Testimony of

Charles Hageboeck

before the

Subcommittee on Financial Institutions and Consumer Credit

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Committee on Financial Services

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Chairwoman Capito and members of the Subcommittee, my name is Charles Hageboeck. I am President and CEO of City National Bank in Charleston, WV. City National is a $2.8 billion bank with 73 locations throughout West Virginia, Kentucky, Virginia and Ohio and over 800 employees. By way of background, I hold a Ph.D. in Economics from Indiana University. I have spent my entire career in the banking industry working at both large and small institutions. I have worked in an executive position at a bank with 10 branches, and I have also worked in an executive position at a large regional bank with $30 billion in assets. I am thankful for the opportunity to present my views on the challenges facing community financial institutions, and particularly how regulatory impediments are making it increasingly difficult for banks like City National Bank of West Virginia to help business and consumers borrow money to purchase homes, expand businesses, and efficiently transact their depository needs.

In my testimony today, I'd like to make several key points:

- ***Community Banks, as differentiated from our nation's largest banks, have an important role in our economy.***
- ***Regulatory Pressures are Affecting Banks' Ability to Serve Small Businesses.***

  Banks are the primary lender to small businesses. As such, the presence of banks in local communities throughout our nation is critical to meeting the unique needs of new and developing companies. Regulatory pressures weigh heavily on our ability to lend to small businesses.
- ***The Cost Of Implementing New Regulations Weighs Most Heavily On Community Banks.***

Community banks generally have more limited resources compared to their larger competitors. As the volume and magnitude of regulations increase, more of these resources are dedicated to compliance rather than making loans to consumers and small businesses.

- ***Dodd-Frank Has Significantly Compounded the Problem of Regulatory Burden and May Drive Community Banks out of Lines of Business Altogether***.

  The cumulative impact of rules emanating from Dodd-Frank may be too much for some banks to bear. New rules on mortgage lending and municipal advisors are particularly problematic and must be addressed.

- ***Future Landscape of the Banking Industry***

  Particularly for small community banks, the future is bleak.

I will discuss each of these in detail in the remainder of my testimony.

I. Community Banks Have an Important Role in our Economy

The U.S. Banking industry is characterized by a few large banks which control a large portion of the banking assets in the U.S, and a large number of relatively small banks which collectively hold only a small portion of U.S. banking assets. There are only 70 banks with over $10 billion in assets, but nearly 8,000 banks with assets under $10 billion. The largest 10 banks in the US control 72% of banking assets. At $2.9 billion in assets, and operating 73 branches, City National Bank is one of these smaller community banks. There are significant structural differences between the largest banks and smaller community banks. Community banks generally operate pretty simple organizations – we make small loans to consumers and businesses and we accept deposits. And while our business model is pretty simple, in general, the products and services that we provide meet all of the banking needs for our consumer and small business clients. Community bank management teams know their employees, know their customers, know their communities, and generally know what is going on throughout their organizations.

West Virginia is a state without any large cities. The Charleston MSA (which is a collection of distinct cities and towns each with their own unique character) has a population of only 250,000 people. Community banks are essential to small towns. Large banks generally avoid small towns – and West Virginia has a lot of small towns. Large banks make large loans. Small banks make small loans – because this is all that they can do. Large banks will make small loans as well, but in my experience their capacity for responsive customer service for small customers is generally quite limited. As I will discuss later, regulatory over-burden is significantly impacting the viability of the small community bank, and in the absence of community banks operating in our small West Virginia communities, I believe that credit would be available from larger institutions only at higher rates and with significantly less attentive service.

As a community bank, City National Bank of West Virginia is focused on building and maintaining long-term relationships with our customers. We have to have this long-term view because we plan to be here for a very long time, and that requires us to provide the financial services that will keep our communities strong and growing. We cannot be successful without such a long-term philosophy and without treating our customers fairly. Because we operate in only a limited number of communities, our success and future depends entirely upon the vibrancy and growth of these communities. For that reason, I believe that community banks like City National Bank are also more involved in supporting the community both financially and through commitment of time and energy by employees and management. In my experience, the large banks in our community are far less visible within our community's cultural and not-for-profit organizations than community banks. The absence of community banks in our West Virginia small towns would significantly undermine community support for these towns.

Community banks like mine pride themselves on being agile and quick to adapt to changing environments. In response to local demand, for instance, we were the first in our markets to introduce an innovative checking option, Bounce Back Checking, for individuals who have been denied the opportunity to open a checking account and are looking for a fresh start. In fact, some of our large bank competitors are known to quietly refer depository customers to City National Bank because their own internal policies prohibit allowing them from openning accounts which they know City National Bank will open.

Having worked at large banks, and having worked at small banks, I believe that there is an important role provided by smaller community-focused banks – particularly in the smaller cities and towns which dominate West Virginia and indeed much of the interior of our country. Community banks operate geographically where large banks would prefer not to operate; Community banks focus on smaller businesses and consumers; Community banks increase competition and make credit available on better terms and with better service than large banks characteristically provide; and, community banks are more invested in their communities. But, the viability of the community bank model is under attack. Earnings are under pressure as a result of low interest rates coupled with weak loan demand. At the same time, as I will discuss in more detail, increased regulation has both raised costs and reduced levels of non-interest income. New laws or regulations might be manageable in isolation, but wave after wave, one on top of another, may overrun many community banks, forcing consolidation of small community banks, often to the detriment of our consumers, small businesses and local communities.

II. Regulatory Pressures are Affecting Banks' Ability to Serve Small Businesses.

Banks face different types of regulation. There are regulations concerning safety and soundness which help to insure that the financial viability of the banking system, which is critical to ensuring that our economy remains strong. There are also many regulations designed to protect consumers. Both types of regulations are, in general, important and can, when appropriately designed and administered, increase economic efficiency. However, during the last decade, the regulatory burden for community banks has multiplied tenfold, with more than 50 new rules in the two years leading upt to the passage of the Dodd-Frank Act. And with the "Dodd-Frank Wall Street Reform and Consumer Protection Act" (which was 848 pages on its own), there are more than 4,000 pages of proposed regulations and almost 4,200 pages of final regulations (as of July 12). It is frightening to consider that we are only a quarter of the way through the more than 400 rules that must be promulgated under this new law.

I appreciate that the Committee is taking time to look at the important topic of how banks, which play a critical role in helping our economy to grow, are now buried by red tape. In my opinion, the cumulative impact of the regulatory burden created over the last few years threatens to undermine the ability of small community-orientated banks to survive and prosper in the years ahead. Banks certainly appreciate the importance of regulations that are designed to protect the safety and soundness of our institutions and the interests of our customers. And we recognize that there will always be regulations that control our business because it is vital to the economy. But the reaction to the financial crisis has layered regulation upon regulation, doing little to improve safety and soundness and, instead, handicapping our ability to serve our communities. Far too often, regulations have been enacted without due consideration of the unintended consequences of such regulation. And, often, the unintended consequences are worse than the original problem.

The calculus is fairly simple: more regulation means more resources devoted to regulatory compliance. More resources devoted to regulatory compliance means fewer resources available for doing what banks do best – meeting the credit needs of our local communities. Less credit in turn means businesses can't grow and create new jobs. As a result, local economies suffer and the national economy suffers as well.

Small Businesses are Critical to Job Creation and Banks are Essential Partners

It is well-documented that small businesses are critical to the national economy. Studies produced by the Small Business Administration demonstrate that small businesses account for over half of all jobs in the U.S. and this share of total employment has been fairly stable over the past few decades. More importantly, small businesses account for as much as 65 percent of net new jobs created over the past 15 years and most new job growth during economic recoveries occurs at new and small firms. Small firms and start-ups promote innovation because they are more flexible and often more daring than larger businesses.

Banks are the primary lender to small businesses and their presence in local communities throughout our nation is critical to meeting the unique needs of new and developing companies.

At City National Bank of West Virginia, we have been helping small businesses in our communities grow for well over 100 years. Without the presence of City National Bank in these communities, I wonder how many businesses that in fact were able to grow and prosper, providing jobs and incomes for many, would never had gotten started or been able to grow? And, the regulatory over-burden is in fact threatening the financial viability of the community bank model which has been successful in our communities for over a century.

The pace of business lending is affected by many things, the most important being of course the demand for credit from borrowers. The state of the local economy – including business confidence, business failures, and unemployment levels – is the single most important factor governing our ability to lend. The national economy remains weak, and thus loan demand remains weak. Our local West Virginia economy remains relatively weak as well. While most of the communities in which we operate did not see the significant downturn in home prices beginning in 2008 that touched off the national recession, the state of West Virginia's economy is significantly correlated with the health of the coal business, and the coal business is suffering from both the slow national economy as well as challenges in getting EPA approval for permits to mine coal. Let's be clear. Banks are anxious to lend to credit worthy customers. Banks do not turn down loan applications because they do not want to lend – lending is what banks do. We lend at every opportunity to those borrowers with viable projects that we deem capable of repaying principal and interest over a reasonable period of time. But, in a slow economy, many proposed projects don't make sense for the borrower or the bank. Were economic growth to increase, some of these potential loan opportunities would once again make sense to borrower and bank alike – and we stand ready to make them.

Our still fragile economy and uncertain economic future makes borrowers less interested in adding new debt. Studies indicate that lack of sales remains the top concern for businesses. Without strong sales prospects, businesses won't hire more workers, grow production, and invest in new products. At City National we are experiencing slow demand for loans and we would characterize loan demand as lower that we would consider healthy. While economists claim the US economy is no longer in recession, if they are correct, the recovery remains far from robust. The lack of economic growth is our single biggest concern.

In the banking industry, our ability to lend to businesses and consumers is also dependent upon our capital levels. Capital levels declined significantly in our industry during the recession as banks charged-off bad loans, which reduced capital levels. The largest banks were able to recapitalize themselves through public offerings of their common stock. However, smaller community banks that experienced significant reductions in capital due to loan losses have generally not been able to increase their capital in the same manner. Coupled with regulatory expectations to maintain even higher capital levels, many of these community banks have indeed been unable to actively lend. City National Bank just announced plans to acquire Community Bank based in Staunton, Virginia. Community Bank, which was a very active lender in the years leading up to the recession, has been forced to restrain their lending practices due to their capital levels and the already high level of loans on their books. The Basel III capital regulations are currently a significant concern for community banks. These regulations were originally not supposed to apply to small community banks. As I understand it, and in their proposed form, they now will apply to community banks. This is of grave concern to community bankers across the US. In particular, banks with significant residential mortgage loans may find that while they were previously considered to be very strongly capitalized, under Basel III, their required capital levels will increase from current levels, which may cause these smaller institutions to constrain their lending activity at a time when availability of credit for business customers is going to be critical to helping the US economy get "un-stuck". A quick review of City National Bank's balance sheet suggests that our capital ratios would fall if subject to Basel III – which would impact our ability to lend to consumers and small business customers. I am told that one estimate is that perhaps half of the community banks would in fact be under-capitalized if subject to Basel III. I would encourage Congress to support delayed implementation of Basel III capital requirements for community banks by banking regulators along with significant study of the consequences to community banks of implementing these requirements.

III. The Cost of Implementing New Regulations Weighs Most Heavily on Community Banks

The burden of regulatory compliance is keenly felt by all banks. But smaller banks generally do not have as many resources as their larger brethren and endure greater difficulty in adapting to new regulations or to changes in existing regulations. 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. Consider that from July 9 to August 10, a 30 day period, the CFPB and other bank regulators issued over 2,500 pages of proposed rulemaking notices, all of which will profoundly change the ways banks operate. (293 pages addressing a high-cost mortgage proposal; 1,099 pages addressing mortgage disclosures; 700 pages regarding Basel III; and 428 pages regarding a mortgage servicing proposal). All in a 30 day period. I am not sure how Bank America keeps up with that, let alone community banks. Consider the plight of one of my peers, Rock Branch Community Bank, operating 1 branch with about 35 employees. Exactly how are they supposed to be make loans, serve customers well, remaining vigilant with regard to our safety and soundness, and address regulations equivalent to 5 reams of paper on a monthly basis? It is an impossible task – all the more frustrating because at our level, for the community bank, we fail to see much redeeming value to the new regulations because the banking industry was already one of the most highly regulated industries in the country.

City National Bank's direct compliance costs exceed $1 million. This includes salaries, compliance training, legal and consulting services, compliance software and IT expenses, printing expenses and privacy mailing expenses, and various record-keeping requirements. While this is a significant expense for City, the real challenge for our company has been the near total distraction for some of our senior officers as they focus on insuring that our policies and practices conform to regulation. Our Senior Vice-President in charge of residential mortgage lending and our Senior Vice-President in charge of Consumer Lending now spend most of their time on compliance – which means they spend virtually no time on figuring out how to make loans more available to consumers who need them.

Unfortunately, in my view (and repeating that I believe that an appropriate level of regulation is desirable and useful) many of the regulations our staff is focused on addressing do not in any way improve the products that we offer to our customers, or improve the manner in which those products are delivered. City National Bank has a history of successfully serving our communities for over a century. We have come through the recession extremely well. We were named the 3rd and 8th best performing bank in the US in 2010 and 2011 respectively by Bank Director Magazine. We did not participate in TARP, our asset quality has remained solid, and our stock has been one of the best performing bank stocks during my tenure at City. Our bank is successful because we make wise decisions about how much risk we are willing to take in pursuit of profit. It is not in our best interest to adopt business practices that are highly risky or that are adverse to our customers. Nor it is generally in the best interests of our peers to do so. In my view, regulatory paradigms need to begin by insuring that the operating environment for banks is such that banks will, generally, choose of their own volition to appropriately balance risk and return, and to adopt business practices that are, generally, in keeping with our customer's best interests. If the environment in which we operate is thusly established, then regulations serve as a back-stop against errors made rather than regulations needing to capture every contingency and potentiality. I believe that the environment in which banks operate today does in fact generally encourage banks to appropriately balance risk and reward, and to treat customers in appropriate ways. The recession which began in 2008 was the deepest and longest since the great depression. Because the recession had its roots in declining residential real estate prices, and because residential real estate loans are the predominant earning asset for many banks, it makes sense (although unfortunate) that the recession's impact upon the safety and soundness of the banking system was dramatic. Despite the serious economic shock that our industry experienced, relatively few banks have failed. (And it should be noted that the most troublesome of those that did fail were very large banks and not community-based banks.) That the banking industry came thru this recession pretty well, all things considered, demonstrates that the landscape in which banks operate today is generally one in which banks have incentives to “do the right things”.

Likewise, with respect to regulations designed to protect customers, my perspective is that bankers recognize that it is in our own best interests to treat customers well. Customers have other options for the provision of banking services, in addition to intense competition between banking institutions. So, if we fail to treat our customers well, then they will select alternative financial service providers. Since our entire future is dependent upon building and growing our customer base in the long-term, we do not begin each day wondering how we can trick or take advantage of our customers. Regulations seem to suppose just the opposite. Again, while I agree that some level of regulation is necessary and appropriate, I believe that the crushing regulatory burden enacted, and being implemented today, begins with a false premise and that the unexpected consequences of the regulation in terms of excessive compliance costs and unanticipated changes in bank behavior exceed any benefits derived from such regulation.

Inconsistencies in Application or Regulation

The regulatory burden on community banks is far more onerous than for large banks. In the last several years, I have had the opportunity to examine the financial records of a number of community banks that were considering joining their franchise with a larger bank like City. My experience has been enlightening. I believe that regulations are not applied consistently to large banks and small banks. In some cases, I think this makes sense. Regulations designed to insure the safety and soundness of small banks and large banks are, I believe, applied differently. This makes sense. Small banks aren’t systemically important. It doesn’t make sense to expect small banks to comply with regulations on capital, liquidity, interest-rate risk management, operational risk management, etc. to the same extent that large banks do. To do so would be too expensive for these banks and the costs would outweigh the benefits. Regulators have understood this for many years. Regulations concerning consumer protection seem to be a different matter. It would be hard to explain why a customer of Bank America should be treated differently than the customer of a small bank operating a single branch in Charleston WV. Both customers deserve the same level of protection. And here is the rub. My experience tells me that small community banks can not, and are not, complying with all of these consumer protection regulations. The regulatory over-burden is so extensive that no small bank could possibly do so. As a result, regulators of small banks must be regulating them differently than large banks, at least now, while the regulations are in the process of being fully implemented. However, in the long-run, I suspect that the regulatory expectations will be similar for these types of regulation – and the cost and burden of complying with them for the small community bank will significantly reduce the financial viability of the small community bank model.

Considering that the median sized bank in this country has $166 million in assets and 38 employees, it is not difficult to see how the burden of absorbing increasing compliance costs is magnified for smaller institutions. And it is not just in-house staffing requirements that must be considered. Banks must also factor in the high cost of attending conferences and seminars, the many subscriptions to legal and accounting services that are necessary to ensure nothing is missed, upgrades to IT software to monitor our activities, and the additional burden of proving that we have in fact complied with the new law. On top of all this, the regulatory agencies want to see independent third-party confirmation, so besides internal audits, banks now have to have outside audits for compliance – a significant expense.

Along with the real, hard-dollar costs are lost opportunity costs. Instead of being trained on how to expand markets or bring in new customers, employees are trained on how to comply with regulations. Money that would normally be employed making loans to consumers and small businesses is instead diverted to pay consultants, lawyers and auditors. And instead of investing capital in new products and services, banks are paying for changes to software to ensure compliance with new regulations.

One example of regulatory over-burden relates to the outdated requirement that a physical placard be affixed to ATMs notifying customers of the possibility that they may be charged a fee for using the machine, even though any actual fees are fully disclosed on the screen before any transaction is completed. Requiring disclosure of fees, and giving consumers the ability to opt-out, is sound policy. But requiring both a physical placard and on-screen notice is a vestige from the days when such information was harder to present on the computer screen. Its main contribution today is to encourage frivolous lawsuits and force banks to spend valuable time and resources scurrying around to all their ATMs to make sure that fee notification stickers – which have no real value to today’s customers – haven’t been peeled off or removed by vandals.

I am certain I speak for all of my colleagues when I say that I am grateful to the House of Representatives for passing legislation, H.R. 4367, that removes this unnecessary and duplicative requirement. Measures such as this can do much to help ease regulatory burdens.

Another example relates to the requirement that a bank send annual privacy notices to customers even if the bank does not share nonpublic, personal information (beyond what is permitted by regulatory exception) and the bank has not changed this practice. The continued requirement that banks send such a notice to their customers every year is costly both in terms of money and man hours. Moreover, receipt of the annual notice irritates consumers and risks desensitizing them to other important communications from their bank. Personally, I get these at my home in relation to several brokerage accounts and I admit that I haven't read one of them in probably a decade. Eliminating the annual re-notification requirement when no changes to the notice have been made would provide real and immediate regulatory relief without impacting a customer's rights or existing privacy protections. That is why I support H.R. 5817 and I urge this body to quickly move to pass this important legislation.

Another very recent example at City National Bank has been compliance with regulatory oversight regarding foreclosures. Due to the serious recession and declining home prices, many borrowers were unable to continue to make payments on their mortgages, and the homes were worth less than the outstanding mortgage balance. This resulted in a huge foreclosure wave across the U.S. As a result of a few abusive practices, bank regulators took it upon themselves to protect borrowers from these abusive practices – which were, as I understand it, generally about foreclosures on homes where the foreclosing institution had little knowledge of the loan that was made, the borrowers, and in most cases wasn't even involved when the original loan was made. Makes sense to regulate these abuses - right? I am not so sure. Our banking regulators recently completed their examination of City National Bank. An inordinate amount of their time was devoted to the issue of foreclosure practices. As a result, a tremendous amount of our staff time was devoted to preparing for the examination of our foreclosure practices, which in the case of City National Bank made no sense whatsoever. During the prior twelve months we had 45 foreclosures in our organization (and many of these involved the death of the borrower). In every case, City officers took the original application, underwrote the loan, were responsible for preparation of all paperwork relating to the loan, closed the loan, and processed payments against the loan until payments stopped. We foreclosed on loans that we made and that we knew and then only after exhausting every other available option with our customer (no bank really wants to foreclose on real estate). We did nothing wrong, and I think our regulator would agree. But, we spent countless hours complying with something that had nothing to do with our company's lending practices.

Loans to consumers to help them or their children continue their education, is another unfortunate example. We used to proudly make these loans. Following new regulations that govern how loans can be made to fund postsecondary education expense, we concluded that the cost to City National Bank to comply with the regulations was so high relative to the revenue that could be derived from these loans that we don't offer them anymore. We will make loans if customers can secure them with their home in the form of a residential mortgage or home equity loan, and customers may utilize proceeds for education. But, for customers that aren't affluent and don't own their own home, their opportunity to borrow to further their education is now more difficult because at least one bank – City National – no longer competes for those loans. Surely this wasn't the goal that was desired, but this is an excellent example of "unintended consequences". Well meaning legislation actually achieved exactly what wasn't wanted.

Flood Insurance is another interesting example. When we lend money to a customer against property that is in a flood plain, we are required to obtain flood insurance – even if the customer doesn't want it. If said property has a small structure on it, say an antiquated shed, we must insure that building. Our regulators take the position that every structure has value – so regardless of how small or antiquated – we must insure it. This is a challenge because often the appraiser refuses to place a separate value on the building (which would be very close to $0) from the land in such a situation. If we place flood insurance on the building, the customer would potentially have a claim against us for forcing them to buy flood insurance when the insurance will not pay anything (because the building isn't worth anything!). This could be interpreted a "unfair & deceptive" act. However, failure to obtain flood insurance carries with it a fine of $2,000 per occurrence – a fine that may well exceed the entire value of the structure. (And yes, this really happens!) There are ways to work with each customer on an individualized basis to address this – but why should we have to? And what does it cost? The answer is it costs a lot of time & energy that could better be devoted to making new loans. And, unfortunately, while we struggle to comply with the law in this case, there is a pretty good chance that a smaller community bank will come along, ignore the law, and make the loan.

IV. Dodd-Frank has Significantly Compounded the Problem of Regulatory Burden and May Drive Banks out of Lines of Business Altogether

As I noted earlier in my testimony, we are only a quarter of the way through the more than 400 rules that must be promulgated under Dodd-Frank. The flood of regulations emanating from Dodd-Frank is so large that bank regulators have been urging banks to add compliance officers to handle it. And despite claims that community banks like mine would be exempt from the new Consumer Financial Protection Bureau, we are not exempt. All banks – large and small – will be required to comply with the rules and regulations set by the CFPB.

The CFPB, at its sole discretion, can join the prudential regulator during compliance exams. In addition, regulators will examine banks for compliance with the CFPB's rules at least as aggressively as the CFPB would do independently. In fact, the FDIC has created a whole new division to implement the rules promulgated by the new CFPB, as well as its own prescriptive supervisory expectations for laws beyond FDIC's rule-making powers. Thus, the new legislation will result in new compliance burdens for community banks and a new regulator looking over their shoulders.

Given that the cost of compliance has a disproportionate impact on small banks as opposed to large banks, it is reasonable to expect this gap to widen even more as Dodd-Frank is fully implemented. The cumulative impact of hundreds of new or revised regulations may be a weight too great for many small banks to bear. 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. Some rules under Dodd-Frank, if done improperly, ***will literally drive banks out of lines of business.*** With regulation as broad and far-reaching as Dodd-Frank, there are too many areas of concern for community banks to address them all, but I would like to review some that standout from my perspective as President of City National Bank.

One of the changes required in Dodd-Frank 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 is ludicrous to conclude that banks need regulators to tell them that borrowers should be able to demonstrate an ability to repay their loans. The sad reality that a few "bad actors" made loans that were beyond the capacity of some borrowers to repay shouldn't be used to justify over-reaching regulations whose unintended consequences exceed the projected benefits. The most important question legislators ought to be asking is: What makes you believe banks are, generally, unable to make these risk-reward decisions on their own? Bankers have made these decisions successfully for centuries. What was different this time? Did banker's inherent ability to make risk-return decisions fail, or was it something else? In this case, an "economic bubble" in home building was created by the belief that residential real estate prices could not drop, (at least very much). This conclusion was based upon past historical observation - in fact home prices had not ever dropped very much. As a result, some banks misjudged the risk-return tradeoff. Economic bubbles occur from time to time in market-based economies. By their very definition they are difficult to recognize until they have already happened. Now that we have recognized that home prices can be quite volatile under certain circumstances, I would propose it unlikely that banks will make the same mistake again. Therefore, I seriously question whether new regulations designed to control how banks make residential mortgage loans are really necessary. All regulation carries with it "Unintended Consequences". If the regulation serves little real purpose, the unintended consequences may create more problems than the regulation fixes. In this case, the risk is that the "unintended consequence" may be far less lending to "non-standard" customers for mortgages that have been successfully made for years to the benefit of bank and customer alike – but will now be subject to potential litigation which will choke many customers that should and could qualify for a mortgage loan out of the market.

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 ("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 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. This is a very real concern for City National Bank and other West Virginia banks. A significant portion of our loans finance residential mortgages. Most of the mortgages we make are not sold through FNMA or FHLMC or other government agencies but are held on our own books. If the Qualified Mortgage is too narrowly defined, then loans to many of the customers we have served for years may not be "Qualified", and we would be forced to restrict our lending to these customers despite the fact that we have been able to successfully underwrite these customer's loans for many years, including throughout the recession which began in 2008. A poorly thought out definition of a "Qualified

Mortgage" would be bad for our customers, bad for us, and bad for small towns across America where perhaps we are able to make home loans that are quite ordinary and reasonable within our markets but don't look the same as mortgages made in big urban markets.

Beyond concerns surrounding QM's, Dodd-Frank 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 also have the unintended consequence of denying quality loans to creditworthy borrowers.

Additionally with respect to mortgage lending, the CFPB is attempting to improve customer disclosures regarding mortgages to insure that customers better understand the provisions of their mortgage. The Real Estate Settlement Act (RESPA) covers escrow accounts, settlement statements, referral fees and other procedures regarding real estate settlement. Regulation Z (Truth in Lending) requires banks to provide disclosure statements explain the terms and cost of credit. Both disclosures statements are complicated (and required). The goal was to combine them into a simple statement easier to understand. While a good goal, implementation has been anything but. The proposed disclosure is just as complicated as the originals. Tremendous management time at our company has gone into, and continues to go into, staying abreast of disclosure requirements. Customers have not benefited and there is no evidence that they ever will. Meanwhile, our internal processes have become much more complicated. We have had to acquire new software to prepare the documents. We are now required to wait 7 days before we complete a home equity loan – in addition to the traditional 3 day right to cancel. We have been required to develop a database to track waiting times (which can change as we go thru the origination process), and processing staff has to be trained so that they understand complicated rules on waiting times. And what is the benefit? What is the consumer protected from? For our home equity loans, we cover all closing costs. So, if the customer decides they don't need the product they may cancel at any time – without cost. If they have borrowed on the line, they may find alternative financing and pay back the loan at any time with the only cost being interest between the date of disbursement and date of repayment. There are no fees or penalties for not closing. Customers prefer and request quick closing timeframes – they do not like the longer wait times, and the delay is not consistent with their needs.

Also in the area of mortgage lending, under Regulation Z, certain loans are now characterized as high-priced mortgage loans (HPML). In the case of City National Bank, some of our small-balance residential mortgage loans would qualify as HPML's. Some loans appropriately carry higher interest rates because the balance is small or the loan is less well secured. However, if the loan meets the definition as a HPML, we are required to escrow taxes and insurance. We are also required to undergo a more extensive underwriting process (which ought to be our choice and not a requirement. If the loan is for $5,000 and we choose to utilize an abbreviated underwriting process it seems to me that ought to be our choice and not a regulatory directive.) For small loans, the requirement that the loan be subject to escrow & taxes makes it more expensive to offer the loan, and thusly more expensive for the customer. As an example, if a customer owns their home free and clear, and wants to borrow $5,000 for a new furnace, we would have to structure the loan and the payments to include the costs of the annual taxes and insurance on their home. Again, these are unintended consequences for small balance loans which are quite common in our market area.

Here is another example. Under the Dodd Frank Act, a great deal of energy has been devoted to derivatives. It is the commonly held belief that "derivatives" are bad, and need to be significantly controlled. And, in their totality, is seems clear that our financial regulators need a much better understanding of the market for derivatives and the impact that they have on the global economy. But it is not true that all derivatives are bad. We frequently use derivatives to benefit our customers. Further, were accounting and regulation not so restrictive, City National Bank would be able to use derivatives to reduce our company's exposure to interest rate risk in ways that would be beneficial to our shareholders. Let's talk about derivatives from our customer's perspective. Banks do not make many long-term loans (where rates are set for more than say 5 years) because we have very few sources of long-term liabilities (we have no deposits with fixed rates for more than 5 years). If we made significant numbers of very long-term loans funded with short-term deposits, we would put ourselves at risk to rising interest rates as happened in the early 1980's when many banks failed for just this reason. However, our customers often would like to make loans with very long-term fixed rates, particularly in this low interest rate environment. As a result, our customers are led to seek financial institutions (such as insurance companies) that are willing to make very long-term fixed-rate loans. City National Bank can solve this problem by adding a derivative to the equation which allows the customer to pay a fixed-rate for a long-time while City National Bank receives a rate tied to Prime which better matches off against our short-term deposits. As a result of the Dodd Frank Act more than a dozen new regulations have been issued affecting the use of derivatives for our customers (which I do not think was ever the intent of the lesiglation. These are again the unintended consequences). While we are still sorting through all the new regulations, we recently received notice that customers may now have to be qualified as “Qualified Participants” as defined in the regulation. Unfortunately our customers are relatively small businesses and many won’t meet the set standard, so we may be unable to continue to meet our customers needs using a very standard product that no one could reasonably object to but which has been made inaccessible to our customer by these new regulations. And, often a large bank, with access to “capital markets” will now be positioned to offer this customer an alternative “2nd best” solution. This is not helpful regulation and it will impact our ability our bank and other community banks to extend credit to small business customers in our markets.

The Safe Act (HUD) National Mortgage Licensing System (NMLS) requires that all bank employees who take real estate secured loan applications have to undergo a background check and register annually at a cost of $69. The real costs of this regulation are that City National Bank had to establish an internal process to track all employees that take mortgage loan applications to insure that they are relicensed annually. And, what is achieved here? A convicted felon can register under the NMLS and a mortgage broker whose business previously failed can register as well. I see the cost. Where is the benefit?

The provision on municipal advisors is also problematic and would limit services to municipalities by community banks. Banks offer public sector customers banking services and are regulated closely by several government agencies. It is generally believed 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. 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. Such regulation would be duplicative and costly. Consequently, community banks would not be able to offer banking services to municipalities at a price that would be competitive and many may decide not to provide them at all. The likely result will be less innovation and diminished job creation and economic expansion. I urge Congress to oversee this implementation and ensure that the rule addresses unregulated parties and that neither Section 975 of Dodd-Frank nor its implementing regulation reaches through to traditional bank products and services.

V. Future Landscape of the Banking Industry

In my testimony I have argued that community banks have a special role within the banking system. Locally based, they are more focused on lending to consumers and small businesses, they operate in small cities and towns sometimes shunned by large banks, they provide service levels not usually seen at large banks, they engender competition which benefits the customers, and they are more invested in the community fabric than large banking institutions.

I have also argued that small community banks are struggling since the onset of the recession in 2008. Many banks, including the small community ones, were hard hit by loan losses during the recession which lowered capital levels. While larger banks were able to recapitalize, smaller banks have generally not been able to do so, which necessarily limits their ability to return to being robust lenders. Low interest rates and slow economic growth have hurt small community banks whose income is primarily driven by the spread between loan rates and deposit rates. And, sources of fee income have been negatively impacted by regulation. On top of all of these challenges, the regulatory over-burden, which was predominantly directed at problems seen to have emanated from large banks, are instead disproportionately falling upon small community banks with limited resources to address these regulations. What then is the future of community banking in the US?

Community Banks come in a variety of sizes from the very small institutions to banks the size of City National Bank. All of us have been negatively impacted by current economic conditions – low interest rates and lack of loan demand has reduced our earnings. Lower earnings means that it has been difficult to rebuild capital levels, and we are at risk that required capital levels are going to be significantly increased by Basel III which will impact our ability to actively lend to help get the economy re-energized. The industry continues to grow more and more competitive, and technological trends threaten our profitability as well. It is a tough time to be a community bank.

Consolidation within the banking industry has been an inevitable force for 30 years, and the forces that drive consolidation will continue. Consolidation is driven by the challenges of getting qualified management, aging boards, increased competition from other financial service providers, the desire for liquidity on the part of small bank shareholders, the opportunity for shareholders to profit from the sale of the small bank to a larger partner, etc. We can not, and probably should not, stop these fundamental market forces. It is my experience that there are relatively large number of small community banks that would like to join with a larger partner, have attempted to do so, are unable to find an interested partner, and so remain independent. In time, these institutions who no longer desire to run independent community banks are likely to find the right opportunity to partner with a larger bank. But, in conversation with almost every small community bank CEO that I have met, regulatory over-burden is greatly accelerating the inevitable trend toward consolidation within the industry. If, as I suggest, the small community bank holds an important part within the financial system for many small communities, this is terribly unfortunate – particularly to the extent that the regulations that they are forced to comply with, as I have demonstrated above, have relatively little to do with their own situations. And, while consolidation of the smallest community banks is probably inevitable, the recent banking crisis should have taught us that consolidation of larger community banks such as City National Bank into the largest banks in the US is undesirable. There is even talk about whether it would be advantageous to break apart the largest banking institutions. At present 10 banks control 72% of banking resources. I don't know whether breaking them up makes sense or not. But, I do believe that allowing these 10 to increase their domination of the banking industry, with the consequent reduction in competition, can not be a good thing.

If you talk with any bank CEO you will hear the same thing - regulatory over-burden is clearly driving community banks to consider consolidation, and I believe that this reality is a very clear, and very undesirable "unintended consequence" of the unfolding regulatory environment.