mistake are going from $500 to $2,000.

And I guess one of the things we would ask is that you consider that penalty applying only to situations where there was actually not coverage on the loan for a period of time instead of just a technical violation.

Mr. PEARCE. Yes, and again it is a real problem, not a problem that you let a date lapse by one day and get stuck for $1,000.

Thank you, Madam Chairwoman.

Chairwoman CAPITO. Thank you.

Mr. Scott for 5 minutes.

Mr. SCOTT. Thank you, Madam Chairwoman.

Mr. Kim, let me direct my question to you, if I may. In getting our hands around the definition of what is a community bank, in your opinion, what is the asset size threshold or limit for a community bank versus say a regional bank?

Mr. KIM. That is a good question. That is a very good question. I would say in terms of—we have talked before about application of capital standards and other rules that it should be more about the business model than it is about a particular asset size.

So if I am a $20 billion bank and these guys are $1 billion banks, and I am doing about the same thing, then I am a community bank. I refer to myself as a "super community" bank, which means I do business in several communities. I bring community-like service and a bit broader product line than sometimes some of my smaller colleagues might be able to offer.

So, $50 billion and under might be the sort of a super community bank; above that they tend to get called regional, but even above $50 million, some of those regional banks can be engaged in pretty much the same business we are.

Mr. SCOTT. Right. So your bank, Commerce Bank, has an asset size of about $22 billion, which could clearly put you into the regional bank category, and the reason I am asking this is because I think you are the right person to get to this whole area of tracking compliance costs.

So you are basically a regional bank. Now, let me ask you this. In what ways are regional banks similar or dissimilar from community banks? And I think you are the right person to ask this.

Mr. KIM. We have larger staffs who exist to handle compliance problems. I have a very large compliance department. I have lawyers. I have people who are solely dedicated to that.

In today's environment though, I am kind of like you guys because—as CEOs, they are spending a lot of their time working compliance instead of serving their customers.

And we are taking a lot of our folks who interface with customers and directing them to compliance. That would be one difference. I have sort of more staff to take this on, but ultimately, it creates the same cost to the consumer.

Mr. SCOTT. And what additional burdens do regional banks face even though they are not systemically significant in that way?

Mr. KIM. I think I am more likely—for instance, take stress testing. Banks above $10 billion have to, starting this fall, undergo stress testing. Some of my colleagues at the $50 billion-plus institutions are submitting 8,000-page documents for stress testing on an annual basis.

Right now, I am interviewing consultants who are going to cost between $500,000 and $1 million to help me with stress testing. I am taking my best and my brightest data analytics people out of the business line and bringing them forward to do stress testing, which if you looked at our record, in terms of safety and soundness and loan losses, I am spending a ton of money on something that is unnecessary for a bank with my capital level and my history.

Mr. SCOTT. So we know the importance of regulatory relief for the community banks. How important is regulatory relief for regional banks?

Mr. KIM. I think it is extremely important. I think it is important to both. I think the risk on the smaller banks is that many of them are going to be forced to combine.

On the regional banks, it is more that we take our eye off the ball of serving the customer, we raise the costs, and eventually we can get squeezed out, too, and then we are left with just the large banks.

Mr. SCOTT. And finally, on the tracking of compliance costs, the FDIC did a study and interviewed a number of banks on how they track regulatory compliance and every one of them said that they didn't track regulatory compliance costs within their bank's internal cost structures because it was too time-consuming, it was too costly, it was interwoven into their operations, and it would be too difficult to break out specific costs.

Is that a general consensus? My point is, you have come to a conclusion as to what your bank's annual cost to comply is. And I was wondering, did you fall in that category? Do you have an estimate of compliance costs? And what would it be?

Mr. KIM. It would be easier for me to do it and I don't have it off the top of my head.

One thing I looked at last year is we have spent about 100,000 hours creating new products in our information technology area; programmers and things working on new—15,000 of those 100,000 hours last year was devoted to compliance matters.

It was about 10 people—and that is just in the IT structure. Like I said, I have lawyers and compliance people and business line people who normally are interfacing or thinking about products and they are thinking about compliance now, and those are the people that it is hard to judge their time.

Although I will say I am tracking time on stress testing because that is going to be a killer and I am going to want to be able to tell somebody someday how much time I spent on that.

Mr. SCOTT. Thank you very much.

Chairwoman CAPITO. Thank you.

Mr. Luetkemeyer for 5 minutes.

Mr. LUETKEMEYER. Thank you, Madam Chairwoman.

The other day I was reading The Wall Street Journal, and there was an article by Sheila Bair, former FDIC Chairman, and in the article she talks about the risk weight models that were introduced as a result of Dodd-Frank, by a lot of banks, and how the difference between the megabanks and their risk models with regards to how they affect capital as well as the risk models that community banks use.

And it was interesting because they were in there. She indicates that—I will give you a for-instance here. For instance, Morgan Stanley, in their weight risk model, the capital asset ratio or capital or the risk-based capital ratio was 14 percent by their particular model.

But if you take out the model and use it the way it should be done, in the old way it was down to 7 percent; it cut their capital in half.

The other bank they were putting in this article here was U.S. Bancorp; they are just basically a big community bank of $350 billion. With their particular risk weight ratio, they are a little bit over nine, but when we went to the original risk based ratio, they were just at nine. So suddenly, they became a much better capitalized bank then Morgan Stanley, and I think this is a concern that I have with regards to what is going on with our community bank situation.

Have you seen, gentlemen who are here this morning, this type of situation affecting your ability to do your job and the competition with the big banks? Do you understand what I am asking?

Mr. BURGESS. I don't think at this point in time it has, but when somebody is trying to calculate what the effect of Basel III is on capital levels, the data to do that calculation does not exist in a public format.

The level of detail that you have to go through to determine what the risk weightings are to determine those capital ratios is not available.

Mr. LUETKEMEYER. I think there is a fairness issue here though from the standpoint that these big guys all get to do their own risk models, where you all basically don't have all these other risky investments to sort of go out here and—when you are risk weighting a real estate loan, let's be honest, there is not a whole lot of risk there to that.

But when you are talking about derivatives and securities, mortgage-backed securities, and all sorts of other products out there that are risky, and they are all guessing at what this is, it certainly puts them at a—whenever the regulators are not trying to put all this on a level playing field, there are a whole lot of problems here, I think.

Mr. KIM. I think what you are illustrating there is the difference between those guys at the top with the complex business models that hold a lot of different assets, and maybe they are able to alter those models to make capital ratios look better.

I am not going to pass judgment on whether they are doing that or not, but the problem really comes when you try to take that same level of information, that same level of modeling, and push it down on us and it was not created for banks our size and it is not going to work well for banks our size.

It is going to put us through a lot of work that yields nothing because we don't have the kind of complex assets and risky assets that some of our brethren at the trillion-dollar level have.

Mr. LUETKEMEYER. I think it really is sort of—it doesn't help the big guys because there is not a level playing field of a model there that actually compares them all. It doesn't make any sense.

So anyway, I will move on here. I know that HMDA exams are a pain in the neck for all banks and I see a lot of heads shaking already and the other day one of my local bankers gave me a quick sheet that they had done, a sort of survey of the civil money penalties that were assessed by the FDIC, the OCC, and the Fed with regards to exams over a 2½-year period from 2010–2012.

And the FDIC came up with 166—and this is the State of Missouri, now where I am from—civil money penalties that they assessed over a 2½-year period and the Fed and the OCC had a combined total of five.

I went to the FDIC, and I showed them this, and I said, "As a former bank regulator, this has red flags all over this. Can you explain this?"

And in discussions with the Chairman and Vice Chairman, in fact they said, "Well, we realize we have a problem. We are going to start advising our examiners to be more forbearing on the first set of exams to see if there is just oversight or if they are still learning the rules and regulations. And the second time we go in that is when we won't really be willing to go start assessing these civil money penalties."

Have you seen, over the last examination maybe not in the last—in the hope—and have you been examined in the last 3 or 4 months? I guess that should be the first question.

Okay. Mr. Loving, have you seen a little bit more forbearance with regards to their exam procedures? Because they have promised that to me.

Mr. LOVING. I can't say that I have because we just recently became a HMDA reporter because of an office we located in SMSA, but I will tell you the cost that we have incurred to make sure that doesn't happen has increased significantly.

The number of days that our compliance officer looks at mortgage compliance from the 2007–2008 era to today is significantly more.

Mr. LUETKEMEYER. I know—if the chairman will bear with me one more second here—I am out of time. In testimony in this committee prior to this, we have already had bankers talk about in a situation like this where when they hire one loan officer, they also have to have one compliance officer.

Is that kind of a standard that you have seen or something similar to that?

Mr. LOVING. Recently, we went to an eight-member senior management compliance committee in addition to our full-time compliance officer who also came to me the other day and said, "I believe we need to start looking at another compliance person because the job is becoming too intense for me to do the review that I need to—to comply to the level that you want to comply at."

So it is not quite one-to-one, but it is getting pretty close.

Mr. LUETKEMEYER. Okay. I thank you for your testimony.

And I thank you for your indulgence, Madam Chairwoman.

Chairwoman CAPITO. Thank you.

Ms. Velazquez for 5 minutes.

Ms. VELAZQUEZ. Thank you, Madam Chairwoman.

Mr. Loving, community banks, as we all know, play a vital role in the small business lending market. We have heard on numerous occasions that regulatory burden is a driving factor in why community banks aren't lending more to small businesses.

What role does regulation play versus other factors like lack of demand or tight lending standards in limiting access to credit for small businesses?

Mr. LOVING. I think it is important to note that community banks under $1 billion have actually funded to 60 percent of the small business loans in our country. So, community bankers are avid small business lenders.

We have faced, due to the economic environment, a challenge in qualified borrowers. Community banks are active lenders in the community and we want to lend in the community but we do have challenges because of the perception from regulators, or for guidance, or from regulation itself that prohibits us from making a particular loan.

So I can't say it is one thing, but it is a combination of many factors that had come into play when you hear that the banks aren't lending, but I can tell you we are all in the business of supplying credit to our communities and we are certainly looking for qualified borrowers to fund.

Ms. VELAZQUEZ. However, at the height—and I would like to hear from Mr. Kim—of the credit crunch in 2009, thousands of valuable small businesses struggled to find credit because banks and credit unions were either unwilling or unable to lend. And we are not talking about unqualified borrowers.

Today, however, the situation has reversed, as lenders are more willing to make loans while the number of borrowers in search of credit has dried up. With demand weak, what steps have your banks taken to attract borrowers and increase small business lending?

Mr. KIM. Small business lending and small business people are great customers for banks. They typically do their personal business with you as well as their small business and maybe even some of their employees bank with you.

So we are making great efforts to try to analyze our customer base to see who is involved in small business, reaching out to them, and offering them products. Maybe it is taking credit cards or maybe it is different kinds of services that might bring them into the bank and garner those relationships.

It is difficult in that when you look at the creditworthiness of people who have been through the credit crisis, a lot of people took hits and a lot of small business people maybe are out of a job and they are starting a small business.

Those are tough things for banks to lend into. You need an equity partner there, not a bank partner, when you are starting up that kind of business, but sort of at that next level up, we are reaching out and trying to get that business.

Ms. VELAZQUEZ. Yes, Mr. Pinkett?

Mr. PINKETT. I will just pick up on Mr. Kim's point. I think a lot of times we talk about capital for small businesses. We should leave open the possibility that what small businesses need is equity capital, not debt capital.

And so, the idea that all small businesses should be able to borrow regardless of the situation of that business is one that we have been working to disabuse some of our customers of.

Good customers, but we explain to them that this is not a debt need. It is an equity need because debt could put you out of business and that is the conversation that we don't have often with our customers in general, but we are starting to have with our customers so they understand our commitment to them is our commitment but it doesn't mean that the solution is a loan.

Ms. VELAZQUEZ. But we do see that the bigger loans, those above $250,000, are much easier if we are talking about qualified borrowers.

Mr. PINKETT. Right.

Ms. VELAZQUEZ. Where we see a gap is between those smaller loans, and we are talking here about debt, those loans to help people start up their businesses for example. We didn't see or we haven't seen business formation at the rate that we saw in previous recessions like in the 1970s and 1980s compared to the one that we are seeing today.

Mr. PINKETT. Yes, I would say that we are making small business loans but small business loans are harder to make in this economy than they have been in the past because the small business owners are not able to generate the revenue as quickly as they need to make that level, that debt service payment, and so that is the challenge.

Helping them ramp up to get to a place where they are stable enough is the challenge. It is a lot easier to make larger loans to larger businesses because they have that capacity.

And then the SBA's involvement in this process and their ability to provide guarantees that we can rely on that, that we can work with them to come up—

Ms. VELAZQUEZ. Those are the loans the community banks and other banks are making. Those guarantees by the SBA, by the Federal Government. And even with those that are guaranteed by the Federal Government, and when we increase that guarantee from 75 to 90 percent, what you saw is that the banks were making the big loans but not the smaller loans.

Chairwoman CAPITO. The gentlewoman's time has expired.

Mr. Barr for 5 minutes.

Mr. BARR. Thank you, Madam Chairwoman.

The tradition of community banking in Kentucky has always been based on the three C's: collateral; capacity; and character, and the last point is what I want to focus on a little bit.

Community banking is relationship banking. It is based on trust. Many times, community bankers go to church with their borrowers. Their children grow up together. It is about knowing your customers and trusting the discretion and business judgment of the banker.

So banking can't just be a fit the boxes defined by some government agency, otherwise why even have bankers in the first place?

My question is, do you get the sense that post-Dodd-Frank, business judgment and discretion has been removed from banking?

Mr. BURGESS. One of the things that I probably pride myself the most on in my banking career, my 35 years of banking, is that as a community banker, I have been able to sit down with each individual customer, whether a consumer, a small business, whatever, and listen to what their problem is, listen to what their need is, and try to custom design a product and a solution for them.

As that box that we keep talking about gets smaller and smaller and smaller, it is taking away our ability for the flexibility we need to be able to do that type of thing.

That is probably the biggest concern I have because we can't make those customized decisions as much anymore, probably more so on the consumer side right now, but I have concerns with some of the new data gathering on the small business that we are going to start heading that way there as well.

Mr. BARR. And while the others answer the question, maybe you could also amplify your answer by talking about the types of services or products that you maybe are no longer able to offer as a result of this removal of the banking judgment discretion.

Mr. LOVING. I will reiterate Mr. Burgess. Over my career, I have prided myself, and the community bankers pride themselves on knowing their customers, and it was heartwarming to hear the stories in this room of those who are where they are today because of the community banker.

And at the end of the day, that is what community bankers do. We want to build better communities. We know our customers better than anyone and to try to fit someone in a box or make sure it fits in a box prohibits our ability to do what we do best.

And so, I am very concerned. We have heard about subjective, and this group uses subjective models, they use subjective thoughts. We have always used subjective methods to approve a loan because we know our customer. We tailor the product. We tailor the loan.

But when you start assigning rules and numbers to certain data, it is hard to fulfill those guidelines, and we will back off.

And again, as I testified, the QM rule is one that—it very, very likely could cut off and strangle mortgage lending in community banks.

Mr. BARR. Let me ask the witnesses also about paperwork for the consumers and whether or not your banks are able to collect or have you collected data after Dodd-Frank implementation about whether or not your consumers feel any safer as a result of some of the requirements that are imposed on the consumer and the borrower?

Mr. LOVING. If I may say that community bankers have always been known to be trustworthy souls, and I am sure many of the community bankers here hear the same thing when we go to a mortgage closing and there is a stack of papers an inch or two inches high. I am not sure it makes the consumer feel any better because they are saying, "Well, just tell me where to sign. Just show me where to sign," and because they know that the product, the service that they are getting from their community bank is a trustworthy product and they trust their banker.

Mr. BARR. Final question: I hear frequently that there is a disconnect between what the regulators say their mission is publicly and what individual regulators do in practice.

In fact, in Kentucky, my community bankers have told me that one of their primary concerns is that there is an incentive for regulators to be excessive in their scrutiny because that is the way they get promoted.

And the common frustration is that there is inconsistency among field examiners even when they are in the same region. Some of you have testified earlier about fear of retaliation.

Could you all comment on this observation from community banks in Kentucky and also specifics about fears of retaliation with examiners?

Mr. BURGESS. I don't personally have a fear of retaliation because we have had a really good relationship with the regulators we have had, and we have not been in an economy where we had to worry about that too much.

But, I think a lot of time the regulators have the best interests in mind to do the job the way it ought to be done and to be thorough and fair.

But as I said before, perceptions based on where they are can change some of that, and I think there is a fear that above them, whoever is evaluating them, if they miss something, they could be in trouble for that. So I think that is where some of the fear comes from.

Chairwoman CAPITO. The gentleman's time has expired.

Mr. Green?

Mr. GREEN. Thank you, Madam Chairwoman.

I thank the witnesses for appearing.

I also think the ranking member for his comments earlier, and I would like to associate myself with the comments with reference to the community banks and the credit unions being the small institutions that have provided a lot of opportunities for persons in various communities.

I like to consider myself a friend of both small banks and credit unions. I am not sure that we have a good definition for a community bank, but my suspicion is that $10 billion is a little bit high for a community bank.

If I am incorrect and $10 billion is about the right size for a community bank, would someone please help me?

Mr. KIM. I might say $10 billion is a little bit low.

[laughter]

Mr. GREEN. $10 billion is a little low?

Mr. KIM. And I think the way you need to evaluate who, if some bankers are going to get favorable treatment and others are not I would suggest—and I am not going to wish unfavorable treatment on anybody, but I think you need to examine the business model.

You need to examine what people do and that is more important, if banks aren't involved in derivatives trading, they don't have complex exotic products, they aren't making exotic loans, you know that. And you serve, and the bank is engaged in serving their community. I don't think that because I happen to serve customers across several communities that makes me any less of a community bank than someone who is maybe all within one county.

Mr. GREEN. All right, let's see if there is another opinion. I seem to have hit a nerve.

Mr. PINKETT. I would weigh in. I think my assessment of the industry is this: It is very difficult for a bank under $100 million to continue to exist profitably. It is going to be difficult across the country.

I think you are going to see that the optimal size of a small bank is going to be somewhere in the neighborhood of $1 billion because that is what it is going to take to have the manpower to do all that is required to operate efficiently.

And I am not suggesting that we should do away with regulation in order to allow smaller banks to exist. I think regulation is important. Compliance is important. Managing in a safe and sound way is important.

Mr. GREEN. May I intercede for just one second? I appreciate where you are going, but would you do this for me? You are using a term that I have not introduced, and that is smaller banks. I have said community banks.

Mr. PINKETT. Right.

Mr. GREEN. Am I to assume that they are the same in your mind?

Mr. PINKETT. No, I am about to tie those two together.

Mr. GREEN. Okay. Thank you.

Mr. PINKETT. Community banks, I think, will be in the range of $0.5 billion up to and I think your $10 billion number is about right. I don't think you are going to find many small banks smaller than that surviving, is the point I am making.

Mr. GREEN. Is it your opinion that smaller banks should survive or should not?

Mr. PINKETT. It would be great if they could survive; I don't see at this moment, given all that is in front of us, the possibility.

Mr. GREEN. The smaller banks that I talked to do tell me that they are, as you have indicated, overregulated, but they don't see themselves in the same league, and maybe this is what one of our panelists have said, as the $10 billion banks.

They really see themselves as true community banks. Now, we can debate that as to who is a true community bank and who is not, but they just see themselves as the real community banks: smaller than $10 billion.

You walk in, you can meet the president, you have people working there who pretty much know the people who come in and out. They do live in the community—$10 billion banks, generally speaking, don't have quite the same relationship in their minds as banks that have $100 million, $200 million, maybe $0.5 billion.

And we have a lot of these banks that are coming to me and saying, "I really need help." I am not demeaning any of the banks, I am just trying to, in my mind, see if there is some merit to what these smaller banks—maybe that is a better term—smaller banks should receive in terms of attention.

Mr. Pinkett, would you elaborate a little?

Mr. PINKETT. That is exactly the point I was trying to make, Mr. Green, that there is a—community bank has become a term of art. There is a level of bank that I think is smaller than that and really needs assistance also, a different level of assistance and so—

Mr. GREEN. Okay. Let's agree that one size doesn't fit all, that community banks, some that are larger, some that are smaller, need some help. And I am amenable to doing what I can to help.

In fact, I have agreed to go into my community—one aspect of it in any event—and actually visit a community bank. They would like to show me, let me have a first-hand view of what is taking place.

And my final question would be this: What one thing should I look for when I go into the bank, the smaller bank, the community bank, to visit? What is the one thing I should look for?

Mr. PINKETT. I think what you will see is the relationship the customers have with the staff. They know each other. And there is a sharing because they are a part of the community in a different way than you can be if you are $20 billion—or I should say $50 billion, not to offend any one size institution.

[laughter]

Mr. GREEN. Mr. Chairman, may I just, in a sense of fairness, give Mr. Kim an opportunity to respond?

If you would, Mr. Kim.

Thank you, Mr. Chairman.

Mr. KIM. And I would agree wholeheartedly with what Mr. Pinkett said. You go in and look and see the connection between the people in the bank with the customers that they are dealing with and I would suggest that we go to great lengths to have staff in our branches who are engaged with the customers who are interested in their communities.

They are in the Rotary Club. They are doing things to serve their community. That is all part of our model. That is who we are.

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

Mr. DUFFY [presiding]. The Chair now recognizes the gentleman from Arkansas, Mr. Cotton, for 5 minutes.

Mr. COTTON. Thank you all for coming today. Thank you for your very helpful testimony and what you do for communities all around America.

In Arkansas, as in so many of your communities, community banks are vital for providing credit to families and to small businesses, to young people who are just starting out.

In Arkansas, we don't have much besides community banks and a few regional bank presences, also very helpful for local charities and schools, so we are very grateful for all you do.

Sometimes, I hear from some of my constituents in Arkansas that banks aren't lending. That is something akin to saying that McDonald's is not interested in selling hamburgers. I think that most of you make your money by lending and to the extent that you are not lending as much as you want is probably the result of unwise decisions and actions on the part of people in this town.

I would like to explore a point that Mr. Pinkett raised in response to the gentleman from Texas. First, you talked about a $100 million bank or less struggling to survive in this environment. Could you elaborate a little bit on why that is and also what the solution to that is if you are a bank with less than $100 million of assets? Do you have the opportunity to grow out of that trap or is there no solution to it?

Mr. PINKETT. I will answer your last question first. I don't know the solution, which is why I am suggesting that there is a real struggle there. This solution would require additional capital. I think it is hard to attract capital at that size because the business model is not robust enough to cause investors to see where the institution will be able to make a go of it in most instances.

Clearly, the cost of compliance is an issue, but it is not just the cost of compliance; it is also the competition. With the competition coming from large institutions, from small institutions, from regional institutions, from unregulated institutions, it is just hard to make that work.

Most institutions of that size have people doing two or three jobs. If you have 15 or 20 employees, you have to have people doing 2 or 3 jobs. The ability to learn that, to know when one person retires who is doing three jobs, retires and you try to replace that person, you can't find another person who can do those three jobs that same way. If you fill that job with three new jobs, you have already increased your overhead costs.

So I think the revenue stream that can be generated off of a $100 million book of business is probably just not sufficient.

Mr. COTTON. Okay. In the debate about the size of the community bank, just to give you some context, in Arkansas I believe that there are fewer than 10 banks that would exceed $1 billion in assets.

There is one bank I have in mind that was started maybe 10 or 12 years ago. It was probably less than $100 million then. It is now one of those few banks that are over $1 billion.

Do you think that kind of growth is possible in today's environment? Can an underserved community create a new bank and then have that grow to be a bank that serves an entire region of a State like Arkansas?

Mr. PINKETT. I would say it is possible. I don't know that we have created a model, though. And I think that is sort of the issue that I would ask you to think about: how do we create models and pathways for success?

One of the things that the regulators I think could do more of is help lead the banks to success as opposed to simply standing over them and pointing out where there is failure.

So I would say that turn in the regulator/bank relationship would be an important one for future success of banks, which in most instances should be considered small businesses, as well as for the communities that they serve.

Mr. COTTON. And is that lack of a model do you think part of the reason why there have been so few charters for new community banks? I think maybe one in the last 2 or 3 years?

Mr. PINKETT. I have no idea about that one—

Mr. COTTON. Maybe if we could just go down the panel and get—same two questions about whether that kind of growth is possible in today's environment and is that part of the reason why there are so few banks starting?

Mr. LOVING. I cannot comment as to why, but I think there has only been one de novo charter issued in the last 2 years, and I think that is because of the stringent regulations required to open an institution and the business model that you have to have.

Unfortunately, many of the de novos that started, they factored in their model, broker deposits, and other non-core funding deposits and those today are not available. So that would prohibit the growth that you saw back at the time that you were talking about.

Mr. KIM. Growth is tricky. If any of us grow our bank too fast, you need to look at us closely, because we may be doing something we shouldn't be doing. It is hard to get a bank to $1 billion.

I think, as you see few charters out there, the business is not as much fun as it was when I entered it some 30 years ago, and it is not fun for these guys who have to spend, CEOs spending time working on compliance.

And so I don't see a lot of people saying, "Wow, that is a great business that I want to be in." Everybody kind of hates them right now. So why go out and start one of those? Plus, the returns on the small banks side, as Mr. Pinkett explained, and I think he is exactly on target—it is hard to attract capital for that.

Now I think the way some banks get to the billion dollars tends to be consolidation, and consolidation makes sense at times and it is not necessarily bad.

Mr. BURGESS. And I think when you are talking about a lot of the small communities that you are talking about, I don't think there are the financial resources or the strength of the economy that would grow a bank that large.

So no, I don't think that is possible. And I actually have a friend who has been running a bank for a number of years in a community of about 10,000 people just down the road. And his board has just asked him to sell the bank because they don't feel like they can handle what is happening anymore.

Mr. COTTON. Thank you all for those answers, and thank you for being here today.

Mr. DUFFY. The Chair now recognizes the gentleman from Washington, Mr. Heck, for 5 minutes.

Mr. HECK. Thank you, Mr. Chairman.

And thank you all very much for being here. Last week, we heard from another part of the financial sector which brought forward to us concerns about regulatory relief in the area of remittances. I have read all of your testimony, and I see no mention of it. Do you just not engage in this activity or is it of such a de minimis concern you didn't care to point it out?

Mr. LOVING. From our particular situation, it is not something that is a problem for us. We don't engage in it, sir.

Mr. HECK. No one?

Mr. PINKETT. Our own participation is through banking customers who are, and so we have some compliance issues around it, but it is not a major issue.

Mr. HECK. All right. Then I would like to move on, if I may. In the last several years, the largest banks have grown, some would say dramatically, some would say astronomically in their market share of retail lending.

Very quickly, what do you think are the major factors that caused that to occur? Maybe start with Mr. Burgess and go down, but be quick if you would, please.

Mr. BURGESS. You are talking about the larger banks?

Mr. HECK. Yes. Their market share of retail lending has gone through the roof.

Mr. BURGESS. From our standpoint, they are set up to be more or less an assembly-line operation. A lot of the products on the retail side have become commodity-type products rather than customized-type products.

And so, the banks like us are more of a customized type shop. We don't do high volume. They do, and they can offer lower rates, which is going to win out with the masses.

Mr. KIM. Yes, and I would agree with that, and maybe echo that serving consumers is difficult and it is costly because the loans are smaller and some of these large banks with the way consumers want to interact with banks now online, much more quickly, not so much coming into the branch, that is going to be in favor of the largest banks.

And I also think the mortgage business has been one that there has just been a lot of consolidation and that is why they own so much of that market. I am not so sure that banks our size have lost it. It has been more consolidation making it look like they have it.

Mr. LOVING. I can say that it is probably a couple of factors. One is based upon the size and the perception of too-big-to-fail. There is a security movement or a movement because of security and there is also a cost beneficial to them from the funding side.

Again, as I said earlier, whether it is 20 basis points or 80 basis points, they can certainly price a product cheaper than we can in many cases and essentially buy the business. And so, I think a lot of it is because of the perception of too-big-to-fail.

Mr. PINKETT. Cost of capital, cost of processing, cost of technology, ability to market broadly, and access to securitizations. They just have a different business model than we have.

Mr. HECK. Thank you. That was very insightful, and I appreciate it.

Lastly, Mr. Green made reference to self-identifying as a friend of both credit unions and community banks, which some in this town would have you believe is a mutually exclusive characteristic.

I want to make a point. If any of you, or as I strongly suspect, all of you, have ever engaged in a private conversation with your families or your colleagues at work in which you expressed frustration with the inability of the Members of the United States Congress, to sit down like adults and solve problems because there was the red side and the blue side and where is the best interest of America when it comes in all of this, then I frankly would just encourage you, the next time you are so tempted, to play back to you the other side of that.

Here we have a circumstance that notwithstanding the fact that you compete for market share, there is consensus up here—there is no doubt about it in my mind—that some form of regulatory relief is in order for both community banks and credit unions.

Next time you are tempted to have that conversation about Congress, remember this, if you would please: You are leaving on the table a phenomenal amount of power and influence to do what, for example, Labor and the Chamber has done with respect to immigration reform, to come together and figure out where your mutual interests are so that we can do our job to grant you that which I think you so eloquently have made the case.

Again, thank you very much for your presence here today.

Mr. DUFFY. The Chair now recognizes the gentleman from Pennsylvania, Mr. Fitzpatrick.

Mr. FITZPATRICK. Thank you, Mr. Chairman.

I also want to add my thanks to the members of the panel for your testimony, which is a great help to the committee and to the communities that you serve as well, as well as to your industry. I want to follow up on that issue of the need for regulatory relief.

Mr. Pinkett, in your testimony earlier today, I found it very insightful that you are talking about when the regulators come to your community bank, to your institution, with the full weight of all of their regulations and the examinations and the sort of impact that has on your ability to operate in the real world as a community bank trying to make loans, trying to be responsive to the customers that you serve and that you want to serve.

I am hearing the same thing from the community banks in Pennsylvania in the communities which I represent. I have a comment here from a community banker in Montgomery County, Pennsylvania, not far from where you are in New Jersey.

He says, “We don’t believe that the regulators understand that their actions and the way they go about their business does impact our ability and willingness to lend and conduct commerce. They just look at their job as enforcing the regulations and not the negative impact of their actions and what they have in the economy. While this condition has always existed, in the current environment, it is material.”

And Mr. Barr earlier was talking about, I think he was discussing the issue of the lack of new charters, the consolidation. We are losing banks. People don’t want to take the risk of creating a small community bank in this regulatory environment that we have.

The last de novo bank in Pennsylvania, I think, was about 5 years ago. It is a small bank in my community, Monument Bank. It started 5 years ago. They have 40 employees. More than half of the employees are earning $50,000 or more, but what I am hearing for the last 5 years is that nobody wants to start a bank under the current regulatory environment.

Those banks that exist don’t want to expand. Any new jobs that are created are jobs that are designed directly to deal with all of these massive government regulations coming out of Washington.

If there was one thing that we could do here, on this committee and in this Congress, to help reverse that trend to get people to start community banks and take those risks, which ultimately will help the community, what would that one thing be?

Mr. Pinkett?

Mr. PINKETT. I would say, the one thing I would ask is that you help the regulators, encourage regulators to recognize their dual mission. They have to protect the economy and so we need regulations. They have to keep us from making bad decisions that would harm the institutions, shareholders, and of course the taxpayers. So we need regulations.

But they have to do that in a way that helps us build the banks so that we can better service the customers. We need regulations for consumers and so that we don't offer products that are harmful because some products are out there that are really harmful to consumers and they need to be regulated out because not everyone is of the same character as the folks you selected today, and they are doing business in harmful ways.

But, we have to do that in a way that encourages the banks to be successful, that allows them to be successful, and encourages them to do a better job of managing the risk associated with this business because it is a high-risk business.

Mr. FITZPATRICK. Mr. Loving?

Mr. LOVING. I would say that from a regulatory perspective, tiered regulation or scaled regulation is imperative to our industry. The risk model that I have and the risk model of one of the largest megabanks is significantly different. Most community banks across the country operate in a different risk model, yet we have to face the same regulation that the largest of the large face and the costs related to it. So I would say tiered regulation or scaled regulation to the risk and size of the institution.

Mr. FITZPATRICK. Mr. Kim?

Mr. KIM. Yes, I would just say the one-size-fits-all, as Mr. Loving said, and the more—one-size-fits-all doesn't work and we need clarity and we need coordination to the extent there is overlap with the regulators and we want to follow the rules. We may not like the rules, but we will follow them because that is what we do.

Bankers—most of us are kind of rule followers. We don't want to get in trouble, so you have to make it clear for us, and that will enable us to comply and then we get opportunities like this to try to make some changes around the edges where there needs to be change.

Mr. FITZPATRICK. I mentioned in my opening statement about the anxiety I have been hearing with respect to the QM rule. I have this small community bank in my hometown of Levittown.

Mr. Terry Sager wrote to me about his concerns about no longer being able to lend outside the box, and Mr. Barr was talking about what he was referring to as character loans that they make in the Commonwealth of Kentucky. We make them in the Commonwealth of Pennsylvania, as well.

Those loans that I guess you are being told now you are not really going to be able to make them. You look somebody in the eye, you know that they are going to be able to make that payment. You know that they have a good idea and that they are going to be successful, but you are now being told you can't do it.

Any anecdotal, any particular case you want to talk about, a loan that you were able to make in the past that somebody was able to go on and build a business and create jobs that you are concerned under these new QM rules you are not to be able to make?

Mr. PINKETT. Can I just say—if there is someone who can look a person in the eye and know they are going to repay the loan, I would like to hire that person. So some of this is just—I think just a little too far.

I hear bankers say that also, but at the end of the day, there has to be some analysis and assessment about the capability of the person whether it is a consumer or business owner and that should be fair and consistent.

And I think all we are saying is—piggybacking on what Mr. Kim said—let's find rules that we would like to follow as opposed to rules that we have to follow because he doesn't want to run his bank into the ground. He doesn't want the taxpayers picking up the tab for his work. He doesn't want to explain to his kids how he was a lousy manager and a steward of resources in this country any more than anyone in any of the regulatory agencies wants him to have that conversation.

So I think we have to be careful about going too far in the other direction also, which is to say that looking you in the eye, I can tell you are going to pay me back. I think we need some rules. We need some regulations, let's just make them fair and reasonable and then we will all want to follow them.

Mr. FITZPATRICK. Okay.

Thank you, Mr. Chairman.

Mr. DUFFY. Thank you.

I want to thank the panel for your time and testimony today. We appreciate you coming in. The committee is grateful.

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.

Without objection, this hearing is adjourned.

[Whereupon, at 12:15 p.m., the hearing was adjourned.]

A P P E N D I X

April 16, 2013

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Testimony of

Kenneth L. Burgess Jr.

On behalf of the

American Bankers Association

before the

Subcommittee on Financial Institutions & Consumer Credit

of the

Committee on Financial Services

United States House of Representatives

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April 16, 2013

Chairman Capito, Ranking Member Meeks, my name is Kenneth Burgess, Chairman of FirstCapital Bank of Texas, in Midland, Texas. I am also the Chairman of the ABA Community Bankers Council. I appreciate the opportunity to be here to represent the American Bankers Association (ABA) to present the views of the ABA regarding regulatory relief for small financial institutions. ABA represents banks of all sizes and charters and is the voice for the nation's $14 trillion banking industry and its two million employees.

Before I discuss the specific changes needed to help community banks, let me describe a bit about my bank. FirstCapital was formed in 1998 in Midland, Texas. At that time, a number of community banks had exited the community through failures or mergers and Midland only had two other locally owned community banks remaining. Our thoughts about the lack of community banks in Midland turned out to be right on point. Since that time we have entered into the Lubbock and Amarillo markets. We are now located in the three major markets in the Panhandle of Texas. Since we began in 1998, we have grown to over $713 million in assets.

We are primarily a business bank, serving small- to medium-size businesses in each of our markets. We also serve many individuals of all means, especially through our mortgage division which provides over $200 million per year in home loans to people living in our three markets. Because of the number of people we serve through our mortgage division each year, I am very concerned about our ability to continue serving these people to the extent we have in the past due to the significant changes in the mortgage rules. We are dedicated to the communities we serve and we strive to be a leader in helping to improve each of our communities. Just one example of this was our recent donation of 26 residential lots to Habitat for Humanity in our Midland market. That donation provided Habitat with about a three-year supply of lots on which to build affordable housing for needy families. At the time, Habitat was almost out of lots on which to build.

Today, our diverse banking industry is made up of banks of all sizes and types, from small community banks to community-based regional banks, to large money center and global banks. This depth and breadth is required to meet the broad array of financial needs of our communities and customers. Our $16 trillion economy requires a large and diverse U.S. banking system.

I realize there is a lot of talk about breaking up large financial institutions. We all agree that no bank—no matter how large—should be too big to fail and that policy makers should use all appropriate tools to ensure that large banks are not insulated from the consequences of their actions. But rhetoric about breaking up large banks does nothing to help community banks. It is a distraction from the fundamental and urgent need to promote the growth and vitality of community banks.

Community banks make up 95 percent of all U.S. banking organizations and have been the backbone of all the Main Streets across America. Our presence in small towns and large cities everywhere means we have a personal stake in the economic growth, health, and vitality of nearly every community. A bank's presence is a symbol of hope, a vote of confidence in a town's future. When a bank sets down roots, communities thrive.

The sad fact is that over the course of the last decade, 1,500 community banks have disappeared. Since Dodd-Frank, 475 are out of business. This is why hearings like today's are so important. It is an opportunity to change the dialogue from just talking about how important community banks are to what can be done to stop the rapid decline in the number of community banks and start taking action to assure we have a healthy and vibrant community bank sector.

There is a widespread appreciation for the benefits community banks provide to their communities across the country. For example, FDIC Chairman Martin Gruenberg said: "By its nature, small business lending is often labor intensive and highly customized, which is the kind of lending that community banks really are set up to do." Federal Reserve Chairman Bernanke recently noted that "community banks play an important part in the financial system and in our economy." Comptroller of the Currency, Thomas Curry, noted: "I am seeing on a daily basis the positive impact that federally chartered community banks and thrifts have upon the towns and cities they serve."

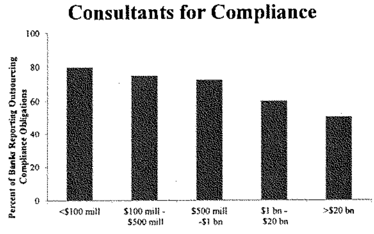
Despite the widespread understanding of the importance of community banks and the concern for the challenges they face, many of the actions taken by these very same agencies have had exactly the opposite effect–hurting, not helping community banks.

For example, at the same time policy makers were urging banks to make more loans to help boost the economy, regulators were clamping down in an effort to drive all risk from the system. At the same time that banks were trying to reach out to their local businesses, the growing list of new rules and regulations meant more compliance officers and fewer customer-facing employees.

At the same time regulators want to see banks grow, they were ratcheting up the required levels of capital and proposing new Basel III standards that will surely force community banks to reduce lending even more than they have had to do already.

At the same time as the housing market was in desperate need of community bank mortgage loans, the sheer volume of new rules and the limited time for compliance are imposing costs so high that many community banks will likely scale back their mortgage operations, lose market share, and may end up out of the mortgage business altogether. Depending on the level of risk and increasing costs of being in this business, our bank may choose to exit the business in the future. This means loans that we have historically provided in our markets will shift to either the big banks or the on-line mortgage providers and our customers will receive a much different level of service.

Smaller Banks Rely on Consultants for Compliance



Source: ABA Bank Compliance Officer Survey

During the last decade the regulatory burden for community banks has multiplied tenfold, with more than 50 new rules in the two years ***before*** Dodd-Frank. Dodd Frank will add hundreds more affecting all banks. Managing this tsunami of regulation is a significant challenge for a bank of any size, but for the median-sized bank with only 39 employees, it is overwhelming. Historically, the cost of regulatory compliance as a share of operating expenses is two and a half times greater for small banks than for large banks. It means more money spent on outside lawyers to manage the risk of compliance errors and greater risk of litigation. All of these expenditures take away from resources that can be directly applied to serving the bank's community.

For example, we originated 1,296 mortgage loans in 2009 with a total mortgage staff of 18. In 2012, we originated 1,080 mortgage loans with a total mortgage staff of 25. All of the additions were added to enable us to maintain compliance with all of the new requirements and ones expected.

Higher compliance costs, fewer sources of revenue and ever-increasing capital requirements have consequences. I recently learned that two banks have stopped all consumer lending and several others are stopping all mortgage lending that they did, not as a primary line of business but to accommodate the needs of their customers.

The fact that there were no new banks chartered in the last year—the first time in FDIC history—is a dramatic indication that the regulatory risk is too great. It is keeping capital on the sidelines rather than helping to finance new lending. I know first-hand the importance of new banks entering a market, as we did in 1998. We knew we could make a difference in our community and make a reasonable return to our investors that provided capital. We were able to survive the financial crisis and grow, continuing to support our communities when they needed it most. Our economy still needs support and we need to encourage new capital into the industry, not drive it away. The Basel III rules, if not corrected, only make matters worse.

Today, it is not unusual to hear bankers—from strong, healthy banks—say they are ready to sell to larger banks because the regulatory burden has become too much to manage. These are good banks that for decades have been contributing to the economic growth and vitality of their towns, cities, and counties but whose ability to serve their communities is being undermined by excessive regulation and government micro-management. Each bank that disappears from the community makes that community poorer.

It is time to move from good intentions to changes that have tangible results. We applaud the efforts of Congress to help community banks. For example, since the Jumpstart Our Business Startups Act went into effect last April, over 100 banks have voluntarily deregistered saving an average approximately $200,000 annually. In addition, the amendment to the Electronic Fund Transfer Act eliminating the requirement that fee notices be affixed to or displayed on automated teller machines will protect ATM operators from frivolous lawsuits related to the fee disclosure.

Also, ABA appreciates the effort of Rep. Luetkemeyer (R-MO) and members of this Subcommittee in moving H.R. 749, the Eliminate Privacy Notice Confusion Act, through the House. This bill eliminates the requirement to provide an annual privacy notice when institutions that do not share personal information (that can be opted-out of) have not made changes to their privacy practices. This eliminates customer confusion and saves considerable time and expense.

More can and needs to be done. For example,

- The financial services examination process can and should be improved;
- Basel III should be reformed so that capital rules enhance rather than inhibit the role of community and mid-sized banks in the economy;
- Mortgage rules should be simplified and consistent so that community banks are encouraged to make these loans rather than face compliance costs which could reduce their lending or force them to exit the market altogether; and
- Traditional banks should be exempt from registration requirements for municipal advisers.

I know the ABA opposition to expanding credit union business lending is well known by this Subcommittee and that it is not the subject of this hearing. I will only say that all competition is local and that means that the primary competitor for many community banks are credit unions which are often much larger than they are. Credit unions were never intended to be tax-exempt banks, but that is what many credit unions—particularly the largest and most aggressive ones—have become. Equal taxation and regulation of firms that provide the same products is a fundamental principle of fair competition. A vote for expanded credit union business lending would be a vote against community banks.

In the remainder of my testimony, I want to first briefly describe the reasons for the concern that I and my community bank colleagues have about our current regulatory environment. Following that, I will provide details about specific actions that can be taken. The ABA stands ready to work with this Subcommittee to make changes that will secure the future of one of this nation's most important assets–community banks.

I. The Costs To Implement New Regulations Are Substantial, Weighing Most Heavily On Community Banks

Community banks, as do all banks, work hard every day to meet the credit and financial needs of their customers and communities. Community banks have a presence much greater than their total assets suggests. According to FDIC's Community Banking Study released in December 2012, community banks accounted for just 14 percent of the U.S. banking assets in our nation, but held 46 percent of all the small loans to businesses and farms made by FDIC-insured institutions. In 629 U.S. counties—or almost one-fifth of all U.S. counties—the only banking offices are operated by community banks. Without community banks, many rural areas, small towns and urban neighborhoods would have little or no physical access to mainstream banking services

The ability to meet local needs has not been easy with the increased regulatory costs and second-guessing by bank examiners. During the last decade, the regulatory burden for community banks has multiplied tenfold and it is no surprise that nearly 18 percent of community banks disappeared in that period. Dodd-Frank is already adding to that burden for all institutions with 5,286 pages of proposed regulations and 5,732 pages of final regulations (as of March 4, 2013) and we're only a third of the way through the 400-plus rules that must be promulgated.

Unfortunately, the cumulative impact of years of new regulations and the proliferation of non-bank and non-taxed competitors (such as credit unions) are combining into a potent mixture that will surely, if left unchecked, lead to more and more consolidations of small banks.

Make no mistake about it, this burden is keenly felt by all banks, but particularly small banks that do not have as many resources to manage all the new regulations and the changes in existing ones. Besides the real hard dollar costs, there are important opportunity costs related to the products and services that cannot be offered or offered only at higher costs to our customers. In dramatic illustration of this point, a 2011 ABA survey of bank compliance officers found that compliance burdens have caused almost 45 percent of the banks to stop offering loan or deposit accounts. In addition, almost 43 percent of the banks decided to not launch a new product, delivery channel or enter a geographic market because of the expected compliance cost or risk.

For my bank, we very conservatively estimate nearly $1,000,000 in hard dollar compliance costs per year. This includes salaries attributable to compliance, annual bank-wide compliance training, legal and compliance consulting services, compliance software and other IT expenses, printing expenses and privacy mailing costs, and various record-keeping requirements. And there are other costs that we simply cannot capture.

We have a total of 13.5 people that are dedicated compliance officers just to handle all the legal and paperwork requirements. We have added 10 new people to staff in the past year directly related to assuring our ability to meet compliance requirements. In addition, we estimate that 64 percent of our total staff have compliance obligations they must fulfill.

Historically, the cost of regulatory compliance as a share of operating expenses is two-and-a-half times greater for small banks than for large banks. In fact, research by the Federal Reserve over the years has confirmed that the burden of regulations falls disproportionately on smaller banks. The Federal Reserve Bank of Minneapolis has estimated that hiring one additional employee to respond to the increased regulatory requirements would reduce the return on assets by 23 basis points for the median bank with total assets of $50 million or less. To put this estimate in perspective, such a decline could cause about 13 percent of the banks of that size to go from being profitable to unprofitable.

Our audit fees have increased by 64 percent from 2010 to 2013. Most of this relates to the new rules from Dodd Frank. We have spent $62,000 in the first quarter on new software and on consulting fees directly related to compliance concerns.

For example, 70 percent of all banks have already incurred higher compliance costs due to Dodd-Frank Act. Of course, we are still in the early stages of the Dodd-Frank implementation, so we are bracing for additional costs that must somehow be borne. Almost 90 percent of bank compliance officers expect higher compliance costs over the next 3 years due to Dodd-Frank. All these extra expenses could have been more productive if they were devoted to providing services to our customers.

As a $713 million bank, we are better able to spread out some of the compliance costs than our smaller brethren. For the median-sized bank in this country with $168 million in assets and 39 employees, the burden is magnified tremendously. I was shocked to learn recently about a $70 million bank in Kansas that has three and a half FTE compliance employees out of a total of 23 employees. He was particularly frustrated to have 15 percent of his staff dealing with government regulations that do nothing for lending in his small community. Besides internal audits, banks now have to have outside audits for compliance which is a significant expense for smaller banks. Then, the regulators spend time auditing the audits. Checkers checking checkers is a costly and wasteful exercise that provides no value-added for the safety and soundness of the bank and does nothing to protect the bank's customers

II. The Financial Services Examination Process Can And Should Be Improved

Bank examinations should add value. They help assure that risks are managed prudently, that bank officials and directors are aware and understand the risks, and the bank has sufficient capital and reserves to absorb losses when loans do not get repaid. While examinations may have fallen short before the financial crises, many of the ones since have gone to the other extreme. In other words, the pendulum has swung too far. Inconsistent examinations have had an unnecessary impact on lending, increased costs, and put in place red tape and other roadblocks that undermine the development of new products and services to bank customers. Our bank has been fortunate in that our exams have continued to be thorough and fair and we feel our regulators have helped us become better. However, I have heard from many other community bankers around the country, a much different story.

While the regulators have made improvements—many in response to Congressional pressure brought about with the introduction of the Financial Institutions Examination Accountability Act (H.R. 3461) in the last Congress—more can be done. For example, Congress could provide immediate relief by creating a more balanced and transparent approach to bank examinations and establishing a way for banks to appeal those examination decisions without fear of retaliation.

Although no single piece of legislation could deal with the wide range of concerns bankers have about the current supervisory environment, the following recommendations will go a long way towards improving the examination process. This would include how, and on what basis, decisions are made by the regulatory agencies in the examination process. The provisions below include the major elements of the Financial Institutions Examination Accountability Act (H.R. 3461), which ABA strongly supported in the 112th Congress and include the Consumer Financial Protection Bureau (Bureau) as one of the agencies that is subject to the bill, as it is actively engaged in bank examinations.

- **Timely Exam Reports.** Require regulators (including the Bureau) to provide banks with more timely examination reports and more information about the facts upon which the agency relied in making examination decisions.

- **Consistent Treatment.** Provide more clarity and consistency regarding how the regulatory agencies and their examiners treat loans with respect to nonaccrual, appraisal, classification, and capital issues.

- **Examination Ombudsman**. Create a new, independent inter-agency Examination Ombudsman within the Federal Financial Institutions Examination Council (FFIEC) to ensure the consistency and quality of all examinations.

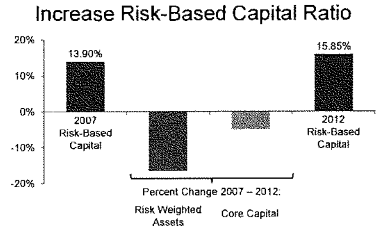
- **Expedited Appeals**. Provide an expedited process for banks to appeal examination decisions without fear of reprisals.

- **No Retaliation**. Specifically prohibit regulatory agencies from retaliating against banks, including their service providers and any institution-affiliated party as defined in the Federal Deposit Insurance Act. An agency cannot delay or deny action that would benefit a bank or institution-affiliated party that is appealing an agency decision.

III. Unnecessary Limits on Bank Capital Should Be Removed

Another measure Congress could take that would provide immediate relief for community banks and allow them to better serve their communities is to remove unnecessary limits on bank capital. There are pending regulations that would unnecessarily limit bank capital formation and block some of the lending needed for economic growth and job creation. This section contains several recommendations for improving bank capital formation.

Community Banks Shrink to Increase Risk-Based Capital Ratio



Source: Federal Deposit Insurance Corporation.
For our calculations we have used the Tier 1 risk-based capital ratio

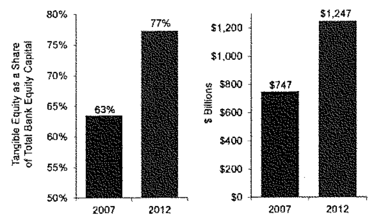
Reform Basel III

ABA recommends fixing the existing problems associated with proposed Basel III capital rules to make them workable for ***all*** banks. Simply ensuring Basel III standards do not apply to community banks will not fix the challenges associated with the proposed capital rules. Regulators would simply take Basel III standards and apply them, under a different name, to community banks creating the same problems. Below are several specific recommendations that would greatly improve the Basel III standards, and allow community banks to continue to serve their communities.

1. Eliminate the requirement that gains and losses on available for sale securities must flow through to regulatory capital

The basic theme of having better quality and adequate, up to date capital levels for all banks is a principle that we as an industry can embrace. In fact, the industry has been asked not only to increase the amount of capital it holds, but the quality as well.

Banks Raise Quality and Quantity of Capital



Source: Federal Deposit Insurance Corporation & ABA Analysis

However, there are elements of this part of the proposal that are counterproductive and need to be removed. These elements include the proposal to insert the volatility of unrecognized gains and losses into capital; capital is supposed to be a cushion to the ups and downs of the markets, not a transmitter and amplifier of volatility.

My bank and others around the country could be forced to reduce the size of our balance sheets as the economy begins to improve, simply because interest rates begin to rise. This could serve to undermine an economic recovery as banks reduce lending and concentrate on pulling back to maintain capital ratios. Our small business customers and consumer customers will be impacted by the reduced availability of credit under this scenario.

My bank's reaction to this will probably be to sell all of our available for sale (AFS) securities and to place all future purchases in Hold to Maturity. This will eliminate the cyclicality and volatility of the proposal, but it will also eliminate our ability to manage our investment portfolio through different interest rate and economic cycles, a core tool to offset the inherent rate risk in our loan and investment portfolios.

2. Grandfather Trust Preferred Securities (TruPS) for Smaller Institutions

The Dodd-Frank Act grandfathered TruPS for banks between $500 million and $15 billion in assets. Instead, Basel III requires the phase-out of TruPS for bank holding companies having between $500 million and $15 billion in total consolidated assets as of December 31, 2009. The regulators should not be changing the plan approved by Congress. Too many of the banks with grandfathered TruPS will likely have to shrink rather than be able to replace that capital.

My bank has held about $3 million in Trust Preferred Securities for about 10 years. This is not a large portion of our capital, but is a very cost effective source of capital for us and has allowed us to grow the bank, and as a result, to better serve our customers. The elimination of this source of capital will reduce our ability to grow our balance sheet by about $35 million. This will reduce the amount of loans we will be able to provide to our communities to support job growth. When you multiply this affect across the country, the potential reduction in loan availability is significant. This proposal is in direct contradiction of the country's goal to spur job growth.

3. Remove increased risk weighting for mortgage loans

The biggest impact on banks is not the change in the total amount of capital, but change in the way that banks do business. The new risk weightings are punitive to mortgage assets, particularly second mortgages and home-equity loans, which then "taint" underlying first mortgages. They are particularly hard on portfolio lenders, as the kind of loans that banks and thrifts hold tend not to be 30-year fixed rate loans with high down payments. Banks currently hold mostly non-standard mortgages, which will be hit with higher capital risk weights under the proposal.

Our bank provides a significant number of mortgages to people living in the three markets we serve. We are one of the largest community bank providers of mortgages in these markets. This proposal, along with some of the proposals being considered by the Consumer Financial Protection Bureau, threaten to significantly reduce or even drive our bank away from this very important business segment.

Since the inception of our bank, we have never lost one cent on a residential home loan. Our underwriting has been very strong as opposed to many of the non-bank mortgage lenders who were the real culprit in the housing crisis. However, the community banks are being forced to pay dearly for the sins of non-bank originators. The new capital proposals relative to the risk weighting of residential mortgages are higher in many cases than other loan types that would be considered much riskier in our experience. This one section of the proposal will definitely reduce the number of loans that we are able to provide in our markets.

4. Delay Basel Implementation

We appreciate the hard work and openness to discussion from the federal banking regulators. This is the most significant single change in regulation to face the banking industry in recent years. It should be taken only after ample input and discussion, because it will permanently change the banking industry, and it will have serious consequences for our customers and communities and for the economy overall. Regulators should consider very carefully the many comments that will be received from bankers. We also believe that on something as fundamental as capital rules, preservation of the dual banking system requires that the views of the state banking regulators be given in this discussion comparable weight to the views of the federal banking regulators. In addition, because of the significance of this rule for the economy and public policy, there should be greater consultation with Congress. There is no need to rush. The Europeans are already backtracking.

There are also other ways that Congress can help to increase the capital for community banks to support more lending. For example:

- ***Brokered Deposit Exception***. Eliminate reciprocal deposits from FDIC's definition of "brokered deposits." Reciprocal deposits do not share the same characteristics as traditional brokered deposits. They are insured, low-cost, have high retention rates, and are based on relationships with local customers. They represent another low-risk souree of deposits that can be used to fund local activities, with appropriate federal oversight against deposit outflow risk. Our bank has a significant amount of this type of deposit and all of them would be considered core deposits if not held in the reciprocal produet that we offer. They are absolutely not brokered deposits, but they are classified as such.
- ***Small Thrift Holding Companies***. Apply the "small bank holding company exemption" from the Collins Amendment to small thrift holding companies. This corrects a technical flaw which shields only small bank holding companies and not small thrift holding companies from various burdensome regulatory capital requirements.
- ***Amend the JOBS Act to Include Savings and Loan Holding Companies.*** The Jumpstart Our Business Startups ACT (JOBS Act) raised the shareholder registration threshold for banks and bank holding companies from 500 to 2,000. In addition, it increased the deregistration threshold from 300 to 1,200. Unfortunately, the JOBS Act omitted savings and loan holding companies. We urge Congress to amend the JOBS Act to extend the changes in shareholder limits to savings and loan holding companies.

IV. Mortgage Rules Should Encourage Community Banks Make These Loans

Mortgage rules should be simplified and consistent so that community banks are encouraged to make these loans rather than face compliance costs which could reduce their lending or force them to exit the market altogether. Also, the mortgage rules are creating severe legal risks and diminishing the types of loans we can offer in our communities. The result of the rules being proposed will be that fewer and fewer people will be able to get loans. Our bank and many bankers I have talked to will not make loans outside the box due to the greater risks. The potential for even higher legal risks in the future will likely force many community banks to exit the mortgage business altogether and out of retail lending altogether.

In examining the causes of the recent financial crisis, a general consensus was reached that traditional community bank lending, based on sound underwriting, conservative but fair and reasonable lending standards, and a demonstrated interest in the borrower's ability to repay were desirable features for the entire industry to follow. The cruel irony of the legislation and regulation that followed is that it imposes draconian new regulations on banks of all sizes-but which will have a disproportionate impact on the community banks whose lending practices never strayed from the tried and true. These lenders will face compliance costs and time constraints for compliance which could impact their continued ability to make mortgage loans.

At the core of community bank's concerns over the new regulations is timing. Most of the new rules required under the Dodd-Frank Act, including the Ability to Repay/Qualified Mortgage rule, new rules on Loan Originator Compensation and appraisal rules are statutorily mandated to take effect in January of 2014. Even as we speak, legal experts are dissecting the rules to understand our potential liability, and bank compliance officers, compliance software vendors and bank management are working to comprehend the 3,200 (and still growing) pages of new regulation, craft policies, construct employee training programs and undertake other necessary compliance activities in order to be in compliance by very early next year. Adding complexity and cost to the situation is the expectation that CFPB will soon release new RESPA/TILA merger rules which, even if relatively straightforward and modest, will still have the impact of forcing a further rewrite of forms, compliance manuals and training regimes as RESPA and TILA are the underpinnings of all mortgage lending. Community banks are struggling to keep up, and some are facing the reality that they will either have to curtail their lending until they can be certain they are in compliance, and thus face losing market share, or worse, are considering exiting the mortgage business altogether. Driving these quality lenders from the marketplace is the exact opposite result of what advocates for mortgage reform intended. We do not come before you today asking that that reform be stopped, but we do ask that Congress and the regulators work to ensure that compliance timelines be made more reasonable.

Therefore we ask that Congress work with the CFPB to take necessary compliance efforts and appropriate time frames into consideration and work to find ways to allow further time for compliance for the entire industry if necessary. Holding to an arbitrary time frame for compliance with these complex new rules will not serve either the CFPB well in ensuring that the rules are workable, or the industry well in being able to comply, but most importantly, it will do a grave disservice to borrowers who will face fewer lending options and higher costs.

Additionally, we would ask Congress to look to several specific concerns posed by several of the new rules.

Balloon Loans and QM

The Ability to Repay/Qualified Mortgage rule required CFPB to provide Qualified Mortgage status to balloon loans, but only those made by a select set of small lenders in rural or underserved areas. The rule proposed by the CFPB adheres to this statutory limitation, but the result is far too narrow and will curtail the use of balloon loans as a tool best suited to some borrowers. Balloon loans have traditionally been made to borrowers with specific characteristics or for properties with specific characteristics which make the loan ineligible for sale into the secondary market, and thus held in portfolio by the originating lender. Borrowers who are not U.S. citizens on a short-term work visa or properties, for which a comparable appraisal is not available, are examples of situations where a balloon loan may be the best, most affordable option for a borrower. These situations arise not just in rural and underserved areas, and such loans are extended by banks of all sizes, not just small banks located in rural and underserved areas. ABA has shared with the CFPB a list of fifteen specific property or borrower characteristics for which balloon loans should be allowed (and eligible for QM status) regardless of geography or size of institution making the loan. We are including this list as an addendum to this testimony. While CFPB may adopt the ABA proposal, they will have to use their exemptive authority to do so beyond the scope of the requirements of the Dodd-Frank Act. A better approach would be for Congress to amend the balloon loan QM provisions to allow for such treatment under the statute.

QM and QRM

A still outstanding issue is the definition of the Qualified Residential Mortgage, or QRM under the Dodd-Frank risk retention provisions. Loans determined to meet the QRM definition will not be subject to the five percent risk retention requirements otherwise imposed under the statute. A proposed rule issued by the bank regulatory agencies along with the SEC, HUD and FHFA in 2011 would have only granted QRM status to loans with at least a twenty percent down payment. This approach has been widely criticized by the ABA along with a vast assortment of industry and consumer groups, as well as many Members of the House and Senate (54 Senators and 304 House members in the last Congress). A twenty percent down payment requirement will put homeownership out of the reach of millions of borrowers. Instead, a broad consensus has developed that a better approach is to align QRM with the already promulgated QM rule. Both rules were intended to improve underwriting. The QM rule puts into place strict new requirements for loan documentation and determination of a borrower's ability to repay. It is widely accepted that the QM rule goes beyond even the conservative underwriting standards prevalent in the market today and may restrict credit availability. The Dodd-Frank Act required that QRM could not be broader than QM, and anything narrower than QM would restrict credit even further. Therefore, consensus among industry and consumer groups, and joined by many members of Congress and some in the regulatory agencies is that QRM should be made co-incident with QM. We urge Congress to consider making the work of the regulators easier and making clear the statutory intent by clarifying that the QM rule and the QRM rule should be co-incident.

Address Loan Originator Compensation

We would also ask Congress to revisit the issue of loan originator compensation and the calculation of points and fees under the Qualified Mortgage rule. The addition of this fee to the points and fees calculation will have a very large impact in terms of disqualifying loans from the QM categories, which in turn means that these loans will likely not be extended. ABA believes that the elimination of such loans is entirely unnecessary, and does not serve to enhance consumer protection in any way. Because the Dodd-Frank Act generally prohibits any form of loan originator compensation based on the terms of the loan, there is no need to add further layers of protection through the inclusion of loan originator compensation in the points and fees triggers of the Qualified Mortgage provisions. Although language in Dodd-Frank can be read to instruct this duplicative inclusion, we ask that Congress act to remove loan originator compensation from the points and fees calculation as being neither warranted nor necessary.

V. Congress Should Adopt Other Measures to Help Community Banks

There are a number of other measures that Congress could take to reduce red tape that imposes unnecessary costs on banks and siphons resources away from lending. The following would make several specific changes to current law to reduce some of these burdens. I am happy to provide additional information on any of these points.

Eliminate red tape

1. Eliminate the Dodd-Frank Act's small business loan data collection requirement. This provision adds unnecessary regulatory burden.
2. Provide for a "seasoned customer" exception to the requirement for banks to file a Currency Transaction Report (CTR) for every deposit or withdrawal of $10,000 or more. CTRs are routinely filed for deposits by well-known customers who run businesses that generate cash, such as retailers and farmers.
3. Eliminate the additional Home Mortgage Disclosure Act (HMDA) reporting requirements under the Dodd-Frank Act. According to an ABA survey, bank employees currently spend on average two hours per loan application record.

Improve Oversight of Securities and Investments

1. Clarify that banks, savings associations, and trust companies are exempt from municipal advisor registration requirements.
2. Clarify that banks may purchase and sell without restriction any bonds issued by municipalities and agencies of a state by modifying Section 619 of Dodd-Frank. The SEC's proposed rules could prohibit banks from purchasing debt that is issued by a state agency; this is a substantial portion of the debt that is issued at the state level.

3. Exempt banks with limited swaps activity from the new clearing requirements. Utilize a risk-based, not size-based, measurement to ensure limited swaps-based activity for risk management activity is not constrained by unnecessary regulatory requirements.

Flood Insurance Reform

1. Clarify that escrow provisions in Section 100209 of the Biggert-Waters Insurance Reform and Modernization Act apply only to new loans.
2. Improve access to cost-effective flood insurance by making needed clarifications to the law, allowing development of a private market for flood insurance. Private market providers, if allowed to compete on a level playing field, can develop more affordable products for consumers.
3. Modify the flood insurance requirements to exclude civil money penalty (CMP) authority where a statutory or regulatory violation does not result in a lack of coverage of property that is determined to otherwise require it.

Conclusion

Community banks are resilient, but even the most resilient institutions can only withstand so much. At some point there is a straw that will break the camel's back. Despite these regulatory headwinds, there are a number of fundamental strengths that community banks have to support them. With Congress's help in lifting some of the burden off of these local institutions, community banks are set to thrive and turn the tide in their favor. In order for this to happen, however, community banks need Congress's help. We need to move from simple, good intentions and bring about tangible results.

New laws and regulations have erected costly barriers to market entry beyond any benefit to our communities. Over-zealous examinations have been long on technical criticism and far too short on constructive supervision. All of these only make it more difficult for existing banks to survive, new investors to establish competitive institutions, or local communities to participate in our nation's economic resurgence.

An individual regulation may not seem oppressive, but the cumulative impact of all the new rules plus the revisions of existing regulations is oppressive. The regulatory burden from Dodd-

Frank and the excessive regulatory second-guessing must be addressed in order to give all banks, and especially community banks, a fighting chance to maintain long-term viability and meet the needs of local communities everywhere. The consequences of excessive regulation are real. Costs are rising, access to capital is limited for community banks, and revenue sources have been severely cut. It means a weaker economy. It means slower job growtb. With the regulatory overreaction, piles of new laws, and uncertainty about government's role in the day-to-day business of banking, meeting local community needs is difficult at best.

Statement of

Charles G. Kim

On Behalf of the

Consumer Bankers Association

Before the

House of Representatives

Committee on Financial Services
Financial Institutions and Consumer Credit Subcommittee

Regarding

Regulatory Relief

April 16, 2013

CBA | CONSUMER BANKERS ASSOCIATION
The Voice of the Retail Banking Industry

CBA

Statement of

Charles G. Kim

Before the

Committee on Financial Services
Financial Institutions and Consumer Credit Subcommittee

April 16, 2013

Madam Chairman, Ranking Member Meeks, and members of the subcommittee, my name is Charles G. Kim and I am Executive Vice President and Chief Financial Officer (CFO) of Commerce Bancshares, Inc. whose principal bank subsidiary is Commerce Bank. Commerce Bank is a $22 billion super-community bank founded in Kansas City in 1865. Our strong Midwestern culture and engaged workforce of 4,700 serves customers through 204 branches and 400 ATMs in Missouri, Kansas, Illinois, Oklahoma and Colorado. Commerce Bank is focused on serving our customers and we are guided by our Customer Promise: **"We ask, listen and solve."**

Commerce is counted among the best capitalized banks in the country and we did not contribute to the economic crisis by originating any sub-prime products. Commerce is one of seven banks in the country to hold Moody's highest assigned Bank Financial Strength rating. For the fourth year in a row, Commerce Bank was ranked among the top ten on Forbes' list of America's Best Banks. Commerce ranked ninth on the list which came out in December, 2012.

I am also a member of the Consumer Bankers Association (CBA) Government Relations Council, which is the association's public policy making group of senior executives. For more than 90 years, CBA has been the recognized voice on retail banking issues in the nation's capital. Member institutions are leaders in all areas of consumer financial services and small business lending. Commerce Bank and CBA both recognize the retail banking industry is built on customer relationships and it is our focus to make sure we are helping consumers meet their financial needs.

I appreciate the opportunity to appear before you today and we thank the Subcommittee for holding this hearing to look at the current regulatory environment to ensure it is allowing banks to serve customers in their communities. CBA would like to thank the Subcommittee for its work over the past year on several important issues.

First, we applaud Chairwoman Capito, and other members of the Subcommittee for highlighting concerns with the CARD Act and how it unfairly impacts the ability of spouses to qualify for credit cards. These efforts have moved us closer to a resolution as we await the CFPB's final to correct this unintended consequence. This is an example of how regulations can unintentionally harm consumers and families, and impact banks' ability to provide financial products, and we are grateful that Members of Congress have helped encourage action to correct this

In addition, I'd like to thank Congressman Luetkemeyer, from my home state, and others for their leadership in the last Congress for helping to remove the duplicative ATM disclosure requirement. This bi-partisan effort to eliminate an unnecessary requirement ended legal claims by bad actors, while still ensuring consumers have the information they need when conducting ATM transactions.

We have seen significant regulatory changes with the passage of the Dodd-Frank Act, the creation of the Consumer Financial Protection Bureau (CFPB) and new rules impacting the banking industry and the customers we serve. A number of these new rules were needed, and welcomed, to protect consumers and ensure we have a healthy banking industry that drives economic growth and recovery. However, as with any major regulatory overhaul, there will be some unintended consequences of varying degree. Policy makers and stakeholders can work together along the way to reevaluate and make continued improvements to the regulatory climate, allowing banks to offer superior products to fulfill customers' needs.

As this Subcommittee takes a deeper look at this evolving regulatory environment, CBA would like to highlight several specific issues and themes that it believes can ultimately allow banks to better serve their customers and communities.

Measuring the Cost of Regulation

First we want to stress that regulations can be critical in ensuring safe and sound banking and consumer protection, such that consumers and businesses are confident in dealing with the financial services industry. But it is also important that the regulation be assessed for its benefits against its costs to the financial institutions and, ultimately to the consumers. If costs are not in proportion to benefits, the consumer will pay more for financial services or will find valuable services in short supply. When an agency conducts a cost benefit analysis when looking at a particular issue, in addition to weighing the impact of a new rule on consumers, smaller financial institutions and rural communities, we would encourage the analysis take into account these other important considerations:

- The one-time cost of implementation, with accompanying IT systems changes, training, legal, compliance, printing, mailing, and other ancillary expenses, sometimes made more difficult by the inadequate time needed to comply;
- The ongoing costs of the rule, with annual compliance, litigation, printing, mailing, and other costs; and
- The impact on new product development and the disincentive to enter markets or engage new products or services due to enhanced risk or costs.
- Relief for banks that are caught in the middle between those with asset sizes which protect them from certain new regulations (less than $10 billion in assets as outlined by sections of Dodd-Frank) and those banks with economies of scale advantages. An example of this is the Durbin amendment which requires debilitating income reductions in the form of reduced interchange for the banks in the middle, like Commerce Bank.

It is also important for the agencies to consider the relationship of the regulation to other regulations. This requires the consideration of at least the following:

- Conflicting or inconsistent requirements among different regulations which can create an uneven playing field and provide unfair advantages to certain players. For example, we experience that with the varying state rules for short-term small dollar loan products. As there are no 'safe harbors,' we can be restricted from offering good solutions at competitive pricing while a competitor 'right next door' does not have the same restrictions;
- Inconsistent definitions among regulations, unless necessary to fulfill different requirements. Conflicting requirements from regulatory bodies as well as the uncertainty of changing rules that can be retroactively applied create a disadvantage for the consumer as it makes banks either not offer a solution or not want to spend time thinking of ways to provide new solutions. For instance, consumers want and need access to funds for short-term gaps and will find ways to get it. Limitations can either cause consumers to be penalized with restrictions they do not want, or to look elsewhere for more punitive and expensive solutions from less palatable sources; and
- The need to continue to comply with obsolete regulations that no longer fulfill their original requirement or are superseded by new regulations.

At times, the burden of regulation is created or made more extreme by the accretion of numerous regulations, each of which alone does not create a huge problem but all together are excessively burdensome. One example of accretion may turn out to be the mortgage rules being issued by the CFPB combined with the qualified residential mortgage rule emerging from the bank regulatory agencies and the potential for a new Basel III. Depending on how these are finalized, it is possible they will create an excessive regulatory framework without adding sufficiently on the customer benefit side of the equation.

CBA

Regulatory Clarity & Enforcement by Regulation

The absence of regulatory clarity combined with overly complex laws and regulations is sometimes a cost that is difficult to quantify but nonetheless significantly increases the difficulty of compliance for financial institutions without commensurate consumer benefits. When the rules are not clear, financial institutions will delay decisions and avoid introducing new products and services, to keep their risks to a minimum. Overly complex rules also cause confusion to customers and uncertainty to regulators and institutions. This is often to the detriment of consumers and small businesses, which do not receive the new services they need or are left with outdated technologies that do not provide them with the products and services when they need them. In some cases it even drives consumers to less regulated entities, which appear to provide for their needs without restriction, but which can carry risks to consumers.

One way this can occur is when guidance is provided by enforcement actions instead of through the regulatory process. Enforcement actions that are not grounded in clear rules may provide little clarity about what the rules are for other institutions in similar markets and circumstances. The problem is magnified as the actions may often result in consent orders when the matters are resolved, rather than going to court and being publicly aired. They also lack the input from consumers and industry, which is part of the rulemaking process and provide critical feedback leading to sound policy-making. The industry and consumers may be left in the dark about the factors that led to the enforcement action and the tools needed to ensure they are fully compliant with the law.

Exam Cost

Exams themselves can be more costly than necessary to both the consumer and the institutions being examined. The supervision process is the hallmark of the way in which consumer protection and safety and soundness are maintained at regulated financial institutions. Dodd-Frank leveled the playing field by expanding that benefit to all financial service providers in the consumer protection realm, and we would encourage the CFPB to move more expeditiously to carry out its mandate to supervise larger nonbank financial service companies. Among the larger nonbank participants, it has, to date, only begun supervising consumer reporting agencies and debt collectors, and has yet to begin supervising many other larger nonbank entities.

For regulated financial institutions, the supervision can become unnecessarily burdensome and costly if the examination process is inefficient, if rules are too complex, if examination teams are inadequately trained or inadequately experienced, if multiple regulatory agencies are covering much of the same examination territory, or if the process is unnecessarily slow. The CFPB is a new agency with some of the difficulties inherent in a start-up business, and has at one time or another been accused of most of these problems to some degree. CBA members have seen improvement in all areas, but more can still be done to enhance and streamline the process, thereby reducing costs to industry and, thereby, consumers and small businesses interacting with these institutions.

Basel III

We all anxiously await the final rules to implement Basel III Capital Standards. While the Basel III proposal impacts banks in a number of different areas, we could see significant reduction in the mortgage market and banks' ability to offer certain home equity products. In particular, under the proposal, banks could face higher capital requirements when offering certain home equity lines and liens to some existing customers but could then have less severe capital requirements for offering the same home equity product to a new customer. Second mortgages are safe and sound products, which allow individuals and families to make home improvements or access equity in their homes to finance other important endeavors.

In addition, second mortgages often are used to help launch small businesses and, if the Basel III proposal is unchanged, it could curtail some lending to small business owners or force families to obtain unsecured lending.

The Basel III proposal is an example of an extremely complicated proposed regulation that will be very difficult and costly for banks to manage and difficult for regulators to oversee. Simpler solutions with fewer unintended consequences and greater capital protection are easily attainable. The Basel III proposal and its complexity will have a number of impacts on the banking industry and its ability to serve communities. We are hopeful that careful consideration and analysis will lead to more reasonable and workable final rules. CBA encourages Congress to continue to monitor this important issue closely.

And while we agree that stress testing serves a very sound and useful purpose, it will be very complex and will add significant costs to all banks over $10 billion in assets, regardless of their sound balance sheets, solid earnings performance and strong management.

Mortgage Rules

We have seen a tremendous amount of change in the mortgage space on everything from underwriting, to appraisals, to loan officer compensation to new mortgage disclosures. These are all important, complex rules which banks are diligently working to implement in a very short period of time. In many cases, these new rules will restrict lending to borrowers on the low end and on the high end of mortgage lending because of the perceived risks attached to those loans.

Basel III and the Qualified Residential Mortgage (QRM) rule will undoubtedly have a major impact on mortgages and their availability, but our priority right now is to comply with the myriad new mortgage rules issued by the CFPB. However, our job has been made more difficult due to the uncertainty still baked in the new rule. CBA has reached out to the CFPB to express our confusion about certain aspects of the final rules, but we are concerned that the Bureau's promised guidance on these issues may come too late.

To give an example, we have a number of issues with the Qualified Mortgage (QM) rule that was issued in January 2013 by the CFPB. These include the relatively short period of time that banks have to comply with this rule, especially since not all aspects of the rule are final and the CFPB has yet to issue all its expected guidance. In addition, the change made to loan originator registrations to include evaluating their personal financial responsibility, while well intentioned, creates a number of challenges. Its guidelines lack clarity and actionable definitions, and when coupled with the impact of the economic downturn on Americans credit profile, it can create challenges for banks to evaluate a possible employee's financial responsibility. CBA is also concerned with the three percent limit on points and fees for QM loans.

Appendix Q, which provides guidance with regard to the underwriting of QM loans, raises a number of problematic issues. In addition to the increased scrutiny with regard to self-employed loan applicants, it seems that employers are expected to virtually guarantee the applicant's future employment, which is an unrealistic expectation. Although based on current Federal Housing Administration (FHA) guidelines, FHA does allow for compensating factors that are not included in Appendix Q. Also, Appendix Q is part of the QM rule and violations of the rule subjects banks to litigation, which is not the case with the FHA guidelines.

The industry stands ready to work with the CFPB to address these still unanswered questions. However, CBA is very concerned that a long delay in getting the answers that we need may lead certain lenders to reduce, or even eliminate, their mortgage lending activities in order to mitigate their exposure to regulatory risk.

E-Sign Act

Today's new generation of customers and their wants and behaviors are evolving rapidly due to technological advancements. Banks and credit unions alike are moving to mobile banking and payments that offer a number of customer solutions online. Much has changed since Congress enacted the E-Sign Act in 2000. As the CFPB has now inherited the E-Sign Act disclosure requirements from other financial regulators, CBA believes it is time for both Congress and the CFPB to review and update the E-Sign Act requirements to reflect the significant technological changes that have occurred over the past 13 years, while ensuring they remain "technology neutral" as intended by Congress when this law was enacted.

Consumers who choose to conduct transactions electronically have a reasonable expectation that their disclosures will also be provided in electronic form. CBA believes banks should be able to provide all disclosures electronically and all inherited regulations should be consistent in this regard except where a statute clearly states otherwise. Allowing consumers the option to decide what format they wish to retain their disclosures is the best way to encourage consumers to read and understand them.

Financial institutions should be provided flexibility to develop innovative ways to accommodate evolving consumer behavior. Employing a "technology neutral approach" will also mitigate situations where regulations would need to be re-written due to new technology.

CARD Act Review Requirement

CBA believes one area to reduce regulatory compliance costs is the rate increase review requirement under the CARD Act. If there is an increase in a customer's rate, the increase must be reviewed every six months for the life of the account or until the rate increase is rescinded. CBA believes there should be some limitation with regards to this review.

For example, one approach would be to require this rate review only for rate increases occurring within the prior 12 months, in which case it would be limited to two reviews. It makes little sense to require constant, periodic reviews of rate increases for the life of an account. This represents a significant review and implementation burden for banks that will continue to increase throughout the life of an account. At the same time, the benefit for consumers declines, as it would seem the reasons for these long ago rate increases would become less relevant to them over time.

Conclusion

We expect the regulatory environment to remain in flux over the next two years as regulators continue to implement requirements of Dodd-Frank, as Basel III is finalized and as the CFPB continues to issue rules and regulations. All of these changes require banks to make adjustments to remain in compliance. This is all occurring in a time of continued economic uncertainty. CBA appreciates the opportunity to highlight these opportunities for regulatory relief and monitoring and we look forward to continuing to work with the Subcommittee on these important issues.

INDEPENDENT COMMUNITY
BANKERS *of* AMERICA

Testimony of

William A. Loving, Jr.
President and CEO of Pendleton Community Bank
Franklin, West Virginia

On behalf of the
Independent Community Bankers of America

Before the

U.S. House of Representatives
Committee on Financial Services
Subcommittee on Financial Institutions and Consumer Credit

Hearing on

"Regulatory Relief for Small Community Financial Institutions"

April 16, 2013
Washington, D.C.

Chairman Capito, Ranking Member Meeks, and members of the subcommittee, my name is William A. Loving, Jr., and I am President and CEO of Pendleton Community Bank, a $260 million asset bank in Franklin, West Virginia that serves four rural markets in West Virginia and one Virginia community. I am also Chairman of the Independent Community Bankers of America and I testify today on behalf of its nearly 5,000 members. Thank you for convening this hearing on regulatory relief for small community financial institutions. Community banks nationwide have identified regulatory burden as a top concern and impediment to their viability and ability to provide credit in their communities.

America's 7,000 community banks are critical to the prosperity of the U.S. economy, particularly in micropolitan and rural communities. Providing 60 percent of all small business loans under $1 million, as well as customized mortgage and consumer loans suited to the unique characteristics of their local communities, community banks are playing a vital role in ensuring the economic recovery is robust and broad based, reaching communities of all sizes and in every region of the country.

In order to reach their full potential as catalysts for entrepreneurship, economic growth, and job creation, community banks must have regulation that is calibrated to their size, lower-risk profile, and traditional business model. Working with community bankers from across the nation, ICBA has 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. By rebalancing 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 crafted to preserve and strengthen consumer protections and safety and soundness. The Plan for Prosperity is attached to this testimony.

I would like to thank this Committee and the House for quickly passing a key provision of the Plan for Prosperity, relief from annual privacy notice mailings when a bank has not changed its privacy policies. My bank simply does not have the scale to automate the annual privacy notice mailings. For us, the mailings are a manual, fairly labor intensive process. The Privacy Notice Confusion Elimination Act (H.R., 749), introduced by Rep. Blaine Luetkemeyer, will save my bank approximately $10,000 a year, real money for a community bank. And importantly, it will do so without putting consumers at risk or reducing their control over the use of their personal data. I encourage this committee to build on the success of H.R. 749 by taking up additional provisions of the Plan for Prosperity that will match or significantly exceed the relief provided by H.R. 749 without increasing risk to customers, community banks, or the financial system.

Perhaps the most serious threat to the community bank business model is the Basel III proposed capital rules. I'm grateful for the opportunity to testify before this subcommittee last November on that topic, and I thank the many members of the Financial Services Committee who have sent letters to the banking regulators expressing their serious concerns about the impact of Basel III and the standardized approach on community banks. Pending the final rule, which is expected this spring, I will focus my remarks today on regulatory relief proposals in the Plan for Prosperity.

While we have recommended specific regulatory relief measures in our Plan for Prosperity, the problem is a cumulative one. Regulations have accreted steadily over past decades, but are rarely removed or modernized, resulting in a redundant and sometimes conflicting burden. To set the stage for this discussion, I'd like to share with you a few broad, headline numbers to illustrate how increasing regulatory burden is fundamentally changing the nature of the business of community banking.

- The cost of Pendleton Community Bank's annual compliance audit increased by 19.5 percent between 2010 and 2012. This is just the cost of the audit, which is of course in addition to the substantial cost of compliance.
- As of 2013, Pendleton Community Bank has established a Compliance Committee consisting of 8 members of senior management that meets monthly to review compliance issues, current regulations, and the impact of proposed regulations or other rule changes on our operation and our customers. This change is a result of the increasing complexity of regulatory compliance and carries with it a costly expenditure of man-hours.
- As recently as 2007, a review of mortgage loan compliance required 3 to 4 days of work quarterly. Today, even with a 15 percent decrease in loan applications, we have to dedicate 8 to 10 days a quarter to mortgage loan compliance review. We expect this burden to increase in the coming quarters.
- Our scarce staff resources are increasingly dedicated to compliance rather than serving customers. We are now considering hiring an additional full-time employee to work exclusively on compliance because our current compliance officer is struggling to maintain the high quality of his review with increasing demands on his time. This new FTE, in addition to the 8 member Compliance Committee noted above, will result in more than 10 percent of Pendleton's 79 FTE staff with a significant role in compliance.

Again, these are just a few broad indicators, though they illustrate a clear trend of growing regulatory burden. I will provide more impact data in the context of the specific provisions covered below, beginning with our recommendations to preserve community bank mortgage lending.

Mortgage Reform for Community Banks

Every aspect of mortgage lending will be subject to new, complex, and expensive regulations that will upend the economics of this line of business. These regulations are being enacted in response to the worst abuses of the pre-crisis mortgage market – abuses in which community banks did not engage.

Key provisions of the Plan for Prosperity are designed to keep community banks in the business of mortgage lending. The Plan for Prosperity focuses on those reforms that will have the greatest impact and are ripe for enactment, including:

- "Qualified mortgage" safe harbor status for loans originated and held in portfolio for the life of the loan by banks with less than $10 billion in assets, including balloon mortgages;
- Exempting banks with assets below $10 billion from escrow requirements for loans held in portfolio;
- Increasing the "small servicer" exemption threshold to 20,000 loans (up from 5,000); and
- Reinstating the FIRREA exemption for independent appraisals for portfolio loans of $250,000 or less made by banks with assets below $10 billion.

ICBA appreciates the CFPB's efforts to accommodate community banks in their recent rulemakings. However, we believe that they did not go far enough in providing for tiered regulation, as does the Plan for Prosperity, that will preserve the role of community banks in the mortgage marketplace.

Community banks represent approximately 20 percent of the mortgage market, but more importantly, much of this mortgage lending is concentrated in the small towns and rural areas of our country, which are not effectively served by megabanks. As the FDIC Community Banking Study showed, in one out of every five counties in the United States, the only physical banking offices are those operated by community banks. Community banks have a starkly different business model than that of larger mortgage lenders, which are driven by volume and margins. Community banks, by contrast, are relationship lenders with deep roots in their communities. Our mortgages are well underwritten because we know our customers, their businesses or employers, and the local economic conditions. The strength of our underwriting is confirmed by Federal Reserve data. In recent years, the delinquency rate of mortgages held by community banks never exceeded 4 percent, compared to 22 percent for fixed rate subprime mortgages and 46 percent for subprime variable rate mortgages. In fact, community bank mortgages have outperformed fixed rate, prime loans, thought to be the best performing category of all loans.[1]

A chief characteristic of community bank mortgages in small and rural communities is that they are often collateralized by unique properties without adequate comparables that don't fit the inflexible requirements of the secondary market. In addition, the borrowers may be farmers or small business owners whose debt-to-income ratios fall outside of secondary market parameters, despite their personal net worth and means to repay the loan. Large lenders shun such loans because they don't fit their underwriting models and require first-hand assessment of the property and the borrower. Only community banks are willing to extend credit to such borrowers, often through the use of balloon loans held in portfolio. Because holding a fixed rate 15 year or 30 year mortgage on the books would expose a community bank to unmanageable interest rate risk, these loans are made typically for 3 or 5 years, and repriced and renewed when they come due. Community banks have safely made balloon mortgages for many decades.

Pendleton Community Bank holds all but a few of our mortgage loans in portfolio, including balloon loans. This is broadly typical of community banks. In a recent survey of community banks, 50 percent of respondents hold all of their mortgage loans in portfolio, and 72 percent of respondents hold at least half of their mortgage loans in portfolio.[2] While secondary market sales are a significant line of business for an important segment of the community banking industry, ICBA estimates that community banks under $10 billion in assets may hold as much as $412 billion in balloon payment mortgages for as many as 5.5 million borrowers.[3] For many community banks, portfolio lending is a necessary corollary of the types of mortgages they underwrite – mortgages that cannot be securitized.

[1] "Community Banks and Mortgage Lending," Remarks by Federal Reserve Governor Elizabeth Duke. November 9, 2012.

[2] ICBA Mortgage Lending Survey, September 2012.

[3] This estimate is based on recent call report data which shows that community banks under $10 billion in assets hold a total of $550 billion in residential 1-4 family mortgages. Assuming that balloon payment mortgages account for 75% of community bank mortgages assets, which is consistent with survey results, the result is $412 billion in balloon payment mortgages. Assuming an average loan balance of $75,000, the result is 5.5 million borrowers.

Another corollary of community bank customized underwriting is that the loans often meet the regulatory definition of "higher priced mortgage loans." Because the loans cannot be securitized they must be funded through retail deposits which include higher cost certificates of deposits, and this results in a higher interest rate. The regulatory definition is heavily weighted toward the pricing that Fannie Mae and Freddie Mac set based on their ability to access capital and funding markets that are not available to community banks. In addition, in today's historically-low interest rate environment, it is more likely that a reasonably-priced loan will meet the Federal Reserve's definition of "higher priced." Almost half of survey respondents (44 percent) said that more than 70 percent of their loans were "higher priced." In Pendleton Bank's portfolio, 89 percent of the HMDA reportable loans originated in 2012 meet the regulatory definition of "higher priced."

This lending model – customized balloon loans held in portfolio and, due to a higher cost of funds, priced higher than securitized loans – has worked well for decades and is a proven private market solution that serves certain borrowers and communities that cannot access the secondary market. If this lending model is made infeasible by new regulation, rural borrowers will have no place to turn and be deprived of credit. The communities they live in will stagnate.

This community bank model of providing mortgages and making home ownership possible to those who, in many cases, would have no other option is under direct threat because the loans share superficial characteristics with subprime loans such as balloon terms and relatively high rates – loan terms that have been targeted by new mortgage regulation. The new ability-to-repay regulations will expose lenders to litigation risk unless their loans meet the definition of "qualified mortgage." However, a staple of community bank mortgage lending, balloon loans, are explicitly excluded from "qualified mortgage" status unless they are made in rural areas under an unreasonably narrow definition of "rural." ICBA has applied the CFPB's definition of rural to every county in the U.S. The results are shown in an attachment to this testimony. I think the members of this committee will be surprised at what counties in their own states and districts fail to qualify as "rural." For example, in the state of West Virginia, 26 out of 55 counties fail to meet the definition of rural. Under any reasonable definition, the entire state of West Virginia should be considered rural. ICBA is urging the CFPB to expand its definition.

Similarly, "higher priced" loans – even when that pricing is aligned with the lender's cost of funds, risk, and other factors – are excluded from the conclusive presumption of compliance (or "safe harbor") protections under "qualified mortgage" and instead carry only a "rebuttable presumption of compliance," a much weaker protection which exposes the lender to unacceptable litigation risk for the life of the loan. We appreciate that the CFPB is proposing a higher price trigger for the safe harbor for community bank loans – 3.5 percent above average prime rate offer (APOR) – though we have recommended that the CFPB adopt an alternative rate threshold that takes into account a community bank's cost of funds.

"Qualified Mortgage" Status for Community Bank Portfolio Mortgages

The Plan for Prosperity solution to this new regulatory threat is simple, straightforward, and will preserve the community bank lending model described above – safe harbor "qualified mortgage" status for community bank loans held in portfolio, including balloon loans in rural and non-rural areas and without regard to their pricing. When a community bank holds a loan in portfolio it holds 100 percent of the credit risk and has every incentive to ensure it understands the borrower's financial condition and to work with the borrower to structure the loan properly and make sure it is affordable. Withholding safe harbor status for loans held in portfolio, and exposing the lender to litigation risk, will not make the loans safer, nor will it make underwriting more conservative, it will merely deter community banks from making such loans in the many counties that do not meet the definition of rural and where a bank's cost of funds results in "higher priced mortgages." In our case, Pendleton's mortgages are qualified mortgages because we satisfy the "rural test"; however, because our mortgages are "higher priced," they are denied "safe harbor" protections and instead carry a "rebuttable presumption of compliance," under the CFPB's final rule. Accordingly, we, like many community banks across our nation, will be forced to make a risk-reward calculation to determine whether we will continue providing mortgage financing to our communities.

Escrow Requirement Exemption for Community Bank Portfolio Mortgages

Escrow requirements for property taxes and insurance are an additional deterrent to community bank mortgage lending. Loans held in portfolio by community banks should be exempt from such requirements. When loans are held in portfolio, lenders have every incentive to protect their collateral by ensuring that tax and insurance payments are current. The escrow requirement for higher priced loans is unnecessary, impractical, and a significant expense for a community bank. A large majority of community banks do not currently escrow because of the cost and requiring them to do so will only deter them from making higher cost loans. In a September 2012 ICBA survey of over 430 community banks, 55 percent of the bankers stated they decreased their mortgage business or completely stopped providing higher-priced mortgage loans due to the expense of complying with escrow requirements for higher priced mortgages that took effect in 2010. Pendleton Community Bank began escrowing in compliance with the Federal Reserve rule at a significant investment in systems and software, employee training and legal fees. We currently escrow for 300 loans in portfolio at an expense of 300 man-hours annually. As we originate additional loans requiring escrows, we will be shackled with additional operating costs. Another West Virginia community banker I know employs four people in escrow at a cost of $240,000 a year including benefits. Many community banks do not have the resources to do it in house. Outsourcing escrow services may not be an affordable option either. For third party servicers it is simply not economical to offer escrow-only services, not packaged with other services, to low volume lenders. The Plan for Prosperity calls for an exemption from escrow requirements for community bank loans held in portfolio.

Small Servicer Exemption

The relationship lending model, so important to community banks, extends beyond underwriting to servicing. Community banks frequently service the loans they originate, whether they are held in portfolio or sold into the secondary market. For community banks that sell their loans, retention of servicing is important to maintaining long-term relationships with customers and the opportunity to meet their future banking needs.

The community bank practices that strengthen underwriting and result in better loan performance also produce stronger servicing. Bankers that know their customers and the economic trends in their communities can better anticipate borrowers' potential difficulties and intervene early and effectively. As is true with underwriting, the data clearly show that community bank serviced mortgages perform better.

Public policy should keep community banks in the business of servicing mortgages and deter further consolidation among servicers.

In this regard, community banks are deeply concerned about the impact of servicing standards that are overly prescriptive with regard to the method and frequency of delinquent borrower contacts, reducing community banks' flexibility to use methods that have proved successful in holding down delinquency rates. Examples of difficult and unnecessary requirements include new monthly statements; additional notices regarding interest rate adjustments on ARM loans; rigid timelines for making contacts that leave no discretion to the servicer; and restrictions on forced placed insurance. Community banks' small size and local presence in the communities we serve make many of these requirements unnecessary.

The CFPB's recent servicing rule provides a small servicer exemption for banks that service fewer than 5,000 loans. We appreciate recognition that the rule is not appropriate for smaller servicers but believe that the CFPB set the threshold too low. Many community banks service larger portfolios that should qualify for an exemption because they use the community bank servicing practices and obtain the strong performance results. A West Virginia community banker I know is not exempt because he services 6600 accounts, yet has a very low delinquency rate, less than 4 percent. This banker estimates the monthly statement requirement alone will cost him about $181,500 annually. He will also have to hire an additional collector, even with his low delinquency rate, to comply with the new early intervention requirements. ICBA's Plan for Prosperity calls for raising the small servicer exemption threshold to 20,000 loans. To put this proposed threshold in perspective, the average number of loans serviced by the five largest servicers subject to the national mortgage settlement is 6.8 million.[4] An exemption threshold of 20,000 would demarcate small servicers from both large and mid-sized servicers. It would help preserve the important role of community banks in servicing mortgages and deter further industry consolidation which is harmful to borrowers.

Appraisal Exemption for Community Bank Portfolio Mortgages

Appraisal standards have changed significantly over the past few years. First as a result of the Home Valuation Code of Conduct from Fannie Mae and Freddie Mac, and more recently as a result of the Dodd-Frank Act. These standards are well intentioned, having been designed to prevent abuses by unregulated mortgage brokers that contributed to the collapse of the housing market. However, they have made it nearly impossible for my bank to use local appraisers. As a result, Pendleton began using an appraisal management company in early 2013. This is quickly becoming the only practical option for a community bank mortgage lender. This expense, coupled with new appraisal requirements, has increased the cost of an appraisal for Pendleton's customers by 40 percent, an experience that is typical of other community banks. Passed on to the borrower, these costs increase the cost of credit. What's more, because the appraisal management company uses appraisers from outside the area, they produce poorer quality appraisals. ICBA's Plan for Prosperity calls for reinstating the FIRREA exemption for independent appraisals for portfolio loans of $250,000 or less made by banks with assets below $10 billion.

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[4] Source: Office of Mortgage Settlement Oversight (www.mortgageoversight.com).

Strengthen Accountability in Examinations

The trend toward oppressive, micromanaged regulatory exams is a concern to community bankers nationwide. ICBA believes that the best means of creating a more balanced exam environment is to create a workable appeals process. ICBA's Plan for Prosperity calls for the creation of an independent body 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.

The current appeals process is arbitrary and frustrating. Appeals panels, or other processes, routinely lack the independence and market expertise necessary to reach a fair, unbiased decision. The Financial Institutions Examination Fairness and Reform Act, introduced in the last Congress, would go a long way toward improving the oppressive examination environment by creating a workable appeals process and consistent, commonsense standards for classifying loans. We are grateful to Chairman Capito and Representative Maloney for introducing this legislation which would improve the appeals process by taking it out of the examining agencies and empowering a newly created Ombudsman, situated in the Federal Financial Institutions Examination Council, to make final appeals decisions. Though we favor additional measures to bring a higher level of accountability to the regulators and their field examiners, we are pleased to support the provisions this legislation.

Municipal Advisor Registration Exemption

ICBA's Plan for Prosperity calls for exempting community banks and their employees from registration as municipal advisors with tbe Securities and Exchange Commission and the Municipal Securities Rulemaking Board. Community banks have always provided traditional banking services such as demand deposits, certificates of deposit, cash management services, loans and letters of credit to the municipal governments of the communities they serve. Pendleton Community Bank currently has numerous municipal relationships and $17 million in municipal deposits. Our servicing of these accounts is closely supervised by our prudential bank regulator. The registration requirement, if interpreted broadly by the SEC, could force Pendleton and thousands of community banks to register as municipal advisors with the SEC and the Municipal Securities Rulemaking Board and be examined by the SEC in order to continue providing traditional banking services to municipalities. An act as simple as a town treasurer phoning a community bank to inquire about CD rates could be enough to trigger registration. As a one-time SEC registrant, we are fully aware of the additional costs associated with registration, not to mention the time devoted to ensuring that we fully understand and comply with yet another regulation.

On behalf of the many community banks that enjoyed substantial savings through the modernization of the shareholder registration threshold, I would like to thank this Committee and Congress for enacting the JOBS Act last year. This was and remains an important issue for Pendleton and other SEC registrants. So important that we decided to go through the painstaking process of deregistration approximately one year prior to modernization of the threshold because we believed that the cost of compliance produced no substantial, if any, improvement in reporting to our shareholders. Deregistration has only confirmed that belief. Conservatively estimated, deregistration saves us $110,000 annually, a substantial amount that can be reinvested back into our community.

I hope that the good work that Congress has done won't be compromised by now allowing the SEC to force Pendleton and other community banks to register as municipal advisors and incur a burden that is anything like the one from which we just escaped.

ICBA is grateful to Reps. Steve Stivers and Gwen Moore for introducing the Municipal Advisor Oversight Improvement Act (H.R. 797), which will exempt enumerated traditional banking activities from triggering registration.

Relief from Accounting and Auditing Expenses for Publicly Traded Community Banks and Thrifts

Another provision of the Plan for Prosperity would increase the current exemption from the internal control attestation requirements of Section 404(b) of the Sarbanes-Oxley Act from $75 million in market capitalization to $350 million. 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 for attestation work. This provision will substantially lower the regulatory burden and expense for small, publicly traded community banks without creating more risk for investors.

Separately, due to an inadvertent oversight in the recently-passed JOBS Act, thrift holding companies cannot take advantage of the increased shareholder threshold by which a bank or bank holding company may deregister as an SEC reporting company under Section 12 of the Securities Exchange Act of 1934. As mentioned above, Pendleton Community Bank recently deregistered our stock at a significant annual savings. Thrifts should be able to reap the benefit as well.

ICBA is grateful to Reps. Womack and Himes for introducing the Holding Company Registration Threshold Equalization Act (H.R. 801) which will correct the oversight in the JOBS Act and allow thrift holding companies to use the new 1200 shareholder deregistration threshold.

New Charter Option for Mutual Banks

Mutual community banks are among the safest and soundest financial institutions. They remained strong during the financial crisis and continued to provide financial services to their customers. The Plan for Prosperity calls for the creation of a new OCC charter for mutual national banks. This option would provide flexibility for institutions to choose the charter that best suits their needs and the communities they serve.

Cost-Benefit Analysis for New Rules

The Plan for Prosperity calls for legislation to prevent the financial regulatory agencies from issuing notices of proposed rulemaking unless they first determine that quantified costs are less than quantified benefits. The analysis must take into account the impact on the smallest banks which are disproportionately burdened by regulation because they lack the scale and the resources to absorb the associated compliance costs. In addition, the agencies would be required to identify and assess available alternatives including modifications to existing regulations. They would also be required to ensure that proposed regulations are consistent with existing regulations, written in plain English, and easy to interpret.

ICBA strongly supports the SEC Regulatory Accountability Act (H.R. 1062), introduced by Rep. Scott Garrett (R-NJ), which would require the Chief Economist of the SEC to determine that the benefits of any proposed regulation justify the costs before adopting such regulation.

Consumer Financial Protection Bureau Reform

The Plan for Prosperity calls for legislation to strengthen the accountability of the CFPB. We thank this committee and the House for passing the Consumer Financial Protection Safety and Soundness Improvement Act, sponsored by Rep. Sean Duffy (R-WI), in the 112th Congress. That legislation would reform the structure of the CFPB so that it is governed by a five member commission rather than a single director; strengthen prudential regulatory review of CFPB rules by reforming the voting requirement for an FSOC veto from a two-thirds vote to a simple majority, excluding the CFPB Director, and change the standard to allow for a veto of a rule that "is inconsistent with the safe and sound operations of United States financial institutions" – a much more realistic standard than under current law. Combined, these changes would better protect the safety and soundness of the financial system, and provide reasonable measures to insulate community banks from additional regulatory burden.

Modernize the Federal Reserve's Small Bank Holding Company Policy Statement

The Plan for Prosperity calls for the Federal Reserve to revise the Small Bank Holding Company Policy Statement – a set of capital guidelines that have the force of law. The Policy Statement, makes it easier for small bank holding companies to raise additional capital by issuing debt, would be revised to apply to both bank and thrift holding companies and to increase the qualifying asset threshold from $500 million to $5 billion. Qualifying bank and thrift holding companies must not have significant outstanding debt or be engaged in nonbanking activities that involve significant leverage. This will help ease capital requirements for small bank and thrift holding companies.

Closing

Thank you again for the opportunity to testify today. I hope that my testimony, while not exhaustive, gives you a sense of the sharply increasing resource demands placed on community banks by regulation and examination and what's at stake for the future of community banking.

Left unaddressed, the increasing burden of regulation will discourage the chartering of new community banks and lead to further industry consolidation. Consolidation will lead to higher loan interest rates for borrowers, lower rates paid on deposits, and fewer product choices – especially in the rural areas and small towns currently served by community banks. A more concentrated industry, dominated by a small number of too-big-to-fail banks, will jeopardize the safety and soundness of the financial system and expose taxpayers to the risk of additional costly bailouts. That's why it's so important to enact sensible regulatory reforms. We hope that ICBA's Plan for Prosperity will serve as a guide to this committee. The Plan is not meant to be comprehensive or the final word on regulatory reform; we anticipate that we will add to it in response to input from the members of this committee and as the regulatory environment evolves and new challenges and proposed solutions emerge.

We encourage you to reach out to the community bankers in your district. Ask them about the current regulatory environment and whether the reforms of the Plan for Prosperity would help them to better serve their customers and the communities of your district. We're confident that they will agree with us.

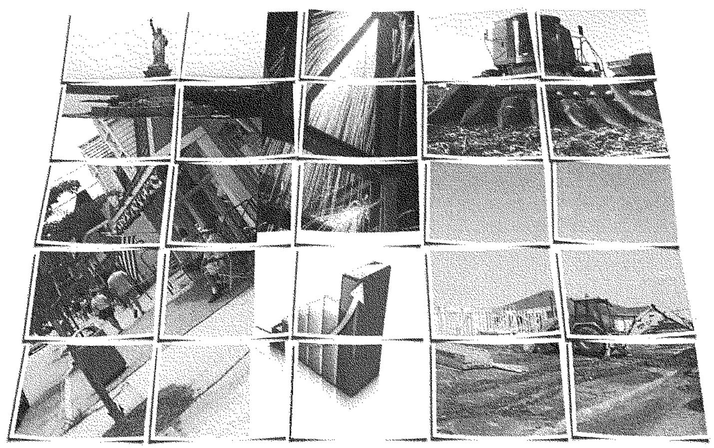
Thank you again for the opportunity to testify today. We look forward to working with this committee to craft urgently needed legislative solutions.

Attachments

- **ICBA Plan for Prosperity**
- **State-By-State Rural County Designation Maps** (blue counties are rural; yellow are non-rural)

ICBA

Plan for Prosperity



A Regulatory Relief Agenda to Empower Local Communities

2013

Plan for Prosperity: A Regulatory Relief Agenda to Empower Local Communities

America's 7,000 community banks are vital to the prosperity of the U.S. economy, particularly in micropolitan and rural communities. Providing 60 percent of all small business loans under $1 million, as well as customized mortgage and consumer loans suited to the unique characteristics of their local communities, community banks are playing a vital role in ensuring the economic recovery is robust and broad based, reaching communities of all sizes and in every region of the country.

In order to reach their full potential as catalysts for entrepreneurship, economic growth, and job creation, community banks must be able to attract capital in a highly competitive environment. Regulation calibrated to the size, lower-risk profile, and traditional business model of community banks is critical to this objective. ICBA's Plan for Prosperity provides targeted regulatory relief that will allow community banks to thrive by doing what they do best – serving and growing their communities. By rebalancing 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. Eaeh provision of the Plan was selected with input from community bankers nationwide and erafted to preserve and strengthen consumer protections and safety and soundness.

The Plan is not a bill; it is a platform and set of legislative priorities positioned for advancement in Congress. The provisions could be introduced in Congress individually, collectively or configured in whatever fashion suits interested members of Congress. The Plan is a flexible, living document that can be adapted to a rapidly changing regulatory and legislative environment to maximize its influence and likelihood of enactment. Provisions of the Plan include:

Support for the Housing Recovery: Mortgage Reform For Community Banks. Provide community banks relief from certain mortgage regulations, especially for loans held in portfolio. When a community bank holds a loan in portfolio, it has a direct stake in the loan's performance and every incentive to ensure it is affordable and responsibly serviced. Relief would include: Providing "qualified mortgage" safe harbor status for loans originated and held in portfolio for the life of the loan by banks with less than $10 billion in assets, including balloon mortgages; exempting banks with assets below $10 billion from escrow requirements for loans held in portfolio; increasing the "small servicer" exemption threshold to 20,000 loans (up from 5,000); and reinstating the FIRREA exemption for independent appraisals for portfolio loans of $250,000 or less made by banks with assets below $10 billion.

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

<u>Redundant Privacy Notices: Eliminate Annual Requirement.</u> Eliminate the requirement that financial institutions mail annual privacy notices even when no change in policy has occurred. Financial institutions would still be required to notify their customers when they change their privacy policies, but when no change in policy has occurred, the annual notice provides no useful information to customers and is a needless expense.

<u>Serving Local Governments: Community Bank Exemption from Municipal Advisor Registration.</u> Exempt community bank employees from having to register as municipal advisors with the SEC and the Municipal Securities Rulemaking Board. Community banks provide traditional banking services to small municipal governments such as demand deposits, certificates of deposit, cash management services, loans and letters of credit. These activities are closely supervised by state and federal bank regulators. Municipal advisor registration and examination would pose a significant expense and regulatory burden for community banks without enhancing financial protections for municipal governments.

<u>Creating a Voice for Commnnity Banks: Treasury Assistant Secretary for Community Banks.</u> Economic and banking policies have too often been made without the benefit of community bank input. An approach that takes into account the diversity and breadth of the financial services sector would significantly improve policy making. Creating an Assistant Secretary for Community Banks within the U.S. Treasury Department would ensure that the 7,000 + community banks across the country, including minority banks that lend in underserved markets, are given appropriate and balanced consideration in the policy making process.

<u>Balanced Consumer Regulation: More Inclusive and Accountable CFPB Governance.</u> Change the governance structure of the CFBP to a five-member commission rather than a single Director. Commissioners would be confirmed by the Senate to staggered five-year terms with no more than three commissioners affiliated with any one political party. This change will strengthen accountability and bring a diversity of views and professional backgrounds to decision-making at the CFPB. In addition, FSOC'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.

Relief from Accounting and Auditing Expenses: Publicly Traded Community Banks and Thrifts. Increase from $75 million in market capitalization to $350 million the exemption from internal control attestation requirements. 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 for attestation work. This provision will substantially lower the regulatory burden and expense for small, publicly traded community banks without creating more risk for investors. Separately, due to an inadvertent oversight in the recently-passed JOBS Act, thrift holding companies cannot take advantage of the increased shareholder threshold below which a bank or bank holding company may deregister with the SEC. Congress should correct this oversight by allowing thrift holding companies to use the new 1200 shareholder deregistration threshold.

Ensuring the Viability of Mutual Banks: New Charter Option and Relief from Dividend Restrictions. The OCC should be allowed to charter mutual national banks to provide flexibility for institutions to choose the charter that best suits their needs and the communities they serve. In addition, certain mutual holding companies – those that bave public shareholders—should be allowed to pay dividends to their public shareholders without having to comply with numerous "dividend waiver" restrictions as required under a recent Federal Reserve rule. The Federal Reserve rule makes it difficult for mutual holding companies to attract investors to support their capital levels. Easier payment of dividends will ensure the viability of the mutual holding company form of organization.

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

Additional Capital for Small Bank Holding Compauies: Modernizing the Federal Reserve's Policy Statement. Require the Federal Reserve to revise the Small Bank Holding Company Policy Statement – a set of capital guidelines that have the force of law. The Policy Statement, makes it easier for small bank holding companies to raise additional capital by issuing debt, would be revised to apply to both bank and thrift holding companies and to increase the qualifying asset threshold from $500 million to $5 billion. Qualifying bank and thrift holding companies must not have significant outstanding debt or be engaged in nonbanking activities that involve significant leverage. This will help ease capital requirements for small bank and thrift holding companies.

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

Facilitating Capital Formation: Modernize Subchapter S Constraints and Extend Loss Carryback. Subchapter S of the tax code should be updated to facilitate capital formation for community banks, particularly in light of higher capital requirements under the proposed Basel III capital standards. The limit on Subchapter S shareholders should be increased from 100 to 200; Subchapter S corporations should be allowed to issue preferred shares; and Subchapter S shares, both common and preferred, should be permitted to be held in individual retirement accounts (IRAs). These changes would better allow the nation's 2300 Subchapter S banks to raise capital and increase the flow of credit. In addition, banks with $15 billion or less in assets should be allowed to use a five-year net operating loss (NOL) carryback through 2014. This extension of the five-year NOL carryback is countercyclical and will support community bank capital and lending during economic downturns.

The Independent Community Bankers of America®, the nation's voice for nearly 7,000 community banks of all sizes and charter types, is dedicated exclusively to representing the interests of the community banking industry and its membership through effective advocacy, best-in-class education and high-quality products and services. For more information, visit www.icba.org.

State-by-State Impact of CFPB "Rural" Definition

Rural (blue) and Non-Rural (yellow) Counties Under the Consumer Financial Protection Bureau's Final "Ability to Repay" Rule

Alabama


LAUDERDALE
LIMESTONE
MADISON
JACKSON
COLBERT
LAWRENCE
FRANKLIN
MORGAN
MARSHALL
DEKALB
MARION
WINSTON
CULLMAN
CHEROKEE
ETOWAH
BLOUNT
LAMAR
FAYETTE
WALKER
ST. CLAIR
CALHOUN
JEFFERSON
CLEBURNE
PICKENS
TUSCALOOSA
SHELBY
TALLADEGA
CLAY
RANDOLPH
BIBB
GREENE
COOSA
TALLAPOOSA
CHILTON
CHAMBERS
HALE
PERRY
SUMTER
AUTAUGA
ELMORE
LEE
MACON
DALLAS
RUSSELL
MARENGO
CHOCTAW
LOWNDES
MONTGOMERY
BULLOCK
WILCOX
BARBOUR
BUTLER
PIKE
CLARKE
CRENSHAW
MONROE
HENRY
WASHINGTON
CONECUH
DALE
COFFEE
COVINGTON
ESCAMBIA
GENEVA
HOUSTON
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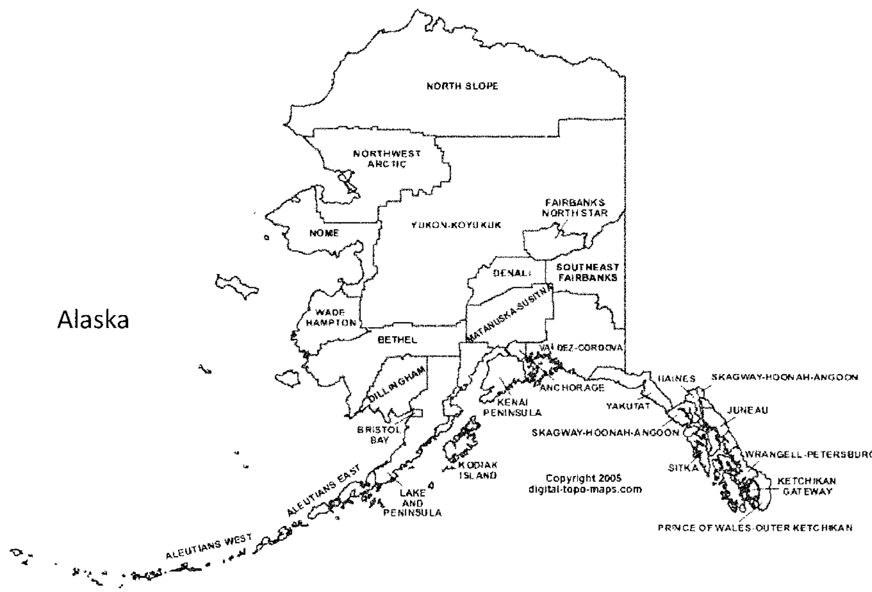
MOBILE
BALDWIN

Alaska



NORTH SLOPE
NORTHWEST ARCTIC
NOME
YUKON-KOYUKUK
FAIRBANKS NORTH STAR
SOUTHEAST FAIRBANKS
DENALI
MATANUSKA-SUSITNA
WADE HAMPTON
BETHEL
VALDEZ-CORDOVA
DILLINGHAM
ANCHORAGE
KENAI PENINSULA
HAINES
SKAGWAY-HOONAH-ANGOON
YAKUTAT
JUNEAU
BRISTOL BAY
SKAGWAY-HOONAH-ANGOON
WRANGELL-PETERSBURG
KODIAK ISLAND
SITKA
KETCHIKAN GATEWAY
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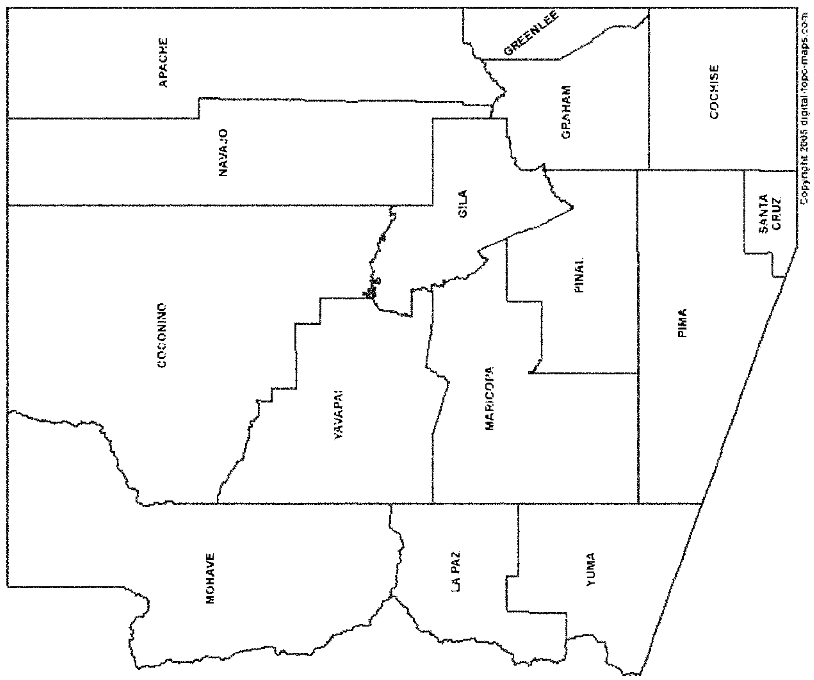
ALEUTIANS EAST
LAKE AND PENINSULA
ALEUTIANS WEST
PRINCE OF WALES-OUTER KETCHIKAN


APACHE
NAVAJO
COCONINO
MOHAVE
GREENLEE
GILA
YAVAPAI
LA PAZ
GRAHAM
MARICOPA
PINAL
YUMA
COCHISE
PIMA
SANTA CRUZ
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Arizona

Arkansas

BENTON
CARROLL
BOONE
MARION
BAXTER
FULTON
RANDOLPH
CLAY
WASHINGTON
MADISON
NEWTON
SEARCY
IZARD
SHARP
LAWRENCE
GREENE
STONE
INDEPENDENCE
CRAIGHEAD
MISSISSIPPI
CRAWFORD
FRANKLIN
JOHNSON
POPE
VAN BUREN
CLEBURNE
JACKSON
POINSETT
CONWAY
WHITE
CROSS
CRITTENDEN
SEBASTIAN
LOGAN
YELL
FAULKNER
WOODRUFF
ST. FRANCIS
SCOTT
PERRY
PRAIRIE
PULASKI
LONOKE
LEE
SALINE
MONTGOMERY
GARLAND
MONROE
POLK
PHILLIPS
HOT SPRING
GRANT
JEFFERSON
ARKANSAS
HOWARD
PIKE
SEVIER
CLARK
DALLAS
CLEVELAND
LINCOLN
DESHA
LITTLE RIVER
HEMPSTEAD
NEVADA
OUACHITA
DREW
CALHOUN
MILLER
BRADLEY
LAFAYETTE
COLUMBIA
UNION
ASHLEY
CHICOT
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California

DEL NORTE
SISKIYOU
MODOC
HUMBOLDT
TRINITY
SHASTA
LASSEN
TEHAMA
PLUMAS
GLENN
BUTTE
SIERRA
NEVADA
MENDOCINO
COLUSA
SUTTER
YUBA
PLACER
LAKE
YOLO
EL DORADO
ALPINE
SONOMA
NAPA
SOLANO
SACRAMENTO
AMADOR
CALAVERAS
MARIN
CONTRA COSTA
SAN JOAQUIN
TUOLUMNE
MONO
SAN FRANCISCO
ALAMEDA
STANISLAUS
MARIPOSA
SAN MATEO
SANTA CLARA
MERCED
MADERA
SANTA CRUZ
SAN BENITO
FRESNO
INYO
MONTEREY
TULARE
KINGS
SAN LUIS OBISPO
KERN
SAN BERNARDINO
SANTA BARBARA
VENTURA
LOS ANGELES
RIVERSIDE
ORANGE
SAN DIEGO
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Colorado


MOFFAT
ROUTT
JACKSON
LARIMER
WELD
LOGAN
SEDGWICK
PHILLIPS
MORGAN
YUMA
GRAND
BOULDER
BROOMFIELD
RIO BLANCO
GILPIN
DENVER
ADAMS
WASHINGTON
EAGLE
SUMMIT
CLEAR CREEK
JEFFERSON
ARAPAHOE
GARFIELD
ELBERT
KIT CARSON
PITKIN
LAKE
PARK
DOUGLAS
MESA
DELTA
GUNNISON
CHAFFEE
TELLER
EL PASO
LINCOLN
CHEYENNE
MONTROSE
FREMONT
KIOWA
CROWLEY
OURAY
SAGUACHE
PUEBLO
CUSTER
SAN MIGUEL
HINSDALE
OTERO
BENT
PROWERS
SAN JUAN
DOLORES
MINERAL
HUERFANO
RIO GRANDE
ALAMOSA
MONTEZUMA
LA PLATA
ARCHULETA
CONEJOS
COSTILLA
LAS ANIMAS
BACA
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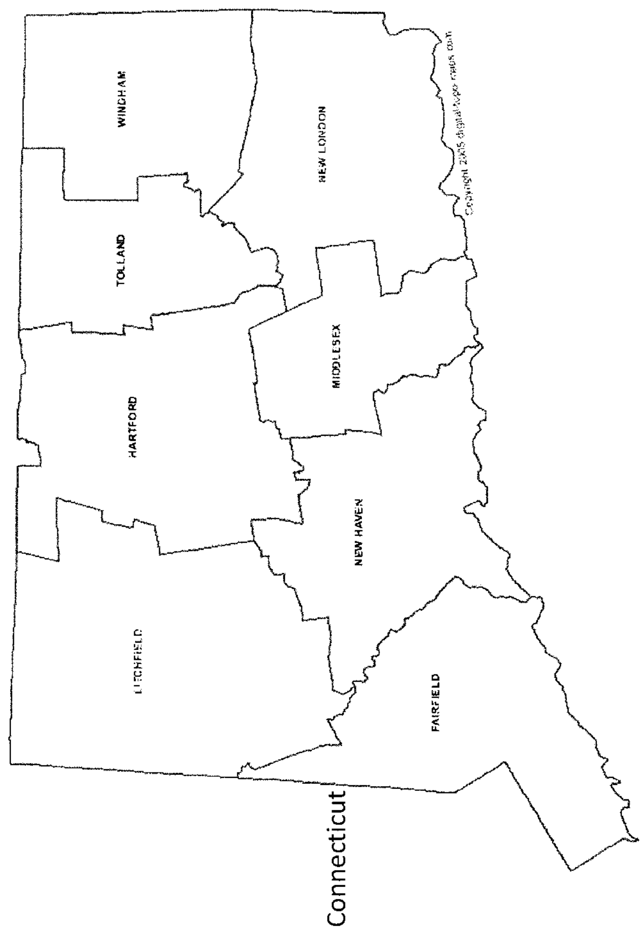
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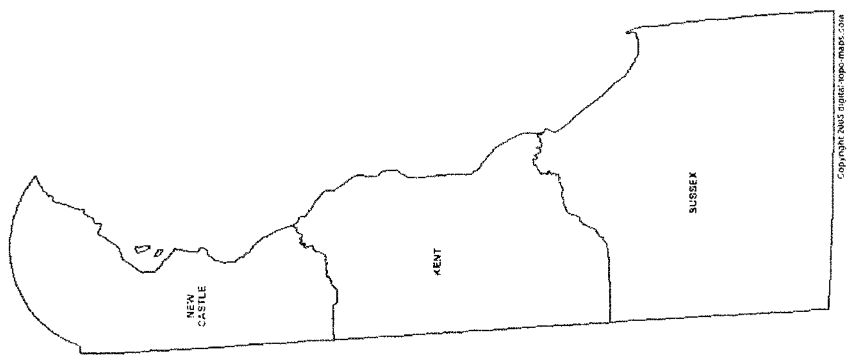
NEW LONDON
TOLLAND
MIDDLESEX
HARTFORD
NEW HAVEN
LITCHFIELD
FAIRFIELD
Connecticut


NEW CASTLE
KENT
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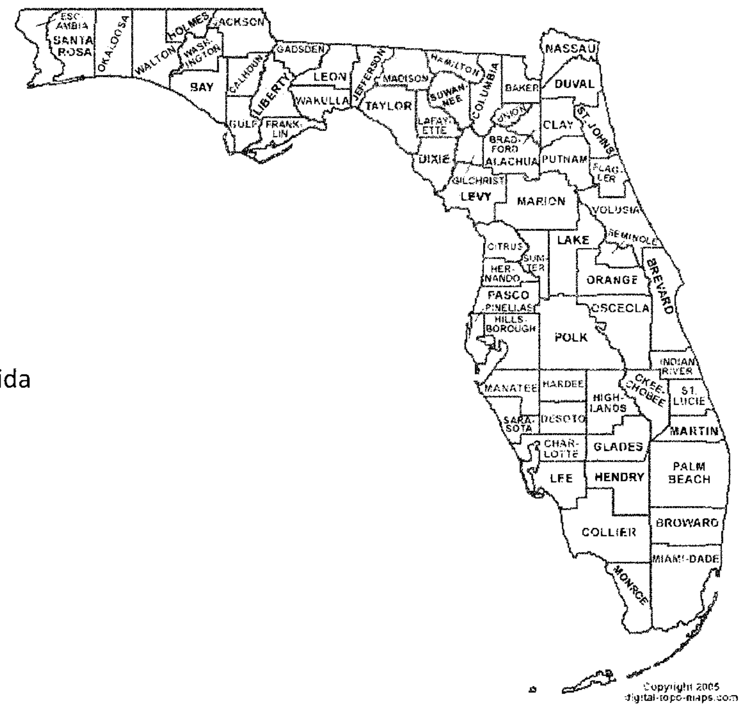
Delaware

Florida


ESC AMBIA
SANTA ROSA
OKALOOSA
WALTON
HOLMES
JACKSON
WASH-INGTON
BAY
CALHOUN
LIBERTY
GULF
FRANK-LIN
GADSDEN
LEON
WAKULLA
JEFFERSON
MADISON
TAYLOR
HAMILTON
SUWAN-NEE
COLUMBIA
LAFAY-ETTE
DIXIE
BAKER
UNION
BRAD-FORD
ALACHUA
GILCHRIST
LEVY
NASSAU
DUVAL
CLAY
ST JOHNS
PUTNAM
FLAG-LER
MARION
VOLUSIA
LAKE
SEMINOLE
CITRUS
SUM-TER
HER-NANDO
PASCO
PINELLAS
HILLS-BOROUGH
POLK
ORANGE
OSCEOLA
BREVARD
INDIAN RIVER
MANATEE
HARDEE
HIGH-LANDS
OKEE-CHOBEE
ST LUCIE
SARA-SOTA
DESOTO
MARTIN
CHAR-LOTTE
GLADES
LEE
HENDRY
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Georgia


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WHITFIELD
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FANNIN
TOWNS
UNION
RABUN
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GILMER
LUMP-KIN
WHITE
HABER-SHAM
STE-PHENS
CHAT-TOOGA
GORDON
PICKENS
DAWSON
HALL
BANKS
FRANK-LIN
HART
FLOYD
BARTOW
CHEROKEE
FOR-SYTH
JACKSON
CLARKE
MADISON
ELBERT
POLK
COBB
GWINNETT
ROCK-DALE
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OGLE-THORPE
PAUL-DING
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HEARD
COWETA
JASPER
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CRAW-FORD
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CHATTA-HOOCHEE
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TOOMBS
WHEELER
EVANS
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DODGE
STEWART
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SUMTER
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CHATHAM
CRISP
WILCOX
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TURNER
IRWIN
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Hawaii

Idaho


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BENEWAH
LATAH
CLEARWATER
NEZ PERCE
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IDAHO
LEMHI
ADAMS
VALLEY
WASHINGTON
CUSTER
CLARK
FREMONT
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BOISE
GEM
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TETON
CANYON
BUTTE
ADA
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BLAINE
ELMORE
BONNEVILLE
BINGHAM
GOODING
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DUPAGE
COOK
WHITESIDE
LEE
KENDALL
WILL
ROCK ISLAND
HENRY
BUREAU
LA SALLE
GRUNDY
PUTNAM
MERCER
STARK
MARSHALL
KANKAKEE
HENDERSON
WARREN
KNOX
PEORIA
WOODFORD
LIVINGSTON
IROQUOIS
FULTON
TAZEWELL
MCLEAN
FORD
HANCOCK
MCDONOUGH
MASON
SCHUYLER
LOGAN
DE WITT
CHAMPAIGN
VERMILION
ADAMS
BROWN
CASS
MENARD
PIATT
MORGAN
SANGAMON
MACON
DOUGLAS
PIKE
SCOTT
CHRISTIAN
MOULTRIE
EDGAR
CALHOUN
COLES
GREENE
MACOUPIN
MONTGOMERY
SHELBY
CUMBERLAND
CLARK
JERSEY
FAYETTE
EFFINGHAM
JASPER
CRAWFORD
BOND
MADISON
CLAY
RICHLAND
LAWRENCE
MARION
CLINTON
ST. CLAIR
WAYNE
EDWARDS
WABASH
WASHINGTON
JEFFERSON
MONROE
RANDOLPH
PERRY
HAMILTON
WHITE
FRANKLIN
JACKSON
WILLIAMSON
SALINE
GALLATIN
UNION
JOHNSON
POPE
HARDIN
ALEXANDER
PULASKI
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Indiana

LAKE
PORTER
LA PORTE
ST. JOSEPH
ELKHART
LAGRANGE
STEUBEN
NOBLE
DE KALB
MARSHALL
KOSCIUSKO
STARKE
WHITLEY
ALLEN
JASPER
PULASKI
FULTON
NEWTON
WHITE
CASS
MIAMI
WABASH
HUNTINGTON
WELLS
ADAMS
BENTON
CARROLL
HOWARD
GRANT
BLACK-FORD
JAY
WARREN
TIPPECANOE
CLINTON
TIPTON
MADISON
DELAWARE
RANDOLPH
FOUNTAIN
MONTGOMERY
BOONE
HAMILTON
HENRY
WAYNE
VERMILLION
PARKE
PUTNAM
HENDRICKS
MARION
HANCOCK
RUSH
FAYETTE
UNION
VIGO
CLAY
MORGAN
JOHNSON
SHELBY
FRANKLIN
OWEN
DECATUR
SULLIVAN
MONROE
BROWN
BARTHOLOMEW
RIPLEY
DEARBORN
GREENE
JENNINGS
JACKSON
OHIO
LAWRENCE
SWITZERLAND
JEFFERSON
KNOX
DAVIESS
MARTIN
SCOTT
ORANGE
WASHINGTON
CLARK
PIKE
DUBOIS
GIBSON
CRAWFORD
FLOYD
HARRISON
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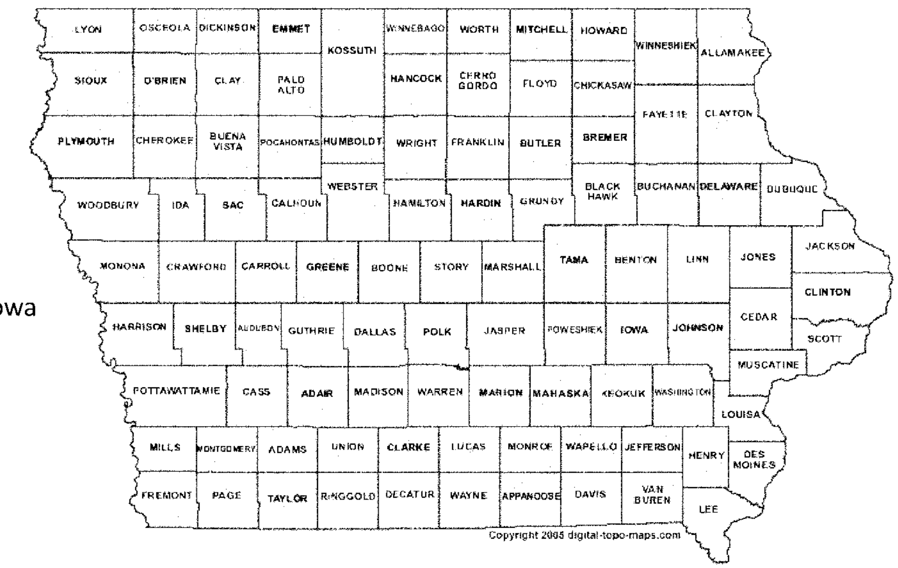
Iowa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VAN BUREN
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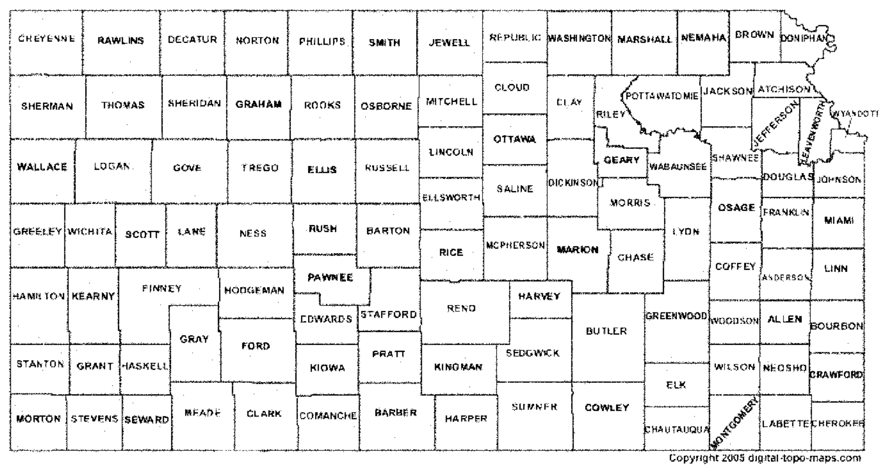
Kansas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GRANT
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KIOWA
PRATT
KINGMAN
SEDGWICK
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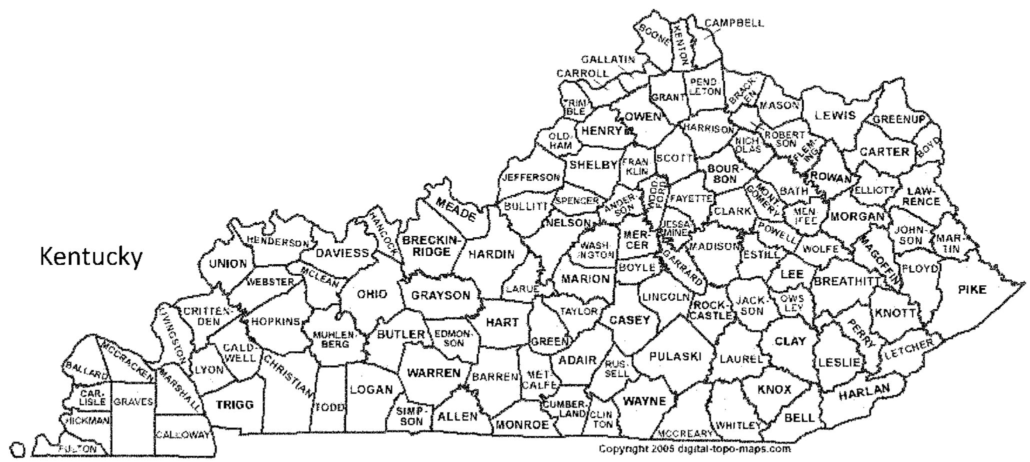
Kentucky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HARRISON
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NICH OLAS
FLEM- ING
BOYD
OLD- HAM
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SHELBY
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SCOTT
BOUR- BON
ROWAN
JEFFERSON
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ELLIOTT
LAW- RENCE
SPENCER
ANDER- SON
WOOD- FORD
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MUHLEN- BERG
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EDMON- SON
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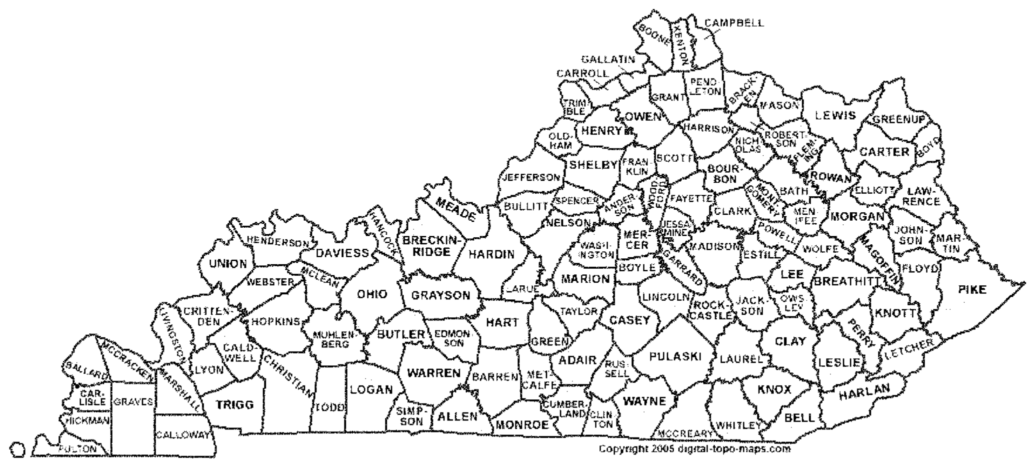
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UNION
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EAST CARROLL
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OUACHITA
RICHLAND
MADISON
BIENVILLE
JACKSON
CALDWELL
FRANKLIN
TENSAS
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LA SALLE
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ORLEANS
ST. BERNARD
ST. JAMES
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JEFFERSON
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PLAQUEMINES
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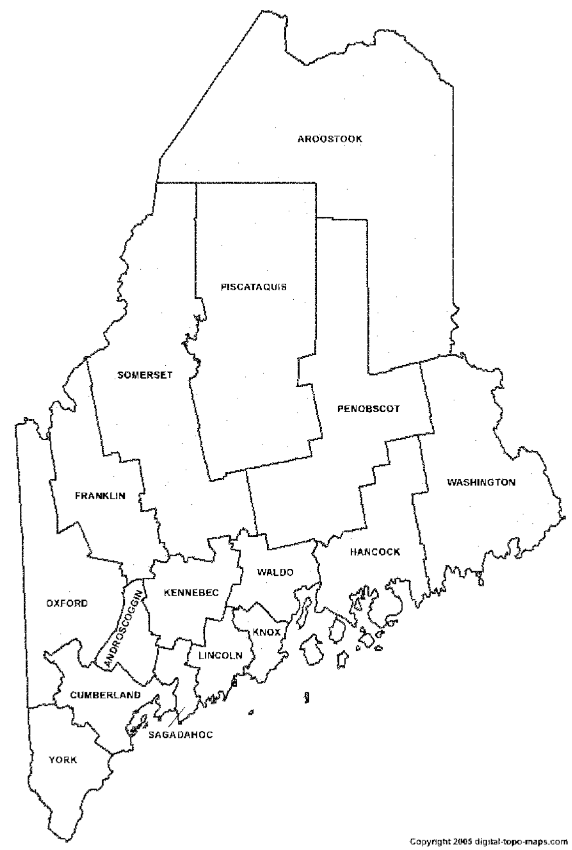
Maine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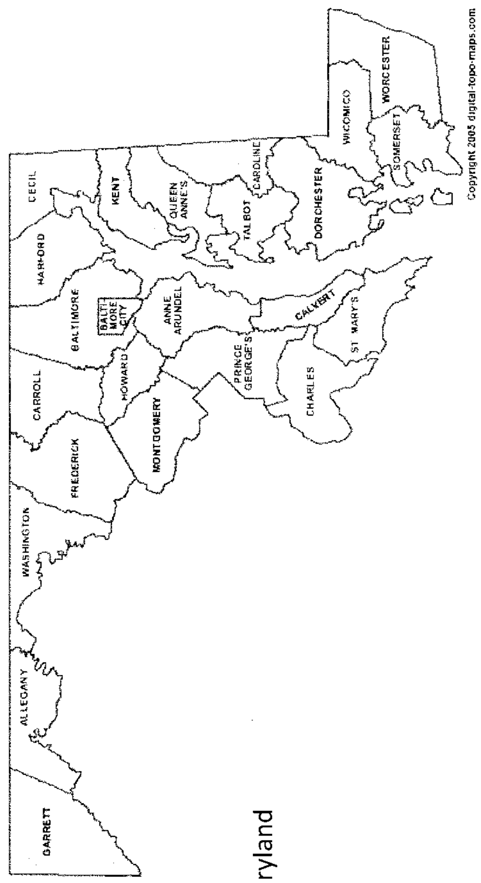
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WICOMICO
WORCESTER
SOMERSET
BALTI MORE CITY
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CHARLES
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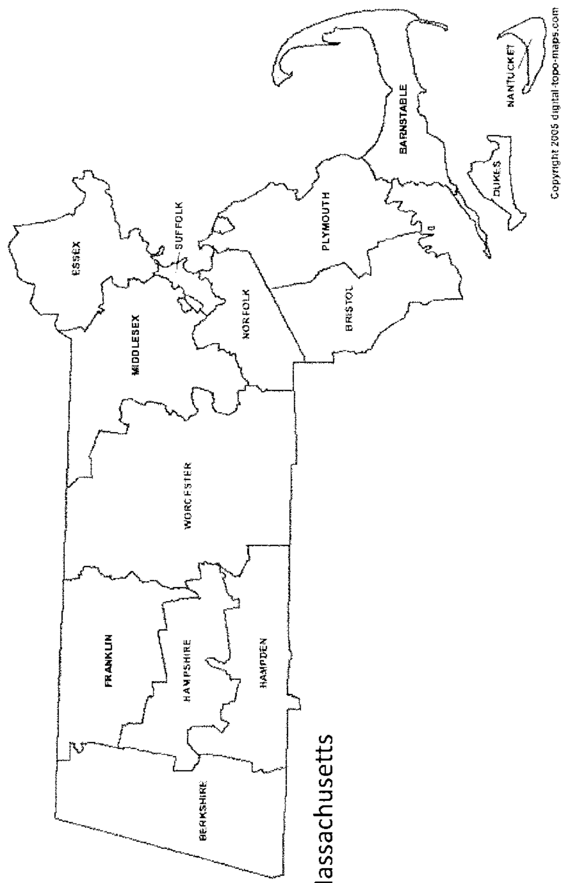
Maryland



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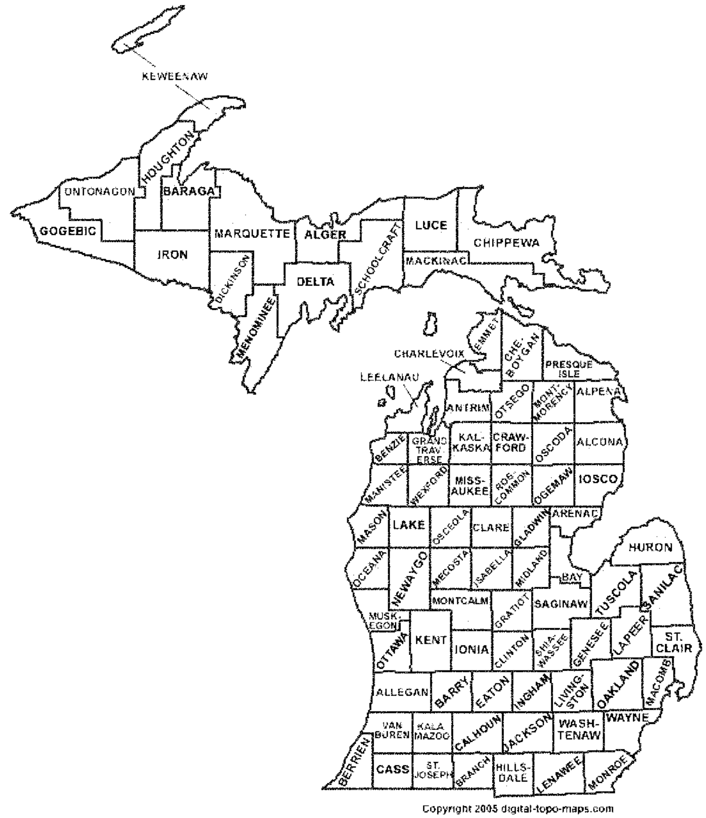
Michigan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CHARLEVOIX
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PRESQUE ISLE
LEELANAU
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OTSEGO
MONT-MORENCY
ALPENA
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ALCONA
MANISTEE
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WASH-TENAW
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MONROE
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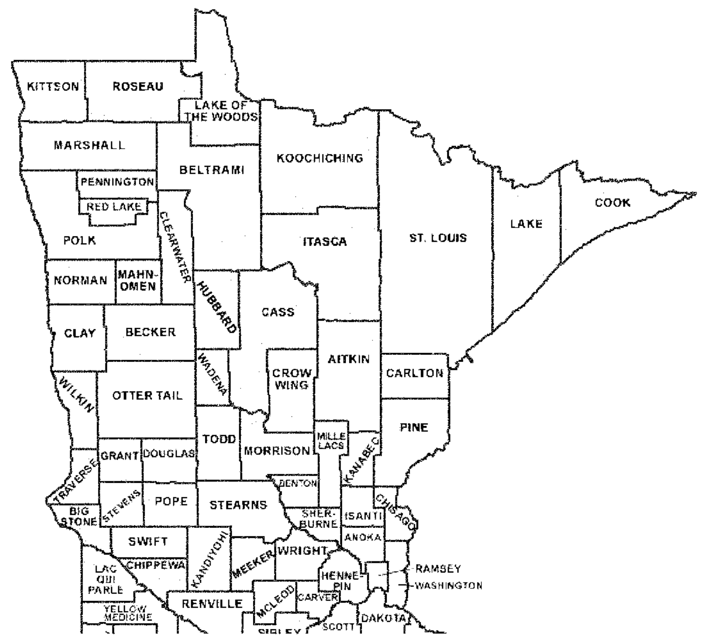
Minnesota



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POLK
CLEARWATER
NORMAN
MAHN-OMEN
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CARLTON
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STEVENS
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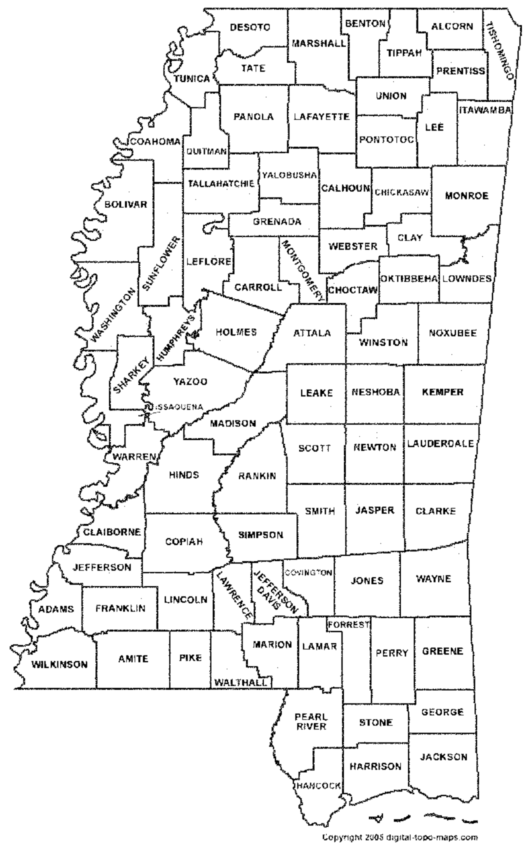

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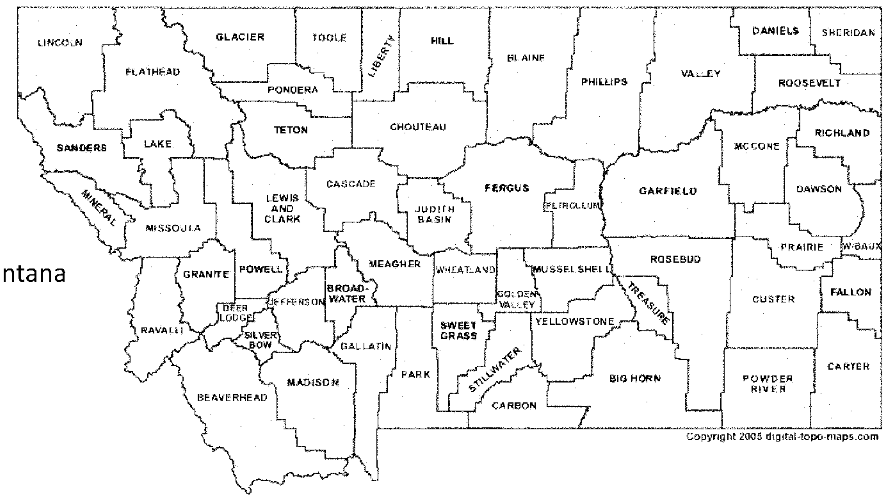
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TETON
CHOUTEAU
SANDERS
LAKE
MCCONE
RICHLAND
MINERAL
MISSOULA
LEWIS AND CLARK
CASCADE
JUDITH BASIN
FERGUS
PETROLEUM
GARFIELD
DAWSON
PRAIRIE
GRANITE
POWELL
MEAGHER
WHEATLAND
MUSSELSHELL
ROSEBUD
FALLON
RAVALLI
DEER LODGE
JEFFERSON
BROAD-WATER
GOLDEN VALLEY
SWEET GRASS
YELLOWSTONE
TREASURE
CUSTER
SILVER BOW
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POWDER RIVER
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MADISON
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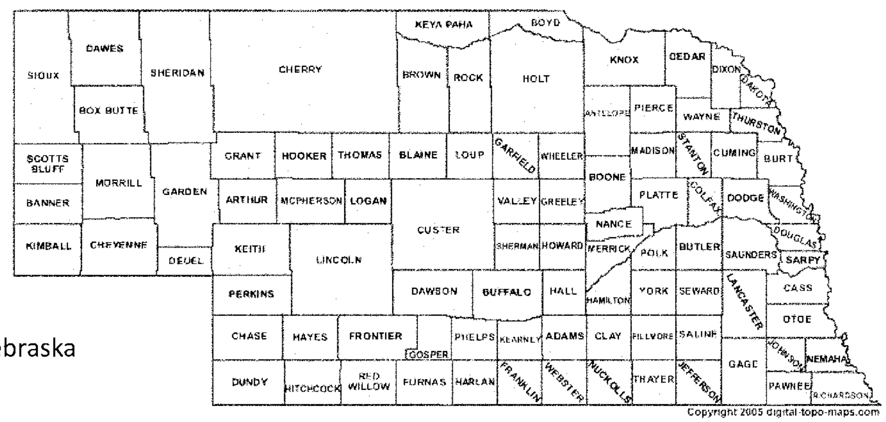
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WAYNE
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SCOTTS BLUFF
MORRILL
GARDEN
GRANT
HOOKER
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BANNER
ARTHUR
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YORK
SEWARD
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ADAMS
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HARLAN
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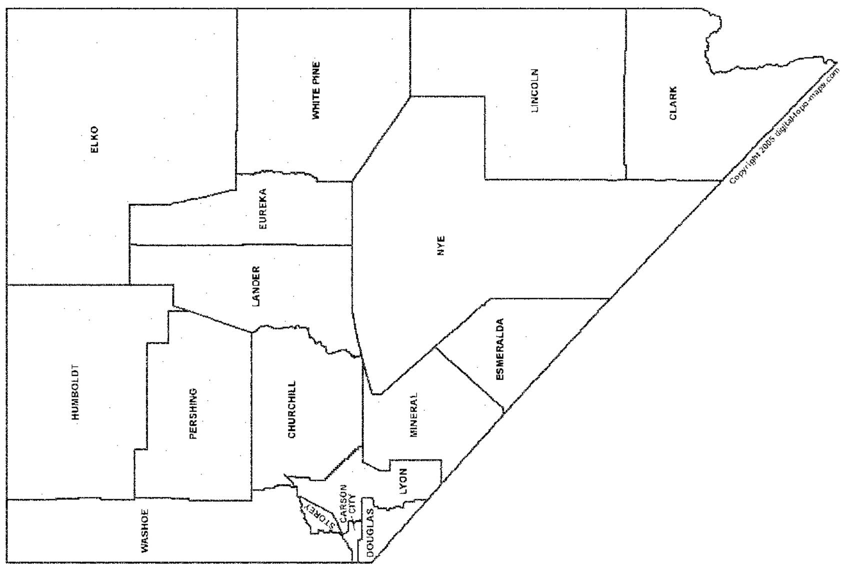
Nebraska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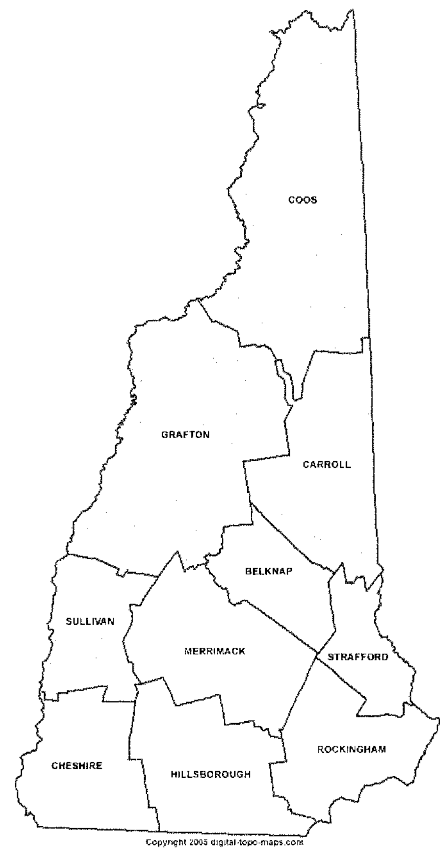
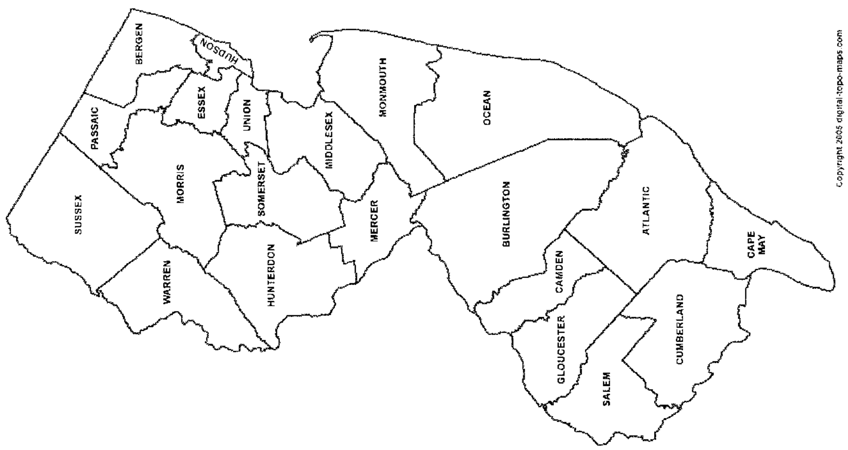
Nevada

New Hampshire

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HUNTERDON
MERCER
BURLINGTON
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ATLANTIC
CAPE MAY
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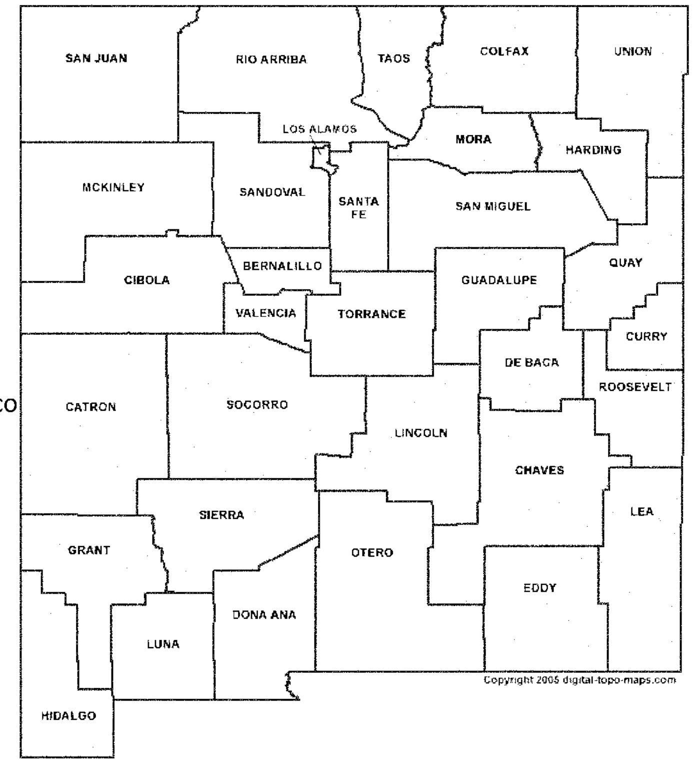
New Jersey

New Mexico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SANDOVAL
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SAN MIGUEL
CIBOLA
BERNALILLO
QUAY
GUADALUPE
VALENCIA
TORRANCE
CURRY
DE BACA
ROOSEVELT
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ORLEANS
MONROE
WAYNE
GENESEE
ONONDAGA
HERKIMER
FULTON
SARATOGA
WASHINGTON
SCHENEC-
TADY
MONTGOMERY
ERIE
WYOMING
LIVINGSTON
ONTARIO
SENECA
CAYUGA
MADISON
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CORTLAND
CHENANGO
OTSEGO
SCHOHARIE
ALBANY
RENSSELAER
SCHUYLER
TOMPKINS
CHAUTAUQUA
CATTARAUGUS
ALLEGANY
STEUBEN
CHEMUNG
TIOGA
BROOME
DELAWARE
GREENE
COLUMBIA
ULSTER
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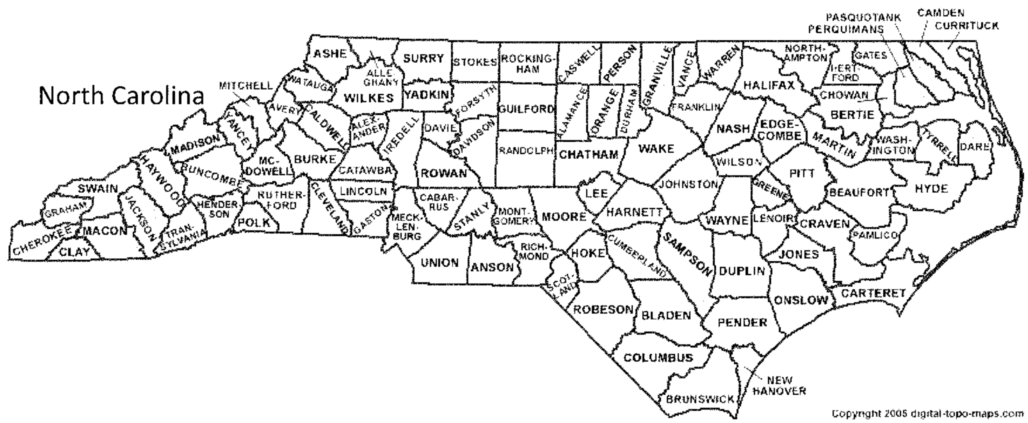
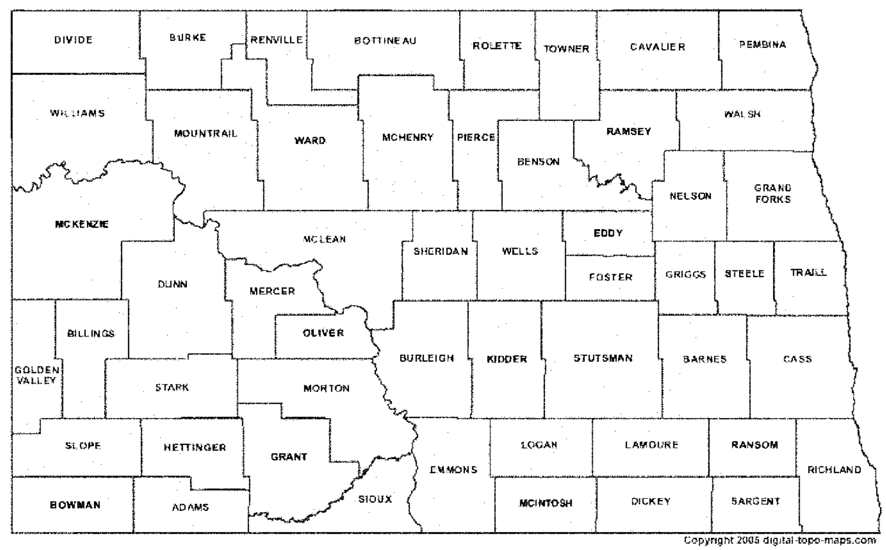


North Dakota



Ohio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HAMILTON
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VINTON
HIGHLAND
MEIGS
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Oklahoma


CIMARRON
TEXAS
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HARPER
WOODS
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OSAGE
NOWATA
CRAIG
OTTAWA
ELLIS
WOODWARD
MAJOR
GARFIELD
NOBLE
WASHINGTON
ROGERS
MAYES
DELAWARE
PAWNEE
TULSA
DEWEY
BLAINE
KINGFISHER
LOGAN
PAYNE
CREEK
WAGONER
CHEROKEE
ADAIR
ROGER MILLS
CUSTER
CANADIAN
OKLAHOMA
LINCOLN
OKMULGEE
MUSKOGEE
SEQUOYAH
OKFUSKEE
MCINTOSH
BECKHAM
WASHITA
CADDO
GRADY
CLEVELAND
POTTAWATOMIE
SEMINOLE
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LATIMER
HARMON
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MURRAY
TILLMAN
COTTON
CARTER
JOHNSTON
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JEFFERSON
BRYAN
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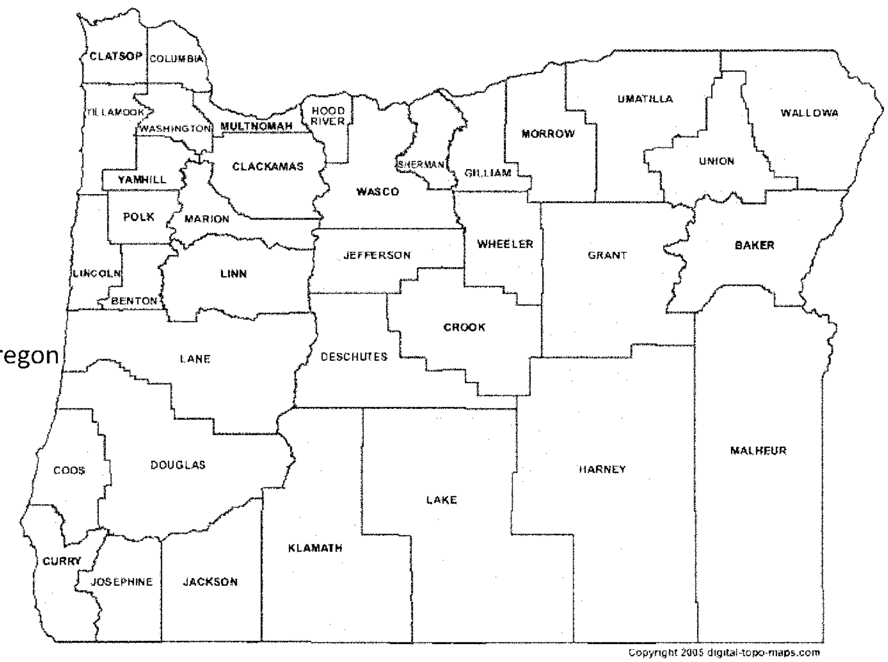
Oregon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GILLIAM
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GRANT
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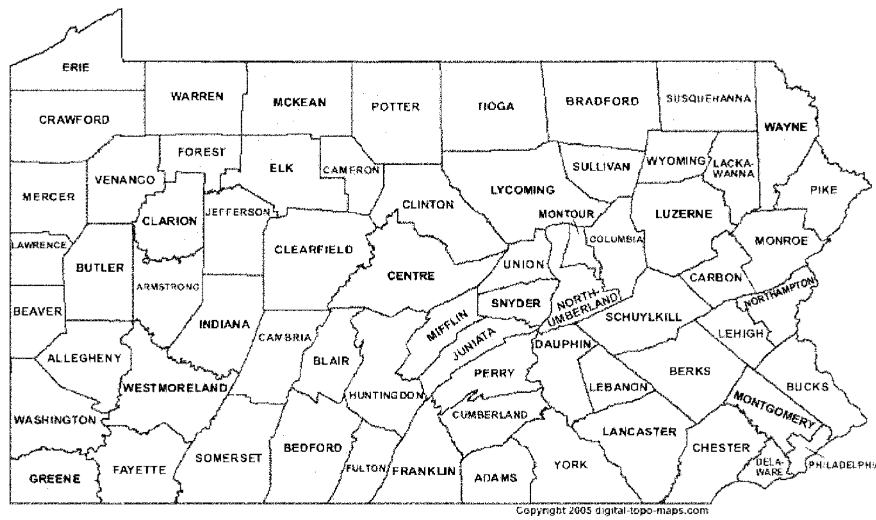
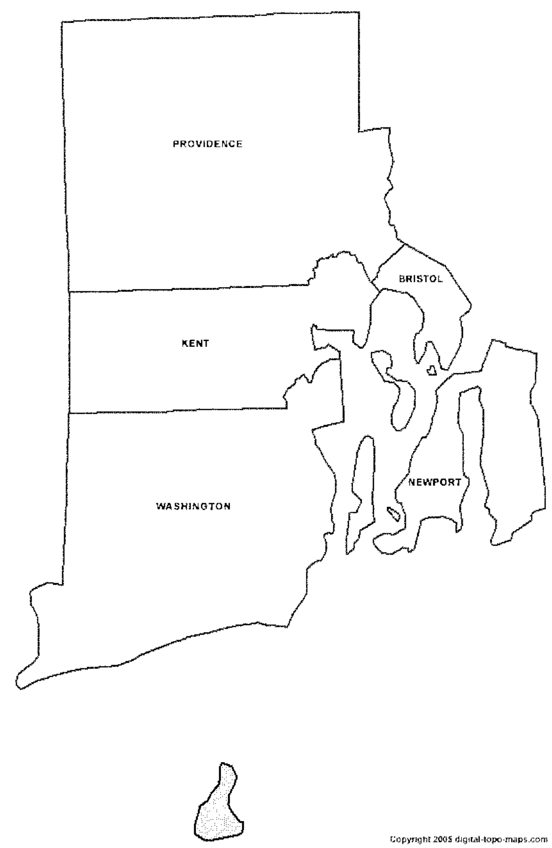
Pennsylvania



Rhode Island



South Carolina

South
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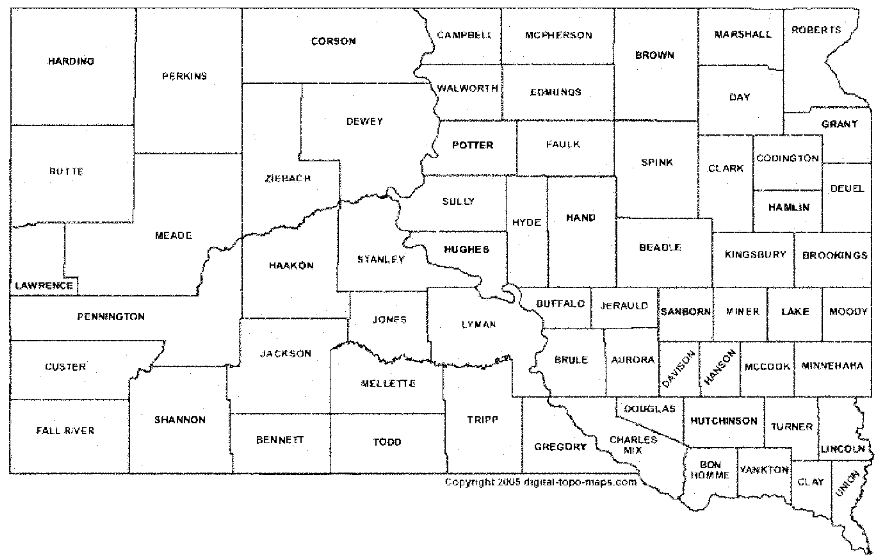

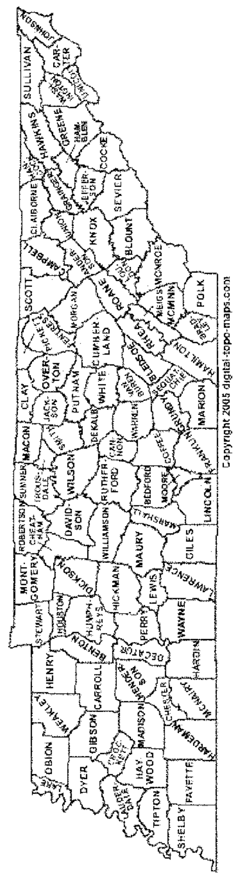
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MADISON
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MCNAIRY
HARDEMAN
OBION
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Tennessee

Texas


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OCHIL-TREE
LIPS-COMB
HARTLEY
MOORE
HUTCH-INSON
ROBERTS
HEMP-HILL
OLDHAM
POTTER
CARSON
GRAY
WHEELER
DEAF SMITH
RANDALL
ARM-STRONG
DONLEY
COLLINGS-WORTH
PARMER
CASTRO
SWISHER
BRISCOE
HALL
CHILD-RESS
BAILEY
LAMB
HALE
FLOYD
MOTLEY
COTTLE
HARDE-MAN
FOARD
WILBARGER
WICHITA
COCHRAN
HOCKLEY
LUBBOCK
CROSBY
DICKENS
KING
KNOX
BAYLOR
ARCHER
CLAY
MONTA-GUE
COOKE
GRAY-SON
FANNIN
LAMAR
RED RIVER
BOWIE
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FRANK-LIN
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PALO PINTO
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SAN PATRICIO
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WEBB
DUVAL
JIM WELLS
NUECES
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ZAPATA
JIM HOGG
BROOKS
KENEDY
STARR
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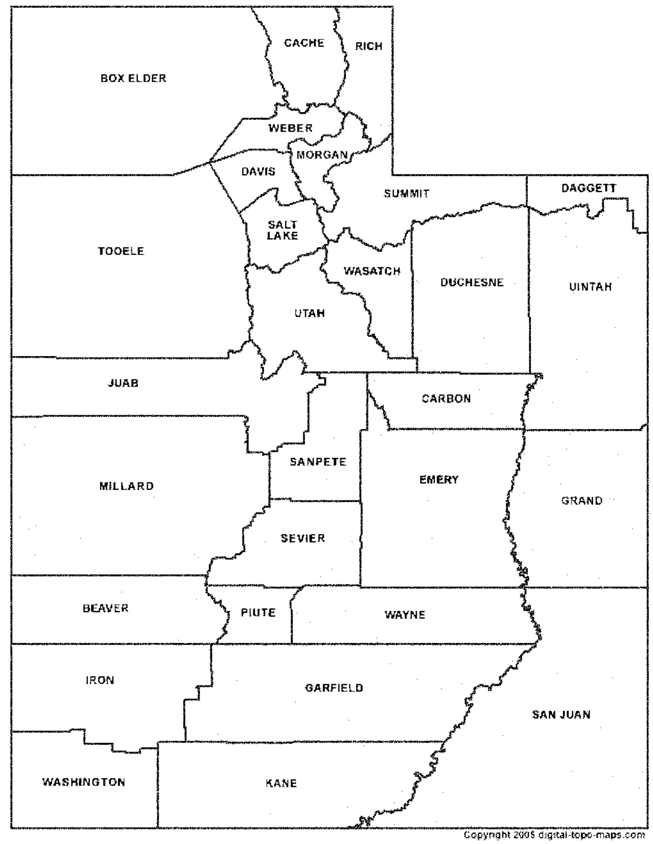
WILLACY
CAMERON

Utah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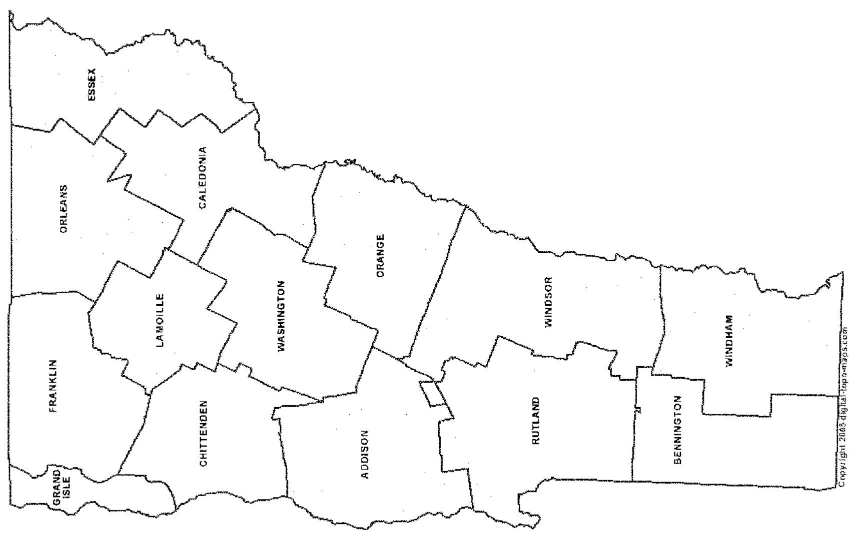
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RUTLAND
BENNINGTON
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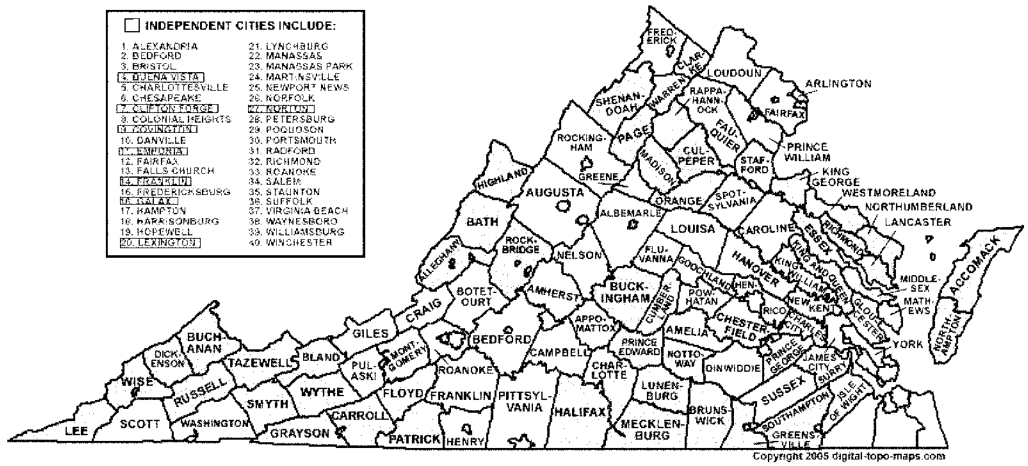
Vermont

Virginia


INDEPENDENT CITIES INCLUDE:
1. ALEXANDRIA
2. BEDFORD
3. BRISTOL
4. BUENA VISTA
5. CHARLOTTESVILLE
6. CHESAPEAKE
8. COLONIAL HEIGHTS
10. DANVILLE
12. FAIRFAX
13. FALLS CHURCH
16. FREDERICKSBURG
17. HAMPTON
18. HARRISONBURG
19. HOPEWELL
20. LEXINGTON
21. LYNCHBURG
22. MANASSAS
23. MANASSAS PARK
24. MARTINSVILLE
25. NEWPORT NEWS
26. NORFOLK
28. PETERSBURG
29. POQUOSON
30. PORTSMOUTH
31. RADFORD
32. RICHMOND
33. ROANOKE
34. SALEM
35. STAUNTON
36. SUFFOLK
37. VIRGINIA BEACH
38. WAYNESBORO
39. WILLIAMSBURG
40. WINCHESTER
FREDERICK
CLARKE
LOUDOUN
ARLINGTON
SHENANDOAH
WARREN
RAPPAHANNOCK
FAIRFAX
FAUQUIER
PRINCE WILLIAM
ROCKINGHAM
PAGE
CULPEPER
STAFFORD
KING GEORGE
WESTMORELAND
NORTHUMBERLAND
LANCASTER
HIGHLAND
AUGUSTA
GREENE
MADISON
ORANGE
SPOTSYLVANIA
ALBEMARLE
LOUISA
CAROLINE
BATH
ROCKBRIDGE
NELSON
FLUVANNA
HANOVER
ACCOMACK
ALLEGHANY
BOTETOURT
AMHERST
BUCKINGHAM
CUMBERLAND
GOOCHLAND
POWHATAN
HENRICO
MIDDLESEX
MATHEWS
CRAIG
GILES
BEDFORD
APPOMATTOX
AMELIA
CHESTERFIELD
NORTHAMPTON
BUCHANAN
DICKENSON
TAZEWELL
BLAND
MONTGOMERY
PULASKI
ROANOKE
CAMPBELL
PRINCE EDWARD
NOTTOWAY
DINWIDDIE
PRINCE GEORGE
YORK
WISE
RUSSELL
WYTHE
FLOYD
FRANKLIN
PITTSYLVANIA
CHARLOTTE
LUNENBURG
SUSSEX
SURRY
ISLE OF WIGHT
LEE
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WASHINGTON
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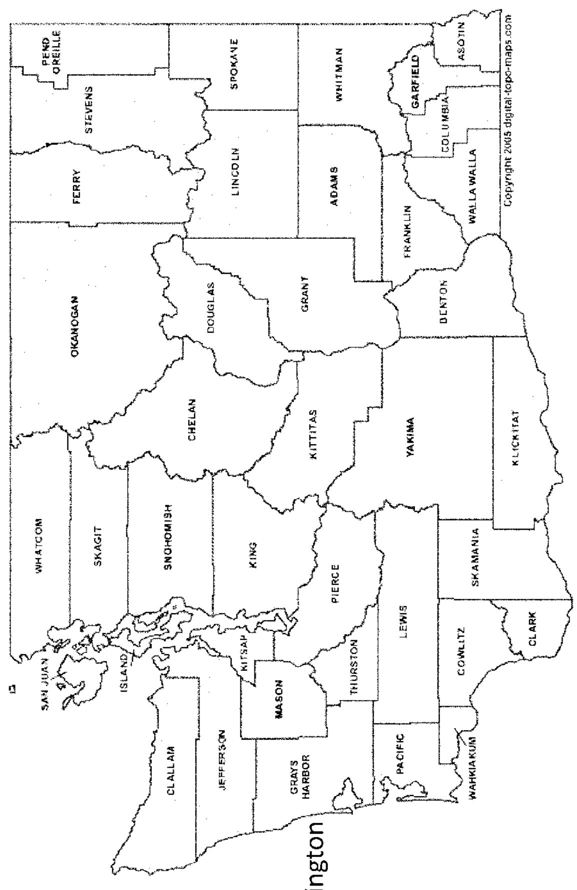
PEND OREILLE
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SPOKANE
LINCOLN
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COLUMBIA
WALLA WALLA
FRANKLIN
GRANT
DOUGLAS
CHELAN
KITTITAS
BENTON
YAKIMA
KLICKITAT
WHATCOM
SKAGIT
SNOHOMISH
KING
PIERCE
LEWIS
SKAMANIA
CLARK
COWLITZ
THURSTON
MASON
KITSAP
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CLALLAM
JEFFERSON
GRAYS HARBOR
PACIFIC
WAHKIAKUM
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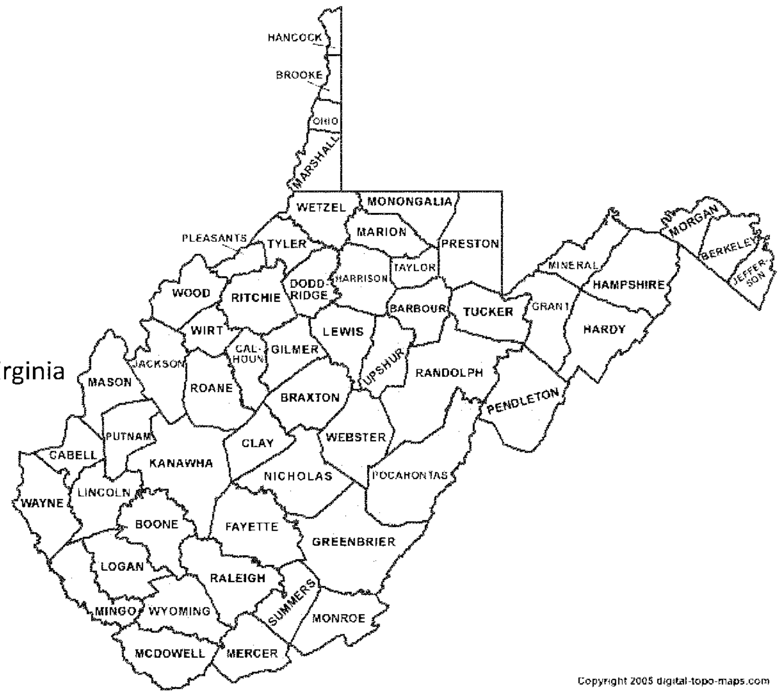
Washington

West Virginia



Wisconsin


DOUGLAS
BAYFIELD
IRON
ASHLAND
VILAS
BURNETT
WASHBURN
SAWYER
PRICE
ONEIDA
FLORENCE
FOREST
POLK
BARRON
RUSK
MARINETTE
LINCOLN
TAYLOR
LANGLADE
ST. CROIX
DUNN
CHIPPEWA
MENO-
MINEE
MARATHON
OCONTO
CLARK
PIERCE
EAU CLAIRE
SHAWANO
DOOR
PEPIN
PORTAGE
WAUPACA
BUFFALO
TREMPEALEAU
JACKSON
WOOD
OUTAGAMIE
BROWN
KEWAUNEE
ADAMS
WAUSHARA
WINNEBAGO
CALUMET
MANITOWOC
LA
CROSSE
MONROE
MARQUETTE
GREEN
LAKE
FOND DU LAC
SHE-
BOYGAN
VERNON
JUNEAU
COLUMBIA
DODGE
WASH-
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OZAUKEE
CRAWFORD
RICHLAND
SAUK
DANE
JEFFERSON
WAUKESHA
MILWAUKEE
IOWA
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ROCK
WALWORTH
RACINE
KENOSHA
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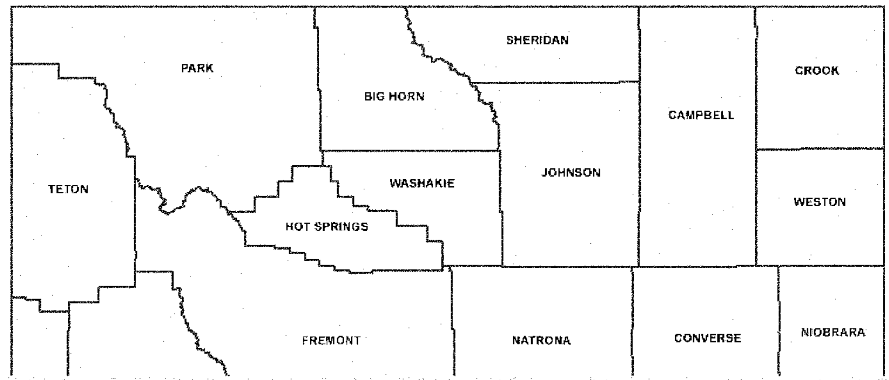
Wyoming


SHERIDAN
PARK
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BIG HORN
CAMPBELL
TETON
WASHAKIE
JOHNSON
WESTON
HOT SPRINGS
FREMONT
NATRONA
CONVERSE
NIOBRARA

Good morning.

Thank you for giving me this opportunity to share my thoughts on the Regulatory impact on community banks.

My name is Preston Pinkett III, President and CEO for City National Bancshares and its primary subsidiary, City National Bank of New Jersey. City National Bank is a $350 million African-American owned and operated bank headquartered in Newark, NJ. We operate 7 branches: 3 in Newark; 2 in New York City (Harlem and Brooklyn); 1 each in Paterson, NJ and Roosevelt, Long Island. At $350 million in assets, we are the 7th largest African American bank in the country. We are the only African American bank and the only regulated Community Development Financial Institution (CDFI) headquartered in NJ.

As a National Bank, our primary regulator is the Office of the Comptroller of the Currency (OCC). In addition, because of the holding company, we are also regulated by the Federal Reserve and of course the bank is also regulated by the FDIC. I have also been appointed to the OCC's newly formed Minority Depository Institutions Advisory Committee (MDIAC). The MDIAC was established by the OCC to advice on the condition of MDIs and what changes they can make to preserve minority institutions,

In addition, I serve on the Board of the National Bankers Association (NBA). The NBA is an eighty-five year old Association originally established to support African-American banks. Over the years, the Association has expanded its focus and today its membership is open to Hispanic- and Asian-owned Minority Depository Institutions (MDIs) as well as Women-owned institutions.

Two years ago, I accepted an assignment to turn-around this financially challenged institution. I accepted because of what I saw as the significance of Minority-owned financial institutions to our communities and society at large. Minority institutions not only service the under- or un-served consumer and small business owner providing them with capital to develop and prosper, but they also provide jobs in these communities that mainstream financial institutions have either overlooked or abandoned as "unprofitable". Without MDIs in a number of these communities, the residents and business owners would be forced to deal with un-regulated providers of financial services and potentially be victimized. Those that can least afford it, being forced to do without safe and affordable access to financial services...

During this time, I have had more than a few opportunities to interact with my regulators. I'd dare say, more than most, and, the first thing I'd like to make sure you understand is that we have very good relations with our regulators. We don't always agree, but we have found them to be committed and caring. Our common objective is to create a financially strong, secure and stable institution successfully implementing a business plan that addresses underserved markets has allowed us to find middle-ground on difficult issues. I too have heard the stories about regulators overreaching but have none to share. To a person, the employees and the leadership that we have interacted with have been sincerely interested in our success.

What I have heard from the regulators is that even though they know that Section 308 of FIRREA instructs them to "preserve and encourage minority ownership of depository institutions", they do not have explicit guidance on what that means nor the authority to adapt specific requirements of to recognize the unique (and often, quite different) circumstances MDIs face. It may be that the direction to "support" is just too vague an instruction for people whose day-to-day work requires that they follow very clear rules.

.... a few ideas or suggestions where guidance or authority from this body might allow those regulators, who like ours, already want to do more, to be able to do so and, for those that think there should be no difference in approach, clear guidance that you mean for Section 308 to be taken seriously and to encourage positive action in support of MDIs

Also, let me applaud this body for the work that you have done and continue to do to ensure that our financial system is at once safe and sound, and simultaneously, fair and responsible. Those of us in the MDI community, agree with the spirit of these actions to create access to financial services at reasonable cost. It is very much the reason why most of our institutions were formed.

Who could disagree with a desire to make consumer financial markets work for American consumers, honest businesses, and the economy as a whole? We are sure you are concerned about the threats from un-regulated financial service providers in many of our communities and hope that you continue to find a balance that protects the consumer as well as the banks that are committed to making only a fair return for quality products and services...including interchange fees and credit card interest rates and fees.

That's why we've been happy to see the degree of responsiveness, flexibility and even a willingness to listen to our concerns from a number of federal agencies. The members of the NBA have seen willingness by this administration to take our concerns seriously. We have had a level of access that indicates a genuine interest in our wellbeing. For that we all continue to be thankful.

That said, the industry and a number of the individual banks face very real and significant challenges, in fact, threats to their survival and your continued support is crucial.

In December, the FDIC released a survey that found that approximately 17 million (1 in 12) U.S. households are unbanked. The survey also found that 20% of households rely on un-regulated, alternative financial service providers. The rate of low-income consumers that are unbanked is more than 3 times that of middle- and upper-income. As I am sure you are aware, these statistics reflect the difficulty that lower-income and minority customers have in participating in the financial mainstream. These families are often forced into arrangements with alternative financial service providers which tend to have a greater negative effect on their financial wellbeing and reinforce a negative, downward spiral. If it's difficult to get a loan when needed and the consumer is forced to pay high fees and rates, it affects the consumer's ability to make other payments on time thereby driving down his/her credit rating and making it that much more difficult to obtain a loan in the future. This may, at least partially, explain why only 25% of African-Americans have a "prime" credit score.

Financing for minority-owned businesses is often provided by friends and family, however since the financial crisis this source as eroded significantly as net worth's have declined even more dramatically in minority communities. Today, the average net worth of an African-American household stands at approximately $6,000. In addition, business loans continue to be difficult to obtain for minority entrepreneurs, specifically African-Americans. The SBA has historically been a good source of assistance for those businesses that need an additional amount of credit support. However, after this latest economic downturn, the largest lenders have begun to retrench and the small loans that were once available are much more difficult to come by.

It is against this challenging backdrop that MDIs, like ours, seek to work. According to the FDIC information I have been able to obtain, there are 180 Minority Depository Institutions operating today. Of that 90 are Asian; 38 are Hispanic; and 30 are African American. In total 28% (51) of these MDIs are under $100 million in assets. Astonishingly enough, almost half of the African American banks are under $100 million causing the average size of an African American bank to be just about $115 million.

As you might imagine, managing an institution of that size in today's complex environment requires a great deal of creativity, grit and determination... and, we need support from this body, our regulators, and this administration.

Given all that I've said about the communities in which we work and the customers that rely on us for services, I'm sure you understand the pressure we face on earnings. Our low-wealth customer base needs institutions that provide education/information in addition to accounts and loans. Competition from the larger institutions (banks and credit unions) with technology, marketing and pricing advantages as well as unregulated check cashers and payday lenders, mean that MDIs earnings opportunities continue to be under pressure.

Given that, our ability to raise capital is also made significantly more difficult. Mainstream investors seeking high returns would have us alter our decades long focus on the most needy and like many other institutions focus on a wealthier and therefore, easier to service customer. The "Social Investors" that do exist and care about this market have found that non-profit (unregulated institutions) are easier to invest in. Their willingness to accept debt (they have no stockholders) and the relative ease with which debt payments can be made (they have no regulators) make these investments much more desirable. The institutions that it seems are perfectly positioned to support our efforts, the SBA's (Specialized) Small Business Investment Companies either have a prohibition against investing in banks or are only able to invest in Minority banks if they are under $100 million in assets. And, as we just discussed, those institutions would struggle to demonstrate viability due to the lack of scale.

The challenges associated with being regulated do not end with access to capital. In fact, the cost of meeting regulations, the time spent keeping abreast of changes to the regulations are up significantly. We understand that there is a need for increased efforts on this front, and only request that this body continues to recognize and encourage the regulators to keep in mind that the business of banking can't just be an exercise in meeting regulatory requirements. So please, as you think of the usefulness of the requirements also think about the financial impact of that compliance particularly on smaller Community institutions. In that vein, let me like so many before touch on those issues that concern us most.

Not only the requirement for additional amounts of common equity but also, the concern over the “quality” of the existing capital is issues that may adversely affect our institutions. If the types of securities that we've used in the past to raise long-term capital at reasonable rates are no longer going to count as Tier 1 capital, we will need not only time to adjust, but assistance in finding alternative types and even sources of capital to allow us to continue to have a stable and strong capital base.

In addition, we would hope this body would reconsider the proposed changes to the way "Risk-weighting" of assets and to the way unrealized gains and losses for "Available for Sale" securities are to be captured and reflected.

I guess my request is that this body continue to keep in mind the unique character of MDIs and work to ensure that these institutions are able able to continue to meet their mandate to improve opportunities for people and in communities that, otherwise, may be left behind.

As we look forward, I offer some additional ideas, suggestions and concerns that I think might be worth exploring in connection with stabilizing and growing the sector...

1. TARP redemption: The process to unwind TARP has begun with the Capital Purchase Program (CPP) and will eventually take place for the Community Development Capital Initiative (CDCI) recipients. Of course, we realize that Treasury has a mandate to recapture as much of their investment as possible, and we'd hope that the issue of "preserving" MDI status would continue to be part of the thinking as these investments get unwound.
2. Tax policy: Many of these institutions have Deferred Tax Assets due to significant losses that will be eliminated if there is a "change of control" with new capital. Today, change of control is defined as a change in ownership of more that 51%. If that definition could be altered to allow for a change in ownership as long as it doesn't change the mission of the MDI, the return on invested capital could increase

significantly for many institutions and possibly even attract investors that otherwise might turn away.

3. In as much as contributions made to non-profit CDFI are tax-deductible and we find ourselves in direct competition with these institutions for capital, we would request consideration of change in tax policy that creates some advantage for making an investment in MDIs. This could be as simple as allowing MDIs to qualify as operating businesses eligible for investment under the existing New Markets Tax Credit (NMTC) program administered by the CDFI Fund in Treasury.
4. Encourage the CDFI Fund to establish an allocation for MDIs so that the allocation competition is one in which they are compared against other like institutions. This would help offset the challenge a MDI faces when being compared to the larger more sophisticated regulated financial institutions or the more flexible unregulated non-profit CDFI.

In addition, let me add one last note of appreciation and support for your efforts to support community banks as evidenced by Financial Institutions Examination Fairness and Reform Act (FIEFRA) and Community Banks Serving Their Communities First Act (CFA).

I appreciate this opportunity to share our perspective and hope we can continue to work to ensure that Minority Depository Institutions are a thriving and successful sector that creates much needed opportunities for un- and under-served individuals and communities to live up to the American ideal.

Again, thank you.

Congress of the United States
Washington, DC 20515

February 19, 2013

The Hon. Ben Bernanke
Chairman
The Federal Reserve System
20th Street and Constitution Ave, NW
Washington, D.C. 20429

The Hon. Martin Gruenberg
Chairman
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, D.C. 20429

The Hon. Thomas Curry
Comptroller
Office of the Comptroller of the Currency
400 7th Street, SW
Washington, D.C. 20219

Dear Sirs:

We are writing to express our continued concern with the current approach to implementation of the Basel III capital requirements for U.S. financial institutions.

On November 29, 2012, representatives from your agencies testified at a joint hearing of the Financial Institutions and Consumer Credit Subcommittee and the Insurance, Housing, and Community Opportunity Subcommittee on the joint proposed rulemakings to implement Basel III. During the hearing, members of the subcommittees expressed near unanimous concern about the blanket application of the proposed rules to all financial institutions regardless of their asset size or business models. Members also received testimony from a diverse group of financial institutions that highlighted the significant consequences of your proposed rule for our financial system. We strongly encourage you to consider the concerns raised by members of the subcommittees as you finalize the proposed rules.

As many of the witnesses reinforced during the hearing, the Basel III capital requirements were designed for large banks that conduct business globally. We believe the application of these standards to regional and community banks could have a significant negative economic effect. Therefore, we urge you to tailor the capital requirements to ensure they are appropriate for the wide range of institutions that comprise our financial system

Unique among the world's developed countries, the United States is served by a large number of relatively small depository institutions. These institutions did not cause the financial crisis—rather they have continued to serve their communities in a prudent manner, and in many cases have played a critical role in the recovery of local economies. We are concerned that the compliance costs of implementing the Basel III framework will force many institutions that are not engaged in global banking to consolidate or go out of business altogether.

We are also concerned that the cost will ultimately be borne by consumers in the form of higher down payments and higher interest rates on residential mortgages. The Basel III standardized approach for risk-weighted assets could severely limit the types of mortgages smaller banking institutions can feasibly offer in their communities and hold in portfolio. Traditional community banking mortgage products that help lower-income consumers finance their homes will become scarcer and more expensive, as the regulatory capital needed to originate and hold these loans will increase substantially. This impact will be especially pronounced in underserved areas, in both rural towns and metropolitan neighborhoods across the nation, where smaller institutions are often the primary source of credit.

The diversity of lenders in this country has traditionally meant that consumers, small businesses, and other borrowers have many sources of credit from which to choose, adding to the resiliency of the U.S. economy. To maintain this valuable benefit, we urge you to tailor the new capital rules in way that is appropriate for the wide range of financial institutions that comprise our financial system and that reflects and preserves its diversity.

We thank you in advance for your consideration of this matter.

Sincerely,

Shelley Moore Capito

Rep. Shelley Moore Capito, M.C.

Carolyn B. Maloney

Rep. Carolyn Maloney, M.C.

1. *What financial regulations can community banks, regional banks and credit unions agree should be changed?*

There are a number of changes that can be made to existing regulations to ease the regulatory burden on all community-based financial institutuions. Good reforms should lift the burden on all community financial institutions, not shift it from one set of institutions to another. The following are a set of reforms that everyone can agree on, that would significantly lift the regulatory burden on all of our nation's community lenders.

- The financial services examination process can and should be improved. The Examination Fairness and Reform Act (H.R. 1553) provides a firm foundation to achieve this. This legislation is supported by community and regional banks, as well as, credit unions.
- Basel III should be reformed so that capital rules enhance rather than inhibit the role of community and mid-sized banks in the economy. The Basel III Case Act (S. 731) would require regulators to conduct a comprehensive study of the Basel III capital proposals impact before issuing any final rules.
- Mortgage rules should be simplified and consistent so that community banks are encouraged to make these loans rather than face compliance costs which could reduce their lending or force them to exit the market altogether. ABA supports efforts to reform these restrictive rules.
- Traditional banks should be exempt from registration requirements for municipal advisers. The Municipal Advisor Relief Act (S. 710) provides a framework to achieve this.

Enacting these bills would help to ease the enormous burden on banks of all sizes.

2. *Many community banks, regional banks and credit unions fear that the disproportionate impact of the ever-mounting regulatory burden is reducing their profitability and causing consolidation in the industry. What are the negative consequences of this consolidation, and how do they affect the local as well as national economy?*

Today, our diverse banking industry is made up of banks of all sizes and types, from small community banks to community-based regional banks, to large money center and global banks. This depth and breadth is required to meet the broad array of financial needs of our communities and customers. Our $16 trillion economy requires a large and diverse U.S. banking system.

Community banks make up 95 percent of all U.S. banking organizations and have been the backbone of all the Main Streets across America. Their presence in small towns and large cities everywhere means they have a personal stake in the economic growth, health, and vitality of nearly every community. A bank's presence is a symbol of hope, a vote of confidence in a town's future. When a bank sets down roots, communities thrive. The sad fact is that over the course of the last decade, 1,500 community banks have disappeared. Since the enactment of the Dodd-Frank Act, 475 are out of business. A further insult to the industry is there have been no new banks chartered the past two years.

Community banks, as do all banks, work hard every day to meet the credit and financial needs of their customers and communities. Community banks have a presence much greater than their total assets suggests. According to FDIC's Community Banking Study released in December 2012, community banks accounted for just 14 percent of the U.S. banking assets in our nation, but held 46 percent of all the small loans to businesses and farms made by FDIC-insured institutions. In 629 U.S. counties—or almost one-fifth of all U.S. counties—the only banking offices are operated by community banks. Without community banks, many rural areas, small towns and urban neighborhoods would have little or no physical access to mainstream banking services.

It is time to move from good intentions to actions that help to stem the tide of consolidation. Predominantly it is smaller banks that end up merging with the larger banks in order to compete. Bills like H.R. 1553 and S. 731 that make the regulatory process better and reform capital rules will help.

Responses from Charles Kim to Representative Posey's Questions

April 16, 2013 Hearing

For all witnesses:

1) What financial regulations can community banks, regional banks and credit unions agree should be changed?

It is hard to speak for other institutions and/or other types of institutions, but if you can go by previous positions held, the Durbin amendment would be a prime example of a regulation all groups opposed. Even when the carve out for smaller institutions was added, the small institutions still universally opposed the price fixing aspect of the bill as it is only a matter of time before the market squeezes their pricing, as well. It was not only opposed because of the price control aspects of the bill, but because it was an example of the federal government picking a winner in an issue between two business groups. It also had nothing at all to do with the financial meltdown and even if one thinks it was needed for punishment, the punishment was meted out to many parties that had no part in the meltdown and it totally missed all the investment banks who that have no retail banking business.

Based on what I hear in the industry, I also think most credit unions, community and regional banks all agree that pushing aspects of Basel III down below the systemically important institutions is a bad idea. The rules are needlessly complex and don't really apply to the business model that is common to the smaller banks and credit unions.

2) ...What are the negative consequences of this consolidation, and how do they affect the local and national economy?

Generally speaking, the consumer benefits from more versus fewer competitive providers of any product. The regulatory burden, among other things, is forcing commoditization of products and making banking an unattractive business in which to invest in and operate. If all banks sell the same products and are forced to spend significant sums on complying with federal regulations, the only banks that will survive are the ones large enough to have economies of scale and can spread the compliance costs across a larger employee and customer base. Serving small, rural communities is not the most profitable place to provide banking services. Because of that, you will see more large financial institutions leaving small, rural communities because they aren't profiting from serving them. If the community and regional banks that serve those communities go out of existence, there will be less credit extended to fuel growth and prosperity in those communities.

For Charles Kim specifically:

1. Is asset size the best way to differentiate between large and small banks?

    - No, asset size is not a good way to differentiate between large and small banks for the purpose of Basel III and Dodd-Frank. Business model is the best way differentiate banks. A regional or Super Community Bank like Commerce is very similar to small community banks except that it is present in a number of communities. The business model of a regional bank is more "main street" and consumer type business like a community bank versus the very large and systemically important Wall Street banks. Regional banks are not involved in investment banking, trading operations, derivative sales, complex international transactions or any of the more risky business lines in which the largest of banks are engaged. Many regional banks like Commerce avoided taking TARP and stayed out of the subprime mortgage business and other problematic business lines that plagued the larger banks. In fact, significantly more small community banks failed than banks in the $10 Billion to $50 Billion category like Commerce. The onerous capital requirements, burdensome stress testing and punitive regulations should not be directed at mid-sized banks any more than smaller community banks.

2. How important is regulatory relief for regional banks? In what ways are regional banks, like Commerce, similar to community banks and how do they differ?

    - Regulatory relief is of paramount importance to regional banks. After the economy, the biggest challenge faced by regional or Super Community Banks like Commerce is the ever continuing and growing amount of regulation. When I get together with my peers, I hear regulatory burden cited as the #1 or #2 problem facing them. Regulations keep us from directing resources to meeting our customer's needs with new innovative products, helping our communities grow, and in the end, raise the cost to consumers for banking services. It discourages bright new graduates from choosing banking and inhibits growth of new banks because of regulatory burden and inability to make returns that justify investors funding new or growing banks. The answer to question #1 speaks to the rest of this question.

3. What additional burdens do regional banks face even though they are not systemically significant, and what do you estimate are your bank's annual costs to comply with federal banking regulations?

    - The biggest cost to banks above $10B not faced by smaller banks is the price controls on debit purchases created by the Durbin Amendment to DFA. The cost of that regulation alone was $28MM to Commerce and it reduced our ability to make a profit on checking accounts requiring us to add fees and eliminate free checking which has forced some customers out of the banking system. Another costly aspect of DFA facing banks above $10B is stress testing. We are in our first round of stress testing and expect the cost to total well over $1MM initially and probably on an ongoing basis as we have to add expensive staff to perform complex modeling exercises in which we see little, if any business value. We now have yet another regulator to deal with in the CFPB and their approach thus far discourages innovation and will result in less credit and services available to the consumers they are tasked with protecting. Estimating the annual costs of complying with federal banking regulations is hard to calculate as those costs are imbedded in our operations. Looking broadly at specific costs of legal, compliance and IT staff devoted to regulatory compliance would approach $10MM annually.