Testimony of

Matthew H. Williams

On Behalf of the

American Bankers Association

before the

Subcommittee on Capital Markets and Government Sponsored Enterprises

of the

House Committee on Financial Services

United States House of Representatives

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Chairman Garrett, Ranking Member Waters, and members of the Subcommittee, my name is Matthew Williams, and I am the Chairman and President of Gothenburg State Bank in Gothenburg, Nebraska. I also serve as the Vice Chairman of the American Bankers Association (ABA). 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.

The topic of this hearing today is an important one for a great many community banks whose shareholders include generations of families and local community members. Many of these community banks have faced a rule that has remained in place for over 40 years without being updated. That rule, which implements parts of the Securities Exchange Act of 1934, causes small, local banks to be subject to the same costly reporting requirements as large public firms. Although my bank is not subject to this rule, I have spoken with many community banks around the country who have struggled with the impact of the increased costs and reporting associated with the Exchange Act rule.

The Exchange Act has two tests to determine whether a company must register its securities with the Securities and Exchange Commission (SEC) and thus become subject to the SEC's significant reporting requirements: $10 million in assets and 500 shareholders of record. Since ***99.5 percent of banks reach the asset threshold for registration as a public company***, the only meaningful test of whether a bank should be registered as a public company is the number of shareholders. ***But while the asset threshold has been increased tenfold since 1964, the shareholder threshold has stayed the same.***

Banks that are nearing the 500 shareholder threshold may have nowhere to turn to raise capital they need to meet the credit needs of their communities. And once registered as a public company, banks are subject to disproportionately high financial and opportunity costs when compared to other smaller public companies. These regulatory requirements and costs eat into capital and limit banks' ability to make loans in their communities.

ABA has long advocated that the shareholder threshold be increased, an update that is much overdue. We are grateful to Vice Chairman Schweikert and to Representatives Himes and Womack for introducing legislative solutions to this problem. These bills would update the shareholder threshold for registration – up to as many as 2,000 shareholders, a level that ABA strongly supports – and allow the SEC to provide much-needed regulatory relief for community banks. ***This change would enable banks to deploy their capital in lending rather than spend it on regulatory requirements that provide little incremental benefit to the banks, shareholders, or the public.***

In addition, this legislation is an opportunity to address the threshold for deregistration, which can occur when the number of shareholders decreases and once-public businesses can become private. Currently, the number of shareholders of record must fall below 300 shareholders before the business can deregister. Raising the threshold for deregistration along with the threshold for registration makes a lot of sense from both a business and corporate governance perspective.

The urgency to address this issue increases every day. Over the last several years, banks have faced increased regulatory costs. This is exacerbated by bank regulators piling on new requests for even greater levels of capital. Combined with hundreds of new regulations resulting from the Dodd-Frank Act, these pressures are slowly but surely strangling traditional community banks, handicapping their ability to meet the credit needs of their communities. Increasing the shareholder limit would open up an avenue to bring capital into small community banks.

ABA is very interested in working with the Subcommittee to move legislation forward that can accomplish these important changes, so that community banks can continue to reach out to our communities for the capital that is vitally important in our efforts to increase lending in our communities.

Before I continue, there is one thing I would like to make very clear: the banking industry is not seeking these changes in order to stop providing investors with disclosures. As this Subcommittee well knows, community banks are part of a highly regulated industry governed by numerous statutes and regulations affecting almost every aspect of banking activity. Each banking institution is regulated by two agencies: a primary federal regulator and, in the case of state chartered banks, by the state regulator, as well. Significant financial and other information regarding every bank and savings association can be publicly viewed on the website maintained by the FDIC. ***All banks are required to make annual reports available to both their customers and investors***. Most provide financial and other information to investors through their company websites. The advantage to the small community banks from increases in the registration and deregistration thresholds would not be a lack of transparency, since keeping shareholders and the public fully informed about the bank's performance is essential to its presence as a community bank. Rather it is a reduction of regulatory burdens and reporting requirements that pose a disproportionate burden on small community banks.

There are two points I would like to make today:

- Community banks are disproportionally burdened by the 500 shareholder threshold; and
- A higher shareholder threshold more accurately reflects public company status.

I. Community Banks Are Disproportionally Burdened by the 500 Shareholder Threshold

Community banks with 2000 shareholders or less are ***local businesses with local shareholders***. These institutions had median revenue of $9.15 million and a median 182 full-time employees as of the second quarter 2011. It is common for these banks to receive little or no analyst coverage, have a limited trading market, and attract little – if any – institutional investment. The small benefit that banks receive from being public is significantly undermined by the disproportionately high costs of regulatory compliance for small companies. It is well documented that the costs of being a public company are disproportionately borne by smaller public companies.[1] Furthermore, banks are already subject to comprehensive regulation and disclosure requirements by the banking regulators while other small companies are not.

These costs come directly out of capital, reducing banks' ability to lend. Capital is the foundation for all lending and is also critical to absorb losses when loans are not repaid. In fact,

[1] See Generally, Foley & Lardner, The Cost of Being Public in the Era of Sarbanes-Oxley (August 2, 2007) available at http:/www.foley.com/publications/pub_detail.aspx?pubid=4487; Exposure Draft of Final Report of Advisory Committee on Smaller Public Companies, SEC Release No. 33-8666 (March 3, 2006) [71 FR 11090].

$1 worth of capital supports up to $10 in loans. The downward spiral of the economy has created losses and stressed capital levels; consequently, the bank regulators have pushed banks to raise their capital-to-assets ratio. Not surprisingly, when the economy is weak, new sources of capital are scarce. Capital may become impossible for banks that are nearing the 500 shareholder threshold. The result is that these banks are forced to shrink – by making fewer loans in order to raise their capital-to-assets ratio. Clearly, it would be better to turn to additional investors to put new capital in place that would support additional community lending.

Furthermore, the negative impact of the low shareholder threshold is felt more acutely by community banks. Unlike other small businesses, community banks are broadly held by shareholders ***in their communities***. Even without ever offering shares publicly, many community banks have seen their shareholder base grow as successive generations distributed their stock holdings among their descendents. These factors exert significant pressure on banking organizations and other affected companies to reduce the number of shareholders in order either to avoid registration requirements or to deregister.

Due to the increasing costs of being a registered public company, a number of small businesses, including some of our member community banks, have determined that deregistration is in the best interests of their shareholders. However, companies that wish to deregister must either have less than $10 million in assets or less than 300 record shareholders. Since 99.5 percent of banks have greater than $10 million in assets, banks who wish to deregister must somehow reduce their shareholder base below 300 record shareholders.

Reducing the number of record shareholders can be costly. Stock buybacks, reverse stock splits and the attendant legal costs are particularly expensive for small businesses. In addition, these transactions can have negative consequences for local communities. As much as community banks would like to get out from under the heavy weight of SEC registration, they often have no desire to reduce the number of shareholders, especially if that means disenfranchising the localized ownership that makes these banks members of the community.

A fellow ABA member – Daniel Blanton, President and CEO of Georgia Bank Financial Corporation – recently testified on this before the SEC Advisory Committee on Smaller Public Companies:

> We are reluctant to [deregister] because the Bank was founded on the belief that the Augusta [Georgia] area needed a locally owned and operated, relationship-based bank. Most of our shareholders live within our market and all but a few do some business with the bank. This localized ownership is quite common at community banks across the U.S. Often times, investing in the local bank is the only remaining investment members of a community can still make.

In other words, not only do community banks benefit from having close relationships with local investors, but those same investors looking for ways to invest locally benefit from having local institutions to invest in that are not franchises or businesses otherwise related to companies that are headquartered outside the community. In addition, community banks that cannot reasonably go private due to a large shareholder base could be forced to merge with a larger partner in order to spread out the cost of compliance. Such regulatory-induced mergers or disenfranchisement should be avoided as a matter public policy.

II. A Higher Shareholder Threshold More Accurately Reflects Public Company Status

In 1964, when Section 12(g) was enacted to expand the registration and reporting requirements beyond companies traded on a national exchange, Congress understood the need for the regulation to be scaled and thus limited the reach of the provisions to ensure that "the flow of proxy reports and proxy statements [would] be manageable from a regulatory standpoint and not disproportionately burdensome on issuers in relation to the national public interest served."[2] Companies are not considered to have a large enough public market presence to be subject to significant reporting under the Exchange Act unless both the asset and shareholder thresholds are met.

In the more than 40 years since Section 12(g) was adopted, the size of the investing market has grown substantially, as has the number of corporations and the number of investing shareholders. A small corporation today with a small investor footprint is significantly different from what it was 40 years ago. While the shareholder threshold of 500 at one time may have been an accurate reflection of a public market, it no longer is today.

[2] Securities Acts Amendments of 1964, Pub. L. No. 88–467, 78 Stat. 565 (adding Section 12(g), among other provisions, to the Exchange Act); .S. Rep. No. 88-379, at 19 (1963).

For the banking industry, the shareholder number is the only meaningful Section 12(g) measure because 99.5 percent of all banks have assets in excess of $10 million. Banks have large dollar assets because the loans they make are considered assets while the deposits they hold are considered liabilities. To give the Subcommittee some perspective, the bank regulators define a small bank for purposes of the Community Reinvestment act as an institution with less than $1 billion in assets,[3] so virtually all community banks that are considered small, in at least one context, will exceed the asset size parameter of the Section 12(g) test.

Over time, the asset measurement standard set by Congress in 1964 has been adjusted "to assure that the burdens placed on issuers and the Commission were justified by the numbers of investors protected, the size of the companies affected, and other factors bearing on the public interest, as originally intended by Congress."[4] Nonetheless, while the asset size parameter has been increased ten-fold from the $1 million level initially required in 1964 to $10 million in 1996 to reflect the exponential growth in the securities market, the 500-shareholder threshold has never been adjusted to reflect the dramatic increase in the number of securities investors, although the SEC noted in 1996 its intention to consider updating the threshold.

Conclusion

My bank's focus, and those of my fellow bankers throughout the country, is on developing and maintaining long-term relationships with customers – and shareholders – many of which live in and around our communities. The antiquated 500 shareholder rule limits banks' ability to reach out to their communities for the capital that is greatly needed to support lending. Updating this rule will provide another valuable capital tool as banks work to improve the economy in our local areas and in the whole of the U.S.

[3] See e.g., 12 C.F. R. §228.12 (u).
[4] Exposure Draft of Final Report of Advisory Committee on Smaller Public Companies, SEC Release No. 33-8666 (March 3, 2006) [71 FR 11090, 11097].

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Committee on Financial Services

"TRUTH IN TESTIMONY" DISCLOSURE FORM

Clause 2(g) of rule XI of the Rules of the House of Representatives and the Rules of the Committee on Financial Services require the disclosure of the following information. A copy of this form should be attached to your written testimony.

1. Name:	2. Organization or organizations you are representing:
Matthew H. Williams	American Bankers Association

3. Business Address and telephone number:

[redacted]

4. Have you received any Federal grants or contracts (including any subgrants and subcontracts) since October 1, 2006 related to the subject on which you have been invited to testify?	5. Have any of the organizations you are representing received any Federal grants or contracts (including any subgrants and subcontracts) since October 1, 2006 related to the subject on which you have been invited to testify?
☐ Yes ☑ No	☐ Yes ☑ No

6. If you answered "yes" to either item 4 or 5, please list the source and amount of each grant or contract, and indicate whether the recipient of such grant was you or the organization(s) you are representing. You may list additional grants or contracts on additional sheets.

7. Signature:

Please attach a copy of this form to your written testimony.