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RISING REGULATORY COMPLIANCE COSTS AND THEIR IMPACT ON THE HEALTH OF SMALL FINANCIAL INSTITUTIONS

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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RISING REGULATORY COMPLIANCE COSTS AND THEIR IMPACT ON THE HEALTH OF SMALL FINANCIAL INSTITUTIONS

Wednesday, May 9, 2012

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 10:02 a.m., in room 2128, Rayburn House Office Building, Hon. Shelley Moore Capito [chairwoman of the subcommittee] presiding.

Members present: Representatives Capito, Renacci, Royce, Hensarling, Pearce, Luetkemeyer, Huizenga, Duffy, Canseco, Grimm, Fincher; Maloney, Watt, Baca, Scott, and Carney.

Ex officio present: Representative Bachus.

Chairwoman CAPITO. The hearing will come to order. Our understanding is that Ranking Member Maloney will be a little late, and she said to go ahead and start. So, I would like to welcome everybody.

Over the last 10 months, the Financial Institutions and Consumer Credit Subcommittee has held a series of field hearings across this Nation. Although the focus of each hearing differed, one common theme emerged, which was that the pressure on small institutions is growing across the country.

One of the most poignant comments I heard during these field hearings was from a community banker who said, "Every banker knows that they will eventually have to consider the option of selling their institution to an acquirer. Unfortunately, the current regulatory environment is forcing many bankers to make these decisions prematurely."

This morning's hearing will provide all members of the subcommittee with the opportunity to learn more about the growing regulatory burden facing small- and medium-sized financial institutions. We are not here this morning to deregulate the financial services industry. Rather, we are here to learn about the unique challenges faced by these institutions and the impact it has on the communities they serve. We must strike the appropriate regulatory balance, and we must pay attention to the cumulative effect of regulatory burden. Outdated and unnecessary rules should be removed as new rules are implemented.

This is not a partisan issue. Treasury Secretary Timothy Geithner echoed many of these concerns in an August 2010 speech:

"We will eliminate rules that did not work. Wherever possible, we will streamline and simplify." Unfortunately, little or no progress has been made on streamlining and simplifying, as many new rules and regulations are being implemented.

I have some serious concerns that the growing regulatory burden for small financial institutions will lead to further consolidation in the industry. Between 1990 and 2005, the percentage of banking assets held by the 10 largest banks grew from 10 percent to 55 percent. Small, rural communities in States like West Virginia depend on community banks and credit unions. There is little or no incentive for larger institutions to serve these communities. If we do not take the steps to ensure the future viability of small financial institutions, the very communities that they serve will be adversely affected. Small-town America cannot have a resurgence without the local community bank and credit union there to spur their economic growth.

I look forward to hearing from our witnesses, and I thank them. Their input will continue to help the subcommittee make informed decisions about the future of small financial institutions.

Mr. Scott, would you like to make an opening statement?

Mr. SCOTT. Sure, Madam Chairwoman. Thank you.

This is an important hearing, and it is one in which I take a particular interest because I think there comes a time when you really have to speak up for the smaller banks and credit unions, and the fact that one size does not fit all. I have said that many times in the committee.

While I am a strong supporter of Dodd-Frank, I am also a strong supporter of small financial institutions, because in so many communities, that is all they have. I think that we were smart to have exempted the smaller banks, I think below the $10 billion in total assets. And I led the fight on that, because the big problem that we ran into in terms of financial crisis was pretty much a fault of your larger financial institutions, not the small ones.

And so as we move forward, we have to, I think, dance with sort of a delicate balance here. I truly want to find the proper mix of regulation of the financial institutions, while at the same time finding the right balance for consumer protection.

The Dodd-Frank legislation was written and was mainly intended to protect consumers, and under a single regulator, in a way that levels the playing field so that it does not put a disproportionate hardship on community banks and credit unions. It was enacted while keeping in mind the burdens that many of our financial institutions already carry, particularly in our recovering economic climate. That is very important.

I represent a State, the State of Georgia, which has led the Nation and still leads the Nation in the failure of small community banks. A combination of two things happened there. There was overleveraging of their portfolios on real estate, but there was also a failure on our part to really provide the proper types of supervision, of bank examinations.

And so it is very important, as we look at Dodd-Frank and the Consumer Protection Bureau, we understand it is required to consult with the financial institutions so that we can get the proper

feedback from the smaller community banks on what effect the proposed rules would have on them, and small businesses, as well.

Currently, the CFPB is working to reduce the regulatory burden of the new guidelines by developing a more simple and efficient method for mortgage disclosures. And under Dodd-Frank, financial institutions are permitted to consider seasonal income when approving mortgage loans. That is very important. Therefore, this authorization allows further access to credit for those who gain income on a seasonal basis, which is very much true in my State and many other States across this country, instead of a more constant income flow throughout the year. This is what I mean by a delicate balance and being sensitive to the particularities of individual communities.

I believe that Dodd-Frank has already had a basically positive effect with small businesses and on small financial institutions. However, I look forward to learning more about its effects by questioning our expert witnesses this morning. And since our economy is still in recovery, this is an especially important and timely subject.

Madam Chairwoman, again, I appreciate you having this hearing, and I yield back.

Chairwoman CAPITO. I thank the gentleman.

I would like to recognize the chairman of the full Financial Services Committee, Chairman Bachus, for 3 minutes for an opening statement.

Chairman BACHUS. Thank you, Madam Chairwoman. And I appreciate the witnesses' attendance.

We are all confronted with a Dodd-Frank Act that was passed and signed into law 2 years ago that represents the most, I guess we call it ambitious, or most radical I would like to call it, changes in the regulation of financial institutions since the Great Depression.

And I would disagree with my colleagues that it has been a positive for community banks and even regional banks. I am not even sure how many of the rules apply, but it is probably 900 or 1,000 new rules. I noticed in the ICBA's testimony that they said the rules are too numerous to list, and I think that is absolutely true. It would take probably 3 days of one person listing the changes.

I know that these rules are not only imposed on the banks, but they are imposed on consumers and the economy as a whole. And I believe it is going to stifle economic growth and employment. So it is not only going to be bad for the banks, it is going to be bad for consumers and bad for the economy and, ultimately, bad for employment. And employment is really the number-one problem in this country, because you identify even more with your job than you do with homeownership. You never get to the dream of homeownership if you don't have a job.

All of us have heard time and time again from community banks and small business owners what these regulations mean. And, basically, they mean not only money, tremendous amounts of money, but your time and resources. Just the cost of data collection is astronomical. We are beginning to hear figures for small banks that one regulation alone is going to cost tens of thousands of dollars and will actually handicap them in making good loans. And, ulti-

mately, these costs are passed on to consumers and they divert private sector resources away from creating badly needed jobs.

As you all probably have followed, we have made some progress. In the JOBS Act, we relaxed the SEC regulations. We passed a bill that Mr. Duffy had on making the CFPB better organized. But there is a long way to go. And I know Mr. Luetkemeyer, being a community banker, has the Communities First Act. But we will continue to work on this.

And we know that every day, we find a new problem with Dodd-Frank, as far as the community banks. One of the things that you don't discuss a lot of times, but you are aware of, is the rule with municipal advisors, but that is just one of literally hundreds. So, we are going to do everything possible to get some of these regulations pared back and repeal them. And I look forward to hearing from the witnesses.

Thank you.

Chairwoman CAPITO. Thank you.

I now recognize Mr. Baca for 2 minutes for an opening statement.

Mr. BACA. I want to thank the chairwoman and the ranking member for calling this hearing today.

And I also want to thank the panelists for being here and offering their insights. We look forward to hearing your thoughts on this issue, so thank you very much for being here this morning.

As we continue to work our way through this recovery, it is important to remember the health—and I state, the health—and the well-being of community banks and credit unions is protected—is protected. Because I think everyone here will agree that these institutions had very little to do with the problems that caused the collapse—and I state, the collapse—of 2008, yet, they are still feeling the impact.

Over the past 2 years, I believe this subcommittee has examined the topic several times through a variety of different perspectives. I believe it is something that we have done a good job with, and I hope that we will be able to keep this practice going forward.

But, obviously, a lot is being made of the costs associated with implementation of Dodd-Frank. It is clear that the implementation of rulemaking procedures hasn't been the smoothest operation, as the Chair just indicated, and there is still some uncertainty about the costs going forward. But in the long run, it will be a savings and protection too, as well. I am proud of the work that has been done as far as Dodd-Frank, and I am quite certain that the costs of doing nothing in the wake of the economic collapse would have been much more tension than we have seen in the past.

Remember, former Federal Reserve Chairman Alan Greenspan said to trust them; they know what they are doing. We did trust them, but they didn't know what they were doing. That is why we needed the oversight and the accountability, and that is why we are where we are today.

It has been said before, when we look at regulations, that we shouldn't be focused on looking for overregulation. Instead, we need to focus on reforming bad regulations, and that is what we should be looking at, and the abuse. I think a discussion based around the facts is the best way that we can continue to rebuild our financial

sector into the vibrant and dynamic market it was before it collapsed.

Again, I want to thank the Chair and the ranking member. I yield back the balance of my time.

Chairwoman CAPITO. The gentleman yields back.

I would like to recognize Mr. Royce for 1½ minutes for an opening statement.

Mr. ROYCE. Thank you, Madam Chairwoman.

The observation I would just like to make here is that the consolidation toward larger and larger institutions increases the amount of systemic risk out there. If we want to look at one of the key factors that created and smashed the banking system of the United States, it was the Federal Reserve for 4 years in a row setting negative interest rates and creating an environment where everybody would go out and borrow against their homes and create that asset bubble, right? And you saw one-third of all transactions were people flipping homes. That is what happens when you do something like that, and we are now living with the consequences of it.

But in order to try to deal with those consequences, there are unforeseen consequences of passing millions of regulations. And the Dodd-Frank Act—I just want to talk for a minute about the impact that is having on community banks. We have about 7,000 community banks in this country. The compliance costs for medium-sized banks compared to large institutions is 2½ times the compliance costs for operating expense. And so, the consequence is they become less and less competitive.

And on top of that, you created this cost-of-capital advantage for the systemically risky institutions by the fact they were bailed out. I was against that, but many thought it was a wise thing to do. We are now living with the consequences, in the fact that their cost of capital is less than the community banks that they compete against. And as a consequence of that, they are gobbling up their smaller competitors, and, again, they are increasing their systemic risk to the entire system.

So at the end of the day, when you have a situation where for every employee who is helping a customer, you have 1.2 manhours spent on compliance, it is time to look again at Dodd-Frank and how we can adjust this.

Thank you, Madam Chairwoman.

Chairwoman CAPITO. Thank you.

I would like to recognize Ranking Member Maloney for as much time as she may consume.

Mrs. MALONEY. I thank the chairwoman for calling this hearing.

And I apologize to my colleagues. I had a doctor's appointment off the campus and was rushing back. And I regret that I was not here to hear the opening statements of my colleagues.

I want to, first of all, thank the witnesses who are here today.

This subcommittee has spent a great deal of time over the course of this Congress looking at the costs of regulatory compliance on small institutions. The implication is that all of this new regulation, including, I might add, the credit card bill which I authored, is costing financial institutions too much and that the benefit is not outweighing that cost.

And while I do think it is the role of this subcommittee to consider the costs to financial institutions of regulations and to always make sure that they are fair and appropriate, it is also critically important to examine the costs to consumers and to the overall economy of underregulation.

After the Great Depression, we enacted three critical reforms that gave this country 70 years of financial growth and prosperity: we created the SEC; we created the FDIC; and we enacted Glass-Steagall. These three reforms were viewed as regulatory burdens at the time, but it was only when we started rolling back these regulations, allowing unregulated areas to stay unregulated, and literally moving areas of regulation, particularly in derivatives on open exchanges off the exchanges, that we got into trouble.

One of my most memorable days was when President Obama came to my district right after Dodd-Frank had passed the Senate. Many people were concerned. And he read this—I want to read what is in The New York Times. And he said the bankers were upset. They were thinking that this was going to cause havoc in the industry. And then he said—in 1932, right after they had enacted the FDIC, the SEC, and Glass-Steagall, which, by all accounts, have given us prosperity and growth in our country.

Now, I am sympathetic to the cost of regulatory compliance. But laws like the Credit CARD Act have saved consumers as much as $10 billion, according to the Pew Foundation report, in the first year it was enacted. And when we passed the CARD Act—because there were many identified abuses that needed to be stamped out, abuses like anytime, any reason, over-the-limit penalty fees, billing gimmicks. These abuses kept the marketplace from functioning properly.

Consumer complaints about credit cards flooded my office and the Federal Reserve. They got over 60,000 complaints on it. So, we implemented reforms to address these complaints in a way that was balanced, that would allow the marketplace to function more competitively.

I might add that many institutions implemented the gold standard of the bill voluntarily, and then they were disadvantaged to other competitors. So it leveled the playing field for institutions and, I would say, gave consumers more tools to manage their credit.

And in Dodd-Frank, we also took great care to minimize the compliance burden on small institutions. As far as the CFPB is concerned, for the first time there will be oversight of the shadow banking industry, those areas that were not regulated, which is a principal focus of the Bureau that does not affect financial institutions. In the area of the Deposit Insurance Fund (DIF), Dodd-Frank changes the formula for deposit insurance assessments so community banks will pay significantly less in premiums. And only the larger institutions will be required to help shore up the DIF, which will help provide a better cushion that will help banks of all sizes. And, finally, we made the $250,000 deposit insurance limit permanent.

So while I am sympathetic to regulatory burdens and cost of compliance, I am also mindful of the cost of not implementing regulations, of deregulation. And we have to remember that during this

crisis, our economy lost over $17 trillion in household wealth, which all economists and all analysts said could have been prevented with better financial regulation.

I want to make sure as the months and years pass since the fall of 2008, that we don't forget how close we came to an economic collapse. We needed these reforms, and I am hopeful that these reforms will give us the same type of prosperity that the reforms after the Great Depression gave this country.

Again, I thank the panel, and I thank my colleagues, and I yield back. Thank you.

Chairwoman CAPITO. Thank you very much.

I would like to recognize Mr. Duffy for 1 minute for an opening statement.

Mr. DUFFY. I thank the Chair for having this hearing, and I appreciate the witnesses taking the time to attend.

I am curious to hear from the witnesses as to whether your testimony is going to be consistent with what I hear back in central and northern Wisconsin, where we have a lot of small banks and credit unions who talk about just the cost of compliance with all these new rules and regulations and what it is doing to them with their ability to get dollars out the door to Main Street America, which is the lifeblood of growth in our economy. And I am curious to hear if you all have the same philosophy that I am hearing back at home.

But also, we are hearing a lot about the unintended consequences of Dodd-Frank from the new rules and regulations, the consolidation that is taking place. But at one point, when I sit back, I wonder, was this really intended, to see this consolidation of our small banks? Maybe it is easier to regulate our small banks and credit unions if there is consolidation. And I have to tell you, when I see that, when I hear about that, that does not benefit rural America, small-town America. It actually, I think, makes it more difficult for our businesses and our communities to grow with this continued consolidation.

And one of my concerns is, as we are going to hear the testimony about the concerns with regard to the new rules and regulations, there are some, with the overwhelming evidence that has come out, who turn a deaf ear to the problems that our small banks and credit unions are facing.

I look forward to the testimony of the panel, and I yield back.

Chairwoman CAPITO. Thank you.

Our final opening statement is Mr. Canseco for 1½ minutes.

Mr. CANSECO. Thank you, Madam Chairwoman, and thank you for holding this very important hearing.

Back in March, this subcommittee held a hearing in San Antonio to examine the challenges facing community financial institutions throughout Texas. One of the witnesses at the hearing, a community banker from El Paso, summed it up best. He explained that in his previous life as an Army commander of a top-performing nuclear combat outfit, he felt that his crew, which had the capacity and firepower to trigger the end of the world, operated with greater discretion and wasn't nearly as micromanaged as his loan officers in El Paso now are as they extend credit to families and businesses in west Texas.

I guess you can say we are officially living in a Dodd-Frank world. Despite all the assurances we have heard that Dodd-Frank will not impact small lenders, every day we are reminded that is simply not the case.

Thank you, and thank you for holding this hearing. And I look forward to hearing from the witnesses.

Chairwoman CAPITO. Thank you.

And that concludes our opening statements.

I would like to recognize each witness for the purpose of making a 5-minute opening statement.

I will first recognize Mr. William Grant, who is chairman, president, and chief executive officer of First United Bank and Trust. And I would like to thank him for wearing the West Virginia tie for me.

STATEMENT OF WILLIAM B. GRANT, CHAIRMAN, PRESIDENT, AND CHIEF EXECUTIVE OFFICER, FIRST UNITED BANK AND TRUST, ON BEHALF OF THE AMERICAN BANKERS ASSOCIATION (ABA)

Mr. GRANT. Thank you very much. Chairwoman Capito, Ranking Member Maloney, and members of the subcommittee, my name is William Grant. I am chairman, president, and CEO of First United Bank and Trust.

My bank is a community bank serving four counties in Maryland and four counties in West Virginia. For decades, and in my bank's case for more than a century, community banks have been the backbone of all the Main Streets across America. We have a personal stake in the economic growth, health, and vitality of nearly all communities.

Unfortunately, the cumulative impact of years of new regulations is taking its toll. While community banks pride themselves on being flexible and meeting any challenge, there is a tipping point beyond which community banks will find it impossible to compete. Over the last decade, the regulatory burden has multiplied tenfold, and, not surprisingly, more than 1,500 community banks have disappeared.

As a banker, I feel like Mickey Mouse as the sorcerer's apprentice in Disney's famous cartoon film "Fantasia." Just like Mickey, with bucket after bucket of water drowning him, new rules, regulations, guidances, and requirements flood into my bank, page after page and ream after ream. With Dodd-Frank alone, there are over 7,500 pages of proposed and final regulations, and we are only a quarter of the way through the 400-plus rules that have to be promulgated.

For my community bank, we very conservatively estimate nearly $2.5 million in hard dollar compliance costs per year and expect that Dodd-Frank will add another $275,000. As a billion-dollar bank, I am able to spread some of those compliance costs. That is not possible for the medium-sized bank of only $166 million with 38 employees.

At a meeting of community bankers just this week, I heard the same story over and over. Many believe that their compliance costs will increase 75 to 100 percent over the next 2 years as they add new staff, hire outside help, train employees, modify systems,

change reporting, and undergo new audits for compliance. For the industry, we believe the compliance costs conservatively exceed $50 billion each year. Even a small reduction in the cost of compliance would free up billions of dollars that could facilitate loans and other banking services.

The direct costs are just part of the story. Instead of money facilitating loans to hardworking people, it is being spent on consultants, lawyers, and auditors. Instead of investing in new products to meet the ever-changing demands of our customers, banks are paying for the changes to compliance software. Instead of our staff teaching children financial literacy in classrooms, my staff is learning about new regulations. Excessive regulation saps staff and resources that should have gone to meeting the needs of our customers.

Before concluding, let me give you two examples of the problem we face.

Many banks are being targeted by enterprising lawyers for not having vigilantly maintained paper signage on our ATMs. Our bank employees have to run around to all of our ATMs to ensure that stickers have not been removed by vandals. That is why ABA supports H.R. 4367, introduced by Representatives Luetkemeyer and Scott. And we appreciate that.

Second, potential legal risks are magnified in Dodd-Frank and may force some banks out of some lines of business. At my bank, we used to offer mobile home financing loans, but no more, due in part to the very large legal risk and cost of refuting unfounded predatory lending lawsuits. Now, people in our rural area have one less option for mobile home financing.

And this story may be about to repeat itself in the entire mortgage market area. Dodd-Frank requires lenders to show that borrowers meet an ability-to-repay test, which can be challenged in court for the entire life of the loan. The legal risk is enormous. Without a full safe harbor, banks will be forced to make loans well within the boundaries of the rule to limit litigation risk. Mortgage credit will contract, and many creditworthy borrowers will see their hopes of homeownership vanish.

Again, bankers this week told me that they are considering ceasing their mortgage lending activities. This would be a chilling consequence of a misguided regulation.

The consequences of excessive regulation are real. It makes it much harder to serve our customers and our communities, and it means a weaker economy and slower job growth.

Thank you.

[The prepared statement of Mr. Grant can be found on page 49 of the appendix.]

Chairwoman CAPITO. Thank you.

Our next witness is Mr. Ed Templeton, president and chief executive officer, SRP Federal Credit Union.

Welcome, Mr. Templeton.

STATEMENT OF ED TEMPLETON, PRESIDENT AND CHIEF EXECUTIVE OFFICER, SRP FEDERAL CREDIT UNION, ON BEHALF OF THE NATIONAL ASSOCIATION OF FEDERAL CREDIT UNIONS (NAFCU)

Mr. TEMPLETON. Good morning, Chairwoman Capito, Ranking Member Maloney, and members of the subcommittee. My name is Ed Templeton, and I am here to testify today on behalf of the National Association of Federal Credit Unions. Thank you for holding this important hearing. We appreciate the opportunity to share our views of the impact that rising regulatory compliance costs have on credit unions and their member owners. Today's hearing could not be more timely or more important to our Nation's credit unions.

While the focus of today's hearing is on small institutions, all credit unions are feeling the impact of increased regulatory burden. Last year, NAFCU surveyed its membership regarding regulatory burden; 96 percent of the survey respondents said their credit union spent more time on it in 2010 than they did in 2008, and they expect the trend to continue. Respondents went on to say that about one-seventh of their total staff time was devoted to working on compliance issues.

My credit union is experiencing the same thing, as we recently doubled our compliance officers from one to two. Additionally, my staff and I spend much more time today focused on compliance issues than we did just a few short years ago.

My written testimony outlines how the Dodd-Frank Act is creating new challenges and uncertainties for credit unions. The mandate of the new CFPB could lead to an overwhelming tide of new compliance burdens. It will be incumbent upon the Bureau and on Congress to ensure that the CFPB also meets its goal of streamlining regulation and protecting small entities in every action that it takes. If the CFPB and other regulators do not do this in a timely and effective manner, Congress must step in. Amending or eliminating outdated regulations must be a priority.

One of our biggest concerns is that the Dodd-Frank Act mandated regulation be finalized so quickly and so often that community-based financial institutions simply won't be able to comply. JPMorgan Chase has estimated that 3,000 employees will be devoted to keeping pace with regulatory change. While my credit union will be subject to a number of the same regulations, I have only two people devoted to this task, and I just hope we can keep up.

One of the most immediate impacts on my credit union from the Dodd-Frank Act has been the debit card interchange provision. While my credit union was supposed to be unaffected by this provision, that has not been the case. We have seen our debit card interchange rate drop by almost 2 cents per transaction since its enactment.

While you hear reports that small institutions have not been affected by these rules, my credit union has, and it is facing lost revenue to the tune of about $300,000 a year. And we are seriously concerned about the future. To put this into a personal perspective, that $300,000 could mean the loss of 10 jobs at my credit union. Further, in order to comply with the new routing requirements

stemming from the regulation, we had to replace hundreds of plastic cards at a cost of over $2 each.

Challenges for credit unions come not only from Dodd-Frank and the CFPB but also from the National Credit Union Administration. While the government-wide review of regulation appears to be a step in the right direction, it will be up to the NCUA and other agencies to ensure that real changes are made and not just given lip service.

Finally, regulatory burden also comes from a number of outdated laws on the books. We hope Congress will take steps to pass legislation that will help relieve some of these heavy burdens, including: H.R. 3467, which would remove an outdated and redundant ATM disclosure fee requirement; H.R. 3461, which would improve the exam process for credit unions; and H.R. 3010, which would modernize the Administrative Procedures Act.

In conclusion, the greatest challenge facing credit unions is the cumulative effect of a rapidly growing regulatory burden. While one single regulation may not be particularly burdensome, the cascading of new regulation on top of old regulation is completely overwhelming to small institutions. We hope that agencies will consider how any one proposed change to a regulation may impact the total compliance burden from all regulations.

Every dollar spent on compliance is a dollar that could have been spent to create jobs and provide additional services. NAFCU urges the committee to move forward with legislation that will provide regulatory relief from outdated laws and regulations for credit unions. We thank you for your time and the opportunity to testify before you today on these important issues to credit unions and, ultimately, our Nation, and welcome any questions you may have.

[The prepared statement of Mr. Templeton can be found on page 68 of the appendix.]

Chairwoman CAPITO. Thank you.

Our next witness is a fellow West Virginian, and I want to welcome Sam Vallandingham here from Barboursville. He is senior vice president and chief information officer for the First State Bank.

Welcome, Sam.

STATEMENT OF SAMUEL A. VALLANDINGHAM, SENIOR VICE PRESIDENT AND CHIEF INFORMATION OFFICER, THE FIRST STATE BANK, ON BEHALF OF THE INDEPENDENT COMMUNITY BANKERS OF AMERICA (ICBA)

Mr. VALLANDINGHAM. Thank you, and good morning.

Chairwoman Capito, Ranking Member Maloney, and members of the subcommittee, I am Samuel Vallandingham, senior vice president and chief information officer of The First State Bank, a $288 million community bank in Barboursville, West Virginia. I am pleased to be here to represent the nearly 5,000 members of the Independent Community Bankers of America at today's hearing.

A surge of new financial regulation has changed the nature of my job and the community banking industry in recent years. The problem, which is already straining our ability to serve customers, only stands to get worse and potentially drive further industry consoli-

dation. We appreciate your raising the profile of this critical issue and hope that you will advance needed legislative solutions.

Our written testimony contains detailed data on compliance expenses incurred by The First State Bank since 2008. Let me just share with you a few discrete examples that illustrate an alarming trend. I am currently spending as much as 80 percent of my working time on compliance-related issues, compared to approximately 20 percent as little as 3 years ago. We have documented 921 compliance changes from a spectrum of agencies implemented since 2008. While not all of these apply to my bank, we have to evaluate each one and determine its impact. In 2011 alone, Fannie Mae and Freddie Mac implemented 36 origination and 59 servicing rule changes. In mortgage servicing alone, we have gone from 1 collector to 3½, and have incurred nearly $100,000 in incremental payroll expenses as a result of new compliance standards, not as a result of higher delinquencies. Webinar training expenses in the first 4 months of 2012 are already double what they were in all of 2008. Other significant expenses include legal and audit fees, software upgrades, and in-house training.

Every dollar spent on compliance is one that I can't invest in my community. Every hour I spend on compliance is an hour I could be spending with small business customers, acquiring new deposits and making new loans, doing the work that won The First State Bank SBA Lender of the Year in 2001 and SBA Community Bank of the Year in 4 consecutive years. Compliance is almost all I do now. Many days, I feel like I am not a banker anymore.

As expensive and wasteful as the current regulatory environment is, we only expect it to get worse in the future. The Dodd-Frank Act, which is only beginning to be implemented, is a source of particular concern. The most troubling provisions of the Dodd-Frank Act include new mortgage lending requirements that run the very serious risk of accelerating industry consolidation. The result would be higher costs and fewer choices for consumers, particularly in small communities.

New CFPB rules are another source of risk. The CFPB must not contribute to our already daunting regulatory burden. It should use its authority to grant broad relief to community banks where appropriate. ICBA also strongly supports legislation passed by this committee and the House, H.R. 1315, to reform the CFPB to make it more balanced and accountable in its governance and rule-writing.

ICBA is very pleased that this committee has recognized the scope and severity of the problem of excessive regulation. In addition to passing H.R. 1315, you are considering a number of bills to provide relief. The most helpful pieces of legislation include H.R. 3461, the Financial Institutions Examination Fairness and Reform Act, which will go a long way toward improving the oppressive examination environment—a priority concern of community bankers and a barrier to economic recovery. We are grateful to Chairwoman Capito for introducing this legislation.

Also, H.R. 1697, the Communities First Act, addresses many of the regulatory concerns highlighted in this testimony. Sponsored by Representative Blaine Luetkemeyer, the Act has over 90 cosponsors from both parties and the strong support of 37 State banking

associations. ICBA is grateful to this committee for convening a hearing on CFA at which our chairman had the opportunity to testify.

Regulatory relief is a key community bank priority, and we are grateful to this committee for focusing on this topic today. I urge the committee to also consider a topic of equivalent interest to community banks: the need for a temporary extension of the FDIC's TAG program. Extending TAG would serve the same goals as I have stressed in this testimony: preserving community bank viability; supporting small business credit; and deterring further industry consolidation.

Thank you for the opportunity to testify today. I hope that my testimony, while not exhaustive, gives you a sense of what is at stake for the future of community banks and the customers we serve. We look forward to working with this committee to craft urgently needed legislative solutions.

Thank you, and I look forward to taking your questions.

[The prepared statement of Mr. Vallandingham can be found on page 97 of the appendix.]

Chairwoman CAPITO. Thank you.

Our next witness is Mr. Terry West, president and chief executive officer, Vystar Credit Union.

Welcome.

STATEMENT OF TERRY WEST, PRESIDENT AND CHIEF EXECUTIVE OFFICER, VYSTAR CREDIT UNION, ON BEHALF OF THE CREDIT UNION NATIONAL ASSOCIATION (CUNA)

Mr. WEST. Thank you. Chairwoman Capito, Ranking Member Maloney, and members of the subcommittee, thank you for this opportunity to testify at today's hearing.

I also could probably repeat what I just heard from those gentlemen. As you are aware, credit unions face a crisis of creeping complexity with respect to regulatory burden. This means that more time and resources are spent complying with ever-changing regulation, with less time and fewer resources being put to use for the benefit of our members. Because of our not-for-profit cooperative structure, the cost of complying with regulation is entirely borne by our membership, who own the credit union.

Over the last several years, our compliance costs have increased significantly because of the high number of new and revised regulations we continue to be subjected to. In addition, the complexity of the requirements imposed by the ever-changing regulations is simply staggering. My written statement includes a list of almost 130 regulations, and this is just a small portion which have either been finalized, amended, or revised again since 2008. That is almost one every other week. The aggregate impact is overwhelming.

And there are other areas that impact us as well. Just obtaining permits for a new building for an ATM or a building, and with it comes compliance requirements. So the Federal regulators are not just the ones that are doing compliance burden; local and State regulators are imposing it, as well.

The latest surge of regulatory changes largely responds to the financial crisis. It was the actions of larger institutions and nonbank financial institutions which created the need for this regulation.

Credit unions were not a source of the problem; however, they continue to be disproportionately harmed by the resulting compliance burden. Most of the costs of compliance do not vary by size and, therefore, proportionately are a much greater burden for smaller versus larger institutions. Consolidation in credit unions is about 300 a year. Most of them say the primary cause is compliance burden.

When a rule is finalized or amended, employee and credit union resources must be used to determine how to comply with the change. Forms and disclosures must be changed. Data processing systems must be reprogrammed. Employees must be trained and often retrained. Credit union members need to be informed, sometimes causing them frustration and confusion.

For those rules which are proposed, we have to spend resources determining how we would comply with a regulation even if it is not finalized in order to be prepared for sometimes extremely short implementation timelines. I received one yesterday. We have until September to put it in place.

A recent and frustrating trend has been when regulators decide to revise or significantly alter a particular rule immediately after it has been finalized and other regulatory changes have just been implemented. This means that resources credit unions expend to comply with the first regulatory change are lost, and now additional resources must be expended to comply with the new change. Continuing an open dialogue with the credit union industry prior to a rule being created or finalized would hopefully eliminate some of this change and help constitute and reduce some of the most significant compliance costs.

In recent years, one example where credit unions have had to make major overhauls to their products and services because of regulatory change is credit card disclosures. As described in my written testimony, credit unions and other card issuers have been through several regulatory changes in this area in the last 3 years, producing understandable confusion and questions for members as well as credit union employees.

Now, after multiple changes, the CFPB is talking about changing them again. Even minor changes will require new forms, and reprogramming by multiple vendors. This takes time and resources. Credit unions need ample time to implement these changes.

There is no end in sight. The best way I could call it is: always increasing, never decreasing. As far as we know, there has been no effort to examine the cumulative effect of regulatory burden on credit unions, despite the high volume of changes over the past few years and the equally daunting volume of anticipated changes in coming years. We have encouraged our prudential regulator to take into consideration the cumulative impact on regulations for credit unions, but we have been told there is nothing they can do about regulations other agencies impose. If every regulator takes this approach, who has the responsibility to reduce it?

We encourage the subcommittee to use its authority to provide meaningful relief in this area for all credit unions. The CFPB was granted the authority by Congress to exempt classes of entities from its rules to help address the disparity in compliance burden. The Bureau is supposed to take into consideration the impact of its

regulations on small credit unions and banks, as well as review its regulations and address those which are outdated, unnecessary, and unduly burdensome.

Chairwoman Capito, we encourage the subcommittee to closely monitor the rules the CFPB considers and urge the Bureau to exercise those authorities to the fullest extent by statute. Credit unions work every day to service the needs of over 95 million members.

Now emerging from the financial crisis, we face a regulatory burden crisis that, if continued, can weaken our ability to provide high-quality, low-cost financial services and products to our members. Because of our structure, costs are borne by the credit union member-owners. We appreciate the attention you have given to this and urge Congress to encourage the CFPB to use its authority to minimize or eliminate these regulations on small institutions.

And I would be happy to respond to any questions. Thank you.

[The prepared statement of Mr. West can be found on page 107 of the appendix.]

Chairwoman CAPITO. Thank you.

Our next witness is Mr. Adam Levitin, professor of law, Georgetown University Law Center.

Welcome.

STATEMENT OF ADAM J. LEVITIN, PROFESSOR OF LAW, GEORGETOWN UNIVERSITY LAW CENTER

Mr. LEVITIN. Good morning, Chairwoman Capito, Ranking Member Maloney, and members of the subcommittee. My name is Adam Levitin, and I am a professor of law at Georgetown University, where I teach courses in financial regulation.

Today, there are almost 15,000 banks and credit unions in the United States. All but 88 of them are community banks or credit unions, meaning they have less than $10 billion in assets. Those 88 megabanks, however, have just shy of 80 percent of all the assets in the United States banking system. Put another way, less than 1 percent of the banks have four-fifths of the assets. The community banks are the "99 percent" of the banking world.

This was not always the case. A decade ago, the megabanks held two-thirds of the assets in the banking system. Twenty years ago, they held but one-third of the assets. As community banks' share of assets has declined, so, too, have the number of community banks. Over the past 2 decades, nearly 13,000 banks and credit unions have simply disappeared. Almost all of that decline has been from small institutions with less than $100 million in assets.

Community banks and credit unions have been steadily losing ground for well over 2 decades, much of which was during an extended period of financial deregulation. This is a shame because smaller community-based depositories have a long and proud history in American banking. They are the centerpiece of lending to local small business. They often provide fairer and simpler products to consumers. And for rural communities in particular, they are often the only provider of financial services.

Small banks face three fundamental business model problems, none of which have anything to do with overregulation. Therefore, changing regulations on the margin is unlikely to change the fundamental position of community banks.

The first problem community banks face is that they lack economies of scale that large banks have. This is a particular disadvantage in areas that can be highly automated, such as credit card lending. Thus, less than half of community banks issue credit cards—half of banks in general issue credit cards, and around 90 percent of card issuance is done by the largest 10 banks.

Second, community banks generally lack the geographic reach of megabanks. This limits their ability to diversify their deposit base and their lending portfolios and to attract customers. Customers who travel or relocate frequently place a premium on having better branch and ATM network coverage.

Third, as Mr. Royce noted, community banks have a cost-of-funding disadvantage relative to megabanks. Megabanks are able to access cheaper funding because they have the scale of operations to access capital markets via securitization, and because they are able to get a too-big-to-fail discount from their creditors. Investors don't demand as high a return from banks they think are likely to get bailed out. Cheaper debt enables megabanks to operate with greater leverage and, thus, generate higher returns on equity. On top of this, community banks frequently do not offer as broad a range of products or services as megabanks.

I mention these structural problems in the community banking business model because it is important not to lose perspective. Focusing on community banks' regulatory burdens is nibbling around the edges. It will not change the fundamental position of the community banking business. The type of regulatory relief being sought by community banks is simply not going to be a game changer.

If Congress truly wishes to reverse the decline of community banks, there is a clear path for doing so: Eliminate "too-big-to-fail." Force the megabanks to slim down. Once we do that, community banks will be viable as an industry.

The other point I wish to make this morning is that it is critical to pinpoint which regulations we are talking about. It is important to be precise about this rather than blasting regulation as a general concept.

Let me emphasize that almost none of the increased regulatory burdens to date on community banks have anything to do with the Dodd-Frank Act or the CFPB. While the Dodd-Frank Act has become the flagship of financial regulatory reform, most of its provisions have little or no bearing on small banks. Derivatives regulation is really not a small-bank issue, for example.

Of the few provisions that do bear on small banks, many of them have not yet gone into effect, so they cannot be blamed for small banks' travails. Moreover, virtually all of the CFPB rulemakings in progress could have been undertaken before Dodd-Frank by Federal bank regulators. And had that been done, they would have occurred without CFPB's required small-business impact review.

Finally, it bears emphasis that a few Dodd-Frank Act provisions are actually quite beneficial to small banks, including some that are likely to reduce their regulatory burdens. First, the creation of the CFPB levels the regulatory playing field between small banks and nonbanks in the consumer finance space. This means that everyone is going to be playing by the same rules. Second, Dodd-

Frank has given the CFPB authority to exempt classes of financial institutions from some of its rules. We will see if the CFPB exercises that authority.

Third, the CFPB has shown from its very beginning a deep commitment to be cognizant of the concerns of small depositories. The CFPB rulemakings on things like mortgage lending disclosures are going to help reduce regulatory burdens for small banks by streamlining paperwork.

Finally, the Durbin Interchange Amendment is the single best piece of legislation for community banks in the past 2 decades. The Durbin Amendment regulates debit card interchange fees but only for depositories with more than $10 billion in assets. What has resulted has been two-tiered pricing: one set of fees for big banks; and a higher set for small banks. This helps offset the small banks' disadvantages from lacking economies of scale.

There are real regulatory burdens on small banks that can be reduced: the ATM signage requirement that was mentioned before; or the annual Gramm-Leach-Bliley privacy notices. But these are targeted, small-bore reforms. The longstanding business model problem with community banks should not serve as cover for a broader agenda of financial deregulation.

Thank you.

[The prepared statement of Professor Levitin can be found on page 60 of the appendix.]

Chairwoman CAPITO. Thank you.

Our final witness is Mr. Mike Calhoun, president of the Center for Responsible Lending.

Welcome.

STATEMENT OF MICHAEL CALHOUN, PRESIDENT, CENTER FOR RESPONSIBLE LENDING (CRL)

Mr. CALHOUN. Thank you, Chairwoman Capito, Ranking Member Maloney, and members of the subcommittee. I appreciate the opportunity to address the issue of regulatory burdens on community financial institutions and what we can do to reduce it.

CRL is the policy affiliate of Self-Help, which is a community lender offering retail banking services, mortgage loans, small business loans, and community facility loans. While Self-Help is relatively small, it has an impact like other community lenders. It is, for example, the largest SBA lender in North Carolina as well as the largest charter school lender in North Carolina.

I have previously served as general counsel for Self-Help, as well as heading up our business lending and secondary market programs, so I have had a firsthand view of the regulatory challenges that small lenders face. I also saw Self-Help lose most of its mortgage business to the deceptive products that dominated lending leading up to the housing crisis. And I have seen the severe impact of that crisis on all depository institutions, especially small ones.

As shown by CRL's research, effective consumer protection and financial stability are two sides of the same coin. Our report issued just this week on credit card companies found that those companies that engaged in the most abusive practices faced the largest increases in losses during the recession, including a number of them

going out of business. We observed similar results with mortgage lenders.

There are four steps that I will outline today that regulators can take to implement protections to increase effectiveness and reduce regulatory burden.

The first is one of the most important regulations that is pending, the definition of Qualified Mortgages (QM), which will largely define the scope of lending. It is critical that there be bright-line standards that set up a broad QM market. This will give lenders both the certainty that they need to make sure that they are originating a QM loan and the ability to provide broad access to credit.

This type of standard, though, is necessarily tied with a rebuttable presumption rather than an absolute immunity for QM loans, and let me explain why. Bright-line, broad QM standards will necessarily permit some unaffordable loans to be included within that standard. For example, the primary tool that regulators will likely use is the so-called debt-to-income ratio, what percentage of a borrower's income is going to pay their mortgage and other debts. For example, a typical figure used is 43 percent. However, for borrowers on smaller incomes or those who have high debts, such as medical expenses, a 43 percent loan, or 43 percent of their income—and that is before taxes—goes to mortgage and other debt would be unaffordable. Without a rebuttable presumption, the only alternative is you have to have much tighter qualified mortgage standards, which would in turn unnecessarily cut off the credit that our economy needs.

CRL and Self-Help have worked at the State and Federal level on mortgage regulations for over 15 years. It was predicted that many of those would cause floods of regulation and floods of litigation. None of them did, including the signature North Carolina law passed in 1999, which has far stronger remedies and far stronger assignee liability than the QM ability to repay rules do.

Let me move onto the other recommendations. The second one is related to QM, and that deals with the Qualified Residential Mortgage (QRM). And to us, the clear path there is that they should make those the same definition so there is one set of standards to apply. That would greatly simplify compliance while still providing the necessary safeguards against reckless lending.

Third, the regulators should continue their focus on nondepository lenders. In the mortgage market, these lenders led the race to the bottom during the crisis and had regulatory advantages over the depository lenders. These lenders generally need to be subject to oversight so they do not unfairly compete against small community lenders and do not provide unfair products.

And finally, we need to look for ways to make regulations more efficient where possible. One example recently was just with the Bank Secrecy Act providing for electronic filing of reports, where that greatly increased the efficiency.

In closing, the regulatory burden to small financial institutions means that rules should be clear and efficient. At the same time, though, we must remember that the greatest damage to small institutions came from the lack of oversight of lending practices that led to the housing crisis and the economic collapse and created an

unlevel playing field for community depository institutions. In sum, our rules must also be effective and apply to all lenders.

I thank you, and I look forward to your questions.

[The prepared statement of Mr. Calhoun can be found on page 42 of the appendix.]

Chairwoman CAPITO. Thank you.

I would like to thank all of the witnesses.

We will proceed with 5 minutes of questioning for each Member, and I will begin with mine.

I think you have all testified that there is obviously an increased regulatory burden with Dodd-Frank as we moved through the last several years. In my opening statement, I mentioned that Secretary Geithner had expressed a desire to scrape out the old regulations while the new, more efficient, and better ones would be coming in. The President mentioned that, I believe, in his State of the Union Address last year, when he mentioned regulation in a general and broader sense.

I would like to ask—I will start with you, Mr. Vallandingham. You mentioned that 80 percent of your time is spent on compliance. Are you finding that any of these older regulations that are less relevant have been removed and been replaced, or are they still in place? And could you give me an example, maybe, of something that you think would be wise to move out as antiquated or outdated?

Mr. VALLANDINGHAM. To date, my experience has been that I have not seen any regulations removed. I continue to see the piling on of additional regulations. And as many of the people who testified today indicated, implementation times are not realistic, and they just—it seems like we are trying to hit a moving target.

In terms of things that I think could be updated, there are good examples where technology has surpassed former regulation like Reg E and some of the other—especially in UCC on check clearing, as we start to clear image checks.

So there are a lot of things, I think, that could ultimately be revised, but the truth is that we don't see anything being removed. And most stifling, in my opinion, is in the mortgage area, we continue to see just piling on and piling on. And it is really increasing the cost to the consumer; it is eliminating dollars that we could invest. And so, that is my experience.

Chairwoman CAPITO. Mr. Grant, do you have a comment on that?

Mr. GRANT. I would agree with what Mr. Vallandingham said. We are not seeing any rollback of any significant amount of regulations.

I would offer up what we in our bank have as the poster child of regulations that just are ineffective, and that is the 3-day right of rescission on certain types of mortgage loans. And maybe it was well-intentioned when it went through in the 1970s, but it basically mandates that distributions cannot be made at the closing table. There has to be a 3-day right of rescission. And I can tell you, in the last 30 years, out of a couple hundred thousand mortgages that we have done at First United, we have only had one person exercise that right of rescission, yet, it remains as a thorn in the side at the closing table. When people want to waive that right so they can close the transaction, they are unable to do so.

And that is just at the head of a very long list of similar types of regulations.

Chairwoman CAPITO. Okay.

In terms of your own institutions, have you—there is a statistic out there that says one of the top 10 fastest-growing occupations in America is bank examiner and compliance officer. Have you yourselves had any recent hires that would kind of back up that statistic?

Yes, Mr. West?

Mr. WEST. One of the things we have done is add, in the last few years, a senior VP of risk management. They are almost impossible to find. And the price range is $300,000 to $350,000 a year just for one person.

On top of that, we have two information security officers. We are about to add a third one because we are a large credit union, so therefore, we have to stay on top of it. We have added—in our bank secrecy area, we had five people; we just added another one. We added $200,000 worth of software to assist them and still added more bodies.

So we are adding people every day, it seems, who are taking more time. I was listening to the 80 percent. My mortgage department VP—and we are a large mortgage processor; we sell and service to Fannie Mae—spends probably 40 percent of her time now on compliance.

And we want to do it right, as a credit union. The challenge we have is, the frequent changes are so much, we will change this and suddenly Fannie Mae changes another rule. So it is not just coming out of Dodd-Frank, it is other entities we may do business with and the cumulative impact. It just becomes onerous, and then trying to understand it.

We also do international wire transfers. Recently, the new remittance rule came out on it. It is 116 pages long. We do about 160 in a high month. We now have had to go through—yesterday, we did something I will rarely do; I increased the price on them to help cover the cost of it. And we sit in our boardroom and try to say, let's find a way not to charge fees. And yet yesterday we said, we don't have a choice, we are going to have to do something. It is just too costly to comply with this.

So we find every part of the institution is spending more time on compliance. My board and I track it quarterly. Sometimes my board now says, when do you do other stuff?

Chairwoman CAPITO. Thank you. We will leave that comment as my final comment.

Mrs. Maloney is recognized for 5 minutes.

Mrs. MALONEY. First of all, many of these regulations came into effect because of the financial crisis, but during the financial crisis, from the community that I represented and many others I have heard from my colleagues, the real backbone that kept providing loans and support and adjusting mortgages and working were the smaller banks. You did a fantastic job during that period, and I want to express my gratitude.

A cornerstone of Wall Street reform is providing regulators with authority to require regulations of the nonbank firms that compete with banks in the financial services marketplace—the brokers, the

AIGs, the swaps, the this, that, and the other. But they were not subject to comparable regulation before the crisis. One of the things that Dodd-Frank did was bring all these nonregulated competitors into the same regulation of community banks and other banks.

Do you agree that more strictly scrutinizing and regulating your nonbank competitors will directly benefit banks of all sizes? I would like to ask Mr. Grant and Mr. Templeton and Mr. Calhoun.

Mr. GRANT. Certainly, we applaud the efforts to regulate the nonbanking sector. I would agree with the Congresswoman that an awful lot of the crisis that hit our country so hard came from the nonbanking sector. And we would encourage that that be the primary focus of the CFPB, remembering that our institutions seated at this table already have prudential regulators with a multitude of regulations and they are in our shops for extended periods of times regulating.

We are a little bit concerned by some of the dialogue coming from the CFPB indicating a desire to go and look at areas on which our prudential regulators have already spent a lot of time. I know the Congresswoman has a lot of thoughts regarding overdrafts. And, certainly, we have seen a wealth of regulation and guidance that has come from the Federal Reserve, and subsequently from the FDIC. And now, we are being told that may be an area of focus by the CFPB. Our sense is, we have already heard a loud and clear message from our regulators on how we should proceed on that, and it is going to be somewhat confusing if now there is another set of regulations. We would rather those efforts go toward the nonbanks.

Thank you.

Mrs. MALONEY. Mr. Templeton?

Mr. TEMPLETON. I think there is general consensus that a lot of the economic problems we have had in the past couple of years have come from a lot of businesses outside of mainstream financial regulation. So I support regulation of nondepository institutions, and that is, I think, a great way to define it.

An illustration of unintended consequence: When the licensing of mortgage loan originating officers began, it began globally; it didn't carve out those working in a depository institution. So we spent, I don't know how many hours, trying to get our officers licensed, filling out the paperwork, butting our head up against the brick wall, trying to figure out how you do this. It was all uncharted territory, a prime example of it having an unintended consequence.

I think looking at the nondepository business segment is a grand thing to do and bring them up to the standards that are already in place of the rest of us.

Mrs. MALONEY. Mr. Calhoun?

Mr. CALHOUN. I think the mortgage example is probably the most striking, where the nondepositories led the charge into the kinds of exotic products that really fueled the housing bubble and added to the crisis. And the challenge is, if you have overhead built into a lending department, what do you do? We offered just fully documented loans, fixed-rate. And somebody else is out there selling tricked-up loans with teaser payments that don't cover your insurance or taxes. It is hard to compete in that market, and it is a very tough business decision at that point.

Unfortunately, a lot of institutions got pulled down and had to go head-to-head with those same products because they had a structure built that they had to stay in business with. We lost the vast majority of our mortgage lending leading up to the crisis because we didn't have those same kinds of reckless products.

Mrs. MALONEY. I want to say that I don't think anyone supports unnecessary regulation. Everybody wants to be efficient and to streamline and to move to electronic filing and other things that you have put forward. And I, for one, would join with the chairwoman in reaching out to the Treasury Department on exactly where they are in reviewing all of these regulations to see if some are unnecessary. But they also have to be looked at in terms of the cost, as well as the benefits, that eliminating them might pose to particular banks or to the financial system overall.

I think all of us would like the 70 years of financial growth that we had after the Great Depression with reasonable regulation. And, certainly, bringing in unregulated areas would hopefully have prevented the crisis that we went through, if they had been regulated from the beginning. So it is an important point, and you need to get the right balance. But I certainly would join my colleagues in reviewing these and pushing to have some oversight on what we could do.

And I just want to know how the compliance costs would differ between a bank that is at $9.5 billion and a bank that is at $10.5 billion. If anyone wants to put it in writing for me, I would like to see the difference.

My time has expired, so I thank you for your testimony. You have gotten my attention. Thank you.

Chairwoman CAPITO. Thank you.

Mr. Hensarling for 5 minutes.

Mr. HENSARLING. Thank you, Madam Chairwoman. And thank you for calling this hearing.

I recall at the passage of Dodd-Frank almost 2 years ago, I predicted that the big would get bigger, the small would get smaller, and the taxpayer would get poorer. And now, as we look at the asset share of our largest financial institutions, as we look at the consolidations of our smaller community financial institutions, and as we look at the Federal debt, unfortunately, those words did prove to be prophetic.

Professor Levitin, have you ever been a community banker?

Mr. LEVITIN. I have not.

Mr. HENSARLING. Okay. Have you ever been employed at one of the larger financial institutions that you referenced in your testimony?

Mr. LEVITIN. No, but I have done legal work for them.

Mr. HENSARLING. Have you ever been an officer in a credit union?

Mr. LEVITIN. No.

Mr. HENSARLING. Do you have an academic background in economics, or is it in law?

Mr. LEVITIN. I would say it is in both, actually.

Mr. HENSARLING. Okay, and what is your background in economics?

Mr. LEVITIN. I have taken courses in economics.

Mr. HENSARLING. Okay. You state in your testimony that "The Durbin Interchange Amendment is arguably the single best legislative development for small banks in the past 2 decades." There are a number of community financial institutions in the Fifth District of Texas that I have the honor of representing, and when I hear from them, they have a decisively different opinion than yours.

When I hear from Jeff Austin, vice chairman of Austin Bank, "This price control amendment and the Federal Reserve rule will dramatically harm my financial institution and its customers." From Elaine Schwartz, COO, Wood County National Bank-Quitman, "This will significantly affect our ability to offer this important customer benefit." From Joe Sepulva, vice president, Citizens National Bank, Malakoff, Texas, "Deprived of interchange revenue and placed at a competitive disadvantage, community banks will potentially exit the market, and large banks will increase their market share."

And then I guess we heard testimony from you, Mr. Templeton, I think it was, that your credit union has now seen the average debit interchange rate go down 1 to 2 cents per transaction. Yes, here is your testimony, "while my credit union was supposed to be unaffected by this provision."

And so, Professor, everybody is entitled to their own opinion, but those who are actually running these financial institutions seem to believe that they have encountered significant harm.

I would be curious, Mr. Templeton, if you are stuck with the Durbin Amendment unchanged, what are the prospects for your members going forward?

Mr. TEMPLETON. Probably noticeably would be our—the first thing we have already done is we have pulled back our involvement in the community education system. With the loss of revenue, we had one person whose full-time job was to go into our school systems and educate our youth on financial education, and we have already pulled back on that program as a prerequisite and as a result of the interchange.

Now, could I say precisely that the interchange made that go away? I am not going to try to tell you that. But I am going to tell you, when you start looking at your income statement and you are looking at where can you cut, when you see the expenses coming, the things that don't yield you a dollar in the near term have to be reassessed, which is what we did.

But my $300,000 is what we are looking at lost in the first 12 months following the Durbin at the rate we are on right now. I can't tell you exactly where it is coming from because it is all so new. We are still trying to get the data together. There are a lot of moving pieces. But the monthly numbers are dropping, although the dollar volume of transactions and the number of transactions are rising.

Mr. HENSARLING. Earlier—

Mr. LEVITIN. Mr. Hensarling, may I—

Mr. HENSARLING. I am afraid not. We have limited time here. I have less than a minute. Hopefully, you will have the opportunity to speak with other Members.

Mr. Cordray, who has been appointed, perhaps under a questionable process, to chair the CFPB, testified at a March hearing that

there can be products that are legally fair yet abusive. And he went on to say, in response to a question from me—I asked him, "Could a product be abusive to one individual consumer yet not abusive to another consumer?" Answer from Richard Cordray, "I think the law seems to pretty clearly contemplate that. Yes."

So when you think in terms of the regulatory burden to be imposed by the CFPB, knowing that one product could be abusive to one of your customers yet not abusive to another, what is that going to do to the availability and pricing of credit and new products, Mr. Grant?

Mr. GRANT. It is certainly going to curtail it significantly. As I indicated in my oral testimony, we are sensitive to litigation risk, and we are going to back up and go into the safest parts of the safe harbor without being close to the edge where we could be subject to the interpretation that you just referred to.

Mr. HENSARLING. I would love to pursue this further, but unfortunately, I see I am out of time.

Thank you, Madam Chairwoman.

Chairwoman CAPITO. Thank you.

Mr. Scott for 5 minutes.

Mr. SCOTT. Yes, I would like to deal with the issue of the fact that we are here to discuss the financial reform law in terms of how compliance costs will force cutbacks—cutbacks on lending, is what I am hearing, cutbacks on investment activities—it could raise fees charged to customers for banking services, and could possibly even lead to further consolidation of the banking industry.

We hear a lot of claims, as I have heard, about this, but I have to note that most of the provisions of the Dodd-Frank Act and our financial reforms either do not apply to small banks in the first instance or they have carve-outs or burden mitigation provisions that result in small banks effectively being exempt. In my opening statement, I mentioned about the exemption for those smaller banks with the $10 billion reduction.

Could any of you respond and identify what particular specific provisions of our Wall Street financial reform or the implementing rules adopted thereunder have increased your burden for your institutions, and then describe specifically the details of the form and the magnitude of this burden?

Mr. Vallandingham, could you start with that?

Mr. VALLANDINGHAM. First, let me say that, as many former regulations have been implemented, over a period of time they become best practices and forced down, even though exemptions exist. One particular example would be risk assessments, as presented by Mr. West. Sarbanes-Oxley was the legislation that implemented risk assessments, and it is now the buzzword of the financial industry and forced down on all financial institutions.

In my institution alone, we have a committee of eight senior executives who meet monthly to talk about risk assessments on new products introduced, upgrades to software, several discussion points that are mandated annually. So, the first thing I would say to you is, yes, while we have an exemption, they don't always apply, because they become best practices and ultimately get forced down anyway.

Some of the mortgage-related things have a direct impact on me. When I look at things like the escrow provisions, the retention of portions of the securitized loans, those are things that would dramatically impact my ability to serve my community. Ultimately, if I were to have to retain a portion of those credits, that would limit how many loans I could make. My institution is very active in mortgage lending. We service over 6,000 loans. And that certainly would impede our ability to serve that market.

So, those are provisions that I think would have direct impact on me and have concern for my day-to-day business.

Mr. SCOTT. Let me just get a mirror of this from each of you. What particular regulations would you suggest we eliminate? What would be the priority if, collectively from the six of you, you could leave this committee with, shall we say, a hit list, of what they would be to give us some guidance, and why?

Mr. TEMPLETON. If I may address that, there is a bill that I think has a lot of merit. It is H.R. 4361, which removes the placard requirement on ATMs. And I think Mr. Scott is familiar with that bill.

Mr. SCOTT. Yes.

Mr. TEMPLETON. It is an arcane piece of legislation. It places a requirement on financial institutions that technology has replaced. And it is putting all financial institutions—not just financial institutions—anyone who operates an ATM machine, be it a convenience store, restaurant, bar, casino, financial institution, everyone is at risk if a vandal removes the labels.

So, H.R. 4361 would be a great start.

Mr. SCOTT. Okay, the ATM, and I agree with that. As you know, we are working on that.

What would be another one? My time is running short.

Yes, Mr. Grant?

Mr. GRANT. I know that there will be some degree of regulation coming out on the QM and the QRM. My suggestion and plea would be that you look at that very, very carefully and recognize that several of us come from small, rural areas. And to try to put us into a plain vanilla product is going to result in significant disservice to our ability to tailor solutions to our mortgage customers.

Mr. SCOTT. All right. Okay. And a third one?

Mr. GRANT. The third one—I would be happy to interject. The municipal advisor rule is going to have a significantly chilling effect if we have to register tellers and customer service officers under that particular rule.

Mr. SCOTT. Would everybody agree that those would be the top three? Good.

Thank you, Madam Chairwoman.

Chairwoman CAPITO. Thank you.

Mr. Renacci for 5 minutes.

Mr. RENACCI. Thank you, Madam Chairwoman.

Professor Levitin, you state in your testimony, "While there are areas in which regulatory burdens on smaller financial institutions can and should be reduced, it should be a surgical operation."

Can you give me some examples of those areas that should be reduced or eliminated?

Mr. LEVITIN. Sure. First, I would just incorporate the suggestions that were just made. All of those are reasonable regulatory reforms.

Another one I would add would be eliminating the annual Gramm-Leach-Bliley privacy notice disclosure. Currently, financial institutions are required, even if their privacy policy is not changed, to mail out a privacy policy disclosure. As a general matter, I am not sure that anyone really reads those disclosures, and, certainly, if there is no change annually, there is no reason to impose that cost on small financial—on any financial institution.

Mr. RENACCI. You also say in your testimony, "As it happens, however, few of the regulatory burdens of Dodd-Frank actually fall on small banks and credit unions." We have small banks and credit unions here talking about some of their burdens. Do you agree with that? Is that an opinion or have you actually sat in a bank and watched what is going on there?

Mr. LEVITIN. I can tell you with great certainty that almost none of Dodd-Frank applies to small financial institutions for two reasons. First of all, of the 16 titles in Dodd-Frank, several of them simply do not apply to community banks. Derivatives regulation is not a community bank issue, for example.

Second, Dodd-Frank itself, most of the provisions and regulations have not gone into effect yet. If you listen to the regulatory burdens that have been cited so far by the gentlemen on my right, they have been about pre-Dodd-Frank rules, pre-Dodd-Frank statutes, servicing requirements by Fannie Mae and Freddie Mac which are not part of Federal law—these are private contractual arrangements—about the way Federal bank regulators have implemented their examinations and what they are requiring in terms of loss reserving and write-downs. These are not Dodd-Frank problems. These are problems that exist outside of Dodd-Frank.

Mr. RENACCI. You teach at Georgetown, though, correct?

Mr. LEVITIN. That is correct.

Mr. RENACCI. If somebody threw 2,000 pages of regulations about your teaching in front of you, would you have to prepare and spend some time and energy and money to prepare for that?

Mr. LEVITIN. Sure. There would be some time and some money. But, also, if I knew that, of those 2,000 pages, only perhaps 150 to 200 actually applied to me as opposed to other teachers at Georgetown, it would certainly reduce the burden on me.

Mr. RENACCI. But you would be concerned about what is in the 2,400 pages.

Mr. LEVITIN. There is a table of contents for Dodd-Frank which makes it pretty obvious. It doesn't take a huge amount of time and money to go through and figure out what applies and what doesn't.

Mr. RENACCI. It is interesting because I was just back in my district last week and I had a regional bank tell me that the CFPB had 11 people there for 13 days. Don't you think that would cost some money, to be prepared for that and also paying attention to what is going on?

Mr. LEVITIN. I am kind of surprised to hear that about a community bank, because the CFPB doesn't have examination authority over them.

Mr. RENACCI. It was a regional bank, but—

Mr. LEVITIN. Okay. If they are over $10 billion, that is a different situation.

Mr. RENACCI. Mr. Grant?

Mr. GRANT. If I may, I would like to just interject one point possibly about unintended consequences.

We have recently been told that the Volcker Rule may apply to our bank. One of the things that we do from time to time is buy into investment pools to satisfy our requirements under the Community Reinvestment Act. And there is some thought that the way Dodd-Frank is drafted, with some of the Volcker pieces, we might actually be subject to some of those prohibitions.

Mr. RENACCI. I want to move on to another question. The original intent of regulatory reform was to consolidate some of the agencies. However, Dodd-Frank actually managed to create several new bureaucracies, including the Financial Stability Oversight Council, the Consumer Financial Protection Bureau, and the Office of Financial Research.

I would like to ask the panel, do you think the Dodd-Frank Act minimized or at least rationalized our patchwork regulatory system? And just give me a description of this regulatory overlap.

Mr. West?

Mr. WEST. I would say it has not minimized; it has added to it.

And I wanted to clarify, the only exemption that credit unions have from Dodd-Frank is if you are under $10 billion, you are exempt from the interchange rule. However, on the CFPB enforcement, we still get that through our Federal regulators. So we are not exempt from anything but the interchange rule, that we have been told so far.

Mr. RENACCI. Mr. Grant, on the question?

Mr. GRANT. Yes, it is just adding more patches to the patchwork quilt, if I can use your phrase. And we are not seeing a rollback in any significant way.

Mr. RENACCI. All right. Thank you.

I yield back.

Chairwoman CAPITO. Thank you.

Mr. Watt for 5 minutes.

Mr. WATT. Thank you, Madam Chairwoman.

And let me apologize first to the witnesses. I did get everybody's testimony. I was here for the testimony of everybody except for Mr. Grant. We have an oversight hearing of the FBI going on in the Judiciary Committee, on which I also sit, so I have been trying to hear testimony over there and testimony over here and questions over there and questions over here. So I have been kind of back and forth.

Are there any advantages of—Professor Levitin talked about the leveling of the playing field between community banks and previously nonregulated entities. Perhaps Mr. Grant and Mr. Vallandingham and Mr. West could comment on whether you see that as an advantage or a disadvantage or no impact?

Mr. GRANT. Certainly, the regulation of the nonbanking industries is a positive thing. We have long talked about how unlevel the playing field was through good and bad times. To the extent Dodd-Frank reaches out and levels that playing field, that is a good thing.

We are just concerned about the additional burden of regulations coming our way. And we already have prudential regulators, and have for a long, long time, unlike some of the nonregulated aspects of the business.

Mr. VALLANDINGHAM. First, I want to say, as Congressman Renacci said, there are 2,500 pages of legislation. It makes it hard to point out which ones are—

Mr. WATT. You just had a chance to answer Mr. Renacci's questions. I am questioning now, so if you don't mind—

Mr. VALLANDINGHAM. I agree. But it makes it hard to point out the positives and negatives.

And first I want to say, the first one I would repeal is Durbin. I think—

Mr. WATT. That was Mr. Scott's question. I am trying to get to my question now.

Mr. VALLANDINGHAM. I understand, but—

Mr. WATT. Okay.

Mr. VALLANDINGHAM. —I want to make sure that—

Mr. WATT. Thank you. We have a limited amount of time.

Mr. VALLANDINGHAM. The point is, there are some positives in the bill. And the Deposit Insurance Fund assessment was one of them. The extension of $250,000 FDIC—

Mr. WATT. But as between you and the nonregulated, previously nonregulated, that was the question I asked.

Mr. VALLANDINGHAM. Okay. And on that point, the shadow banking environment was an unlevel playing field. They were out there doing things that we weren't allowed to do, even though it was against the law, because nobody was watching them.

Mr. WATT. And that was a substantial competitive disadvantage to you?

Mr. VALLANDINGHAM. Absolutely.

Mr. WATT. Okay.

Mr. VALLANDINGHAM. Not just in consumer lending, but in mortgage lending as well.

Mr. WATT. Okay.

Mr. West?

Mr. WEST. I was going to say, I think the number one value in that is to the consumer themselves, because so many of those programs absolutely abuse the consumer. For us, I would hope that it is going to help us in some way be able to reach out to them before they go out to agencies like that and get that service. It is a bit too early to tell. But, absolutely, it is good for the consumer.

Mr. WATT. Okay.

There is a lot of work going on behind the scenes and discussions going on behind the scenes that I am aware of about this Qualified Mortgage definition and the rule. I think there has been a fairly substantial consensus reached between consumer groups and banking groups about what that definition should be, that it should be broad.

Do you all agree with Mr. Calhoun? Mr. Grant and Mr. Vallandingham, in particular. I am not excluding Mr. Templeton, but these are questions that relate to community banks, not—

Mr. TEMPLETON. Absolutely.

Mr. WATT. —credit unions, so I am not—

Mr. VALLANDINGHAM. Yes, I do think the definition of a Qualified Residential Mortgage should be very broad. There are oftentimes borrowers who come into our facility and don't qualify for a secondary market mortgage, yet we still intend to make that loan. And it may not be because of their credit quality but because of the nature of the property.

Mr. WATT. And if that occurs, Mr. Grant, won't that address this concern that you were raising about rural—because the standards will be pretty broad to enable that to be taken into account?

Mr. GRANT. Yes, if the standards are very broad and allow for the individual attributes in the rural markets and markets really all over the country, then, yes that could help out.

Mr. WATT. So you all basically agree with Mr. Calhoun's testimony on the QM and the QRM, that they should be consistent?

Mr. GRANT. I would think so. And we just need to see what the final details look like. The devil is in the details.

Mr. WATT. All right. Thank you, Madam Chairwoman. I yield back.

Chairwoman CAPITO. Thank you, Mr. Watt.

Mr. Duffy for 5 minutes.

Mr. DUFFY. Thank you.

Let's not make a mistake here; we all understand that our financial institutions are highly regulated. We had a crisis, and we all believe we had to look at new reforms to address the cause of that crisis to make sure it doesn't happen again. We need to learn from our mistakes. And so, I am in favor of that. I think it is important, though, to use a scalpel as opposed to a hatchet, going through the regulatory process.

I want to ask all of our bankers and our credit unions on the panel, I am concerned because I keep hearing from my banks and my credit unions that Dodd-Frank is having an impact on their ability to effectively engage in the banking process, but I think it was Mr. Levitin who said that we are just nibbling around the edges if we deal with Dodd-Frank. And I guess I want to be clear; I want to go after the biggest meat here.

Do you all believe that we are just nibbling around the edges when we are discussing Dodd-Frank?

Maybe I will start with Mr. Grant.

Mr. GRANT. I agree with the position of the professor. When you talk about economies of scale, small banks' compliance costs are going up 75 to 100 percent, that further impedes the economies-of-scale disadvantage that some of us obviously have.

I think Dodd-Frank casts a pall across all of the community banking industry.

Mr. DUFFY. But do you agree that when we are trying to address the rules in Dodd-Frank, we are just nibbling around the edges? Do you agree with that statement?

Mr. GRANT. No, I don't.

Mr. DUFFY. Okay.

Mr. Templeton?

Mr. TEMPLETON. I think we are nibbling on the edges, because I don't know that we really know what the meat of the matter is going to be because many of the regulations haven't been rendered yet. So from what we have seen on the edges, if the edges are a

precursor of what the middle is going to be, I am terrified to death. How are we going to keep pace? And one of the big things is the rate of change through that process.

Mr. DUFFY. Mr. Vallandingham?

Mr. VALLANDINGHAM. I would say we are nibbling on the edges. The Communities First Act lists a number of regulatory relief initiatives that we think would be beneficial to the banking industry. The SEC registration bill that you all passed certainly was beneficial. One institution told me it saved them $250,000 a year.

So, I think that we are nibbling on the edges. The pendulum swings, and it went way too far, and we continue to be overburdened. We are trying to hit moving targets. There is no allowance for implementation periods. You either have it right or you don't. And the regulators are coming in and fining us and just hitting us hard. They don't give you any leeway whatsoever.

Mr. DUFFY. And so, do you say that our focus on Dodd-Frank and all the rules that are coming out is—there is too much focus there, and looking at just Dodd-Frank, we are nibbling on the edges, the real meat is not there?

Mr. VALLANDINGHAM. I think Dodd-Frank has some provisions which need work. I think there are other regulations that have provisions that need work. The Communities First Act is obviously a good start.

Mr. DUFFY. Mr. West?

Mr. WEST. I would agree. I think we are nibbling on the edges. I commented earlier; there are 127 regs I listed. Those came from 15 different agencies. So, it is not just Dodd-Frank; it is some of everything coming at us.

And I want to go back and reemphasize, while we are exempt from interchange, every single rule we have seen come out yet applies to us as a credit union. When we are talking about the QRM mortgage, we are a large mortgage lender to serve our members; it applies to us.

So we haven't—and his point, that what is coming is what alarms us, because so few rules have actually been written yet, and now with Mr. Cordray in place as the Director of the CFPB, we anticipate there will be a tremendous volume coming at us, and trying to keep up with it.

I would also cite, the president of CSX in Jacksonville—

Mr. DUFFY. But just quickly, so you are saying that—Dodd-Frank—you are talking about the CFPB—

Mr. WEST. Yes.

Mr. DUFFY. —and you are concerned about the rules, but that is still—we are just nibbling around the edges?

Mr. WEST. Absolutely. There is a huge volume coming.

Mr. DUFFY. Under Dodd-Frank or elsewhere?

Mr. WEST. Dodd-Frank and elsewhere.

Mr. DUFFY. Okay. But if you look at the CFPB, which falls under Dodd-Frank, you look at interchange, are you telling me that is not where the real money is at, it is elsewhere?

I think Mr. Levitin was saying, don't really be concerned about Dodd-Frank, look at what is happening with regard to the deregulation that took place that allowed the bigger banks to improve their market share within all of your markets.

Mr. WEST. I would still say Dodd-Frank is going to have a huge impact on us going forward.

Mr. DUFFY. Huge impact.

Mr. WEST. I think that answers your question.

Mr. DUFFY. Yes.

And I guess, just to be clear, if you look at the CFPB, which was going to exclude community banks and credit unions, it is very clear that the rules may not be enforced by the CFPB but you are still going to be forced—

Mr. WEST. That is right.

Mr. DUFFY. —to comply with those rules.

Mr. WEST. That is correct.

Mr. DUFFY. We had Chairman Bernanke in here last year, and when he was talking about the interchange change, he also indicated that it more than likely will have an impact on our small community banks and our credit unions, as well.

So whenever these rules come out, and we set up exemptions for small community banks and credit unions, it seems like they never really go through, and all of the rules come to bear on our small community banks and credit unions. And when you look at economies of scale, you are less able to bear the brunt of those regulations as compared to the larger banks, which means you guys are disadvantaged to a greater extent.

My time has expired, so I yield back.

Chairwoman CAPITO. Mr. Carney from Delaware.

Mr. CARNEY. Thank you, Madam Chairwoman. And I want to thank you for holding this hearing today, and also thank the panelists for coming and sharing your thoughts with us.

I hear from my community bankers—we don't have a lot of community bankers in our State; it is a small State, but we have a few. In fact, I spoke with one of the leaders of that organization yesterday. I hear this and we hear it as Members all the time about all these regulations that are impacting your businesses and your ability to lend to the small businesses and consumers in our district. And so, I am really delighted this morning that we are hearing more specifics about what you would change and how you would change it. And then, to the extent that you could provide me with additional information in writing, that would be helpful.

I would like to just take a few minutes to address a couple of questions.

The first is, Professor Levitin, in your statement, you say that what we need to do to level the playing field here for smaller community banks is to make the big banks smaller and weaker so community banks can compete. Is that really what we need, in terms of our financial system writ large?

Mr. LEVITIN. I think you—

Mr. CARNEY. And how would you do that?

Mr. LEVITIN. I think you characterized it a little differently than I did.

Mr. CARNEY. I probably did.

Mr. LEVITIN. I don't think I used the word "weaker." I think I was talking about the need to slim down the large banks, put them on a diet, if you will.

Mr. CARNEY. So how do you do that, and what do you mean by that?

Mr. LEVITIN. There are numerous ways that can be done, everything from very direct, blunt tools such as taxation to more indirect things such as what you do in terms of capital requirements.

The bigger point here, though, is if you look at the community banking business, if you take sort of the big-picture view of this, this is like a patient with a tumor, and right now what we are discussing is a broken arm. The broken arm hurts right now, but even if you fix that broken arm, there is still a tumor there.

So if you are concerned about the long-term viability of community banking, that will not be changed by changing ATM signage regulations or any of the other things that—

Mr. CARNEY. So you have to make the larger banks smaller and—

Mr. LEVITIN. We have to go back to a world where we do not have too-big-to-fail banks.

Mr. CARNEY. Okay. The clock is ticking. Do any of the community bankers or credit union folks have a quick view of that?

Mr. Grant had his hand up first.

Mr. GRANT. Certainly, we strongly support eliminating "too-big-to-fail," making that stick. And certainly, investors should take the loss. But I guess I would have a slightly different view. Our country needs banks of all sizes, whether it is community banks, small community banks out in the middle of Kansas, to the large money center banks. If we go after tearing down the large banks in this country, that void will have to be filled. It will be filled with non-American banks—

Mr. CARNEY. Exactly.

Mr. GRANT. —because there are customers out there who need the really large banks. So, there has to be a balance.

Mr. CARNEY. Mr. Vallandingham, did you want to quickly add to that?

Mr. VALLANDINGHAM. Certainly. We support the too-big-to-fail initiative. I think that they have outgrown their statutory limits. They basically have created systemic risk on our economy and ultimately need to be dealt with. We saw that in the economic bailout. Community banks didn't participate on that.

We do serve an important role in the financial system. Most of your too-big-to-fail banks are not interested in a less-than-$250,000 commercial loan—

Mr. CARNEY. Right.

Mr. VALLANDINGHAM. —which is how I became SBA Lender of the Year 4 years in a row, because we serve that market.

Mr. CARNEY. Good.

Mr. VALLANDINGHAM. So, ultimately—

Mr. CARNEY. Let's talk about that market. The time is ticking. Mr. Westmoreland—who is not here today—in the full Financial Services Committee laments all the time about the 60-or-some-odd banks in his district that have failed. And as I understand what has happened there, it is because of real estate lending of some kind of another. And yet, I hear from all of you about concern over the QM and QRM standards. And it seems to me that those were

created by Dodd-Frank, or the process to create those regulations was initiated by Dodd-Frank to address that problem.

Is there a better way to do it?

Mr. VALLANDINGHAM. I will go ahead and take that.

Mr. CARNEY. Please.

Mr. VALLANDINGHAM. We are kind of hitting the problem with a sledgehammer. In reality, what was—

Mr. CARNEY. So what does the scalpel look like? I have 20 seconds left.

Mr. VALLANDINGHAM. The outliers were the subprime and the Alt-A loans that were being securitized and sold in investment banking houses. Those have nothing to do with Qualified Residential Mortgages or the Freddie-Fannie market.

Mr. CARNEY. But the lending standards, right? Have you read the financial crisis inquiry report? There was pretty loose lending going on out there by a lot of folks.

Mr. VALLANDINGHAM. But it wasn't the community banks, it wasn't the smaller financial institutions. I didn't make any subprime loans—

Mr. CARNEY. So you all shouldn't have lending standards and the rest of the market should? That doesn't make a lot of sense to me.

Mr. VALLANDINGHAM. No, but—and I understand your point of view.

Mr. CARNEY. Do you know what I mean?

Mr. VALLANDINGHAM. I will say that—no, I was saying that I understand your point of view. But, ultimately, we weren't the ones causing the problem, so we shouldn't bear the brunt of the regulation. When you look at my portfolio, it was very low-risk. I run a delinquency rate that is less than 2 percent in Michigan, which has an average of 16 percent.

Mr. CARNEY. I don't have any time left. I would like to have a longer discussion about this because—

Mr. VALLANDINGHAM. Absolutely.

Mr. CARNEY. —it seems to me it is a very important issue. Thank you very much for your testimony and your help today.

Mr. RENACCI [presiding]. I recognize Chairman Bachus for 5 minutes.

Chairman BACHUS. Thank you.

Chairwoman Capito mentioned that financial examiners are one of the 10 fastest-growing occupations. In fact, if you look at the 2011 to 2013 edition of the Bureau of Labor and Statistics Occupational Outlook Handbook, it states that, and this is a quote from a government document, "Employment of financial examiners is projected to grow 27 percent from 2010 to 2020, faster than the average for all other occupations."

That means that you are going to have to hire people to answer those questions and to handle those reviews—and we have talked about this—and I think everybody agrees that their compliance staffs have doubled or that they are much bigger, but they are going to get bigger still. We are about a third of the way through the implementation.

Can any of you give me just sort of some specifics on before Dodd-Frank and some of the other bills that have passed? I actu-

ally voted for the subprime lending bill, and I don't think it was a bad bill. But just give me some numbers.

Mr. GRANT. Yes. Just to give a little longer historical perspective, in our own shop, when I came to the bank over 30 years ago, Congressman, I was actually the bank's first compliance officer, and I spent maybe about an hour a week staying up with regulations. We now have over six full-time equivalents involved in some level of full-time compliance work. And over two-thirds of our staff spend an hour or better a day in compliance-related entities.

As I mentioned in my testimony earlier, at over a billion, we can spread some of that cost. But I have a very good friend who has a small bank out in the middle of Kansas. The total size of his bank is $72 million. He, a couple of years ago, or a year ago, had 23 employees. He now has 25 employees. The last two expensive hires have been compliance officers. And we bankers and credit union people look at something we call an efficiency ratio that says how efficiently you are running, so the lower the number, the better. And his particular bank went from an efficiency ratio of 64 to 72 just because of those hires.

Thank you.

Chairman BACHUS. Thank you.

Anyone else?

Mr. TEMPLETON. Congressman, as you were talking about the labor stats, the 27 percent increase, that is exactly what I was thinking. That simply translates into a 27 percent increase in examination time, but exponentially it is even more than that when you dial in the improvements in technology and what they can do quicker.

It is going to become an ongoing process of examination. And a part of that process should be some type of risk evaluation, particularly technology: Do we need to spend as much time here as we do there? And I think that is something I would encourage you, to the extent possible, to look into, is risk-based examinations.

Mr. VALLANDINGHAM. In preparing for the hearing, I documented the increase in our payroll. It was close to a half-million dollars, so almost about a 25 percent increase just since 2008. Most of that was in loan review compliance, where we are getting ready to add another compliance officer, as well as people who do post-closing reviews. In talking with mortgage originators, we do two compliance reviews before it ever gets to underwriting that we never did before because of all of the excess compliance that has been put on us in the last few years.

So, yes, we are seeing a definite increase in labor, time, and outside third-party resources, where we have employed more reviews from our third-party compliance people as well as our auditors. We are employing special reviews that we haven't had in the past, including risk assessments. So, we are seeing it in every aspect of our business.

Mr. WEST. We are seeing the same thing. We tried to put a dollar number on compliance, and we stopped at well over $2 million. And the reason we did was because the fingers reached so far out, we stopped spending time on it and said, we have more important things to do. We are still going to have to comply.

But we have added—I just mentioned a moment ago that we have added two information security officers. We are about to add a third. We added a new senior vice president of risk management. We added an entire vendor management department during all of this. And the reason for that is because you have contracts with so many critical outside vendors, your responsibility over them is even tighter now.

So the costs just keep coming. Our regulators have increased their budget for the last 2 years. Most of it is to hire more examiners.

Mr. CALHOUN. And, Mr. Chairman, Self-Help has five examiners coming next week. So, I can identify well with this.

I think, though, two things in context. One is, we have to remember, though, we have had and have not finished processing through record levels of bank failures. And it is a job of the regulators to see, are there other at-risk institutions? And there are more at-risk institutions over these last few years than we have seen in 70 years. So hopefully, some of that will subside. That is not going to address all of the issues, by any means, that you have heard today.

And the second, and it has been alluded to here, is we do need to get to a point of less uncertainty. It is very hard right now to build the business model when there are so many parts out there that you don't know what they will be. And I will just go back to my point. We need, for example, to tie down this QM definition, which will affect a huge part. We have agreement that there needs to be broad, bright-line standards.

And I would urge again that we then simplify and not add on to that with yet another standard with QRM, which is not required under the statute. That is totally discretionary. They should use that same definition. That would be one place where it would give the market some clear direction of where to go.

Chairman BACHUS. I thank you. And I know Mr. Luetkemeyer and the chairman have legislation, I think, that will address many of these concerns. But we appreciate it. And we will probably have a hearing on "too-big-to-fail," which is too-big-to-manage and maybe too-big-to-exist. But that will be for another day.

Mr. Grant, I started out where you were, and I guess I am still there, that we need all sizes. But if that means we are going to have a bailout fund, I am not sure that is where I would remain if those were my two choices.

Mr. GRANT. And I would agree with you.

Chairman BACHUS. Thank you.

Mr. RENACCI. Thank you.

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

Mr. CANSECO. Thank you, Mr. Chairman.

Last month, the firm of Davis Polk issued their Dodd-Frank status report regarding rulemaking in the wake of Dodd-Frank. The report noted that out of an estimated of 400 rules to be written, only 100 have been finalized thus far.

So, as financial institutions that are responsible for pricing risk and making sound loans, how are your business and your customers affected when there are still 300 rules yet to be finalized by Dodd-Frank?

Mr. Grant?

Mr. GRANT. There is certainly an effect both in our communities and the banks and with our customers. And it is causing us to feel a tug to contract from lending, to stay out of areas where there is risk. There is also a large level of confusion. Customers are surprised that we are now requiring so much more documentation, so much more demonstration of creditworthiness to the nth degree.

So certainly, we are concerned. You are exactly right; we are just partway through the rulemaking process. And it is just those concerns of uncertainty, added costs, added requirements that are coming our way.

Mr. CANSECO. Mr. Templeton?

Mr. TEMPLETON. Thank you. And I echo what Mr. Grant said. It seems like everybody, starting with me and going through the regulator, is in the "CYA" business today. We can't seem to do business while making sure we dot the i's and cross the t's. And, in many cases, we are trying to dot i's and cross t's that don't exist; we are trying to figure out where might they be.

There is no commonsense approach to mortgage lending today. We sell all of our nonportfolio items, and getting appraisals today are just ludicrous. We live in an area where you might have a house with an acre-and-a-half lot surrounded by neighborhoods that have quarter-acre lots, and you can't get comps on it. Loan-to-value on the appraisal is 50, 60 percent, and the underwriters are saying, we don't know about it because we can't get a good comp.

Debt-to-income ratio, I looked at one this week, 51 percent loan-to-value and 18 percent debt-to-income ratio, a retired person, and the underwriters won't take it because they can't get comps on the property. Two years ago, 3 years ago, everybody would have been clapping and cheering and clamoring to get that loan. Today, everybody is saying, oh, we shouldn't do it.

So I think it is the fear, the "CYA," the "I may make a mistake," that has people just running scared right now.

Mr. CANSECO. Mr. Vallandingham, would you agree with that?

Mr. VALLANDINGHAM. I absolutely would. We are focusing our resources on making sure that we don't suffer regulatory enforcement and making sure that we cross every "t," dot every "i," and we are not out building business, we are not growing our deposit base so that we can turn around and lend that in our communities.

As I indicated in my testimony, I have gone from probably 20 percent of my time focused on compliance-related issues to almost 80 percent of my time focused on compliance issues. And so, instead of being out there investing in my community and building relationships and investing in small business, I am back in my office making sure that we have updated this policy and that the boards reviewed it and approved it and that we have implemented these new procedures or sent out new disclosures for things that we have been doing for 107 years.

Mr. CANSECO. Mr. West?

Mr. WEST. I agree with all that they have said.

As a member-owned cooperative, as I mentioned earlier, every time we have an expense, ultimately it costs our members in some way. And what we have seen more is the confusion on members'

faces. And we talked about mortgage loans. They often ask, "Why do I have to go through this? Why can't I get my loan sooner?" And we explain, these are regulations, we want to do this properly.

So it is an education on their part, and then it is an education on our employees' parts. Last year when the SAFE Act came out, we worked diligently to comply with it. Our initial cost, hard cost, just right out the gate, was $100,000 to register our employees. This year, it is about $75,000 to re-register them.

The thing that happened, though, we had to stop delivering a couple of new products we had planned, to stop and deliver the SAFE Act timely. So we actually delayed giving new services to members last year for that.

The numbers you quoted, 300 more coming, that is what we worry about. And so far, we have not found any part of this law that does not affect us except for the interchange. And we are like him; we have had some reduction in transaction prices.

Thank you.

Mr. CANSECO. Thank you.

One very brief question for all four of you: How can you make a 5-year plan with the uncertainty that exists under Dodd-Frank?

Mr. WEST. It is almost impossible.

Mr. GRANT. I would agree that it is nearly impossible.

Mr. CANSECO. Mr. Grant, let me ask you a very quick question. Alluding to what Professor Levitin said, in your opinion, is Dodd-Frank the tumor or the broken arm?

Mr. GRANT. I believe it is the tumor.

Mr. CANSECO. And Mr. Templeton?

Mr. TEMPLETON. Tumor.

Mr. CANSECO. Mr. Vallandingham?

Mr. VALLANDINGHAM. I will agree with that.

Mr. CANSECO. Yes.

And Mr. West?

Mr. WEST. I would agree with that. I think there are some other tumors out there, too, though.

Mr. CANSECO. All right. Thank you. My time has expired, so thank you very much.

I yield back.

Mr. RENACCI. Thank you.

I recognize the gentleman from Missouri, Mr. Luetkemeyer, for 5 minutes.

Mr. LUETKEMEYER. Thank you, Mr. Chairman.

I thank the panel for enduring the morning here. We are getting close to the end.

And I just wanted to also thank you for some of the kudos that you gave some of the legislation that I am working on. The ATM bill—I know that Mr. Grant and Mr. Templeton both mentioned that. It is an issue I think is very important. We are going to continue to push on that. I know Mr. Vallandingham talked about the Communities First Act a number of times. And there are a number of provisions in there we are very excited about, that can hopefully give some relief to certain things. I know Professor Levitin also made reference to the privacy disclosure provision that is in there, and I appreciate the heads-up on that.

One of the things that is concerning to me is, during the course of your testimony, I think two of you—I think Mr. Grant made the comment, and I think I saw Mr. Vallandingham's head nod whenever you talked about ceasing mortgage lending activities. This is something that is very concerning to me, because when I was back in my district over the last 2 or 3 weeks, I have talked to some bankers, and they are very concerned, and a couple of them have talked about and are considering stopping mortgage lending altogether.

Can you give me some rationale on why you are thinking about that or considering that and elaborate on it a little bit?

Mr. GRANT. At our bank, we have not had any serious discussions regarding that, but coming back from a meeting of community bankers this week, there are some who already have decided to exit it.

And the reason why is, the regulatory risk and the litigation risk far outstrips the commoditized pricing that you really find in mortgages today. And the thought that you might book a loan today and 5 years, 10 years from now you might be subject to scrutinization on whether or not you should have ever made the loan.

So I think a lot of the smaller banks are just—

Mr. LUETKEMEYER. Mr. Vallandingham?

Mr. VALLANDINGHAM. In my testimony, I pointed out that in 2011 alone, there were 39 origination guide changes by Freddie Mac and 59 servicing changes.

When you look at provisions like the escrow requirements that a lot of smaller financial institutions would have to take on, the QRM provisions as well as some of the compliance-related—some of the compliance changes that occurred, with the good faith and the truth-in-lending, they require multiple compliance reviews, and if you don't meet certain tolerances, you lose money on the transaction and you can't reprice.

Those are all things that, looking at the cost of compliance and the risk of regulatory reaction, as well as some of the other provisions, it just makes it impossible. They just say, it is too complicated. We don't even let our consumer lenders do mortgages anymore. We have mortgage-only originators, because they have become so complicated that it is impossible for a consumer lender, who traditionally has done these loans, to comply with all of the compliance associated with it.

Mr. LUETKEMEYER. What you are saying is kind of interesting from the standpoint that you don't make any money unless you loan money out, and yet you are considering stopping activities that are lending money out because of the complication and the cost and the liability that you could incur because of that activity. Is that what you just told me?

Mr. VALLANDINGHAM. Our financial institution is willing to take on the task, but there are many smaller financial institutions. There is no way they could absorb the cost of some of these functions, especially in the servicing side.

Mr. LUETKEMEYER. Right.

I know that Mr. Templeton and Mr. West, as well, have talked about this morning, besides Mr. Grant and Mr. Vallandingham,

some difficulties with the regulators in trying to get them to understand your concerns and your problems.

What is the attitude of the regulators whenever you talk to them and explain to them some of your concerns? Would you like to have some common sense in this, or where is the rationale or the reason for this regulation?

Mr. VALLANDINGHAM. I will start. In a recent conversation with a regulator at a community event, I asked, "Is there any cost-benefit analysis done on the implementation of regulations?" And they laughed and said, "No."

And my point is, in any business you make the decision whether there is a benefit to the cost of the implementation. If the benefit is so small but the cost is so high, what is the point? And most regulations that come down the pike, they just say, "Well, that is what it is, and you have to comply."

Mr. LUETKEMEYER. It is interesting that Mr. Calhoun made the comment about the uncertainty that is causing difficulty in putting together a business model. And I think that Dodd-Frank and all the regulatory environment that we are in today makes that uncertainty very difficult to try and deal with. And it seems that you discussed that.

Mr. Grant, do you want to comment on that?

Mr. GRANT. Yes. I think, to the points that are made and why we would support the exam bill, it is to try to have some consistency of regulation. As it is, we actually have a pretty good relationship with our regulators. But when I talked to community bankers at a recent meeting, it is all over the board. There are some who are scared to death because the regulators just are very, very aggressive. And to the point made earlier, there doesn't seem to be any cost-benefit. So, just consistency is what we had need.

Mr. LUETKEMEYER. Thank you.

I have one more question before my time runs out. I will ask Mr. West, because he has been adamant during the discussion here about explaining all the additional costs that he is incurring.

How are you passing on those costs? Are you eating those costs? Are you passing them on to your consumers? Are you passing them on to your shareholders? How are you able to survive with those additional costs?

Mr. WEST. We have thin margins. We so far have not—and we purposely have not passed it on to the consumer, particularly in this economic environment. We have absorbed it, other than the one that I mentioned earlier on wire transfers. We did increase that by 100 basis points. It will be effective in a couple of weeks.

A couple of times on mortgages, we could have actually lowered the rate in the market just a hair, and we didn't because of some of the points that they are making.

Mr. LUETKEMEYER. So, in essence, you did raise the cost to consumers?

Mr. WEST. A little bit.

We, by nature, try not to charge fees. And what we spend a lot of time on, will we be forced down the road to change our business model and add fees when we don't want to? Because as a cooperative, all of our members have to share in the cost. So that is what worries us most right now, how do you deal with this ongoing in

the future. So, we haven't had to do it large-scale, but we are worried about it.

Mr. LUETKEMEYER. Thank you very much.

Thank you, Mr. Chairman.

Mr. RENACCI. Thank you.

I want to thank all the panel today for their testimony.

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 30 days for Members to submit written questions to these witnesses and to place their responses in the record.

This hearing is now adjourned.

[Whereupon, at 12:01 p.m., the hearing was adjourned.]

A P P E N D I X

May 9, 2012

Testimony of Michael Calhoun
President, Center for Responsible Lending

Before the House of Representatives Committee on Financial Services
Subcommittee on Financial Institutions and Consumer Credit

Hearing: Rising Regulatory Compliance Costs and Their Impact on the Health of Small Financial Institutions

May 9, 2012

Chairman Capito, Ranking Member Maloney, and Members of the Subcommittee, thank you for inviting me to testify at today's hearing. I look forward to answering your questions.

I currently serve as President of the Center for Responsible Lending (CRL), a nonprofit, nonpartisan research and policy organization dedicated to protecting homeownership and family wealth by working to eliminate abusive financial practices. CRL is an affiliate of Self-Help, a nonprofit community development financial institution with a 30 year track record of serving low-income, rural, women-headed, and minority families. Self-Help's two credit unions, the state chartered Self-Help Credit Union and the federally chartered Self-Help Federal Credit Union, manage a total of $950 million in assets for approximately 90,000 members in North Carolina and California. Prior to my current position at CRL, I have also served at various points as General Counsel, Director of Real Estate Development and Director of the Secondary Market Program at Self-Help.

In my testimony today, I would like to touch on three main points:

- **Abusive Lending Practices Led to the Ongoing Foreclosure Crisis, Which is Not Yet Halfway Over:** As we all know, the 2008 financial crisis and the related housing market collapse have been disastrous for households and communities across the country. CRL's research shows that we are not yet halfway through the foreclosure crisis, which was fueled by abusive lending practices that have disproportionately affected African-American and Latino borrowers.

- **Financial Reform – Including the Creation of the Consumer Financial Protection Bureau – is Good for Consumers as well as for Safety and Soundness:** In the years leading up to the 2008 financial crisis, federal banking regulators failed to protect consumers from abusive and predatory practices. This not only harmed individual consumers, but it also jeopardized the safety and soundness of financial institutions and the broader financial sector. The Dodd-Frank Wall Street Reform and Consumer

Protection Act – as well as the CARD Act – are important financial reforms that will produce benefits for both consumers and financial institutions.

- **Upcoming Regulations on Mortgage Lending Will Level the Playing Field for Consumers:** The Consumer Financial Protection Bureau's upcoming rulemaking on the Ability to Repay and Qualified Mortgage provisions in Dodd-Frank will be a critical reform, especially for communities that were targeted for mortgages with abusive and predatory terms. CRL supports an Ability to Repay and Qualified Mortgage rulemaking that 1) specifies a broad qualified mortgage definition to encompass the vast bulk of the market; 2) establishes bright lines providing lenders with certainty about whether a mortgage can be designated as a qualified mortgage; and 3) determines that qualified mortgage status is a rebuttable presumption and not a safe harbor from any future liability concerning lender requirements to determine a borrower's ability to repay a mortgage.

1. **Abusive Lending Practices Led to the Ongoing Foreclosure Crisis, Which is Not Yet Halfway Over.**

In looking at the current regulatory environment for financial institutions, I believe it is essential to begin my remarks today talking about the recent financial crisis and housing market collapse. It is an understatement, as we all know, to say that the last five years have been difficult ones for homeowners and communities. In recent years, homeowners have lost over $7 trillion in home equity, leaving over 11 million homeowners owing more on their mortgage than the current value of the house. Additionally, millions of homeowners have lost their home through foreclosure.

Further, the far-reaching impact of the 2008 financial crisis on financial institutions of all sizes has revealed the dramatic cost of lax regulation. Since 2008, over 400 financial institutions have failed, which is a substantial increase from 27 failures between 2000 and 2007. As of 2010, bank write downs and credit losses in the U.S. have exceeded $1 trillion.[1]

Over the last ten years, CRL has produced research highlighting the increased foreclosure risk posed by abusive lending practices. In 2006, which pre-dated the worst of the foreclosure crisis, CRL released a report estimating that abusive and predatory lending would lead to approximately 2.2 million foreclosures among subprime mortgages.[2] At the time, our report was denounced by the mortgage industry as absurdly pessimistic. Sadly, the system was even more

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[1] *See* Jan Schildbach, Deutsche Bank Research, *Direct fiscal cost of the financial crisis*, (May 14, 2010), available at http://www.dbresearch.de/PROD/DBR_INTERNET_EN-PROD/PROD0000000000257663.pdf.

[2] *See* Ellen Schloemer, Wei Li, Keith Ernst, and Kathleen Keest, *Losing Ground: Foreclosures in the Subprime Market and Their Costs to Homeowners*, (December 2006), available at http://www.responsiblelending.org/mortgage-lending/research-analysis/foreclosure-paper-report-2-17.pdf

loaded with risk than we reported, and the damage has been far worse, spreading from the subprime sectors to Alt-A loans, catalyzing a housing-led recession and triggering historic levels of unemployment.

At the end of last year, CRL released a report entitled *Lost Ground* that builds on our pre-2007 research to conclude that the country is not yet halfway through the foreclosure crisis.[3] This research shows that for mortgages made during the 2004 to 2008 lending boom, 8.3% were at least 60 days delinquent or in the foreclosure process as of February 2011. This represents another 3.6 million households that could possibly lose their homes. This is on top of the 6.4% of mortgages – totaling 2.7 million households – identified in CRL's study that have already gone through foreclosure. Because our research focused only on 2004 to 2008 originations, these estimates are likely to be on the conservative side. For example, Moody's has reported the completion of 5 million foreclosures or short sales already.

Lost Ground also demonstrates the link between abusive lending practices – which exploded between 2004 and 2007 – and higher foreclosure rates and serious delinquency rates. Loans originated by a mortgage broker, containing hybrid or option ARMs, having prepayment penalties, and featuring high interest rates (subprime loans) were all significantly more likely to be seriously delinquent or foreclosed upon than a 30-year fixed-rate mortgage without a prepayment penalty.

Research that controls for borrower characteristics confirms this link between abusive lending practices and foreclosure rates. In a study conducted by the University of North Carolina at Chapel Hill and CRL, the authors found a cumulative default rate for borrowers with subprime loans to be more than three times that of comparable borrowers (e.g., those with low FICO scores and high LTVs) who received prime loans through a Self-Help lending program.[4] Furthermore, the authors found that adjustable interest rates, prepayment penalties, and mortgages sold by brokers were all associated with higher loan defaults. In fact, when risky features were layered into the same loan, the resulting risk of default for a subprime borrower was four to five times higher than for a comparable borrower with the lower- and fixed-rate mortgage from a retail lender.

The costs of this steering and predatory lending have been particularly high for African-American and Latino borrowers. *Lost Ground* found that foreclosures and mortgage delinquencies continue to have had a disproportionate impact on African-American and Latino borrowers. It is critical to emphasize that this disproportionate impact persists even when

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[3] *See* Debbie Gruenstein Bocian, Wei Li, Carolina Reid, and Roberto G. Quercia, *Lost Ground, 2011: Disparities in Mortgage Lending and Foreclosures*, (November 2011), available at http://www.responsiblelending.org/mortgage-lending/research-analysis/Lost-Ground-2011.pdf.

[4] *See* Ding, L. et al. (2011). "Risky Borrowers or Risky Mortgages: Disaggregating Effects Using Propensity Score Models," *Journal of Real Estate Research* 33(2): 245-77.

comparing borrowers with higher incomes. CRL's research also demonstrates that African-American and Latino borrowers were much more likely to receive mortgages with the harmful features described above. For example, African-American and Latino borrowers with FICO scores above 660 were three times as likely to have a high interest rate mortgage than white borrowers in the same credit range.

2. Financial Reform – Including the Creation of the Consumer Financial Protection Bureau – is Good for Consumers as well as for Safety and Soundness

Self-Help is one of the country's largest community development financial institutions, and our mission is to create ownership and economic opportunity for all. Our two credit union affiliates, the state chartered Self-Help Credit Union and the federally chartered Self-Help Federal Credit Union, now manage $950 million in assets on behalf of nearly 90,000 members across North Carolina and California. In addition, Self-Help has provided over $6 billion in capital to more than 74,000 families of modest means, small businesses, and non-profit organizations. The credit unions have combined to help more than 4,700 families become homeowners and have originated more than 13,000 responsible auto and personal loans. Overall, 82% of Self-Help's borrowers have been low-income and 45% have been people of color.

Even before the financial crisis and housing market collapse, Self-Help and CRL had been at the forefront calling for proper regulation of abusive lending practices. Federal regulators should have been policing the marketplace and creating fair rules of the game. Instead, the agencies responsible for protecting depositors, shareholders, taxpayers, borrowers, and the general financial system failed. They stood by as predatory practices and dicey lending became commonplace, ravaging the mortgage market and setting off a chain reaction of financial devastation.

It was in the context of these massive federal regulatory failures that Congress enacted the Dodd-Frank Wall Street Reform and Consumer Protection Act, which included the creation of an independent Consumer Financial Protection Bureau. The history of the financial crisis is one in which prudential regulators – tasked with evaluating both safety and soundness and consumer protection concerns – largely focused on short-term profitability as an illusory proxy for safety and soundness, giving short shrift to consumer protection. By creating the CFPB, Congress wisely consolidated the consumer protection functions of the federal prudential regulators into one independent agency with a mission to protect borrowers from abusive financial practices. This will not only benefit borrowers, it will also help ensure the long-term sustainability of financial institutions.

Self-Help and CRL supported passage of the Dodd-Frank Act, including the creation of the CFPB in Title X and the Mortgage Reform and Anti-Predatory Lending Act in Title XIV. This support was out of recognition that proper regulation is necessary in order to have a marketplace that is safe for consumers of all incomes and for the ongoing safety and soundness of financial institutions themselves. It also reflects Self-Help's mission and belief in serving borrowers with affordable products that help families build wealth.

The mortgage reforms of the Dodd-Frank Act will prevent a reoccurrence of the mortgage crisis. They include limiting upfront points and fees to 5% for non-HOEPA loans; significantly limiting prepayment penalties; prohibiting compensation for mortgage originators based on loan terms other than principal balance (i.e., yield-spread premiums); prohibiting single premium credit insurance and mandatory arbitration; requiring that escrows be included for higher-price mortgage loans; requiring that lenders document income; and giving lenders incentives to offer safer, low-fee qualified mortgages. In addition, Congress gave the CFPB examination and enforcement authority over non-bank mortgage brokers and nonbank mortgage lenders and also provided the CFPB with rulemaking authority on national servicing standards. These efforts will not only level the playing field among industry actors, but they will also ensure that consumers have improved access to mortgage products and services that build wealth instead of stripping equity.

Much attention has been paid in recent months on the regulations resulting from the passage of Dodd-Frank. I think, however, it is worth emphasizing that the largest threats to Self-Help's operations – and to our depositors and borrowers – were the causes and outcomes of the 2008 financial crisis. In the aftermath of the crisis, we have had to focus our resources on helping customers and borrowers deal with the challenges of the current economy over making new loans, although this focus is changing as the economy improves. In contrast, Self-Help has not faced increased regulatory compliance costs as a result of Dodd-Frank to this point. Because Self-Help, along with most smaller depository financial institutions, does not engage in proprietary trading, for example, the Dodd-Frank provisions on this issue have not affected our credit unions. Instead, Self-Help's ongoing regulatory resources in the years following the financial crisis have continued to focus on areas such as Bank Secrecy Act requirements, although these obligations are not related to the financial crisis itself.

It would be overly simplistic to give the impression that Self-Help will never face regulatory compliance costs associated with Dodd-Frank requirements, but Self-Help does not anticipate this being an undue burden in the future. In addition, Self-Help's two credit unions and our depositors will benefit from a post-Dodd-Frank level playing field where large financial institutions and non-bank entities are supervised by the CFPB, which is particularly notable for those non-bank entities facing supervision for the first time. Furthermore, the regulatory reforms

included in Dodd-Frank will also help prevent future financial crises if they are implemented and enforced appropriately.

While the benefits of these Dodd-Frank provisions to level the playing field far outweigh the costs of adapting to this new regulatory system, it is also important to highlight that Dodd-Frank made several accommodations for smaller financial institutions in creating the CFPB's new authorities. This includes exempting small financial institutions with less than $10 billion in assets from CFPB supervision. Instead, all consumer protection supervision for these smaller institutions will remain with their prudential regulator. The CFPB is also required to evaluate and consider the impact of future rulemaking on small financial institutions, and the mortgage bill includes several accommodations to the needs of community banks. Additionally, Dodd-Frank requires the CFPB to reduce future regulatory burdens by streamlining regulations, such as CFPB's "Know Before You Owe" initiative to combine TILA and RESPA mortgage disclosures.

In addition to Dodd-Frank reforms, I should also mention reforms that have occurred because of the Credit Card Accountability, Responsibility and Disclosure Act (CARD Act). This legislation is another example of how improved oversight both benefits consumers and levels the playing field among lenders. Just yesterday, CRL released a new research report *Predatory Credit Card Lending: Unsafe, Unsound for Consumers and Companies* that examined marketing and pricing practices prevalent in the credit card industry before the CARD Act eliminated them.[5] These practices—which were often done in a deceptive, non-transparent way—included imposing high-cost penalty interest rates even when a consumer paid his card on time, manipulating indexes to calculate interest rates to the disadvantage of card holders, and shortening billing cycles to trigger late fees. The CRL report shows that credit card losses in the current downturn increased faster at banks engaged in such practices. That's because these predatory practices were not used as risk-management tools, as lenders claimed at the time. Instead, CRL's research shows, these predatory fees and rates didn't reflect the likelihood that a consumer would default but *were* the risk that drove consumers into default.

It is also worth noting that we found that these deceptive practices were concentrated among the largest credit card lenders, while smaller lender practices were much more transparent. And previous CRL research shows that CARD Act reforms have made pricing clearer, without making credit scarcer or more expensive.

In sum, strong consumer protections make pricing more transparent and lenders more financially stable. That's good for consumers, companies and the economy.

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[5] *See* Joshua M. Frank, *Predatory Credit Card Lending: Unsafe, Unsound for Consumers and Companies*, (May 2012), available at http://www.responsiblelending.org/credit-cards/research-analysis/Unsafe-Unsound-Report-May-2012.pdf.

3. **Upcoming Regulations on Mortgage Lending Will Level the Playing Field for Consumers.**

Before closing my testimony, I want to highlight the importance of the CFPB's pending rulemaking on Dodd-Frank's Ability to Repay and Qualified Mortgage provisions. The Ability to Repay provision requires lenders to make a "reasonable and good faith determination" of a homeowner's ability to repay a mortgage. Dodd-Frank then goes one step further and creates the Qualified Mortgage category of loans with sufficiently safe features so as to meet an ability to repay presumption.

The purpose of these Dodd-Frank provisions are to ensure that homeowners have broad access to 30-year, fixed-rate, fully amortizing loans with limited up-front fees instead of products with high fees and deceptive terms that borrowers cannot afford. Implementation of these provisions will improve the mortgage lending market for homeowners, particularly low-income homeowners and individuals of color who were disproportionately steered into high-cost and unaffordable loans in the years leading up to the 2008 financial crisis.

As the CFPB considers its final rulemaking on the Ability to Repay and Qualified Mortgage regulations, CRL has supported a rulemaking that 1) specifies a broad qualified mortgage definition to encompass the vast bulk of the market; 2) establishes bright lines providing lenders with certainty about whether a mortgage can be designated as a qualified mortgage; and 3) determines that qualified mortgage status is a rebuttable presumption and not a safe harbor from any future liability concerning lender requirements to determine a borrower's ability to repay a mortgage.

On the points raised above, there is broad consensus among both consumer advocates and lenders that the CFPB should write a broad Qualified Mortgage definition with clear standards. Such a definition will permit smaller institutions to make and sell loans to all of their creditworthy customers with the transparent terms they have always used, and with a reduced risk of litigation. Qualified Mortgage and Ability to Repay regulations adhering to these parameters will produce benefits that far outweigh the implementation costs to mortgage lenders.

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

May 9, 2012

Testimony of

William B. Grant

On behalf of the

American Bankers Association

before the

Subcommittee on Financial Institutions and Consumer Credit

of the

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Chairman Capito, Ranking Member Maloney, and members of the Subcommittee, my name is William Grant, Chairman and CEO of First United Bank and Trust. My bank is a 112-year old community bank, headquartered in Oakland, Maryland—a rural town in Appalachia with a population of about 2,000. We have assets of $1.38 billion, and serve four counties in Maryland and four counties in West Virginia. I also serve as Chairman of the Community Bankers Council at the American Bankers Association. ABA represents banks of all sizes and charters and is the voice of the nation's $13 trillion banking industry and its two million employees.

Every day community banks make loans to small businesses in your states and provide financial services to all your constituents. For decades—and in my bank's case more than a century—community banks 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.

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 is threatening the very existence of community banks.

Banks appreciate the importance of regulation that protects the safety and soundness of the bank and protects the interests of our customers. We know that there will always be regulations that control our business – but the reaction to the financial crisis has layered on regulation after regulation that does nothing to improve safety or soundness and only raises the cost of providing credit to our customers. As a banker, I feel like Mickey Mouse as the Sorcerer's Apprentice in Disney's famous cartoon Fantasia. Just like Mickey with bucket after bucket of water drowning him, new rules, regulations, guidances, and requirements flood in to my bank page after page, ream after ream. With Dodd-Frank alone, there are 3,894 pages of proposed regulations and 3,633 pages of final regulations (as of April 13) and we're only a quarter of the way through the 400-plus rules that must be promulgated.

While community banks pride themselves on being flexible and meeting any challenge, there is a tipping point beyond which community banks will find it impossible to compete. During the last decade the regulatory burden for community banks has multiplied tenfold, with more than 50 new rules in the two years ***before*** Dodd-Frank. Over the last decade 1,500 community banks have disappeared from communities. Each new law or regulation in isolation might be manageable, but wave after wave, one on top of another, will certainly over-run many more community banks.

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

I know that my credit union colleagues at this hearing share many of the same concerns as community banks regarding the monumental task in dealing with any new law or regulation or a

change in existing ones. Excessive regulation affects all lenders. While not the subject of this hearing, we do differ with the credit union trade associations on the issue of expanding the business lending cap for credit unions. As this Subcommittee is well aware, the banking industry is strongly opposed to an expansion of credit union business lending authority. It is hard enough for community banks to compete without Congress giving special privileges to a direct, taxpayer-subsidized, competitor. Simply put, a vote for expanding the cap on credit union business lending would be a vote against community banks.

Congress must be vigilant in overseeing regulatory actions. If left unchecked excessive regulation will surely negatively affect our customers. Holding oversight hearings like this one is critical to ensure that banks are allowed to do what they do best—namely, meet the financial needs of their communities.

There are three points I would like to make today.

- The costs to implement new regulations are substantial and weigh most heavily on community banks;
- The opportunity costs and unintended consequences of Dodd-Frank have far-reaching effects; and
- Dodd-Frank may drive many community banks out of lines of business altogether.

I. The Costs to Implement New Regulations are Substantial and Weigh Most Heavily on Community 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.

For my bank, we very conservatively estimate nearly $2.5 million 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 several dedicated compliance officers just to handle all the legal and paperwork requirements and, in addition, estimate that another 244, or 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.

Changes in existing regulations and the new regulatory requirements that will flow from Dodd-Frank have forced us to add another full-time compliance person. That cost, plus many other ancillary costs of these new changes will add another $275,000 to the overall cost. Of course, we are only in the early stages of the Dodd-Frank implementation, so we are bracing for additional costs that must somehow be borne. All these extra expenses could have been more productive if they were devoted to providing services to our customers.

As a $1.38 billion bank, we are better able to spread some of the compliance costs than our smaller brethren. For the median-sized bank in this country with $166 million in assets and 38 employees, the burden is magnified tremendously. One $70 million bank in Kansas that I spoke to recently 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.

For larger banks, Dodd-Frank imposes significant changes that are already driving an entire reevaluation of business lines and models. Together with the new Basel capital and liquidity rules these added costs total in the hundreds of millions of dollars.

For the industry, a very conservative estimate of all the hard dollar costs would be about $50 billion annually, or about 12 percent of total operating expenses. Given all the new obligations, it is likely that the cost is far greater particularly as new processes and systems are being implemented.

II. The Opportunity Costs and Unintended Consequences of Dodd-Frank Have Far-Reaching Effects

The direct out-of-pocket expenses are just part of the story when one realizes the significance of the opportunity costs. Instead of teaching staff to reach out to new markets, trainers are bringing the employees up to speed on the latest regulations. Instead of money being used to make loans to hardworking people and businesses in our communities, it is being spent on consultants, lawyers, and auditors. Instead of investing precious capital into new products to meet the ever-changing demands of our customers, banks are paying for changes to software to assure compliance with all the new changes. Excessive regulation saps staff and resources that should have gone to meeting the needs of our customers. Even a small reduction in the cost of compliance would free up billions of dollars that could facilitate loans and other banking services.

New regulations just keep being piled on top of older outdated requirements. Just to give you one example, many of my colleagues from Michigan to Georgia and in states from coast to coast are being targeted by enterprising lawyers for not having vigilantly maintained redundant paper signage on our ATMs alerting customers about the possibility of fees when any actual fees are fully disclosed on the screen before any transaction is completed. That there is a statutory requirement for such an outdated rule and a statutory private cause of action for its enforcement is mind-boggling, but worse it causes our bank employees to chase around to all our ATMs in an effort to assure that stickers that have no real value to today's customers have not been peeled off or been removed by vandals. That is why ABA supports H.R. 4367 and we thank Representatives Luetkemeyer and Scott for sponsoring this important piece of legislation. We hope this overdue fix becomes law as soon as possible.

Businesses—including banks—cannot operate in an environment of uncertainty. Unfortunately, Dodd-Frank increases the legal and regulatory uncertainty for banks. For example, consider the new "abusive" standard added in Dodd-Frank. Banks know that the definition will involve not just a new regulation, but years of court battles in many states before a standard emerges that is clear.

Let me highlight another example of unintended consequences. We thought that the Volcker rule was something that only our colleagues in the largest banks had to attend to.

Instead, the regulators have proposed to implement the Volcker rule in a way that requires even a bank of our size to carefully examine any security we buy to manage our mix of assets and liabilities so that we do not accidentally do something that the implementing rule may not permit. We will also have to review every community investment we make for the same reason. Both asset and liability management and community reinvestment are basic banking activities that our regulators expect us to do day to day. Now we have to develop policies and procedures to make sure we are evaluating those activities regularly in light of some 300 pages of technical regulatory guidance that is intended to address activities it wouldn't even occur to us to conduct.

These and other changes will have a pernicious impact on banks and their communities. They raise credit costs and litigation costs (for even minor compliance issues), lead to less hiring or even a reduction in staff, make hedging risks more difficult and costly, and restrict new business outreach. In fact, banks' biggest risk has become regulatory risk.

III. Dodd-Frank Rules May Drive Community Banks Out of Lines of Business

Congress must be vigilant in its oversight of the efforts to implement the Dodd-Frank Act to ensure that rules are adopted only if they result in a benefit that clearly outweighs the burden. Already we are seeing proposals—such as those implementing the rules regarding municipal advisors and swaps transactions—that fail that simple test. Some rules under Dodd-Frank, if done improperly, ***will literally drive banks out of lines of business.*** New rules on mortgage lending and on registration as municipal advisors are two particularly problematic provisions. Before discussing these, let me begin with a real situation where the potential legal risks—which are magnified by changes in Dodd-Frank—forced us out of a line of business.

First United serves customers in rural Maryland and West Virginia in the Appalachian Mountains, a region dotted with mobile homes. We use to offer the loans that enabled people to buy those mobile homes, but no more. Mobile home financing entails a great deal more risk than a mortgage on a single family dwelling. Late payments on mobile homes are consistently higher than nearly all other consumer credit products. Moreover, mobile home prices always tend to decline in a slow economy, not just in the severe recession that we have witnessed recently. As you are well aware, the way that all financial markets—not just banks—handle risk is to price for it. As a consequence, mobile home loans cost customers more. Since the customer base that

purchases mobile homes tends to be lower income, such pricing for risk can be misconstrued as predatory lending. For First United, this posed a very large legal risk and we decided it was not worth even the expense of refuting unfounded law suits to offer this product. Now people in our area have one less option in their search for home financing.

This story may be about to repeat itself in the ***entire*** mortgage market. One of the changes required in the Dodd-Frank Act is that lenders must show that borrowers meet an "ability to repay" test—***which can be challenged in court for the entire life of the loan***, raising the risk of litigation tremendously. It also imposes broad risk retention requirements on most loans sold into the secondary market. These requirements have the potential to make it much more costly for banks to make loans and could have the unintended consequence of denying quality loans to creditworthy borrowers.

Dodd-Frank does provide that banks can show they have met the ability to repay test by making loans that fall into a category known as a Qualified Mortgage or QM. The QM is intended to be a category of loans with certain low risk features made to borrowers shown to be creditworthy and able to meet the payment terms. The Consumer Financial Protection Bureau (CFPB) is tasked with finalizing a rule setting forth exactly what will qualify as a QM, but a number of concerns have arisen with regard to the approach which the CFPB may take. If the QM category is made too narrow by excluding too many loan types or by requiring borrowers to meet too high a standard of creditworthiness, then credit will contract and potential borrowers will be denied credit for which they would otherwise qualify. HUD Secretary Shaun Donovan shares this concern, noting in comments on April 19th that credit standards today are far tighter than those which led to the financial crisis, and that, in his own words: "I am very concerned that some of the proposals that have been out there would go too far in restricting credit going forward."

We also have grave concerns about the level of legal protection that the QM category will provide. The proposed rule, which was set forth by the Federal Reserve Board last year—but which will be finalized by the CFPB, set out two different options—for either a full safe harbor or for only a rebuttable presumption. Without the protections in a full safe harbor, banks will be forced to make loans that stay well within the boundaries of the rule to limit litigation risk.

Mortgage credit will contract, and many qualified borrowers who, while creditworthy, would see their hopes of homeownership vanish.

In order for QM to work, lenders must have the predictable, unambiguous legal protections that only a safe harbor provides. A broadly defined QM with a safe harbor will enable lenders to preserve flexibility. It will ensure that the largest number of creditworthy borrowers is able to access safe, quality loans for all housing types. It also will allow for quick disposition of lawsuits in cases where the borrower's ability to repay should not be in question. Borrowers also benefit: a safe harbor protects a borrower's ability to sue in cases of fraud, misrepresentation and wrongdoing. A safe harbor also minimizes litigation costs that would add to the cost of borrowing and divert resources that would otherwise be used for lending—ultimately a boon to both lender and borrower.

Much like the ability to repay rule's QM category, the risk retention rules required by Dodd-Frank also contain a category of loans, known as the Qualified Residential Mortgage or QRM, which would be exempt from risk retention requirements. The QRM is intended to include loans with certain characteristics that are proven to be well underwritten and of low risk to the borrower. However, the proposed risk retention rule, released last year by the federal banking regulators along with the SEC, HUD and FHFA, is far too restrictive in defining the QRM. The proposal would require a minimum twenty percent down payment by borrowers to meet the QRM definition—placing the vast majority of potential borrowers outside the QRM. The result will be unnecessarily higher costs for those borrowers—or an inability to qualify at all. Over 360 Members of the House and Senate have raised objections to this overly restrictive proposal, and we continue to press the regulators to revise this rulemaking.

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

Let me make this very clear: in my interactions with bankers on ABA's Community Banker's Council, I have already heard bankers say that they are considering ***ceasing their mortgage lending activities***. These are vibrant institutions with strong consumer lending programs who will conduct a risk/return analysis to determine whether it is worth the risk to continue offering one of the most basic bank products, home mortgages.

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

Another example of how Dodd-Frank rules may drive banks out of business is the implementation of the rules on municipal advisors. If done improperly, it will drive community banks out of providing basic banking products to local and state governments.

ABA believes that Dodd-Frank intended to establish a regulatory scheme for ***unregulated*** persons providing advice to municipalities with respect to municipal derivatives, guaranteed investment contracts, investment strategies or the issuance of municipal securities. Most community banks do not deal in bonds or securities. But community banks do offer public sector customers banking services and we are regulated closely by several government agencies.

The Securities and Exchange Commission has proposed a very broad definition of "investment strategies" that would cover traditional bank products and services such as deposit accounts, cash management products and loans to municipalities. This means that community banks would have to register as municipal advisors and be subject to a whole new layer of regulation on bank products for no meaningful public purpose. The result of this duplicate and costly regulation: community banks like mine may decide not to provide banking services to their local muncipalities, forcing these local and state entities to look ***outside*** of their community for the services they need. This proposal flies in the face of efforts to streamline federal oversight and avoid new regulations that impede innovation, diminish U.S. competitiveness, and restrain job creation and economic expansion.

We support H.R. 2827, introduced by Representative Dold. This legislation would exempt banks from Section 975 of the Dodd-Frank Act. If Congress fails to enact this legislation we urge you to oversee this implementation and ensure that the rule addresses ***unregulated*** parties and that ***neither*** Section 975 of Dodd-Frank or its implementing regulation should reach through to bank products and services.

Conclusion

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 growth. 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.

My bank's philosophy—shared by community banks everywhere—has always been to treat our customers right and do whatever we can to make sure that they understand the terms of the loans they are taking on and their obligations to us. We will continue to do this, but now there will be many new hurdles that we will have to jump to serve our customers' most basic needs that will inevitably add cost, time, and hassle for my customers.

GEORGETOWN UNIVERSITY LAW CENTER

Adam J. Levitin
Professor of Law

Written Testimony of

Adam J. Levitin
Professor of Law
Georgetown University Law Center

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

"Rising Regulatory Compliance Costs and Their Impact on the Health of Small Financial Institutions"

May 9, 2012
10:00 am
2128 Rayburn House Office Building

Witness Background Statement

Adam J. Levitin is a Professor of Law at the Georgetown University Law Center, in Washington, D.C., where he teaches courses in financial regulation. Professor Levitin has previously served as Special Counsel to the Congressional Oversight Panel supervising the Troubled Asset Relief Program (TARP) and as the Robert Zinman Scholar in Residence at the American Bankruptcy Institute.

Before joining the Georgetown faculty, Professor Levitin practiced in the Business Finance & Restructuring Department of Weil, Gotshal & Manges, LLP in New York, and served as law clerk to the Honorable Jane R. Roth on the United States Court of Appeals for the Third Circuit.

Professor Levitin holds a J.D. from Harvard Law School, an M.Phil and an A.M. from Columbia University, and an A.B. from Harvard College, all with honors.

Professor Levitin has not received any Federal grants nor has he received any compensation in connection with his testimony, and he is not testifying on behalf of any organization.

Ms. Chairman Capito, Ranking Member Maloney, Members of the Subcommittee:

Good morning. My name is Adam Levitin. I am a Professor of Law at the Georgetown University Law Center in Washington, D.C., where I teach courses in financial regulation. I have also previously served as Special Counsel to the Congressional Oversight Panel supervising the Troubled Asset Relief Program (TARP).

I am here this morning to urge the Subcommittee to be cognizant of the regulatory burdens on small financial institutions, but also to take a targeted, nuanced approach in considering any changes to the current regulatory regime. While there are areas in which regulatory burdens on smaller financial institutions can and should be reduced, it should be a surgical operation and not serve as cover for a broader ideological agenda of financial deregulation was a significant cause of the financial crisis in 2008.

In particular, it bears emphasis that the problems of smaller financial institutions are not the product of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010. The Dodd-Frank Act itself did little to affect the regulatory burden of small banks. Moreover, part of the Act, the Durbin interchange amendment, actually makes small banks more competitive in a core product market—the deposit account. The Durbin interchange amendment is arguably the single best legislative development for small banks in the past two decades.

Pointing the finger at "overregulation" avoids discussion of the real problems in the small bank business model in a world of megabanks. Going back to where we were before the financial crisis in terms of regulation will not stem the decline in the number of small banks and credit unions.

DOES DODD-FRANK AFFECT SMALL BANKS' REGULATORY BURDENS?

There is no doubt that the 849 pages of the Dodd-Frank Act plus its numerous implementing regulations will add to the regulatory burdens of financial institutions. This is not entirely a bad thing. Some of these increased burdens are misguided or wishful regulation, such as the Orderly Liquidation Authority in title II of the Act. Other provisions, however, are important and necessary safeguards to protect the U.S. economy from excessive risk-taking by financial institutions seeking to maximize their short-term profits such as we saw during the housing bubble from 2003-2008.

The 2008 financial crisis was driven primarily by the behavior of large banks, not small. Small banks and credit unions were generally victims, not perpetrators of this crisis. Accordingly, it would be unfair if small banks bore the brunt of the regulatory response. As it happens, however, few of the regulatory burdens of the Dodd-Frank Act actually fall on small banks and credit unions. Most of the burdens fall on the large banks and their investment affiliates.

While the financial institution lobbying associations testifying today are all concerned about regulatory burdens, it is simply hard to identify much in the Dodd-Frank Act that has already affected small banks' and credit unions' regulatory burdens. This is not to say that there are not significantly regulatory burdens that come with the privilege of a banking charter or that these burdens affect small banks more because they lack their larger competitors' economies of scale. But the problems facing small banks are not the product of the Dodd-Frank Act. Instead, it is simply increasingly difficult for smaller financial institutions to compete with larger banks

that can leverage economies of scale and more diversified lending bases to their advantage in terms of funding, hiring, technology, and compliance. This challenge is all the greater in a period of high unemployment, foreclosures, and underwater mortgages.

If Congress is looking to help make small banks more competitive, then rolling back the Dodd-Frank Act is hardly the way to go. The solution is not so much reducing regulatory burdens on small banks as increasing them on the too-big-to-fail megabanks so as to truly end our too-big-to-fail problem. Put another way, if we want to slim down our biggest banks, the solution is not to make smallness marginally cheaper, but to make bigness more expensive so that we do not have too-big-to-fail megabanks.

Turning to the Dodd-Frank Act itself, I can only identify a handful of provisions that meaningfully affect small banks' regulatory compliance burdens. Dodd-Frank has sixteen titles. Thirteen of the sixteen have no or the most indirect bearing whatsoever on small banks and credit unions: Titles I (financial stability), II (orderly liquidation authority), III (changes to bank regulators), IV (investment advisors for hedge funds), V (insurance), VII (swaps), VIII (clearinghouses), IX (securities investor protection), XI (Federal Reserve system changes), XII (authorizing grants for experimental small dollar loan programs) XIII (TARP fund repayment), XV (miscellaneous issues like conflicts minerals, and XVI (section 1256 contracts). That leaves only titles VI, X, and XIV to be addressed. An examination of these titles indicates that none of them have yet to increase small banks' regulatory burdens and that they could in fact help to *decrease* them in some instances.

Title VI

Title VI of Dodd-Frank makes changes to the regulation of bank holding companies. By and large these changes are incremental; they do not add major new compliance costs. Instead, title VI does things like expand the limitation on loans to insiders to include derivative transactions that may be economically equivalent to a loan exposure.[1] While there is some increased compliance cost to determining if a derivative transaction with an insider qualifies, this is not a likely scenario for small banks.

Title X

Title X of Dodd-Frank creates the Consumer Financial Protection Bureau (CFPB). While the CFPB has been the focus of a great deal of angst from the financial services industry, it has not materialized as the boogeyman that was feared. To date, the CFPB has not undertaken any action that would warrant alarm except from those opposed to consumer protection as an ideological matter.

The CFPB has also had little effect on small banks thus far. First, the CFPB does not have examination authority over small banks.[2] That authority remains with the small banks' prudential regulators. Second, other than a rulemaking on remittances required by Dodd-Frank,[3] the CFPB has not yet engaged in a rulemaking under a power created by Dodd-Frank. *All other CFPB rulemaking activity has been under pre-existing federal consumer protection laws that were merely transferred to CFPB as part of Dodd-Frank.* Therefore, it is hard to point to Dodd-Frank as having already created additional regulatory burdens for small banks via the CFPB,

[1] Dodd-Frank Act § 611, *codified at* 12 U.S.C. §1828(y).
[2] Dodd-Frank Act § 1026, *codified at* 12 U.S.C. § 5516.
[3] Dodd-Frank Act § 1073, *codified at* 15 U.S.C. § 1693o-1.

with one exception: section 1071's requirement that the CFPB collect data on small business loans.[4]

A. Section 1071 (Small Business Data Collection)

Section 1071's small business loan data collection requirement (not yet implemented via regulation) will add to small banks' regulatory burden. The real burden, however, is fairly minimal. It should not take a lot of effort to obtain and record some very basic information about a borrower and to keep it separate from the loan underwriting process: the date of the loan application, the type and purpose of the loan being applied for, the amount of credit applied for and approved, the bank's action on the loan (grant, deny, etc.), the census tract of the residence of the applicant's principal place of business (the FFIEC website enables free conversion of street addresses to census tracts[5]), the applicant's gross annual income in the preceding year, and the applicant's race, sex, and ethnicity. This is less than a page of information to be requested from a borrower. Obtaining it, recording it into an electronic record, and storing that record so that it cannot be accessed by underwriters involves some minor initial costs and then *de minimis* on-going compliance costs.

There is also good reason, however, to mandate this data collection. First, financial regulators know shockingly little about lending. It may surprise members of this Subcommittee, but federal regulators do not know basic things like the number of mortgages in the United States (estimated to be between 50-60 million), the amount of credit card debt (the Federal Reserve's statistics lump together credit card debt with overdraft and other revolving consumer debt), or the amount of student loan debt (simply estimated). Likewise, we are told that community banks are the major source of credit for small businesses. I have no reason to doubt it, but I am unaware of any hard data supporting the claim. It's hard to craft good regulatory policy without good data; absent data, regulators are flying blind.

Second, the small business lending data collection requirement is meant to facilitate the application of the Equal Credit Opportunity Act, particularly to protect women-owned and minority-owned small businesses from discriminatory lending. The simple collection of the data may itself help to ensure against discriminatory lending, but without the data it is difficult to determine if such discriminatory lending does in fact exist. If we value fair, equal, non-discriminatory access to credit as a society, then this data collection is the price to pay for it.

Other than section 1071, however, title X of Dodd-Frank does not in and of itself add to small banks' regulatory burdens. If and when the CFPB starts to use its Dodd-Frank rulemaking powers other than under the "enumerated consumer laws" transferred to the agency, this situation may change, but until that point, it is premature to point to title X or the CFPB as a source of increased regulatory burdens. The CFPB has not yet materialized as the boogeyman of over-regulation. Indeed, the transfer of existing federal consumer laws to the CFPB actually added a layer of additional protection from undue regulation for small banks. The CFPB, unlike other federal financial regulators, is required to submit its rulemakings to small business panels for preliminary review under the Small Business Regulatory Fairness Act. Thus, the transfer of existing federal laws to the CFPB is likely to reduce, rather than increase regulatory burdens as the result of rulemaking activity.

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[4] Dodd-Frank Act § 1071, *codified at* 15 U.S.C. § 1691o-2.
[5] http://www.ffiec.gov/Geocode/default.aspx.

B. Section 1075 (Durbin Amendment)

Title X of the Dodd-Frank Act also includes the Durbin Interchange Amendment (section 1075 of the Act).[6] While many small banks and credit unions opposed the Durbin Amendment, it has thus far proven to be a competitive boon for them, as I and others predicted.[7] The Durbin Amendment is the single best piece of legislation for small banks in the past two decades.

Statistics released by the Federal Reserve Board this month indicate that the Durbin Amendment has resulted in two-tiered interchange fee pricing that is very favorable to smaller banks and credit unions, which are making on average 50 basis points or 19 cents more than large banks on every debit card transaction.[8] Small banks feared that there would not be two-tiered pricing, but there is every reason for the payment card networks to have two-tiered pricing as they compete for small banks' business.

The Federal Reserve statistics also show that small banks' share of the debit card payment market increased slightly,[9] perhaps as a result of consumers shifting their accounts away from large banks that have tried, unsuccessfully to make up for reduced interchange revenue by raising consumer fees. In other words, the Durbin Amendment has helped level the playing field for small banks to compete for payments, where they face disadvantages because they lack the large banks' economies of scale. By making small banks more competitive with deposit accounts—the gateway financial product—they are more competitive in general because of greater cross-selling opportunities. In any event, the Durbin Amendment creates no real regulatory burdens for small banks; its burdens fall on payment card networks.

Title XIV & Escrow Requirements

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

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

Title XIV actually offers an opening for *reducing* compliance costs for small banks. A major pre-Dodd-Frank Act compliance cost for small banks was the Reg Z escrow requirement for high-cost Home Ownership and Equity Protection Act of 1994 (HOEPA) loans.[10] In July 2008, the Federal Reserve promulgated its first rulemaking under HOEPA. The rulemaking required that borrowers have the ability to repay, prohibiting some prepayment penalties, and

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[6] Dodd-Frank Act § 1075, codified at 15 U.S.C. § 1693o-2.

[7] *See, e.g.*, Adam J. Levitin, *Interchange Regulation: Implications for Credit Unions*, Filene Research Institute, Issue Brief 224 (Nov. 2010), at 37-39, *at* http://www.law.georgetown.edu/faculty/levitin/documents/LevitinFileneInterchangeBrief.pdf.

[8] *See* Board of Governors of the Federal Reserve System, Average Debit Card Interchange Fee by Payment Card Network, *at* http://www.federalreserve.gov/newsevents/press/bcreg/bcreg20120501a1.pdf. *See also*, accompanying data release, *at* http://www.federalreserve.gov/newsevents/press/bcreg/bcreg20120501a2.xls.

[9] *Id.*

[10] 12 C.F.R. § 226.35(b)(3).

requiring escrowing of taxes and insurance.[11] The escrow provision did not go into effect until April 2010, in response to community bank concerns about the difficulties and costs in setting up escrows.[12]

The reach of the escrow requirement is quite broad in a low interest rate environment. Higher priced loans are currently defined as those with APRs at least 1.5 percentage points higher than the prime rate for loans within the GSE conforming loan limit or at least 2.5 percentage points higher than the prime rate for loans larger than the conforming loan limit.[13] In today's low-rate environment, this means a 5.26% APR loan could require an escrow.

Section 1461 of the Dodd-Frank Act authorizes the CFPB to exempt small originators or those in rural and underserved areas from escrow requirements.[14] While an understanding of the particular cost problems involved in escrowing would seem essential to any rulemaking,[15] it seems reasonable for the CFPB to exercise its authority to exempt some depositaries from the escrow requirement. The CFPB has not yet passed regulations under title XIV or on HOEPA loans, but it is important to recognize that CFPB regulatory action can *decrease* as well as increase regulatory burdens.

SMALL BANKS' REGULATORY BURDENS

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

There are unquestionably financial regulations that do little other than add to regulatory burdens. For example, the Gramm-Leach-Bliley Act/Reg P privacy disclosures create an on-going regulatory burden for financial institutions, which have to craft their privacy policies and send annual disclosures to consumers, irrespective of whether there have been changes to the policies.[16] Yet the benefits from these disclosures are at best small and likely non-existent or negative; few consumers read the policies, and they cannot be negotiated. Gramm-Leach-Bliley Act privacy disclosures instead substitute for meaningful substantive privacy protections. While I would urge Congress to consider more substantive privacy protections rather than mere disclosure that there are few protections, I would also urge the elimination of the entire Gramm-Leach-Bliley Act privacy disclosure requirement even if there is no substantive replacement, and, at the very least, eliminate the requirement of an annual disclosure when there has been no change to the policy.

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[11] 73 Fed. Reg. 44522-44614 (July 30, 2008). If the Federal Reserve Board had acted on its regulatory authority between 1994 and 2008 rather than deliberately refraining from regulation because of an ideological antipathy toward regulation, the housing bubble and ensuring financial crisis would have been much less severe.

[12] 73 Fed. Reg. 44562 (July 30, 2008).

[13] 15 U.S.C. § 1639d(b)(3)(A)-(B).

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

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

[16] 15 U.S.C. § 6803; 12 C.F.R. § 216.5.

In considering the regulatory burdens on small banks, it is important not to lose sight of something very fundamental: banks exist first and foremost to serve the public and only secondarily for their shareholders. Banks are not like ordinary businesses. Entry into banking is limited. It is a privilege, not a right, and banks have duties and responsibilities that no other businesses have because of their special role in the national economy. Banks' right to make a profit is always subject to their safe and fair provision of financial intermediation services.

There's a rough market barometer of whether we are overregulating the banking industry, namely whether banking is attracting sufficient private risk capital to meet America's financial intermediation needs. Putting aside the long-standing problem of provision of financial services to rural or poor urban communities (situations in which small depositaries are especially important), there is nothing that that regulation is driving out public risk capital by depressing bank profitability to the point that a bank is an unattractive investment. As it is, the size of the US banking sector has been growing, not shrinking.[17] (The number of banks has been shrinking,[18] but that is a separate issue about real and perceived economies of scale in financial services.)

CONCLUSION

There's a lot to like about small depositaries—they're community-based, the service is better, and they generally don't try to ensnare their customers—their neighbors—with tricks and traps. Their business model is built on relationships and loyalty. Yet, it's not clear whether the small bank business model is long-term viable against large banks in an age of interstate and international branch banking any more than the corner green grocer can survive against Wal-Mart.

Unfortunately, there's a temptation for small banks to point the finger at overregulation because they believe they are more likely to accomplish changes there than by pushing against too-big-to-fail, and this lets small banks' business model problems be hijacked for ideological deregulatory agendas. But does anyone really believe that repealing regulations like the requirement that ATMs have signage merely noting that fees may apply will fundamentally affect the position of small banks?[19]

If we truly value small banks, the best way to help them is not to chip away at their marginal regulatory burdens and pretend that it will fix everything. The strains on the small banking business model should not provide cover for deregulatory agendas. Instead, to help small banks, we need to focus on eliminating too-big-to-fail institutions that put the entire economy at risk.

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[17] FDIC Statistics on Depositary Institutions (Total Assets, All Institutions—National) (showing annual growth every year since 1992 with the exception of decline from 2008-2009).

[18] FDIC Statistics on Depositary Institutions (Number of Institutions Reporting, All Institutions—National).

[19] *See* Letter from ICBA to CFPB, dated Mar. 5, 2012, *at* http://www.icba.org/files/ICBASites/PDFs/ICBA%20Comment%20Letter%20CFPB%202011%200039.pdf (urging the repeal of ATM signage requirement of 12 C.F.R. § 205.16(c)).

Testimony of

Ed Templeton

President and CEO of SRP FCU

"Rising Regulatory Compliance Costs and

Their Impact on the Health of Small Financial Institutions"

On behalf of

The National Association of Federal Credit Unions

Before the

House Financial Services Committee

Subcommittee on Financial Institutions and Consumer Credit

United States House of Representatives

May 9, 2012

Introduction

Good morning, Chairman Capito, Ranking Member Maloney, and members of the Subcommittee. My name is Ed Templeton and I am testifying today on behalf of the National Association of Federal Credit Unions (NAFCU). Thank you for holding this important hearing. We appreciate the opportunity to share our views on the impact that rising regulatory compliance costs are having on credit unions and their member-owners.

I am the President and CEO of SRP Federal Credit Union, headquartered in North Augusta, South Carolina. I have been with SRP in this capacity for nearly 25 years. SRP has $600 million in assets and serves more than 100,000 members at over 20 branches across the entire Central Savannah River Area community in both South Carolina and Georgia. I also serve as Treasurer on the Board of Directors at NAFCU.

I formerly served on the NAFCU Education Committee and was President of the Columbia Chapter of Credit Unions. I received my BBA from Augusta College, graduated from the Georgia School of Banking and the BAI School of Bank Administration at the University of Wisconsin.

As you know, NAFCU is the only national organization that exclusively represents the interests of our nation's federally chartered credit unions. NAFCU is comprised of over 800 member-owned and operated credit unions. NAFCU member credit unions collectively account for approximately 66% of the assets of all federally chartered credit unions.

Background on Credit Unions

Historically, credit unions have served a unique function in the delivery of necessary financial services to Americans. Established by an Act of Congress in 1934, the federal credit union system was created as a way to promote thrift and to make financial services available to all Americans. Credit unions have been widely recognized as a banking alternative for those who would otherwise have limited access to financial services. Congress established credit unions as an alternative to banks and to fill a precise public need – a niche still filled today for nearly 94 million Americans.

Every credit union is a cooperative institution organized "for the purpose of promoting thrift among its members and creating a source of credit for provident or productive purposes." (12 U.S.C. §1752(1)). While over 75 years have passed since the *Federal Credit Union Act* (FCUA) was signed into law, two fundamental principles regarding the operation of credit unions remain as critically important today as they were in 1934:

- Credit unions remain singularly committed to providing their members with efficient, low-cost, personal service.

- Credit unions continue to emphasize traditional cooperative values such as democracy and volunteerism.

The nation's approximately 7,100 federally insured credit unions serve a different purpose and have a fundamentally different structure than banks. Credit unions exist solely for the purpose of

providing financial services to their members while banks strive to make a profit for their shareholders. As owners of cooperative financial institutions united by a common bond, all credit union members have an equal say in the operation of their credit union – "one member, one vote" – regardless of the dollar amount they have on account. These singular rights extend all the way from making basic operating decisions to electing the board of directors. Federal credit union directors also generally serve without remuneration – a fact epitomizing the true "volunteer spirit" permeating the credit union community.

Today, credit unions continue to play a very important role in the lives of millions of Americans from all walks of life. As consolidation among financial depository institutions has progressed, and the delivery of financial services has become much less personal at some large banks, consumers are not only focused on services provided but also the quality and cost of what is available to them. While many large banks have increased their fees and curtailed customer service as of late, credit unions continue to provide their member-owners with high quality personal service at the lowest cost possible. This is evidenced, most recently, by the thousands of Americans that turned to their local credit unions as national banks proposed new monthly fees on basic banking services.

Credit Union Performance & the Financial Crisis

While lending practices of many other financial institutions contributed heavily to the nation's subprime mortgage debacle, credit unions and other community based financial institutions were not the cause of the housing and financial crises. As the Subcommittee is aware, this point has been made by members of the House Financial Services Committee on both sides of the aisle.

Still, credit unions have consistently been among the most highly regulated of all financial institutions, facing restrictions ranging from who they can serve to their ability to raise capital.

Despite the fact that credit unions are already heavily regulated, were not the cause of the financial crisis and actually helped blunt the crisis by continuing to lend to credit worthy consumers during difficult times, they are still firmly within the regulatory reach of provisions contained in the *Dodd-Frank Act*. The additional regulatory requirements mandated in this massive overhaul have added to the overwhelming number of compliance burdens for credit unions. Undoubtedly, an immense amount of time, effort, and resources will be expended at credit unions as they struggle to keep up with new regulation.

Increasing Compliance Burdens at Credit Unions

Today's hearing could not be more timely or more important to our nation's credit unions. NAFCU appreciates the opportunity to discuss the impact of increased regulatory burden on credit unions today and how this unchartered territory, including the creation of the Consumer Financial Protection Bureau (CFPB), could impact credit unions in future years. While the focus of today's hearing is on small financial institutions, **all** credit unions have felt the impact of increased regulatory burden.

While not the direct subject of this hearing, providing credit unions relief from the outdated arbitrary member business lending cap and allowing credit unions access to supplemental capital would provide some needed regulatory relief from outdated restrictions.

In April 2011, NAFCU surveyed its membership about what they were experiencing with respect to increased regulatory burdens. Almost all of the survey respondents (96.4 percent) said that their credit union spends more staff time on regulatory compliance issues today than it did in 2008, and most of those respondents did not expect to spend any less time on compliance issues over the next 12 months (96.3 percent). Survey participants further stated that, on average, 14.1 percent of staff time, as measured by their credit union's total full-time equivalents, was spent on compliance issues in 2010. The majority of the responding credit unions (82.7 percent) indicated that this number had increased when compared to 2009, while the remaining 17.3 percent did not see any change. None of the credit unions responding experienced a decrease in the staff time spent on regulatory compliance issues in 2010.

My credit union is experiencing the same thing, as we recently doubled our compliance officers from one to two. Additionally, my staff and I spend much more time today focused on compliance issues than we did just a few short years ago.

While three quarters of the survey respondents indicated that their credit union was, at the time, not considering reducing any products and/or services as a result of the increased regulatory burden, almost two thirds said they have increased or were considering increasing fees on products and/or services due to the increased regulatory burden cost or loss of other income due to recent regulatory changes. In addition, one quarter of responding credit unions stated that they were anticipating accepting mergers or were considering merging itself out as a consequence of the increased regulatory burden.

My testimony below will outline how the *Dodd-Frank Act* is creating new challenges and uncertainty for credit unions. The mandates of the new CFPB could lead to an overwhelming tide of new compliance burdens. It will be incumbent upon the Bureau and Congress to ensure that the CFPB also meets its goals of streamlining regulation and protecting small entities in every action that it takes.

Challenges for credit unions do not only come from Dodd-Frank and the CFPB, but also the National Credit Union Administration (NCUA). While the government-wide review of regulation appears to be a step in the right direction, it will be up to the NCUA and other agencies to ensure that real changes are made and not just given lip-service.

Finally, regulatory burden also come from a number of outdated laws on the books. We hope Congress will take steps to pass legislation that will help relieve some of these heavy burdens on our nation's credit unions.

New Burdens Stemming from the Dodd-Frank Act

One of the biggest impacts on my credit union from the *Dodd-Frank Act* has been the hastily crafted debit interchange provision added in the Senate. While my credit union was supposed to be unaffected by this provision, that has not been the case. We have seen market forces drive our average debit interchange rate down about 1-2 cents per transaction (depending on PIN or signature usage) since its enactment. Furthermore, in order to comply with the new routing requirements stemming from this provision, my credit union had to re-issue hundreds of plastic cards at a cost of over $2.00 per card. While you may hear reports that some small institutions

have not been impacted by these new rules, there are other small ones like mine out there that have felt the impact. As discussed below, the biggest impacts from *Dodd-Frank* remain to be seen.

Dodd-Frank Rulemaking Underway

While NAFCU encourages in-depth review of existing regulations, credit unions already find themselves struggling to keep their heads above water as a steady stream of Dodd-Frank related regulation moves forward.

As widely publicized, the CFPB estimated that its first rule on international remittance transfers would require 7.7 million total employee hours of work for the industry to implement and comply with. This mindboggling headline strikes at the very core of what credit unions fear most – Dodd-Frank mandated regulation will be finalized so quickly, and so often, that community-based financial institutions simply won't be able to keep up. In a recent letter to JPMorgan Chase stockholders, CEO Jamie Dimon estimated that over the next few years 3,000 employees will be devoted full time toward helping the megabank come into compliance with regulatory changes. While my credit union will be subject to a number of the same regulations, I have just two employees working on compliance issues. I just hope we can keep up and continue to serve our members.

It is worth noting that revisions that led to the CFPB's final rule on international remittance transfers were originally proposed by the Federal Reserve, but as mandated in Dodd-Frank, finalized by the CFPB. On the same day the rule was finalized, the CFPB simultaneously issued

a proposed rule and request for comment that sought feedback on the disclosure process for recurring remittance transfers. The proposed rule also sought comment on whether it should allow an exception for institutions that infrequently provide such services. NAFCU appreciates the Bureau's decision to seek more input regarding the unique problems that arise with preauthorized or reoccurring electronic fund transfers. We hope the CFPB continues to seek input, when necessary, on difficult issues such as this.

Under the proposed rule, an exception for remittance transfer providers, presumably made to accommodate small financial institutions, falls far short of offering any tangible relief to credit unions who operate in this space. Those providers making less than 25 international remittance transfers a year would be exempt and therefore free of the extensive disclosure requirements that are mandated for those providers above that threshold. This arbitrary and exceptionally low number will not provide relief for credit unions.

Furthermore, a vast majority of credit unions that provide remittance transfer services rely on open network systems. By the CFPB's own admission, under the rule already finalized, it will be exceedingly difficult for open network systems, as currently configured, to comply. This leaves credit unions with two plausible choices – stop providing international remittance transfers, a service that many members utilize and value, or pay for a massive reconfiguration of the payment networks needed to comply. It should be noted that Congress only recently gave credit unions the ability to provide remittances for all consumers in their field of membership, in an effort to reach the under- or un-banked. The cooling of remittances will very likely

discourage those populations from using credit unions, and other traditional financial services providers.

While the international remittance transfer rule was the first and only rule related to *Dodd-Frank* to be finalized by the CFPB thus far, there are an overwhelming number of upcoming Dodd-Frank mandates that will directly impact credit unions. The CFPB's mandates are particularly daunting as related to Regulation Z, the implementing regulations for the *Truth in Lending Act* (TILA). Nearly every aspect of current compliance requirements with respect to operating a mortgage portfolio has the ability to change.

By January 2013, the CFPB is expected to expand the scope of coverage under the *Home Ownership and Equity Protection Act*, address mortgage origination and mortgage servicing standards, amend rules associated with the *Truth in Lending Act* and *Financial Institutions Reform, Recovery, and Enforcement Act*, change requirements for escrow accounts and issue rules under *Dodd-Frank* relative to what constitutes a "qualified mortgage." While many of the details are yet to emerge, the sheer pace at which these new rules are scheduled to be implemented should cause serious pause. Even if they are well-intentioned and ultimately bring about positive changes, there is a burden on small institutions in just keeping up.

With respect to mortgage lending, NAFCU would like to take this opportunity to recognize the CFPB's efforts in collecting information from credit unions as they work to streamline mortgage disclosure forms to be provided to consumers at settlement. A colleague of mine that also sits on NAFCU's board participated in the recent Small Business Regulatory Enforcement Fairness Act

review panel on this topic, and was encouraged that the Bureau appears to be carefully considering the impact of this action on small institutions. NAFCU is hopeful that these panels will be held in the future, and input given will translate into commonsense rulemaking that doesn't create additional and unnecessary compliance burdens for credit unions. That will be the true test.

Review of Existing Regulations

In January of last year, President Obama announced a government review of existing regulations. We hope that this ongoing review by the Administration and the efforts by Congress will help identify the problem that credit unions like mine know all too well – the issue is not necessarily one single bill or regulation, but the cumulative effect of new regulations piled on top of each other, without studying the effects placed on small financial institutions that don't have an army of lawyers with which to comply. These burdens do not just come from one or two regulators, but from a panoply of federal agencies and laws that can impact our business. For small financial institutions, this is almost a death by a thousand cuts.

As part of this review, National Credit Union Administration (NCUA) Chairman Debbie Matz informed the Obama Administration that, since NCUA began to review their regulations every three years, they have been successful in reducing regulatory burdens. However, I can say from a credit union perspective that despite their claimed "success", burdens on credit unions remain. It is still unclear to credit unions whether there is a true process for NCUA to eliminate regulations or if they have set or met any particular benchmarks in reducing compliance burdens.

In the past two years, NCUA has made changes to its Regulatory Flexibility (RegFlex) program. Under the RegFlex regime certain well-run credit unions were exempt from a number of regulatory requirements. Recently, NCUA expanded the RegFlex program to include all credit unions, but it also eliminated two very beneficial RegFlex provisions relative to fixed assets and personal guarantees. NAFCU feels that NCUA can and should do much more to eliminate outdated regulation. Even small changes to NCUA's rules can have a major impact on operations. Furthermore, NCUA should actively embrace and take into consideration technology advancements when promulgating regulations – that would be one way to ease some burden.

Updating Outdated Regulations

Despite the well-meaning intent behind the creation of the new CFPB, NAFCU is concerned with the impact it will have on credit unions of all sizes. The Bureau has rule writing authority over all credit unions, regardless of size, meaning all stand to face new compliance burdens every time a rule is updated or a new regulation is released.

As the CFPB ramps up, NAFCU has actively participated in the Bureau's request for comment on an array of issues including regulatory streamlining. To truly understand how the onslaught of regulation scheduled to be finalized through Dodd-Frank will impact credit unions, one must look at the regulatory environment that already exists. NAFCU is hopeful that the CFPB will use its authority not only to identify, but also to streamline and simplify regulation where possible. If the CFPB and other regulators will not do this in a timely and effective manner, Congress must step in and do so. Amending or eliminating outdated regulation must be a

priority as unnecessary day-to-day compliance costs at credit unions represent resources that could otherwise be used to help members purchase a new car or start a new small business.

A prime example of an outdated compliance burden is the redundant and unnecessary requirement in the Electronic Funds Transfer Act and its implementing rule (Regulation E – 12 CFR 1005.16) requiring automated teller machine (ATM) operators to provide two separate notices to consumers regarding the imposition of a fee for use of the ATM. The first is a fee disclosure on the ATM screen where a consumer is required to affirmatively indicate whether he or she accepts the fee. If the fee is declined, the transaction is cancelled. NAFCU fully supports this type of prudent disclosure. However, Regulation E also requires ATM operators to attach a physical placard to the ATM stating that a fee may be charged. If the physical placard isn't attached, the law creates a right of action against ATM operators. Unfortunately, there are unscrupulous individuals out there remove or obscure the sign in order to bring such a law suit. Consequently, my staff must spend time constantly policing all of SRP's ATM machines at various branches to ensure documentation, as the threat of frivolous lawsuits is very real.

NAFCU strongly supports the bipartisan legislation (H.R. 4367) introduced by Financial Service Committee members Blaine Luetkemeyer (R-MO) and David Scott (D-GA) that would eliminate the unnecessary placard fee disclosure requirement. NAFCU has also urged the CFPB to exercise its broad authority to address this outdated regulation.

Another increased burden for credit unions comes from recent changes in the exam process. Part of the response to the economic crisis was to create new layers of regulation and institute more

aggressive enforcement of existing law. In order to aggressively enforce new and old regulations and to avoid a repeat of the crisis, regulators have increasingly tightened examination standards. Exam cycles are shorter, adding an element of burden to credit unions as staff time and resources are dedicated to prepare and respond to the exam. It is with this in mind that we also urge the committee to move forward and vote on the *Financial Institutions Examination Fairness and Reform Act* (H.R. 3461) introduced by Chairman Capito and Ranking Member Maloney.

As you know, H.R. 3461 will bring additional transparency and consistency to the examination process by establishing an Office of the Ombudsman within the Federal Financial Institutions Examination Council. The legislation would apply to both the NCUA and the CFPB and could help foster consistency in the exam process as credit unions navigate a new regulatory landscape.

It is important to understand that the current NCUA exam manual is more than five years old, with outdated law and citation. They are currently in the process of revision, but this will likely take another two years before completion. How can a credit union be expected to be in full compliance when their exam manual is filled with law that is no longer applicable? This is extremely burdensome for all credit unions.

In addition to these two examples, I cannot overstate how critical it is for the CFPB to review and simplify the complex regulatory framework credit unions already face. Such an effort could help mitigate layering regulation upon regulation to the detriment of credit unions and their member-owners.

Another example of the CFPB using its authority to simplify compliance matters for credit unions without any substantive change to the protection afforded to consumers, would be reviewing the adverse action notices required under Regulation B (Equal Credit Opportunity Act - ECOA) and very similar risk-based pricing notices required under Regulation V (Fair Credit Reporting Act - FCRA). In July 2011 the Federal Reserve finalized two rules on model adverse action notices and risk-based pricing notices to implement section 1100F of the Dodd-Frank Act pertaining to credit score information. These two very closely linked issues cause confusion as the FCRA's adverse action notice requirements have no implementing regulation. In order to comply with the FCRA's adverse action notice, creditors may use the model forms included in Regulation B intended to implement the ECOA. The rest of the FCRA, however, is implemented through Regulation V. NAFCU believes this unnecessarily complicated situation offers CFPB an opportunity to rewrite the regulations in a way that is simple and more straightforward. We hope that they will use their authority to address this in a timely and efficient manner.

At SRP FCU we spent an enormous amount of time adjusting our software to accommodate the risk-based pricing disclosure requirements described above. Staff attention to this issue encompassed a number of departments at my credit union including IT, credit, and compliance. Making commonsense changes to streamline the model forms for risk-based pricing and adverse action notices would immediately diminish the number of staff hours necessary to produce the requested information without altering the content of what SRP provides to the members.

Attached for the Subcommittee's review, please find NAFCU's detailed response to the CFPB's request for comment on regulatory streamlining (Docket No. CFPB-2011-0039). Again, NAFCU

and its member credit unions remain hopeful that steps are taken to update and streamline existing regulation before new regulation is simply pushed through and layered on top of it.

Cost-Benefit Analysis

One thing that is unfortunately missing from far too many regulations and laws is a robust cost-benefit analysis for the changes that are sought. This is particularly important with not-for-profit credit unions. Are the benefits to the consumer greater than the cost of compliance? At a not-for-profit credit union, each dollar spent on compliance is a dollar unavailable for serving members or providing them with the loan that they need.

Federal agencies are required to conduct cost-benefit analysis before they issue certain proposed or final rules. These requirements have been added incrementally by various statutes and executive orders over the past 50 years. The elements of analysis usually include some or a combination of the following: quantitative and qualitative estimates of costs and benefits, effects on the national economy, consideration of a range of alternatives, selection of the alternative that is least costly, most cost-effective, or least burdensome, or an explanation of why that alternative was not selected.

Many of the current requirements have substantial exclusions and exceptions, giving federal agencies substantial discretion to decide whether an analysis is required. For example, some requirements do not apply to rules that are issued without a prior notice of a proposed rulemaking, and agencies can avoid regulatory flexibility analyses if they certify that their rules do not have a "significant" economic impact on a "substantial" number of "small entities". At

NCUA, only credit unions under $10 million in assets are currently considered "small entities". NCUA should consider raising the "small entities" benchmark. For example, the CFPB uses $150 million for the Small Business Regulatory Enforcement Fairness Act review panels.

The number of *economically significant* regulations—those costing the regulated community more than $100 million or having a significant adverse impact on competition, employment or **productivity**—has increased substantially.

These major, complex, and costly rulemakings are a primary focus of the *Regulatory Accountability Act of 2011,* a bill to modernize the *Administrative Procedure Act* (APA).

The APA requires agencies to regulate openly, with notice to and comment from the public, and subject to judicial review. Over time, the APA's procedural protections grew in importance as Congress passed vague laws delegating more and more to agencies. Agencies have become so skilled at their own regulatory procedures that they routinely find ways to legally circumvent them. With increased judicial deference to agency decisions and weak Congressional oversight, federal agencies now possess legislative power nearly equal to that of Congress.

The legislation would update and modernize the regulatory process in several important and balanced ways:

- Requires Advance Notice of Potential Rulemakings to increase public participation in shaping a regulation before it is proposed.

- Requires that agencies must choose the lowest cost option or explain why another was chosen, or demonstrate a compelling need to protect public health, safety, or welfare.
- Gives interested parties the opportunity to hold agencies accountable when they rely on data that does not meet the standards of the *Information Quality Act*.
- Provides for on-the-record administrative hearings for major regulations so that interested parties will be able to question agency personnel responsible for developing the regulation.
- Places additional requirements on agencies' use of interim final regulations and provides for expedited judicial review of whether that approach is justified.
- Makes regulations on which a hearing has been held subject to the more rigorous "substantial evidence" test in legal challenges rather than the current "arbitrary and capricious" standard.

The *Regulatory Accountability Act of 2011* will make the regulatory process more transparent, agencies more accountable, and regulations more cost effective. NAFCU believes many of the rules flowing from Dodd-Frank could be vastly strengthened by these measures, while maintaining their original objectives. Additionally, we feel that many more could be narrowed or abandoned altogether, after a thorough cost-benefit analysis.

Other issues with current agency adherence to the APA include:

- Analysis is only done prior to regulation (if it is done at all);

- Analysis usually focuses on the implementation cost and time even though the annual compliance burden is just as big of a component;
- Once regulations are passed and "in place" it is very hard to remove the continual daily compliance burden;
- Regulators rarely, if ever, look back at promulgated rules to see if they are equitable or effective in reaching their original goal.

Conclusion

The greatest challenge facing many credit unions is cumulative impact of the rapidly growing number of regulatory burdens in the wake of the financial crisis. While any one single regulation may not be particularly burdensome, the layering of new regulation on top of old and outdated regulation can completely overwhelm small financial service providers like credit unions. Unfortunately, every dollar spent on compliance, whether stemming from a new law or outdated regulation, is a dollar that could have been used to reduce cost or provide additional services or loans to members.

It is with this in mind that NAFCU continues to urge the Committee to move forward with legislation that will provide regulatory relief from outdated laws and regulations for credit unions.

We thank you for your time and the opportunity to testify before you here today on these important issues to credit unions and ultimately our nation's economy. I welcome any questions you may have.

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NAFCU | Your Direct Connection to Education, Advocacy & Advancement

March 2, 2012

Monica Jackson
Office of the Executive Secretary
Consumer Financial Protection Bureau
1801 L Street, NW
Washington, D.C. 20036

RE: Docket No. CFPB–2011–0039

Dear Ms. Jackson:

On behalf of the National Association of Federal Credit Unions (NAFCU), the only trade association that exclusively represents federal credit unions, I am writing to you regarding the Consumer Financial Protection Bureau's (CFPB) request for comment on regulatory streamlining. NAFCU very much appreciates the CFPB's early identification of the critical importance of streamlining regulations.

Over the last several years, there has been an ever-increasing regulatory burden for credit unions, particularly in the area of lending. In general, credit unions are smaller institutions, with lesser economies of scale; consequently, these constant changes have a more significant impact on their ability to serve their member-owners. Further, given that every dollar a credit union must pay starts with a member at a teller window, the changes have a very direct impact on credit union member-owners. There are a number of steps the CFPB can take to streamline and simplify the complex regulatory framework for credit unions. Following is a detailed explanation of several regulatory issues that NAFCU urges the CFPB to simplify.

Regulation Z

There are several small issues with Regulation Z, primarily relating to mortgages and credit cards, which could be improved with relatively modest changes.

Mortgages

Lender Cost of Funds

The CFPB should use its authority to eliminate the "lender cost of funds" disclosure that the *Dodd-Frank Wall Street Reform and Consumer Protection Act* (the Dodd-Frank Act) requires on mortgage disclosures. This is one of NAFCU's top

priorities for the streamlining process as the disclosure does not provide any useful information and, in some cases, may be misleading. The implication of the disclosure is that the lender is making a profit spread between the cost of funds and the rate the borrower is paying. Important components that make up the ultimate price, such as interest rate risk and credit risk are ignored by the disclosures and consequently will be ignored by borrowers. The purpose of the Know Before You Owe project is to simplify and clarify disclosures for consumers. Instead, this disclosure provides consumers additional information that they likely will not understand and that has only a tangential bearing on the cost of the mortgage.

Further, in the context of mortgage loans sold into the secondary market, the disclosure is also potentially misleading. The mortgage lender likely does not know the cost of funds for the investor at the time these disclosures are made. Consequently, the best that could be accomplished in this context is for the Bureau or some other entity to publish an average rate on a daily, weekly or monthly basis that could be used to make the disclosure. Providing borrowers an average rate that may be days or weeks old, we believe, detracts from the purpose of the disclosures.

NAFCU recommends the CFPB consider using its authority under section 104 of the Truth In Lending Act (TILA), which enables the Board to exempt disclosures that "are not necessary to carry out the purposes" of the Act. Alternatively, the Bureau could use its exemption under section 105, which permits the Board to exempt statutorily required disclosures based on a five factor balancing test. Either exemption would apply to this proposed disclosure, which provides little if any value and only confuses a process which the agency's Know Before You Owe project is designed to clarify.

Waiting Period after Re-disclosure

The agency should also make changes to the rules implementing the Mortgage Disclosure Improvement Act (MDIA). Lenders are currently required to provide early disclosures three days after a mortgage application is received. Lenders must also provide updated or final disclosures at settlement. If the annual percentage rate (APR) changes beyond a certain threshold or if certain fees exceed a threshold, new disclosures must be provided. Further, section 1026.19(1)(2)(ii) requires that at least three days pass between re-disclosure and closing. Truth in Lending (Regulation Z), 76 Fed. Reg. 79,801 (proposed Dec. 22, 2011) (to be codified at 12 C.F.R. pt. 1026). NAFCU recommends the CFPB modify the three day waiting period. While well intentioned, the three day minimum is potentially harmful and, at the very least, bothersome to borrowers who understand the changes and want to move forward with closing the loan. The regulation only allows for a waiver of the waiting period if waiting will create a bona fide personal financial emergency for the borrower; however, the only example the regulation provides that would qualify is if the borrower will lose his home to foreclosure if funds are not released. Id. at 79,986. There are a number of other potential scenarios that may create such a hardship but lenders are wary of moving forward without more guidance. Further,

there are dozens of other legitimate reasons for a borrower to wish to move forward with the loan that certainly fall short of a "bona fide personal financial emergency."

NAFCU recommends the agency consider three different options. First, if the agency insists on keeping a non-negotiable, minimum wait time, it should allow borrowers to move forward after one business day. One business day would still provide borrowers sufficient time to examine the changes. Further, the rule could still allow borrowers to have up to three business days after re-disclosure to examine the documents if they so choose. Permitting a minimum one day wait would minimize the hardships for people who have compelling reasons to move forward but who fail to qualify for the bona fide personal hardship exception. Additionally, a one day minimum period would still ensure that borrowers would have time to consider the changes on their own and would protect against borrowers being pressured into the change at closing. Second, the CFPB should consider relaxing the waiver requirement and allowing borrowers to waive the three day period at their discretion. Third, the agency should, at the least, provide more guidance as to what constitutes a bona fide personal financial emergency.

Credit Cards

Ability to Repay and Non-working Spouses

The CFPB should modify one aspect of the existing rule regarding the ability to repay a credit card account. Currently Regulation Z does not permit a credit card issuer to consider household income when determining whether a consumer has the ability to repay a credit card account. 12 C.F.R. § 1016.51. Requiring that issuers determine the ability to repay based solely on personal income, even in cases where there is sufficient household income to make payments is shortsighted and disproportionately impacts now-working spouses. This rule serves little practical purpose in terms of ensuring the debt will be repaid. In cases where there is a steady household income, creditors should be permitted to consider that income, rather than only the applicant's personal income. The applicant presumably has access to the household income to pay the credit card bill and the inquiry should end there. The rule forces non-working applicants to seek the spouse's approval for any extension of credit.

The rule is also incongruent. The rule only permit lenders to consider personal income, while at the same time requiring consideration of all household liabilities when making the determination of whether the debt is likely to be repaid. In addition to this aspect of the proposal being inconsistent, it, again, will only exacerbate the negative impact on non-working spouses. Issuers should be permitted to take into consideration household income on which the applicant states he or she can rely. The current rule negatively impacts all non-working spouses and greatly reduces the availability of credit for all non-working spouses.

Reevaluation of Rate Increases

The CFPB should consider modifying 12 C.F.R. § 1026.59, which requires credit card issuers to reevaluate rate increases. If a card issuer increases the APR on the account for virtually any reason, it is then required to reevaluate the APR at least every six months for an indefinite period of time. NAFCU understands the purpose behind the requirement, however, to require reevaluations every six months indefinitely for *all* APR increases is unduly burdensome. Under the current rule, a cardholder's credit score could drop by 50 percent (or more) and the credit card issuer would still be required to reevaluate the APR every six months as long as the account is active. This requirement is problematic for two reasons. First, it is a waste of resources as the issuer is required to reevaluate an account every six months when there is very little possibility that the APR will be reduced in the near future. Second, the requirement creates a perverse incentive as it drives up the cost on already risky accounts, which encourages lenders to close the account rather than work with the borrower. Accordingly, the CFPB should terminate the obligation in instances where the cardholder's credit score has dropped dramatically. This change is all the more reasonable given that most issuers will review a consumer's account upon request.

If a cardholder suffers a decrease in credit score of 5 percent, for example, it will take him a considerable amount of time to repair his credit to the point that he is eligible for the initial APR he received prior to his score decreasing. There is no benefit to consumers in requiring card issuers to reevaluate accounts every six months given the length of time it will likely require to repair the credit score. There are, however, considerable costs involved for the institution in reevaluating each account every six months. Terminating the obligation in instances where the cardholder's credit score has dropped dramatically is a reasonable way in which to balance the institution's costs against the consumer protection concerns advanced in the *Credit Card Accountability, Responsibility and Disclosure Act* (CARD Act). Further, the credit card market is highly competitive and it will likely ensure that consumers who are able to quickly repair their credit will be able to take advantage of better rates. Consumers who suffered a credit problem and have since repaired that problem will undoubtedly receive solicitations at a better rate if their current card issuer refuses to lower the APR. Indeed the credit card market is one area in which there are virtually no barriers to a consumer moving from one company to another if a better price is offered. NAFCU understands the need for consumer protection and government oversight. However, the CFPB should set some limits on the reevaluation requirement in cases where a borrower has suffered a serious decline in creditworthiness.

NAFCU urges the CFPB to alter the rules regarding household income and to simplify the reevaluation requirement in cases where a cardholder's credit score has dropped significantly.

Annual Statement of Billing Rights

The CFPB should eliminate the requirement that lenders provide borrowers an annual statement regarding their billing rights, as required by 12 C.F.R. § 1026.9. Institutions are already required to disclose all relevant information regarding the consumer's billing rights during the application and account opening process. Institutions should only be required to send an updated statement if the policy has changed. Further, these statements can be made available online and in branches and would eliminate this costly and generally useless burden.

The Annual statement of billing rights is one of three annual disclosures (privacy policies and error resolution policies are discussed below) that institutions must regularly provide. Eliminating all three of these annual disclosures is a top priority for NAFCU. The CFPB indicted it will look at five primary factors in determining whether to adopt a proposed change. Those factors are:

- The potential benefits and costs of the proposed change for consumers and regulated entities;
- The likelihood that the Bureau would be able to achieve benefits consistent with the underlying statute;
- The speed with which the public would realize the benefits;
- The governmental and private resources it would take to realize the benefits; and
- The state of the evidence with which to judge the previous four factors.

In the case of all of the annual disclosures, the benefit to regulated entities is significant as they would save considerable amounts of time and money printing and sending the annual disclosures. The change could be made consistent with the underlying statute. Further, the CFPB has considerable authority to implement TILA as it sees fit, if certain disclosures or requirements are redundant or unnecessary. The benefits would be realized immediately for financial institutions and would not require any governmental resources beyond changing the regulation. While the change may seem modest, it would save institutions a significant amount of money printing and sending the disclosures. Additionally, the change would free up valuable time for employees who would otherwise need to carry out the process. On balance, the factors heavily weigh in favor of eliminating the requirement.

General Concerns with Regulation Z

The CFPB specifically asked if the transaction threshold for coverage under Regulation Z should be increased. Currently, lenders that make twenty-five or fewer non-home secured loans a year are not covered by Regulation Z. Similarly, lenders that make five or fewer home secured mortgages per year are not covered by the rule. NAFCU recommends increasing the threshold exemption to 50 loans per year for all loan types.

Additionally, for the special rules for private student loans, NAFCU recommends a similar exemption. Specifically, a lender should not be required to comply with the existing rules for private education loans included in 12 C.F.R. §§ 1026.46-50 unless it makes at least fifty private student loans per year. The disclosures required for private student loans are lengthy and complicated. Further, the rule is so broad that virtually any loan that a borrower intends to use for education purposes is subject to the rule. Consequently, some lenders have chosen not to extend credit if the loan might be construed as a private education loan as the costs of compliance outweigh the income that can be derived from extending a small number of covered loans. Accordingly, NAFCU recommends an exemption from the requirements if a lender makes fewer than fifty private student loans per year.

Regulation E

ATM Fee Disclosure

NAFCU's top priority is eliminating the redundant and unnecessary requirement that automated teller machine (ATM) operators place a fee disclosure notice *on* the ATM, as required by 12 C.F.R. § 1025.16(c)(1). The requirement is outdated, unnecessary and has spawned a number of frivolous lawsuits. Plaintiffs have filed suit claiming the disclosures are not large enough, despite the fact that the statute and regulation do not contain size requirements and only state that the disclosure must be conspicuous. Further, it is impossible for ATM operators to ensure compliance as the sign on the ATM can simply be removed or obscured.

All ATMs include a fee disclosure on the screen during the transaction and provide consumers an opportunity to terminate the transaction without paying any fee. The on-screen disclosure should be sufficient to notify consumers. The utility of the physical sign disclosure is all the more questionable since that disclosure must only state that there may be a fee, but not the actual amount of the fee.

Accordingly, NAFCU has two recommendations. First, NAFCU encourages the CFPB to eliminate the disclosure requirement included in 12 C.F.R. 1025.16(c)(1). While this disclosure is required by statute under 15 U.S.C. § 1693b(d)(3)(A)(i), the statute also provides the CFPB authority to prescribe regulations that "contain such classifications, differentiations, or other provisions" that "provide for such adjustments and exceptions for any class of electronic fund transfers...as in the judgment of the [agency] are necessary or proper to effectuate the purposes of this subchapter, to prevent circumvention or evasion thereof, or to facilitate compliance therewith." Id. at § 1693b(c). The broad authority accorded the CFPB is sufficient to allow an exception for signs located on ATMs. The requirement is duplicative at best as more detailed on-screen disclosures are provided on every ATM. Consequently, an exception would not undercut the consumer protections provided by the statute. Alternatively, if the CFPB refuses to eliminate the requirement, it should consider adding an additional provision to the regulation that holds harmless an ATM operator that can show it did affix a sign to an

ATM. While this option is not as helpful, it would be useful in cases where a vandal or prospective litigant removes the disclosure from an otherwise compliant ATM.

The factors the CFPB will use in determining what proposal to adopt all weigh in favor of eliminating this requirement. The potential costs and benefits for consumers and regulated entities weigh heavily in favor of eliminating the provision. Not only does the disclosure provide little, if any, benefit, it has grown increasingly costly for ATM operators as a result of litigation. In the case of not-for-profit, member owned credit unions; these costs are passed on directly to the member-owners. As discussed above, the statute provides the CFPB considerable authority to make adjustments as it sees fit to effectuate the act. The benefits would be realized immediately as ATM operators would not need to contend, going forward, with frivolous lawsuits spurred by an out of date consumer protection requirement that provides consumers little in the way of actual protection. There would be virtually no governmental or private resources required to realize the benefits. Accordingly, the CFPB should eliminate this requirement.

Account Truncation

NAFCU recommends the CFPB allow financial institutions to truncate account numbers in some cases. Regulation E requires a periodic statement for accounts from which electronic fund transfers may be made. 12 C.F.R. § 1005.9(b). Practically speaking, any checking and savings account falls under the regulation's coverage. Further, § 1005.9(b)(2) requires the periodic statement to include the account number. NAFCU recommends permitting truncation of the account number on the periodic statement. Truncating the account number is a useful way to help combat fraud and identity theft. Indeed, § 1005.9(a) specifically allows for truncation to as few as four digits for receipts at ATMs or other electronic terminals. Understandably, there is a heightened concern that ATM receipts will be quickly discarded in a public place. Periodic statements are, perhaps, less likely to be discarded in a public place, nonetheless, allowing for truncation would help protect consumers by minimizing fraud risks. There is little, if any, reason not to allow truncation in this instance.

Annual Statement Regarding Error Resolution

Regulation E currently requires an annual notice concerning error resolution. The CFPB should eliminate this requirement. Institutions are already required to provide the notice at account opening. Institutions should only be required to send an updated error resolution notice if the institution's policy has changed. Error resolution policies are generally available at branches and online and the CFPB could require the document be made available online in place of the current requirement. Requiring institutions to mail the same policy year after year serves little benefit. Indeed many consumers likely assume the disclosure means there has been some change to the policy. NAFCU recommends the agency eliminate the requirement to send error resolution policies every year if the policy has not changed. For all the same reasons discussed above in the

section regarding the annual statement of billing rights, NAFCU believes the CFPB's factors for consideration weigh in favor of making this change.

Regulation P

The agency should also eliminate the requirement that financial institutions send customers annual privacy notices. This requirement is included in 12 C.F.R. § 1016.5. Again, institutions are already required to provide the privacy notice at account opening. The CFPB should eliminate the annual requirement and instead only require a notice after account opening if the institution's privacy policy has changed. Privacy policies are also generally available at branches and online. Requiring institutions to mail the same privacy policy year after year serves little benefit. NAFCU recommends the agency eliminate the requirement for annual privacy policy disclosures in cases where the policy has not changed. For all the same reasons discussed above in the section regarding the annual statement of billing rights, NAFCU believes the CFPB's factors for consideration weigh in favor of making this change.

Regulation C

Under Regulation C, institutions that refinance a single loan in a calendar year must file a Home Mortgage Disclosure Act (HMDA) report. NAFCU recommends instituting a minimum threshold of at least fifty refinance transactions before an institution is subject to the rule. A threshold of fifty would make the rule consistent with Regulation Z, without undercutting the policy rationale of HMDA. Institutions that refinance fewer than fifty transactions per year are arguably not even offering refinancings in the normal course of business. An institution that extends fifty or fewer such transactions is likely only doing so as an accommodation to existing customers. Granted, a threshold exemption will result in a small number of loans going unreported. However, Regulation C will still capture the vast majority of all mortgage loans and refinancing transactions. Further, the very small cost of slightly fewer reporting entities is outweighed by the fact that these entities are likely more willing to extend credit for a refinancing on a case-by-case basis if they can do so without automatically becoming subject to the HMDA reporting requirements.

The agency should also alter the requirement for lenders to guess an applicant's race or natural origin. Currently, if an applicant declines to answer the question, the loan officer is required to provide his or her best guess based on observation or the applicant's surname. Given the breadth and depth of data gathered under HMDA, it does not seem necessary to require lending officers to report their educated guesses. Further, many applicants may find such a guess offensive. Simply put, there is sufficient data to further the goals of HMDA without forcing lending officers to guess the race or national origin of applicants.

Regulation V

Regulation V, which implements the *Fair Credit Reporting Act* (FCRA) requires lenders making firm offers of credit to include certain opt-out disclosures. Specifically, 12 C.F.R. § 1022.54(c)(1) requires a "short notice" regarding opt-out rights. Additionally, 12 C.F.R. § 1022.54(c)(2) requires a "long notice" that includes some of the same information included in the short notice and some additional information. NAFCU recommends streamlining the notices and permitting institutions to provide a single disclosure.

It would also be helpful if the CFPB streamlined and simplified the adverse action notices required under Regulation B and the very similar risk-based pricing notices required under Regulation V. The FCRA and the *Equal Credit Opportunity Act* (ECOA) have virtually identical adverse action notice requirements. In addition, the FCRA has a very similar, but different, risk-based pricing notice requirement. Further complicating the issue, the FCRA's adverse action notice requirements have no implementing regulation. In order to comply with the FCRA's adverse action notice, creditors may use the model forms included in the Board's Regulation B, which implements the ECOA. The rest of the FCRA, however, is implemented through Regulation V.

What's more, the adverse action notice required by Regulation B and the risk-based pricing notice required by Regulation V are virtually identical and are given under similar – but not the same – circumstances. An "adverse action" notice is given if the consumer was denied credit or there was a change in terms of an existing credit arrangement. A risk-based pricing notice is provided to a consumer that receives credit, based in whole or in part on his credit score, on terms that are materially less favorable than the most favorable terms available to a substantial proportion of consumers.

The policy underlying the risk-based pricing notice is identical to the policy underlying adverse action notices (to inform consumers that lenders – or others – are examining their credit history). The content of the two different disclosures is virtually identical. The circumstances under which the disclosures must be made are very similar. Yet, lenders must look to two different regulations to determine how to comply. Further complicating the matter is that the Federal Reserve Board chose to implement most of the FCRA through Regulation V but chose to implement one discrete section (the adverse action notice requirement) through Regulation B.

This is a case where two closely linked issues that had the potential to be confusing have, indeed, grown incredibly complex as a result of the way in which the regulations were implemented. Understandably, some of the issues are a result of the way in which the underlying statutes were written. This is, however, an issue where the CFPB could simplify matters for financial institutions without any substantive change to the protections afforded consumers. NAFCU is not seeking fewer notices or less detailed disclosures. Rather, we only ask that the CFPB reconsider the way in which these closely

related statutes are implemented and re-write the regulations in a way that is simple and straightforward.

Conclusion

NAFCU appreciates the opportunity to provide input regarding regulations that can be modified or streamlined, and we very much appreciate the CFPB's decision to make this one of the first items on its regulatory agenda. Credit unions have been forced to contend with a significant number of regulatory changes over the last several years, particularly in regards to TILA and Regulation Z. We are hopeful that the CFPB will move forward and eliminate some of the less useful, redundant or unnecessary provisions in the regulations that it oversees. Should you have any questions or concerns, please feel free to contact me or Carrie Hunt, NAFCU's General Counsel and Vice President of Regulatory Affairs at 703-842-2234.

Sincerely,

Fred R. Becker, Jr.
President/CEO

Testimony of

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On behalf of the
Independent Community Bankers of America

Before the

Congress of the United States
House of Representatives
Committee on Financial Services
Subcommittee on Financial Institutions and Consumer Credit

Hearing on

Rising Regulatory Compliance Costs and Their Impact on the Health of Small Financial Institutions"

May 9, 2012
Washington, D.C.

Opening

Chairman Capito, Ranking Member Maloney, and members of the Subcommittee, I am Samuel Vallandingham, Senior Vice President and Chief Information Officer of First State Bank, a $288 million community bank in Barboursville, West Virginia. I am pleased to be here today to represent the nearly 5,000 members of the Independent Community Bankers of America at this hearing on "Rising Regulatory Compliance Costs and their Impact on the Health of Small Financial Institutions." Rising compliance costs have changed the nature of my job and the community banking industry in recent years. The problem, which is already straining our ability to serve customers, only stands to get worse and could possibly drive further industry consolidation. We appreciate you raising the profile of this critical issue and hope that you will advance needed legislative solutions.

Community banks play a crucial role in the economic life of rural areas and small communities passed over by larger banks. The credit and other financial services we provide in these communities will help advance and sustain the economic recovery and ensure that it reaches every corner of the country. Community banks are responsible for 60 percent of all small business loans under $1 million. As the economy recovers, small businesses will lead the way in job creation with the help of community bank credit. I'm proud to note that First State Bank was awarded SBA Lender of the Year in 2001 and SBA Community Bank of the Year in four consecutive years: 2005, 2006, 2007, and 2008. But the role of community banks in advancing and sustaining the recovery is jeopardized by the increasing expense and distraction of regulation drastically out of proportion to any risk posed by community banks. We didn't cause the recent financial crisis, and we should not bear the weight of new, overreaching regulation intended to address it.

Regulatory Compliance Expenses Have Risen Sharply

Let me share with you some headline numbers, derived from First State Bank. The examples below are discrete and limited but illustrate the overall trend of dramatically rising regulatory complexity and compliance costs.

- As a senior executive, I am currently spending as much as 80 percent of my working time on compliance-related issues compared to approximately 20 percent as little as 3 years ago.
- Every job function at my bank has assumed a greater compliance component. Loan officers, who should be focused exclusively on clients and underwriting, are diverting more and more of their time to compliance. Loan originators who used to spend 5 to 10 percent of their time per file on compliance now spend 30 to 35 percent of their time. This does not include training or education just to remain current on changes.

- Mortgage lending now involves such regulatory complexity that it can only be done by a dedicated specialist. More generalized consumer lenders can no longer originate mortgages. We've had to add a new mortgage originator and plan to add a third.
- First State originates and sells mortgages to Freddie Mac, which we then service on their behalf. Since 2008, the annual rate of rules changes has roughly quadrupled. Any one year brings as many changes as we saw in the four years prior to 2008. In 2011 alone, we saw 36 origination and 59 servicing rule changes. Most of these changes require costly software upgrades.
- As a result of new servicing requirements stemming from HAMP, HARP, and other foreclosure avoidance programs, since 2008, we've gone from one collector to 3.5 collectors at an incremental payroll expense of over $93,000 – a substantial expense for a community bank.
- Our expenses for webinar training in the first four months of 2012 alone ($12,000) are double our webinar expenses for all of 2008 ($6,000). This does not even include the expense of in-house training.
- We've formed a risk assessment committee of 6 to 8 senior employees that meets monthly.

Though illustrative, these examples do not capture the full impact and expense of compliance changes. Every change requires software updates, a lengthy process that includes a risk assessment, installation on a test network, testing, installation on a production network, more testing, procedural review, training and audit. What's more, policy revisions require committee review and Board approval. Compliance changes result in legal and audit expenses and sometimes the expense of printing and mailing new disclosures.

But even these "hard costs" do not tell the full story. Soft costs – harder to measure but of no less impact – have also increased dramatically over this time frame. Employee turnover is a good example of a soft cost. Regulatory complexity causes employee turnover and increases the cost of such because of the expense of training new employees to comply with increasingly complex rules.

Compliance Costs Directly Reduce Community Investments

Every dollar spent on compliance is a dollar less that we have to lend and invest in the communities we serve. Every hour I spend on compliance is an hour I could be spending with customers and potential customers, acquiring new deposits and making new loans. There is of course an important role for compliance, but regulation should be balanced, practical, and calibrated to the systemic and consumer risk posed by any given bank. Like many community banks, First State Bank has been in business for over a century and survived the Great Depression and many intervening recessions. Our longevity is a testament to our conservative risk management. We treat our customers fairly because we live in the same communities and because an unimpeachable reputation for putting customers first is the key our success. The compliance costs that we are now incurring are vastly out of proportion to any risk we pose.

I talk to a lot of community bankers from my region and across the country, given my active role in ICBA, and I can tell you that my experience is sadly typical. The job title, Vice President for Risk Assessment, unheard of three years ago in the community banking industry, has now become commonplace. Compliance is almost all I do now. Many days I feel like I'm not a banker anymore.

What Regulations Are Driving the New Costs?

What regulations in particular are driving these costs? They are too numerous to discuss in full or even to catalogue here. We have documented an astronomical 921 compliance changes, from a spectrum of agencies, implemented since 2008. While not all of these apply to my bank, we nonetheless have to evaluate each one to determine to what extent our organization is impacted. My Board members, who represent a range of industries, including insurance, manufacturing, energy, and accounting, often express their astonishment at the surge of new rules facing the financial services industry, even when compared to their highly regulated industries. So while I have a daunting surplus of examples from which to draw for this testimony, let me focus in on a few recent and particularly troubling ones.

Servicing standards. Mortgage servicing is a substantial component of First State's business. New standards for loans serviced for Fannie Mae and Freddie Mac, which went into effect last year, have added significantly to our compliance burden. Overly prescriptive with regard to the method and frequency of delinquent borrower contacts, the new standards are a challenge to implement and have reduced our flexibility to use methods that have proved successful in holding down delinquency rates. Examples of difficult and unnecessary requirements include rigid timelines for making contacts that leave no discretion to the servicer; mandatory property inspections; establishing a single point of contact for the borrower; the creation of a special servicing group for delinquent loans; requiring significant oversight of third-party providers; developing burdensome compliance programs; and annual independent audits of controls and processes. Servicing quality control is new, costly and very burdensome. Our small size and our local presence in the communities we serve make many of these requirements unnecessary. ICBA is also concerned that the servicing standards set forth in the recent state attorneys general settlement agreement, though targeted at the five largest national mortgage servicers, will become the foundation for national servicing standards to be written by the CFPB. First State Bank services loans with care, diligence, and accountability because quality servicing contributes to the reputation we enjoy in our communities. For us, customers are more important than a large volume of transactions. This is a fundamental difference between the larger national servicers and my bank. We don't need threat of enforcement to incentivize quality servicing.

Regulatory examinations. The trend toward oppressive, micromanaged exams is a grave concern to community bankers nationwide. The harsh examination environment impacts community banks both because we are forced to expend time and resources in interacting with examiners and because examiners are unjustifiably requiring capital

levels much higher than current official standards and are inappropriately downgrading performing commercial real estate loans. Both aspects of the exam environment adversely affect community banks' ability to lend, further exacerbating the current economic downturn.

New appraisal standards. 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. Hiring an appraisal management company is quickly becoming the only practical option for a community bank and has raised appraisal costs by 25 to 50 percent. 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.

Future Prospects Are Not Reassuring

As expensive and wasteful as the current regulatory environment is, far from the relief that is needed, we only expect it to get worse in the future, absent legislative action, as new regulations become effective. The Dodd-Frank Act, which is only beginning to be implemented, is a source of particular concern among community bankers, and I will focus my remarks on that Act.

The Dodd-Frank Act was generational legislation and will permanently alter the landscape for financial services. Every provider of financial services – including every single community bank – will feel the effects of this new law. Community banks don't engage in abusive consumer practices and did not cause the financial crisis, and we appreciate the support our industry received to shield us from some of the provisions designed to respond to the crisis. Because we pose no risk to consumers or the financial system, the manner in which we are regulated should be distinct from that of large banks and Wall Street firms. Regulation calibrated to large bank risks and business models can suffocate smaller banks and thereby harm the communities we serve.

The full and ultimate impact of the Dodd-Frank Act won't be known for years, depending on how the law is implemented and how the market adjusts to it. A perfect example of this is the Durbin Amendment, which imposed price controls on debit interchange fees. Such a dramatic and unnecessary intervention in the market will without question have a direct impact on the revenue received by community banks like mine, despite the exemption for issuers with less than $10 billion in assets. For example, already my bank has seen portions of our debit program's compliance costs *double* as a direct result of the Durbin Amendment's provision mandating the use of multiple PIN debit networks. Prior to Durbin, we did business with one PIN debit network because it was better for our business model and met the needs of our customers. Now we are forced to enter into a contract with an additional network, must train staff on a new set of compliance standards, and absorb significant new costs, while our customers receive no net benefit.

There's still an opportunity to improve negative provisions in the law – with the help of this committee and Congress – and provisions that could be helpful to community banks are still at risk of being weakened in the implementation. Below I discuss the provisions of the Dodd-Frank Act that pose the greatest threat to community bankers.

Consumer Financial Protection Bureau

While we are pleased that the Dodd-Frank Act allows community banks with less than $10 billion in assets to continue to be examined by their primary regulators, ICBA remains concerned about CFPB regulations, to which community banks will be subject. ICBA strongly opposed provisions in the Dodd-Frank Act that excluded the prudential banking regulators from the CFPB rule-writing process. Bank regulators have long expertise in balancing the safety and soundness of banking operation with the need to protect consumers from unfair and harmful practices.

Community banks are already required to spend significant resources complying with voluminous consumer protection statutes, as I have detailed for you. CFPB rules should not add to these costs. The Dodd-Frank Act gives the CFPB authority to exempt any class of providers or any products or services from the rules it writes considering the size of the entity, the volume of its transactions and the extent to which existing law already has protections. ICBA urges the CFPB to use this authority to grant broad relief to community banks and/or community bank products where appropriate.

ICBA is particularly troubled that the CFPB intends to play an active role in developing servicing standards, which I have already discussed as a major source of compliance costs, and in writing overdraft rules, not instead of the prudential regulators but in addition to them.

Risk Retention

Community banks make commonsense mortgages supported by sound, conservative underwriting. As the banking regulatory agencies implement Section 941 of the Dodd-Frank Act, which requires mortgage originators to retain credit risk on non-qualified residential mortgages, ICBA strongly urges them not to define "qualified residential mortgage" too narrowly. An unreasonably narrow definition of QRM will drive thousands of community banks and other lenders from the residential mortgage market, leaving it to only a few of the largest lenders. Too narrow a definition will also severely limit credit availability to many borrowers who do not have significant down payments or who, despite high net worths, have relatively low incomes and high debt-to-income ratios. In ICBA's view, the definition of QRM should be relatively broad and encompass the largest portion of the residential mortgage market, consistent with the stronger underwriting standards called for by the Act. An unduly narrow definition of QRM will disadvantage community banks because they lack access to the increased capital needed

to offset risk retention requirements, despite conservative underwriting. What's more, community banks operating in rural areas will be driven out of the market by Farm Credit System direct lenders who carry an exemption for the loans or other financial assets that they make, insure, guarantee or purchase.

Escrowing for taxes and insurance would be costly for small lenders

The Act's new mortgage escrow requirements will be costly to community bankers, particularly those that serve rural areas. Rural customers have unique credit needs, collateralized by rural properties, which do not lend themselves to securitization. As a result, community banks that serve rural customers tend to hold loans in portfolio, where the lender is exposed to the entire credit risk of the borrower for the full term of the loan. They not only have "skin in game," but bear the full risk of default. For this reason, portfolio lenders exercise special diligence in underwriting, and we believe that portfolio loans held by banks with assets of less than $10 billion should be exempt from the requirement that first lien mortgage lenders establish escrow accounts for the payment of taxes and insurance. There is a significant cost involved with establishing escrow accounts, particularly for community banks that have small lending volumes, and many community banks would need to outsource their escrow services at a significant cost. A long-standing industry rule of thumb held that the break-even point at which it made business sense for a lender to establish escrow accounts was a portfolio of $250 million. That break-even point has escalated in recent years as delinquencies have given rise to negative escrow balances that must be funded by the lender. At First State Bank, unfunded escrow balances have ballooned 816 percent since 2007. The costs are such that an escrow requirement could lead many community banks to sharply reduce or eliminate their mortgage businesses.

Community Banks Must Be Able to Rely on Credit Rating Agencies

The Dodd-Frank Act requires the regulatory agencies to replace all references to "credit ratings" with an "appropriate" standard for measuring creditworthiness. Community banks, lacking the resources to independently analyze credit quality, will be disproportionately affected by this provision.

As an alternative approach that addresses the legitimate concern with credit ratings, ICBA recommends amending Dodd-Frank to reintroduce the use of credit ratings, but also give the regulators the authority to confirm the credit ratings in those situations where additional credit analysis is warranted.

Municipal Advisor Registration

Another concern for community bankers is the Dodd-Frank Act municipal advisor registration requirement. 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. Community banks provide these services under close supervision by state and federal

bank regulators. The Dodd-Frank Act provision, if interpreted broadly by the SEC, could force 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. ICBA strongly supports legislation introduced by Rep. Robert Dold, H.R. 2827, to provide an exemption for banks from this onerous and over-reaching requirement.

Small Business Loan Data Collection Requirements

Community bankers are deeply troubled by the Dodd-Frank Act's new HMDA-like data collection requirements. In addition to maintaining records of all credit applications received from small businesses, community banks are required to maintain records of applications from women-owned and minority-owned businesses of all sizes and a separate record of the responses to all such applications. Where feasible, these records are to be kept separate from the underwriting process. In other words, the requirement creates a separate bureaucracy within the bank that cannot be integrated with lending operations. Further, data collected by community banks and subsequently made public by the CFPB could compromise the privacy of applicants in small communities where an applicant's identity may be easily deduced, despite the suppression of personally identifying information.

What Can Congress Do to Help?

ICBA is very pleased that this committee has recognized the scope and severity of the problem of excessive regulation and is considering a number of bills to provide relief for community bankers. ICBA supports these efforts and urges this committee to advance them. The most beneficial pieces of legislation include the following:

The Financial Institutions Examination Fairness and Reform Act

The Financial Institutions Examination Fairness and Reform Act (H.R. 3462) will go a long way toward improving the oppressive examination environment, a priority concern of community bankers and a barrier to economic recovery, by creating a workable appeals process and consistent, commonsense standards for classifying loans. We are grateful to Chairman Capito for introducing this legislation. 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. H.R. 3461 is a good start to improving 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 of H.R. 3461 as a foundation on which to build a more rigorous appeals process in the future.

Consumer Financial Protection Bureau Reform

ICBA strongly supported legislation passed by this Committee and the House to strengthen the accountability of the CFPB. The Consumer Financial Protection Safety and Soundness Improvement Act (H.R. 1315), sponsored by Rep. Sean Duffy (R-WI), 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 2/3rd 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.

Communities First Act

Many of the regulatory concerns highlighted in this testimony are addressed in the Communities First Act (H.R. 1697) – from a community bank exemption from the new mortgage escrow requirement, to restoring the use of credit ratings for bank-held investments, to making the CFPB more accountable, and a range of other community bank regulatory and tax relief provisions. Sponsored by Rep. Blaine Luetkemeyer (R-MO), himself a former community banker, the Communities First Act has over 80 cosponsors from both parties and the strong support of 37 state banking associations. ICBA is grateful to this committee for convening a hearing on CFA on November 16 at which our Chairman had the opportunity to testify.

Temporarily extend the FDIC's Transaction Account Guarantee Program

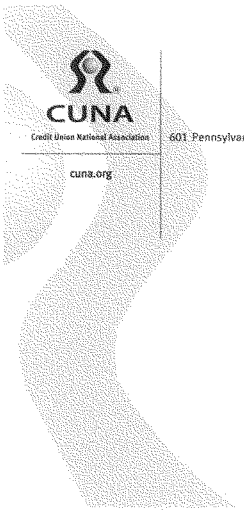
Regulatory relief is a key community bank priority, and we're grateful to this committee for focusing on this topic today. I urge this committee to also consider a topic of equivalent interest to community banks – the need for temporary extension of the FDIC's transaction account guarantee (TAG) program. Extending TAG would serve the same goals that I have stressed in this testimony: preserving community bank viability, maintaining small business credit, and deterring further industry consolidation. If TAG is allowed to expire at year-end 2012, in a still fragile and uncertain economic recovery, large commercial and municipal transaction account deposits will be abruptly withdrawn from community banks in favor of the too-big-to-fail banks. I urge this committee to keep these deposits in the community where they are reinvested for the benefit of the community and to protect small business and municipal deposits by providing a 5-year extension of the FDIC TAG program.

SEC registration relief

Finally, I'd like to thank the committee for passing H.R. 1965 which raised the threshold number of bank shareholders that triggers SEC registration from 500 to 2,000. Registration is a significant expanse and an update to the threshold trigger was long overdue. This provision, which was included in the Communities First Act, was a long-standing ICBA priority and we were extremely pleased to see it enacted into law as part of the JOBS bill.

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. I can assure that the experience of First State Bank is broadly typical of our industry. On behalf of the nearly 5,000 members of ICBA and all community banks, I urge this committee to provide legislative relief to our industry in order to preserve our viability and directly aide the economic recovery and job creation. We look forward to working with this committee to craft urgently needed legislative solutions.



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TESTIMONY
OF
TERRY WEST
PRESIDENT AND CHIEF EXECUTIVE OFFICER
VYSTAR CREDIT UNION
ON BEHALF OF THE
CREDIT UNION NATIONAL ASSOCIATION

BEFORE THE
SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT
COMMITTEE ON FINANCIAL SERVICES
UNITED STATES HOUSE OF REPRESENTATIVES

HEARING
ON
"RISING REGULATORY COMPLIANCE COSTS AND THEIR IMPACT ON THE HEALTH
OF SMALL FINANCIAL INSTITUTIONS"
MAY 9, 2012

Testimony of
Terry West
President and Chief Executive Officer
VyStar Credit Union
On behalf of the
Credit Union National Association
Before the
Subcommittee on Financial Institutions and Consumer Credit
Committee on Financial Services
United States House of Representatives
Hearing on
"Rising Regulatory Compliance Costs and Their Impact on the Health of Small Financial Institutions"

May 9, 2012

Chairman Capito, Ranking Member Maloney, Members of the Subcommittee:

Thank you very much for the opportunity to testify at today's hearing. My name is Terry West, and I am President and Chief Executive Officer of Vystar Credit Union, a state chartered credit union with total assets of $4.7 billion, headquartered in Jacksonville, Florida, serving 413,000 members. I am testifying today on behalf of the Credit Union National Association, the largest credit union advocacy organization in the United States, representing nearly 90% of America's 7,200 state and federally chartered credit unions and their 95 million members.

Credit unions greatly appreciate the opportunity to testify at the series of hearings you have held on regulatory burden and examination issues over the last several months. As CUNA has said before, credit unions face a crisis of creeping complexity with respect to regulatory burden. It is not just one new law or revised regulation that challenges credit unions but the cumulative effect of regulatory changes. This is not a new phenomenon. It certainly was not directly caused by the enactment of the Dodd-Frank Act; however, as the Bureau of Consumer Financial Protection (CFPB) continues to promulgate and review the regulations under its jurisdiction as required by the Dodd-Frank Act and other statutes now subject to its jurisdiction, there will likely be hundreds of additional changes credit unions will be required to make, notwithstanding the fact that everyone agrees that credit unions did not cause or contribute to the financial crisis.

The Effect of Compliance Costs on Credit Union Resources, Lending and Consolidation

In the invitation letter, you asked me to discuss the resources and staff I devote to complying with federal financial regulation, and how this compares to years prior to the crisis. The letter further asked me to discuss how lending and other lines of business are affected, if more resources are devoted to compliance, and, the impact on industry consolidation.

The frequency with which new and revised regulations have been promulgated in recent years and the complexity of these requirements is staggering. Since 2008, we estimate that credit unions have been subjected to in excess of 120 regulatory changes from at least 15 different federal agencies, a list of which has been attached to this testimony. The burden of complying with ever-changing and ever-increasing regulatory requirements is particularly onerous for smaller institutions, including credit unions. This is because most of the costs of compliance do not vary by size, and therefore proportionately are a much greater burden for smaller as opposed to larger institutions. If a smaller credit union offers a service, it has to be concerned about complying with most of the same rules as a larger institution, but can spread those costs over a much smaller volume of business.

Today there are nearly 1,000 credit unions operating in the U.S. with one or fewer full-time equivalent employees. Nearly one-half of the nation's 7,200 credit unions operate with just five or fewer full-time equivalent employees. Anecdotally, many of these folks tell us they put in 70- and 80-hours a week trying to keep up with regulations and the constant barrage of regulatory changes. Not surprisingly, smaller credit unions consistently say that their number one concern is regulatory burden. Difficulties in maintaining high levels of member service in the face of increasing regulatory burden are undoubtedly a key reason that roughly 300 small credit unions merge into larger credit unions each year.

Every dollar a credit union spends complying with these changes is a dollar that is not spent to the benefit of credit union members. Because credit unions are member-owned financial cooperatives, the entire cost of compliance is ultimately borne by credit union members. Greater compliance costs reduce net income, which is credit unions' only source of net worth.

While increased compliance costs will not drive credit unions into immediate insolvency, it will reduce, on the margin, the protective cushion provided by capital, leaving credit unions less resilient during the next big financial shock.

Assigning a dollar figure on the cost of compliance with ever-changing regulations is impossible. When a regulation is changed, there are certain upfront costs that must be incurred: staff time and credit union resources must be applied in determining what is necessary in order to comply with the change; forms and disclosures must be changed; data processing systems must be reprogrammed; and staff must be retrained. It also takes time to discuss these changes with credit union members, and at times members get frustrated because of the change. The ongoing costs of doing business in a manner that complies with the new regulation, compared to how it was conducted previously, is more challenging to measure. Trying to survey credit unions on compliance costs would be just another burdensome request – no one has been able to convince us that trying to spend valuable time to quantify compliance costs will have any positive impact in actually reducing our compliance burden. We can tell an agency how much it costs us to mail one disclosure statement, but I can't imagine trying to quantify all the direct and indirect costs associated with developing, maintaining, completing, storing, revising, explaining, training, and everything else surrounding that disclosure statement. The best way to characterize compliance costs is: "Always increasing, never decreasing."

Monitoring the Cumulative Effect of Regulatory Burden

In the invitation letter you also asked me to discuss the efforts on the part of federal financial regulatory agencies to examine the cumulative effect of regulatory burden on small financial institutions. Simply put, there have been no efforts to examine the cumulative effect of regulatory burden. The credit union prudential regulator, the National Credit Union Administration (NCUA), has told us over the years, essentially, "we will do what we can with respect to our regulations, but we can't do anything about regulatory requirements imposed on credit unions by other agencies." If each agency takes this same approach, and no one has as its responsibility to take into consideration the cumulative effects of regulation, then the role of Congress in this regard is that much more important. This hearing and others like it are critical

because they keep the spotlight on the plight of small institutions whose most significant concern today is how to keep up with the changes.

The CFPB Should Aggressively Use Section 1022(b)(3) of the Dodd Frank Act

The latest surge of regulatory changes largely responds to issues that caused or contributed to the recent financial crisis. It was the actions of the larger bank and non-bank institutions which created the need for more regulation. Credit unions find it particularly galling that they were not the source of the problem, and are very consumer-oriented; yet, they continue to be disproportionately harmed by the resulting compliance burdens.

We believe one of the reasons that Congress gave the CFPB the authority under Section 1022(b)(3) of the Dodd-Frank Act to exempt classes of entities from its rules is to help address the disparity in compliance burden. We encourage the Subcommittee to closely monitor the rules that the CFPB has under consideration and urge the Bureau to exercise this authority with alacrity.

In public statements, CFPB representatives indicate that they understand this disparity. Steve Antonakes, CFPB Assistant Director for Large Bank Supervision, said in the March/April edition of the American Banker Association Bank Compliance magazine, "I can understand why (rulemaking) is a reason for consternation… To me, it's incumbent upon us to keep all institutions in mind when we write rules, and not be solely focused on the large institutions. I think the goal of the Bureau is to be smart in its rulemaking and see where we can actually improve disclosure while reducing costs. That's the sweet spot that we're shooting for."

He added, "We are very conscious of the fact that if we proceed with a rule that significantly increases costs disproportionately for smaller institutions, then that conceivably leads to consolidation. That ultimately reduces choice for consumers. If what we do results in

reduced choice, then we see that as directly in conflict with what our mission is—protecting consumers."[1]

Credit unions are hopeful that Mr. Antonakes's words hold true as the CFPB begins its rulemaking; however, we fear that, despite the best of intentions, the gargantuan task of designing far reaching and important new regulations for large institutions will leave insufficient time and attention to ensuring that those new rules do not harm smaller institutions. Credit unions' skepticism is understandable, especially considering the possible ramifications of the first and only substantive regulation that the CFPB has issued that applies to credit unions.

Required by Section 1073 of the Dodd-Frank Act and effective in February 2013, this regulation imposes a series of new requirements on those entities making international remittance transfers. Basically, the regulation requires a "remittance transfer provider" that sends international wire or ACH transfers in the "normal course of business" for consumers to a recipient in a foreign country to comply with very detailed rules. Until now, few credit unions would have ever considered themselves to be "remittance transfer providers," believing this term would cover companies such as Western Union or MoneyGram.

Let me give you some idea of what VyStar will be required to do to comply. We currently originate about 140-160 international wire transfers a month. We are fortunate because we already have a software system that contains the exchange rate but we will need to review if other data processing changes are needed. We will need to revise forms to incorporate the receipt requirements. We will need to put into place the specific error resolution process required by the regulation, and conduct staff training. Obviously, staff in several departments is thoroughly analyzing what needs to be changed, even though our members haven't had problems with their international wire transfers.

Under the final regulation, any credit union that provides this service to members will have to comply. Surprisingly, at the same time the Bureau issued the final regulation (which was

[1] Kelly, Joseph M. "CFPB Spotlight," ABA Bank Compliance. March-April 2012. 11.

116 pages of text and explanation in the *Federal Register*), it issued a proposal to define a key term, "normal course of business." The agency proposed a definition that would say any credit union that makes 25 or fewer international remittances a year would not be considered a "remittance transfer provider." Credit unions were surprised at the very low number proposed, which would only help a very, very small number of institutions.

Many credit unions have said they will simply stop providing this service to their members because of the burden of complying with this new remittance regulation. CUNA has urged them to wait to make that decision until the final regulation is issued. We are pleased that the Bureau is using the exemption authority provided by the Dodd-Frank Act. However, the Bureau has authority to make the exemption effective and we hope that the Bureau will not adopt a meaningless 25 transfer level. CUNA originally urged a 2,400 annual transfer threshold for coverage, which was rejected, and we are now asking that a credit union may make at least 1,000 transfers a year before being subject to this burdensome regulation.

Credit unions subject to or exempted from the regulation will not be determined so much by their asset size but rather by their field of membership, that is, those people whom they are chartered to serve. A major part of VyStar's membership is military personnel, civil service personnel and their family members who will want to initiate international wire transfers from their accounts. A credit union can be very small and serve, for instance, an immigrant population who will also want such a service. Time and again, the CFPB and members of Congress have acknowledged that credit unions do a good job providing services to their members, and it is a shame when a regulation imposes such a burden that a credit union has to either raise the fee for providing the service or discontinue the service.

We hope that this subcommittee will convey to the CFPB your expectation that the general exemption authority provided in the Dodd-Frank Act will be used by the Bureau not only to end up with a reasonable international remittance regulation but also to be seriously considered throughout the long process ahead of putting the innumerable mortgage lending regulations dictated by the Dodd-Frank Act, and other rules the Bureau may consider, into place.

There is No End in Sight

Congressional oversight of the agency rulemaking process is critical, and it is very important that the subcommittee engage in this effort at the beginning of the rulemaking process. There have been a number of cases in recent years when regulators have decided to revise a particular regulation immediately after a regulation has been finalized or other regulatory changes have just been implemented. This means that resources credit unions put into complying with the first regulatory change are lost, and additional resources must be applied to comply with the even newer changes. And it is **changes** to regulation that constitute some of the most significant costs of compliance. It is critical that Congress exercise its oversight function of the regulatory agencies with extraordinary diligence to help assure a rational regulatory process occurs.

Two areas in which this phenomenon of continually changing regulations has – and continues -- to play out are with credit card and mortgage lending regulations. Attached to this testimony are timelines of recent regulatory proposals in both these areas. As you consider the impact of these regulations on smaller financial institutions, it is critical that you keep in mind that while the bulk of a credit union's compliance costs occur after the rule is finalized, credit unions do take steps during the rulemaking process to understand what is being proposed, consider what steps they will need to implement the proposals under consideration, determine how each a proposed and final rule may impact the credit union and its members, and hopefully provide input into the regulatory proposal process. All this requires staff resources and often legal or consulting resources that could otherwise be used to providing membership service.

Battered by the volume of regulatory changes which have taken place over the last three years, credit unions are bracing for the next wave which will occur once the CFPB hits its stride. While the CFPB has and continues to reach out to solicit input from credit unions, and its leadership is complimentary of credit unions and their business model, if the remittance rule is any indication, credit unions correctly have significant concerns with what may lay ahead in terms of regulatory changes with which they will be forced to comply.

Next month the CFPB has announced that it expects to finalize the "ability to repay" regulations required by the Dodd-Frank Act which raises concerns on how the definition of "qualified mortgage" will impact mortgage lending programs. In the coming months, we expect the CFPB to proceed with rulemaking in a number of areas that will impact credit unions, including:

- TILA/RESPA Mortgage Disclosure Integration
- Mortgage servicing
- Disclosure rules and protections for certain high cost mortgage loans
- Mortgage originator standards
- Requirements for escrow accounts
- Supervision of larger depository institutions and their affiliates (which impacts only the three largest credit unions subject to the bureau's direct supervision)
- Business lending data
- Home Mortgage Disclosure Act
- Registration and supervision of certain nondepository covered entities
- Appraisals
- Credit card fee limitations

In the interest of brevity, I will discuss only the potential impact of the first two bulleted items, the reconciliation of TILA and RESPA requirements and the anticipated mortgage servicing rule change, may have on credit unions.

One of the much hailed benefits of the Dodd-Frank Act is the potential to reconcile and consolidate TILA and RESPA disclosure requirements. Certainly, elimination of redundancies is welcomed, and CUNA supports this effort. Nevertheless, the reconciliation of TILA and RESPA requirements is a good example of how even an attempt to reduce regulatory burden can represent a significant cost to those required to comply.

When the regulation is final, we will have to work with our vendors to design and produce forms which are compliant; our forms may require customization, which will cost more and for which our vendor may not provide a warranty or guarantee of compliance. This means we will have to engage legal counsel to review our vendor contracts, our actions and disclosures to ensure we are in compliance. We will have to update our software products – and there are multiple products involved. And, we will have to train all affected personnel. This is on the heels of going through form changes to our existing good faith estimate form which were

required by amendments to the Real Estate Settlement Procedures Act's regulation that were effective in January of 2010.

In the long run, credit unions and their members will benefit from seeing these requirements consolidated; however, in the short term, it will just add to the increased compliance costs credit unions face.

There is no end in sight for changes impacting credit unions' mortgage loan programs. The CFPB recently announced it would proceed to make several changes affecting mortgage servicing. Specifically, the CFPB has announced it is considering a rule which would require significant changes to monthly mortgage statements. The CFPB has also indicated it is considering rules that would require earlier disclosures before the interest rate changes on most adjustable-rate mortgages, earlier communication before borrowers are charged for force-placed insurance, and a requirement that servicers make a good-faith effort to contact delinquent borrowers and notify them of their options to help avoid foreclosure. The CFPB further anticipates rules requiring servicers: to post to borrowers' accounts the day they receive payment; to establish information-management policies to minimize errors and help with quick corrections; and to provide delinquent borrowers with direct, ongoing access to staff who are dedicated to servicing troubled borrowers.

These endeavors are all well-intentioned, and we recognize are mandated by the Dodd-Frank Act; however, each will require a change in procedures, forms, disclosures, and training by credit unions which are less likely to foreclose on a member's mortgage loan than a bank or non-bank financial provider, more likely to work with the member to avoid foreclosure, and more likely to already provide clearer disclosures than many of our competitors. Furthermore, because the average credit union's staff is very small, we question whether most credit unions would be able to comply with a rule requiring them to dedicate staff to service troubled borrowers despite the fact that credit unions are more likely to work with their members in difficulty than other financial institutions – it is in their interest to do so because the member is not just a customer but also an owner of the credit union. The not-for-profit structure motivates credit unions to

focus on what's best for the member as opposed to a for-profit model that motivates banks to generate profits for shareholders.

Before I close, let me mention two other examples in the last three years where credit unions have had to make major overhauls to their products and services due to regulatory changes but that the CFPB is expected to revisit. The Bureau made it clear when it first was established last summer that reviewing credit card disclosures will be a high priority. As our third attachment shows, credit unions and other card issuers have been though several major regulatory changes in credit card disclosures and restrictions just in the last three years – producing a lot of understandable confusion and questions for members as well as credit union staff. Facing the prospect that these rules could be changed again in the near future has understandably frustrated many credit unions. Even minor changes in credit card rules require new forms, re-programming of data processing systems and staff resources, which equals costs, which we have noted will be borne disproportionately on the small institutions which have not caused the problem. And, as I have previously noted, these costs are ultimately borne by credit union members.

Credit unions have been equally dismayed to learn that the bureau is starting a review of overdraft protection programs. Major regulatory changes have been made in recent years to address concerns, but more changes seem likely. Credit unions work with their members to offer various types of overdraft programs. These include programs that feature transfers from another account of the consumer at the credit union as well as ones that cover items that would otherwise be unpaid and charge the member a fee that is vernally the equivalent of an NSF fee. Credit unions do not entice their members to overdraw their accounts and work with their members continually to ensure members avoid overdrafts whenever possible. Credit unions simply do not need any new regulations in this area and we urge this Subcommittee to help us communicate that message to the CFPB.

When credit unions are providing good services and safe products to their members, they should not be subjected to additional compliance burdens because others in the industry are not adequately protecting their customers. The incentive structure at a credit union is much different

than at a for-profit financial institution. Because the members own the credit union, management has considerable incentive to work closely with members, provide clear information, and help members when they are in need. When an unnecessary, duplicative or otherwise overly burdensome rule is applied to credit unions, the cost of complying may be reflected in the interest rates or fee for the member who uses that service, but it is often borne by the entire credit union membership.

While much of this testimony focused on regulations under the Dodd-Frank Act, credit unions have also had concerns about regulations from the National Credit Union Administration. Two proposals in particular have caused significant worries on the part of credit unions: a pending rule to limit loan participations and one to provide greater oversight authority to the agency on credit union service organizations. The agency has indicated that it is reviewing concerns about these proposals and is considering changes to minimize the impact of these proposals on credit unions. CUNA has communicated with the agency on a number of occasions its concerns about these proposals. CUNA will continue to advocate for improvements in these proposals and as invited, will be following up with this Subcommittee.

Conclusion

As this statement demonstrates, credit unions are anxious about the prospect of a range of new regulations from the CFPB. We are working hard to ensure that the agency is well informed about credit union concerns and how its proposals would affect our credit union members. We commend the CFPB for its efforts to involve CUNA and credit unions in dialogue sessions that discuss developing issues. This approach is a model that other agencies should adopt. The CFPB has also included credit unions on panels it has held around the country on various issues and this has provided important venues for credit unions to reinforce the distinctions between them and for-profit institutions.

We have and will continue to strongly urge the CFPB to consider using its statutory authority to exempt from its regulations certain products or classes of financial institutions or

establish transaction thresholds when appropriate. And, we hope the Subcommittee will do the same.

On behalf of America's credit unions and their 95 million members, thank you very much for the opportunity to testify at today's hearing. I am pleased to answer any questions that you may have.

Attachment 1

Finalized Federal Regulatory Changes Applicable to Credit Unions
(Since January 1, 2008)

	Regulatory Change	Effective Date	Agency
1.	FEMA Flood Map Changes	1/1/2008	FEMA
2.	Annual Electronic Filing Requirement For Small Tax Exempt Organizations – Form 990-N	1/1/2008	IRS
3.	IRS Form 990 Instructions - New Reporting Form	1/1/2008	IRS
4.	IRS Redesign Form 990	1/1/2008	IRS
5.	Final Rules On Transaction Origin Identification	2/25/2008	NACHA
6.	Disclosures for Subprime Mortgage Loans	5/29/2008	NCUA
7.	CAN-SPAM Act Rules	7/7/2008	FTC
8.	Hope for Homeowners Program for Subordinate Lienholders	10/1/2008	FHA
9.	Use of Fair Value in an Inactive Market	10/10/2008	FASB
10.	Share Insurance Signs to Reflect Increased Limits	10/22/2008	NCUA
11.	Official Advertising Statement	10/31/2008	NCUA
12.	Incidental Powers	11/21/2008	NCUA
13.	Share Insurance Signs for Shared Branching	11/21/2008	NCUA
14.	Amendments to the Impairment Guidance of EITF Issue No. 99-20	12/15/2008	FASB
15.	PCA: Amended Definition of Post-Merger Net Worth	12/31/2008	NCUA
16.	Criteria to Approve Service to Underserved Areas	1/2/2009	NCUA
17.	Interim Final Rule on Hope for Homeowners Program	1/7/2009	FHA
18.	Final RESPA Rule	1/16/2009	HUD
19.	Unlawful Internet Gambling	1/19/2009	FED
20.	Share Insurance Signs for Shared Branching	4/1/2009	NCUA
21.	RegFlex Changes for Unimproved Land	4/27/2009	NCUA
22.	Technical Changes to the FACT Act "Red Flags"	5/14/2009	NCUA
23.	Fair Value: Decrease in Market Activity/Transactions That Are Not Orderly	6/15/2009	FASB
24.	Recognition and Presentation of Other-Than-Temporary Impairments	6/15/2009	FASB
25.	Restructuring of Federal Reserve's Check Processing Operation: Districts 10, 11, and 12	6/20/2009	FED
26.	Fed Rule Authorizing Excess Balance Accounts and Earnings on Balances	7/2/2009	FED
27.	Fed Rule Authorizing Pass-through Accounts and Adjusting the Limitation on Savings Account Transfers	7/2/2009	FED
28.	Restructuring of Federal Reserve's Check Processing Operation: Districts 6 and 8	7/19/2009	FED

	Regulatory Change	Effective Date	Agency
29.	Restructuring of Federal Reserve's Check Processing Operation: Districts 4 and 9	7/25/2009	FED
30.	Revisions to Regulation Z Mortgage Loan Disclosures	7/30/2009	FED
31.	Credit Union Reporting	9/1/2009	NCUA
32.	Restructuring of Federal Reserve's Check Processing Operation: Districts 4 and 7	9/12/2009	FED
33.	Regulation Z Disclosures for Private Student Loans	9/14/2009	FED
34.	Regulation Z Rule Implementing the CARD Act	9/21/2009	FED
35.	Amendments to the Home Mortgage Provisions of Regulation Z	10/1/2009	FED
36.	Restructuring of Federal Reserve's Check Processing Operation: Districts 11 and 12	10/17/2009	FED
37.	Restructuring of Federal Reserve's Check Processing Operation: District 4	10/18/2009	FED
38.	Restructuring of Federal Reserve's Check Processing Operation: District 6	10/18/2009	FED
39.	Election of Federal Home Loan Bank Directors	11/6/2009	FHFA
40.	Restructuring of Federal Reserve's Check Processing Operation: Districts 11 and 12	11/14/2009	FED
41.	Share Insurance Coverage for Revocable Trust Accounts	11/30/2009	NCUA
42.	Temporary Increase in SMSIA; Display of Official Sign; Coverage for Mortgage Servicing Accounts	11/30/2009	NCUA
43.	Restructuring of Federal Reserve's Check Processing Operation: District 3	12/12/2009	FED
44.	Exceptions to the Maturity Limit on Second Mortgages	12/24/2009	NCUA
45.	Overdraft Protection Disclosures	1/1/2010	FED
46.	Revisions to Regulation S	1/1/2010	FED
47.	Operating Fees	1/1/2010	NCUA
48.	Truth in Savings Rule for Overdraft Protection and Electronic Disclosures	1/1/2010	NCUA
49.	NCUSIF Premium and One Percent Deposit	1/4/2010	NCUA
50.	Federal Home Loan Bank Membership to Include Non-Federally Insured CDFI Credit Unions	2/4/2010	FHFA
51.	Expansion of Special Information Sharing Procedures To Deter Money Laundering and Terrorist Activity	2/10/2010	FinCEN
52.	Regulation Z Disclosures for Private Student Loans	2/14/2010	FED
53.	Regulation Z Rule Implementing the CARD Act	2/22/2010	FED
54.	Consolidation of Federal Reserve's Check-Processing Operations	2/27/2010	FED
55.	Interagency Policy Statement on Funding & Liquidity Risk Management	5/21/2010	NCUA
56.	Establishment of Term Deposits at Federal Reserve Bank	6/4/2010	FED

	Regulatory Change	Effective Date	Agency
57.	Direct Access Registration Requirement	6/18/2010	NACHA
58.	Risk Management and Assessment	6/18/2010	NACHA
59.	Final Rules for Student Loans	7/1/2010	ED
60.	Regulation Z Open-end Credit Final Rule	7/1/2010	FED
61.	Regulation E Final Rule for Overdraft Protection Plans	7/1/2010	FED
62.	FACT Act Rules and Guidelines on the Accuracy of Credit Information	7/1/2010	FTC
63.	FACT Act Rules and Guidelines on the Accuracy of Credit Information	7/1/2010	NCUA
64.	NCUA Final Rule on Unfair and Deceptive Practices for Credit Cards	7/1/2010	NCUA
65.	Disclosures for Non-federally Insured Credit Unions	7/6/2010	FTC
66.	Chartering and Field of Membership (FOM): Community Credit Unions	7/26/2010	NCUA
67.	FedACH SameDay Service	8/2/2010	FED
68.	Low-Income Definition	8/5/2010	NCUA
69.	Payments Made in Settlement of Payment Card and Third-Party Network Transactions	8/16/2010	IRS
70.	Final Rule Implementing the CARD Act Provisions for Penalty Fees and Rate Reviews	8/22/2010	FED
71.	Regulation E Rules for Gift Cards	8/22/2010	FED
72.	Display of Official Sign; Permanent Increase in Standard Maximum Share Insurance Amount	9/2/2010	NCUA
73.	Clarifications of Reg E and Reg DD Overdraft Rules	9/7/2010	FED
74.	Clarifications on Reg DD Overdraft Protection Rules	9/7/2010	NCUA
75.	SAFE Act	10/1/2010	NCUA
76.	FHA Risk Reduction Final Rule	10/4/2010	HUD
77.	Reverse Mortgage Guidance	10/18/2010	NCUA
78.	RegFlex Program Changes	10/25/2010	NCUA
79.	Short-Term, Small Amount Loans	10/25/2010	NCUA
80.	Extension of CARD Act Effective Date for Gift Cards	11/29/2010	FED
81.	Conversions of Insured CUs: Definition of Regional Director	12/23/2010	NCUA
82.	Model Privacy Notices	12/31/2010	NCUA
83.	FACT Act Risk-Based Notice Rule	1/1/2011	FED
84.	Consumer Notification of Mortgage Loan Sales or Transfers	1/1/2011	FED
85.	Notice Regarding Charges Permitted Under the FCRA	1/1/2011	FTC
86.	Mobile ACH Payments	1/1/2011	NACHA
87.	Confidentiality of Suspicious Activity Reports	1/3/2011	FinCEN
88.	Corporate Credit Union Rule	1/18/2011	NCUA
89.	IRPS 11-1 Supervisory Review Committee	1/20/2011	NCUA

	Regulatory Change	Effective Date	Agency
90.	Fiduciary Duties at Federal Credit Unions, and Mergers and Conversions of Insured Credit Unions	1/27/2011	NCUA
91.	Interim Final Rule on Disclosures Required under the Mortgage Disclosure Improvement Act	1/30/2011	FED
92.	Extension of CARD Act Gift Card Rules	1/31/2011	FED
93.	Conversions of Insured Credit Unions: Definition of Regional Director	3/14/2011	NCUA
94.	Corporate Credit Unions: Technical Corrections	3/23/2011	NCUA
95.	PCA: Amended Definition of "Low-Risk Assets	3/23/2011	NCUA
96.	Garnishment of Accounts Containing Federal Benefit Payments	3/24/2011	Treasury
97.	Amendment to BSA Regulations: Reports of Foreign Financial Accounts	3/28/2011	FinCEN
98.	IRPS: Chartering Corporate Federal Credit Unions	3/28/2011	NCUA
99.	Interim Final Rule on Appraisal Independence	4/1/2011	FED
100.	Loan Compensation and "Steering" of Loans	4/1/2011	FED
101.	Temporary Minimum Capital Increase for FHFA Regulated Entities	4/4/2011	FHA
102.	Technical Correction - Golden Parachute and Indemnification Payments	6/24/2011	NCUA
103.	Temporary Unlimited Share Insurance for Noninterest-bearing Transaction Accounts	6/24/2011	NCUA
104.	Golden Parachute and Indemnification Payments	6/27/2011	NCUA
105.	Consumer Financial Rules to be Enforced by the CFPB	7/21/2011	CFPB
106.	Regulation D Interim-Final Rule Implementing the Alternative Mortgage Transaction Parity Act	7/22/2011	CFPB
107.	Sample Income Data to Meet the Low-income Definition	7/25/2011	NCUA
108.	Remittance Transfers Interim Final Rule	7/27/2011	NCUA
109.	Technical Corrections & Clarifying Amendments to RESPA Regulations	8/10/2011	HUD
110.	Fair Credit Reporting Risk-Based Pricing (Credit Score Disclosures)	8/15/2011	FED
111.	Regulation B - Equal Credit Opportunity Act (Credit Score Disclosures)	8/15/2011	FED
112.	Mortgage Acts & Practices - Advertising Rule	8/19/2011	FTC
113.	SAFE Mortgage Licensing Act: Minimum Licensing Standards and Oversight Responsibilities	8/29/2011	HUD
114.	CARD Act Clarifications	10/1/2011	FED
115.	Debit Interchange Fee and Routing Regulations (Regulation II)	10/1/2011	FED
116.	Federal Reserve Board's Interim Final Rule on the Interchange Fee Fraud-Prevention Adjustment	10/1/2011	FED
117.	NCUA Net Worth & Equity Ratio	10/31/2011	NCUA

Regulatory Change		Effective Date	Agency
118.	Notification of Employee Rights under the National Labor Relations Act	11/14/2011	Labor
119.	NCUA Remittance Transfers Rule	11/30/2011	NCUA
120.	Low-Income Designation – Technical Amendment	12/23/2011	NCUA
121.	Accuracy of Advertising and Notice of Insured Status	1/1/2012	NCUA
122.	Corporate Credit Union Rule – Technical Amendment	1/23/2012	NCUA
123.	Corporate Credit Union Follow-up Rule	5/31/2012	NCUA
124.	Amendments to Regulation D	7/12/2012	FED
125.	NCUA Interest Rate Risk Policy and Program Final Rule	9/30/2012	NCUA
126.	Guidance on Troubled Debt Restructurings	12/15/2012	FASB
127.	Remittance Transfers Final Rule	2/7/2013	CFPB

Attachment 2

AN OVERVIEW OF NUMEROUS FEDERAL REGULATIONS THAT HAVE BEEN PROPOSED, FINALIZED, AMENDED, RE-PROPOSED, CLARIFIED AND ARE YET-TO-COME THAT IMPACT MORTGAGE LENDING COMPLIANCE (SINCE MAY 2009)

May 2009: The Federal Reserve Board (Fed) finalized the regulations to implement the Mortgage Disclosure Improvement Act of 2008 (MDIA)

June 2009: Federal agencies proposed regulations to implement the Secure and Fair Enforcement for Mortgage Licensing Act of 2008 (SAFE Act) to require the registration of mortgage loan originators

Aug. 2009: Fed proposed a comprehensive revision of the Truth in Lending Act (TILA) regulations for closed-end mortgages and home equity lines of credit (HELOCs)

Aug. 2009: Department of Housing and Urban Development (HUD) issued clarifications about instructions on how to complete the new Real Estate Settlement Procedures Act (RESPA) forms

Nov. 2009: Fed issued an interim regulation to require notice when a HELOC or closed-end mortgage loan is sold or transferred

Jan. 2010: HUD's revised RESPA regulation on the HUD-1 and good faith estimate forms became effective, and the agency issued further clarifying information on how to comply

April 2010: HUD issued additional clarification on the new RESPA requirements (and did so quarterly for the next year)

Aug. 2010: Federal agencies issued final SAFE Act regulations

Aug. 2010: HUD issued a revised settlement cost booklet

Sept. 2010: Fed issued a final regulation to require notice when a HELOC or closed-end mortgage loan is sold or transferred

Sept. 2010: Fed issued interim MDIA regulations to revise the disclosure requirements for closed-end mortgage loans

Sept. 2010: Fed issued final regulations on loan originator compensation practices for closed-end mortgage loans

Sept. 2010: Fed issued proposed revisions to escrow account requirements for "jumbo" closed-end mortgage loans

Sept. 2010: Fed issued proposed regulations to require enhanced consumer protections and disclosures for closed-end mortgage loans

Oct. 2010: Fed issued interim regulations on appraisal standards

Dec. 2010: Federal agencies issued appraisal and evaluation guidelines

Dec. 2010: Fed issued clarifications to its September interim MDIA regulations

Jan. 2011: SAFE Act registration process was finalized (initial registration required by July 2011)

Feb. 2011: Fed announced that it would not finalize three pending mortgage lending regulations (the two proposed rules issued in August 2009 for closed-end mortgage loans and HELOCs and the September 2010 proposed rule on enhanced consumer protections) since the CFBP would take over this rulemaking in mid-2011

March 2011: Fed finalized a regulation to increase the APR threshold used to determine whether an escrow account must be established for first-lien jumbo closed-end mortgage loans

March 2011: Fed proposed a regulation to expand the minimum period for mandatory escrow accounts for first-lien, higher-priced closed-end mortgage loans

May 2011: Fed proposed a regulation regarding a consumer's ability to repay a closed-end mortgage loan

July 2011: HUD issued clarifications to its 2008 RESPA regulations

Attachment 3

AN OVERVIEW OF NUMEROUS FEDERAL REGULATIONS THAT HAVE BEEN PROPOSED, FINALIZED, AMENDED, RE-PROPOSED, CLARIFIED THAT IMPACT CREDIT CARD COMPLIANCE (SINCE JANUARY 2009)

January 2009: Federal Reserve Board (Fed) finalized open-end regulations with an effective date of July 1, 2010. The rule included comprehensive changes to the format, timing and content for five main types of open-end credit disclosures.

- Credit & charge card applications & solicitations
- Account opening disclosures
- Periodic statement disclosures
- Change-in-terms notices
- Advertising provisions

May 2009: Fed published proposed clarifications for the open-end final rule.

May 2009: Congress passed the Credit CARD Act. The provisions became effective in three stages: August 20, 2009, February 22, 2010, and August 22, 2010. The CARD Act covered many of the provisions in the January 2009 open-end final rule and moved their effective dates from July 2010 to August 2009 and February 2010, thus providing less time for credit unions to make the necessary changes to become compliant.

July 2009: Fed published an interim final rule for provisions of the CARD Act that became effective August 20, 2009. The provisions included an increase in the notice period from 15 days to 45 days and a requirement to provide periodic statements 21 days prior to the payment due date for all open-end loans. This second provision caused major problems for credit unions because in an effort to be more accommodating to member needs, credit unions permitted payment due dates any day of the month and also permitted weekly, bi-weekly and semi-monthly payments that coincided with members pay periods.

September 2009: Fed published a proposed rule covering the CARD Act provisions that became effective February 22, 2010.

November 2009: The Credit CARD Technical Corrections Act of 2009 was passed by Congress which limited the 21-day timing requirement for periodic statements only to credit card accounts and open-end loans with a grace period.

February 2010: Fed published a final regulation covering the majority of the CARD Act changes. The rule became effective on February 22, 2010—the same day the final rule was published in the Federal Register.

February 2010: Fed published a final rule withdrawing the January 29, 2009 final rule and noting that the requirements of the January 2009 final rule were incorporated in the other rule published on February 22. These requirements from the original January 2009 final rule had an effective date of July 1, 2010.

March 2010: Fed published a proposed regulation for those provisions of the CARD Act that were to become effective on August 22, 2010.

June 2010: Fed published a final regulation containing the provisions of the CARD Act that became effective on August 22, 2010—re-evaluation of rate increases and reasonableness of penalty fees.

November 2010: Fed published a proposed regulation to clarify certain provisions of the CARD Act.

April 2011: Fed published a final regulation to clarify certain provisions of the CARD Act. The effective date of the final rule was October 1, 2011.There were a number of significant changes in this rule, but the one that caused the most problems for credit unions was the requirement that periodic statements be provided at least 14 days prior to the date an account could be treated as late for any purpose. For accounts with a courtesy period that date would be the end of the courtesy period and for accounts without a courtesy period that date would be the actual payment due date.

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