Subcommittee on Financial Institutions and Consumer Credit
"Regulatory Reform: Examining How New Regulations are Impacting Financial Institutions, Small Businesses and Consumers"

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Wausau City Hall, Wausau, WI

Testimony of Marty Reinhart, President
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Chairman Capito, Ranking Member Maloney, and members of the Subcommittee, I am Marty Reinhart, president of Heritage Bank, a $100 million asset community bank located in central Wisconsin. Almost 50 percent of Wisconsin's banks have been serving their communities for more than 100 years and Heritage Bank is one of them, having been formed in 1908. I am pleased to be here today to represent the 200 members of the Community Bankers of Wisconsin. Thank you for convening this field hearing examining how new regulations are impacting financial institutions, small businesses and consumers.

Community banks are playing a significant role in the broad based economic recovery of our nation because we serve rural, small town, and suburban customers and markets that are not comprehensively served by large banks. Our business is based on longstanding relationships in the communities in which we live. We make loans often passed over by the large banks because a community banker's personal knowledge of the community and the borrower provides firsthand insight into the true credit quality of a loan, in stark contrast to the statistical models used by large banks located in other states and regions. These localized credit decisions, made one-by-one by thousands of community bankers, support small businesses, economic growth, and job creation.

At the end of 2008, the national economy and that of rural Wisconsin were starting to feel the full impact of the recession. While there has been publicity that banks have been unwilling to lend, a recent report published by the Community Bankers of Wisconsin shows banks with assets less than $10 billion having an increase of over 4.0% in commercial and industrial loans as well as small business loans of $1,000,000 or less, year over year. I am pleased to say that over the past two and one half years, Heritage Bank increased our outstanding loans by over 30%, while maintaining our rating with the FDIC.

Dodd- Frank Wall Street Reform Act

I recognize the seriousness of the financial situation that existed prior to the passage of the Wall Street Reform Act and the need for congress to take action. The community banking industry appreciates the efforts that were made to distinguish between the large money center banks with assets greater than $10 billion, and smaller community banks. The new system for computing FDIC premiums will lower assessments for 98 percent of these smaller institutions, saving community banks roughly $4.5 billion over the next three years. Allowing the community banks to be exempt from examination by the Consumer Financial Protection Bureau maintains the current examination and oversight conditions that exist today. And making the FDIC insurance

coverage of $250,000 permanent, benefits the entire banking industry by easing the concerns our depositors have about their money being safe.

Having said this, with regulatory and paperwork requirements, both new and old, there continues to be a disproportionate burden placed on community banks due to their more limited resources, diminishing their profitability and ability to attract capital and support their customers, including small businesses. Every provider of financial services – including every single community bank – feels the effects of increased regulatory burden. The uncertainty associated with how new regulations will be written and interpreted, causes anxiety about the future of our industry and our ability to compete.

While there are many examples of the costs associated with regulation, I would like to highlight some of those associated with a residential mortgage loan. The application process has been changed several times with new HUD regulations and RESPA requirements. The process for ordering and reviewing appraisals has become more cumbersome and involved. Extra forms with early disclosures and having to register and finger print mortgage loan officers, adds to costs associated with this type of lending. It creates delays, additional cost and confusion on the part of the borrower. A typical mortgage file will have more than 100 pages by the time the loan is closed.

Consumer Financial Protection Bureau

While it is too early to tell how many of the new regulations of the Dodd-Frank Wall Street Reform Act will affect community banks, one source of concern is the new Consumer Financial Protection Bureau or CFPB. While we are pleased that Dodd-Frank allows community banks with less than $10 billion in assets to continue to be examined by their primary regulators, we remain concerned about CFPB regulations, to which community banks will be subject. In particular, the CFPB should not implement any rules that would adversely impact the ability of community banks to customize products to meet customer needs. Because bank regulators have long expertise in balancing the safety and soundness of banking operations with the need to protect consumers, CBW supports amending the law to give prudential regulators a more meaningful role in CFPB rule writing.

On behalf of CBW, I would like to take this opportunity to thank Representative Duffy, Chairman Capito and other members of the subcommittee that supported H.R. 1315, the Consumer Financial Protection Safety and Soundness Improvement Act, which passed the House. This bill would improve the current structure of the CFPB by changing its governance from a single director to a five-member commission. It would also raise the threshold for the FSOC to be able to overturn a CFPB rule from a 2/3rd majority to a simple majority and it would postpone transfer of functions to the CFPB until a Director is named.

Examination Environment

While there is a recognition there has been some improvement as the number of problem banks has diminished, one of the most frustrating aspects of the current regulatory environment has been the trend toward oppressive exams. The current examination environment is hampering

lending at the very time that bank credit is needed to sustain the economic recovery. While all banks accept the need for balanced regulatory oversight, the pendulum has swung too far in the direction of over-regulation. Specifically, examiners are:

- Requiring write-downs or reclassification of performing loans based on the value of collateral, disregarding the income or cash flow of the borrowers;
- Placing loans on non-accrual even though the borrower is current on payments;
- Substituting their judgment for that of the appraiser;
- Criticizing the use of certain types of non-core funding such as Federal Home Loan Bank advances;
- Moving the capital level goalposts back beyond stated regulatory requirements.

Community bankers nationwide have reported that bank regulators are often demanding significant capital increases above the minimum regulatory levels established for well capitalized banks. For example, some examiners are requiring banks to maintain minimum leverage ratios as high as 8 to 9 percent (versus the 5 percent required by regulation) and minimum Tier 1 risk-based ratios as high as 10 percent (versus the 6 percent required by regulation). To bankers, the process appears arbitrary and punitive. A moving and unpredictable capital goalpost makes it nearly impossible to satisfy capital demands in a difficult economy and capital marketplace. As a result, bankers are forced to pass up sound loan opportunities in order to preserve capital. This is not helpful for their communities and for overall economic growth. All bank lending requires judgment and calculated risk. If regulators work to squeeze every ounce of risk out of the system, they will only succeed in stemming the flow of credit to local economies and threatening bank viability. There has to be a reasonable regulatory balance.

What is particularly frustrating to us is that field examination practices are often not consistent with the directives from Washington. A disconnect exists. For example, the November 2008 Interagency Statement on Meeting the Needs of Creditworthy Borrowers states: “The agencies expect all banking organizations to fulfill their fundamental role in the economy as intermediaries of credit to businesses, consumers, and other creditworthy borrowers.” Unfortunately, this policy is often overlooked, especially in the regions most severely affected by the recession. We understand that examiners have a difficult job, and the stakes were raised sharply after the financial crisis. But I believe many examiners have overreacted, with adverse consequences for banks and the economy.

Before the crisis, examiners frequently worked in partnership with the banks they examined. They were a resource in interpreting often ambiguous guidance. Where corrections were needed, opportunity was given to make them, and compliance was a mutual goal. This is the best means of achieving safety and soundness without interfering with the business of lending. I understand examiners are not evaluated on the banks’ contributions to support the local economy. They have become overly cautious in their analysis of the bank’s condition and as a result, the examiner’s incentive is to err on the side of writing down loans and demanding additional capital. The current crisis was not caused by a failure to adequately examine community banks.

Additionally, bankers used to receive prompt feedback following their exams which they could act on immediately as part of the exam process. Today, detailed examination reports often arrive

months after the examiner's visit, with little opportunity for the banker to sit down with the examiner, go over the results, and respond to the examiner's concerns on the spot. The misplaced zeal and demands of examiners are having a chilling effect on credit. Loan opportunities are passed over for fear of criticism and examiner write-downs, resulting in loss of income and capital. The contraction in credit is having a direct, adverse impact on the economic recovery. Exams could be greatly improved by being made more consistent and rational. This would encourage prudent lending without loosening standards.

The Communities First Act (CFA)

Finally, I would like to advocate for an important piece of legislation that would help to relieve community banks of certain burdensome regulations they face, both in examination and in compliance, and help community bank customers save and invest.

The ICBA and CBW-backed Communities First Act (CFA, H.R. 1697), introduced in the House by Rep. Blaine Luetkemeyer (R-Mo.) and cosponsored by members from both sides of the aisle would:

- Increase the threshold number of bank shareholders from 500 to 2,000 that trigger SEC registration. Annual SEC compliance costs are a significant expense for listed banks (this legislation mirrors H.R. 1965, recently approved by the entire committee);
- Require the SEC to conduct a cost/benefit analysis for any proposed accounting change;
- Provide relief from new Dodd-Frank data collection requirements in connection with loan applications from women-owned and minority-owned businesses;
- Extend the 5-year net operating loss (NOL) carryback provision to free up community bank capital now when it is most needed to boost local economies;

These and the many other provisions of CFA would improve the regulatory environment and community bank viability, to the benefit of their customers and communities. This legislation has gained the support of 34 state community banking associations, including CBW. There is a hearing scheduled on November 16th and I would encourage you to learn more about the bill and ask if you are not a cosponsor that you consider cosponsoring H.R. 1697, the Communities First Act.

Closing

There is no question that the current regulatory and examination environment is an impediment to the flow of credit that will create jobs and advance the economic recovery. I appreciate the opportunity to testify before the subcommittee and your keen interest in this matter.

Thank you.

United States House of Representatives
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:**
Marty Reinhart	Community Bankers of Wisconsin
3. Business Address and telephone number:	
[redacted]	
4. Have you received any Federal grants or contracts (including any subgrants and subcontracts) since October 1, 2008 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, 2008 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: [signature]	

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