AN EXAMINATION OF THE CHALLENGES FACING COMMUNITY FINANCIAL INSTITUTIONS IN OHIO

FIELD 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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MONDAY, APRIL 16, 2012

APPENDIX

AN EXAMINATION OF THE CHALLENGES FACING COMMUNITY FINANCIAL INSTITUTIONS IN OHIO

Monday, April 16, 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 a.m., at the Carl B. Stokes U.S. Courthouse, 801 West Superior Avenue, Cleveland, Ohio, Hon. Shelley Moore Capito [chairwoman of the subcommittee] presiding.

Members present: Representatives Capito, Renacci, and Duffy.

Chairwoman CAPITO. The hearing will come to order.

I would first like to thank the City of Cleveland for welcoming the Financial Institutions and Consumer Credit Subcommittee to the Carl B. Stokes U.S. Courthouse, which is beautiful, and for allowing us to use this chamber for our hearing. So thank you to the City of Cleveland.

I am going to kind of walk everybody through today's hearing. Obviously, this is a field hearing, so we will be a little more informal than we might be in the regular hearing room.

Mr. Renacci and Mr. Duffy and I will each give an opening statement, and then our witnesses each will be recognized for a 5-minute opening statement. And then, we are going to have a couple rounds of questioning where each Member will be recognized for 5 minutes. We should be finished in plenty of time for us to catch our flights back to Washington. We are returning after a 2½ week Easter recess.

I haven't gotten a chance to really compare notes with my colleagues, but I think we have—I certainly did, in my 2 weeks home, get a lot of feedback where people are questioning what direction we are going, and a lot of frustration, really, and concern. So I hope that, with the great witnesses that we have today, we will be able to dig down deep in some of this, at least in terms of the Financial Institutions Subcommittee.

Over the past year, we have held field hearings across the Nation to gain a better understanding of the unique challenges faced by financial institutions in different regions of the country.

In Georgia, which has had the highest number of bank failures since the financial crisis, they have very unique difficulties.

In Wisconsin, in Mr. Duffy's district, we heard from community banks, credit unions, and small businesses about ways to promote economic growth.

I also went to San Antonio last month where community bankers and credit unions also discussed the growing regulatory burden and cost of compliance.

And our most recent field hearing in Nevada provided me and other Members with insight into private sector solutions to mitigate foreclosures. They have an enormous issue with their real estate in and around Las Vegas and in the State of Nevada.

Each hearing has been a learning experience for me, further providing solutions to our Nation's problems and also reinforcing that those solutions aren't going to necessarily come out of Washington D.C. They will come out of the heartland of America.

By the way, I am from West Virginia, for those who haven't had a chance to hear me brag about that. There are a lot of West Virginians here in Ohio. And I did say that if you all would just learn how to drive, we would feel a lot better about that. But, please, no West Virginia jokes. I don't want to hear them.

This will mark the fifth field hearing for us. And I would like to thank Mr. Renacci for serving as our host. He is my vice chairman on the subcommittee, and he brings a wealth of experience and a broad-based business background that has been extremely helpful, not just in the subcommittee, but to me, in particular. And I want to thank him for that.

We also have Mr. Duffy from Wisconsin, who is a freshman, as well. And he has led the charge on some of our CFPB legislation and others. So I want to thank him for coming today.

Today, we are going to continue on the theme of a better understanding of the local financial institutions. Our panel of witnesses will provide insight as to the unique challenges faced by financial institutions of varying sizes.

We will hear from small community banks and credit unions about the regulatory impediments to promoting economic growth, and KeyBank will provide Members with a better understanding of the unintended consequences of the Volcker Rule, the very complicated Volcker Rule.

Finally, we will hear from a community development financial institution about their efforts to splurge off growth.

As with other hearings, we are here to listen and learn, and I look forward to that.

We normally have a timer, but I was just informed that the timing device is in California. I don't know what it is doing there, but there is another field hearing in California. I left my watch in West Virginia when I left at 5:30 this morning, so I have my dutiful staff members back there to tap me on the shoulder. So if you hear me kind of wrestling around, you will know it is time to move along a little bit. But I appreciate everybody, really, the witnesses and the audience for coming.

And I would like to now yield to Mr. Renacci for the purpose of making an opening statement.

Mr. RENACCI. Thank you, Madam Chairwoman. And I want to begin by thanking you for holding this important hearing and for being gracious enough to hold it in the wonderful City of Cleveland.

I also want to thank all the witnesses here today. I can't emphasize enough what a pleasure it is to be in front of a hometown crowd this morning.

I am proud to say that Ohio is home to some of the finest financial institutions in the country, and I have no doubt these institutions are committed to helping our economy achieve a more robust and sustainable economic recovery.

When I travel around the 16th District, meeting with small business leaders, I find a frustrated group who are eager to expand their businesses, but are prohibited from doing so because they cannot access the necessary capital.

At the same time, the financial institutions in my district repeatedly say they are ready to extend credit to these small businesses and have the capital to do so, but are unable to do because of overzealous, inconsistent, and ever-changing regulations. We are here today because cities like Cleveland and institutions like yours are the ones affected by Washington regulations. I believe part of the problem is that, for too long, lawmakers have legislated from Washington with no real sense of how the regulations will impact people across the country.

I have no doubt that most regulations are drafted with the best of intentions. The most problematic regulations are the ones that sound reasonable on their face, but, taken accumulatively, have a devastating impact. A perfect example is the Dodd-Frank Act. The drafters' intentions were noble: to prevent another financial crisis and prove transparency; to stop banks from taking excessive risks; to prevent abusive financial practices; to and end too-big-to-fail.

Unfortunately, instead of sound regulation aimed at reining in fraudulent and destructive behavior, we ended up with hundreds of pages of hastily thrown-together regulations. Instead of preventing the next financial crisis, we have managed to paralyze our financial institutions by creating a sense of uncertainty and confusion.

Instead of sound regulations, we have left many of our financial institutions standing on the sidelines unwilling and unable to provide liquidity to our markets because they are unsure what the rules are and when they might be unilaterally changed again. The uncertainty in costs of new regulations is having an especially profound impact on smaller institutions. Without a large compliance staff or back office legal teams, our smaller institutions are forced to divert precious capital to keep up with new regulations; this is capital that would be better used in the hands of its customers. That is why we are here today. I want to hear the issues being discussed inside our community institutions.

I want to hear how regulations coming out of Washington, D.C., are impacting access to credit, how they are impacting your institutions' ability to conduct business. I realize that many of you are tired of telling your stories. I know sometimes it seems like no one is listening. I want to assure you that we are listening and we care.

Myself, Chairwoman Capito, Mr. Duffy, and many other members of this committee have heard from similar institutions across the country and we recognize that your institutions are the key to our economic recovery.

Thank you, again, for being here today, and I look forward to hearing your testimony.

Chairwoman CAPITO. Thank you. I now recognize Representative Duffy for the purpose of an opening statement.

Mr. DUFFY. Thank you. And it is an honor to be here in Cleveland. This is my first trip to Cleveland, and I only got to see it from about midnight last night until this morning, but what I have seen so far is fantastic.

It is also great to be here with Chairwoman Capito, who has done a fantastic job leading our subcommittee, and also to be here with Mr. Renacci. As part of the freshman class, we serve on financial services together. But, also, as a freshman class, he is one of our greatest leaders and does a fantastic job moving this herd of a freshman class, driving us forward, and is respected by everybody and is, again, one of the best leaders we have.

So it is a privilege to be here in Cleveland today.

I come from central and northern Wisconsin. I have had a chance to talk to our small banks and our credit unions time and time again, and I keep hearing the same thing over and over; the regulations are killing them. It is making it harder for them to do their jobs, to get capital out into their communities. They talk about regulations that are stifling their community and stifling their business.

They talk about the regulators coming in and these outrageous reviews that take place, and standards are changing from one regulator to the next, year over year. And the outcry has been quite loud.

I guess I am interested today to see if you gentlemen have the same stories that I hear in central and northern Wisconsin. And if it is just a Wisconsin phenomenon or if it is a phenomenon that takes place around the country.

I would also like to hear if you gentlemen have any ideas for solutions. Obviously, we know we have to change the law and the structure, but it would help if you would say, "There is a lot to be done, but if you could really focus on this area first, that would do the most for us to help us do our jobs better."

So I am here with open ears and I look forward to hearing your testimony.

Chairwoman CAPITO. That concludes our opening statements. We will now turn to our panel. Your full written statements will be made a part of the record, and I will introduce each of you individually to give a 5-minute summary of your testimony. We will then get to the question portion of the hearing.

First, I would like to recognize Mr. Stan Barnes, CEO of the CSE Federal Credit Union. Welcome, Mr. Barnes.

STATEMENT OF STAN BARNES, CHIEF EXECUTIVE OFFICER, CSE FEDERAL CREDIT UNION

Mr. BARNES. Thank you, Chairwoman Capito.

Chairwoman CAPITO. I don't know if your microphones are on or working. Is there a green light on?

Mr. BARNES. Yes, there is.

Chairwoman CAPITO. There we go.

Mr. BARNES. Thank you, Chairwoman Capito, and members of the subcommittee. Thank you for this opportunity today to represent Ohio's 377 credit unions and 3 million Ohio credit union

members and to share with you on their behalf the difficult circumstances facing community-based credit unions in the form of overburdensome regulations and lack of transparency in the examination process and to update you on the current and future role of the credit union movement.

My name is Stan Barnes. I am the president and CEO of CSE Federal Credit Union in Canton, Ohio. We are a $150 million not-for-profit financial service cooperative, and we proudly serve 30,000 members in the northeast Ohio area. And like every credit union, we do so under the business philosophy of not for profit, not for charity, but for service.

Regulatory burden and the cost of compliance, as you have noted, is the number one concern among Ohio credit unions. Attached to my testimony and submitted for the record are the Federal regulatory requirements for both banks and credit unions, which should put into some perspective the time, the effort, and the cost tied to compliance.

In many cases, when credit unions should be dedicating resources to the financial livelihood and benefit of their members, they are instead challenged with the increasing burden of following far-reaching rules and regulations.

And these regulations are particularly onerous on small asset credit unions, which are subject to the same regulations, but struggle to adhere to these guidelines due to thin operating margins and small staffs. In fact, the vast majority of Ohio credit unions, 65 percent, are small credit unions under $35 million in assets.

To give you a sense of the increasing regulatory burden, since 2008, Ohio credit unions have been subjected to more than 160 new rules and regulations from 27 different Federal agencies.

Additionally, there are at least 27 rulemaking proposals pending at various agencies, including the National Credit Union Administration, the Federal Reserve, the Consumer Financial Protection Bureau, the Department of Housing and Urban Development, the Financial Accounting Standards Board, the Treasury FinCEN, and the Federal Trade Commission, among others.

Unfortunately, even though the natural person credit unions that I represent did not cause the financial crisis, they have been subjected to a flood of regulation that creates unnecessary burden without any measure of the effectiveness of the changes. With regard to examination standards and inconsistencies, the experience of the majority of Ohio credit unions is that the high standard of transparency and accountability expected of financial institutions is underwhelmingly practiced by the National Credit Union Administration (NCUA) during the examination process.

Credit unions have voiced to the NCUA that their examiners are practicing regulatory micromanagement and overreach. Quite simply, regulators are dictating the business of operating a credit union.

It is important that examiners not overregulate or exceed their authority and substitute their judgment for that of the volunteers and the executives in the governance, management, and operations of credit unions.

While the relationship that I enjoy with my examiner is transparent, professional, and rooted in mutual respect, colleagues of mine have experienced the exact opposite.

I urge the committee to consider improvements to the examination process. H.R. 3461, sponsored by the chairwoman, is a good step in that direction. It does address the examination process and is a positive step in balancing the relationship between the regulated and the regulator.

It also provides for a more transparent and consistent examination process. And I know that the Credit Union National Association (CUNA), of which CSE is a member, supports the legislation and is working closely with the NCUA to incorporate examination enhancements and transparency.

CUNA has also urged the NCUA to take several steps to improve the regulatory process and relieve credit unions' regulatory burden. I have submitted a copy of a letter from CUNA to NCUA Chairwoman Debbie Matz that recommends immediate actions to relieve overwhelmed credit unions.

Credit unions have called on the NCUA to impose a moratorium on new regulations for at least the next 6 months, and have suggested that the agency reinstate the regulatory flexibility program which provides well-managed and well-capitalized credit unions an exemption from certain regulations that are not statutorily required.

Despite the issues caused by regulatory overreach and examination transparency, I am proud to say that credit unions continue to serve their members with responsible and affordable financial products and services. Over the years, credit unions have grown considerably and play an important role in local communities. In fact, research by the Credit Union National Association finds that credit unions save Ohio members $132 million annually by offering better-priced, conservatively-managed products and services. The not-for-profit cooperative model is working and, in my opinion, it is best suited to meet the needs of all Ohioans.

I have submitted as part of my testimony examples of the Credit Union Difference in Action and how credit unions are helping Ohioans in today's economy through financial education.

But credit unions can do more. With commonsense regulation that would essentially double the arbitrary cap on small business lending, credit unions can infuse $13 billion of new capital into small businesses.

We ask that you support S.2231 and H.R. 1418.

Similarly, H.R. 3993, which would allow well-capitalized credit unions to receive supplemental capital, a much needed financial resource as credit unions face a difficult revenue building environment and increased pressure to perform by regulators. Again, we ask for your support in that measure.

We look forward to continuing to work with Congress to resolve issues facing community-based financial institutions. We ask that as you consider legislation in this arena, you regularly consult credit unions in your districts. We want to be a solution to the economic issues facing our State and country and we are here to help.

Thank you for the opportunity to present to you this morning, and I am happy to answer any questions that you may have.

[The prepared statement of Mr. Barnes can be found on page 34 of the appendix.]

Chairwoman CAPITO. Thank you, Mr. Barnes.

Our next witness is Mr. Bill Blake, deputy general counsel of KeyBank.

Welcome.

STATEMENT OF WILLIAM J. BLAKE, DEPUTY GENERAL COUNSEL, KEYBANK

Mr. BLAKE. Thank you. Thank you, Chairwoman Capito, Congressman Renacci, and Congressman Duffy. It is a privilege for me to be invited here today to talk about the Volcker Rule and the proposed regulation. KeyBank and other regional banks submitted a joint comment letter on the proposed regulation several weeks ago. The letter was signed by Branch Banking and Trust Company, Capital One, Fifth Third, KeyCorp, PNC, Regions Financial, Suntrust, and U.S. Bancorp.

All of our institutions have one thing in common. Our primary mission is to serve our local communities by providing traditional banking services: deposits; loans; and trust and asset management.

We are regional banking organizations who share the same concerns about the Volcker Rule. We are not the complex, global, interconnected businesses that Dodd-Frank was intended to address. Our organizations don't engage in proprietary trade, nor do we have any substantial interest in running hedge funds or private equity funds.

Congress did not intend the Volcker Rule to unduly restrict traditional banking and customer-facing activities or impose substantial compliance burdens on banking organizations primarily engaged in traditional banking activities.

The proposed implemented regulations too often take a one-size-fits-all approach that results in unintended consequence.

In today's testimony, I would like to highlight four areas in which the rule negatively affects our ability to serve our customers, manage risk, control costs, and avoid losses. We are concerned that the proposed regulation will actually increase, rather than decrease, the risks to safety and soundness of our organizations.

First, the proposal hampers our ability to meet the liquidity needs of customers, especially small and middle-market companies. We have long provided liquidity through our market-making activities and market-making operations. Small and mid-market companies have security issuances that are relatively small in size and traded less frequently than large companies.

Under the proposed rules, our legitimate market-making activities and less liquid securities face a substantial risk of being improperly viewed as illegal proprietary trading. The implementing regulations need to ensure that issuances of small and middle-market companies are not disadvantaged compared to larger companies.

Second, effective hedging and asset liability management activities are critical to the way we manage risk and ensure the soundness and safety of our institutions. The proposal fails to clearly protect bona fide hedging and ALM activities.

Organizations like ours will operate in a continuous zone of uncertainty, unsure whether bona fide hedging and ALM activities and trades will, on an after-the-fact basis, be determined by an agency to constitute impermissible proprietary trading.

Without the ability to execute our critical asset liability activities, banks may scale back even traditional lending if the risks associated with them cannot be appropriately hedged. Small and middle-market businesses, as well as municipalities, may see a reduction in lending and an increase in borrowing costs.

Third, our organizations are committed to maintaining strong and effective compliance programs that are appropriate to the size, nature, and complexity of our organization's activities, but the costly, detailed programmatic compliance requirements of the Volcker Rule proposal go beyond what is appropriate for regional banking organizations that do not in any way, in a meaningful way, engage in trading that could be viewed as proprietary.

We do not believe our organizations need such programs to prove a negative in the fact that we don't do proprietary trading. Instead, we think the Volcker Rule dollar threshold for a programmatic compliance program should be raised from $1 billion to $10 billion. In fact, raising it to even $15 billion would still capture more than 97 percent of the total trading assets and trading liabilities of all U.S. banking organization.

Finally, the rule requires banking organizations to divest existing legacy investments in private equity funds, subject to certain extensions. The purpose of this extended period was to allow banks to unwind these investments in an orderly fashion without the need for fire sales. Most of these investments provide capital to small and middle-market companies.

All of the investments were legally made at the time they were acquired, but the Volcker Rule now requires us to dispose of all of them. The rules, as written, would likely result in forced sales of private equity fund interests at distressed prices, which would transfer significant value from the regulated banking industry to private investors.

The rules essentially negate the availability of the statutory 5-year period for running off illiquid investments. The Volcker Rule provisions in Dodd-Frank are scheduled to go into effect on July 21, 2012, a little more than 3 months from now. The proposed rules generated over 17,000 comments from academia, Members of Congress, trade groups, public interest groups, and other interested parties.

We and a growing chorus of other interested parties believe that substantial revisions to the proposed regulations are necessary.

Accordingly, a final point I would like to make is that our regional banking group strongly supports the efforts being made by a bipartisan group of Senators, including Senators Crapo and Hagan, to delay the effective date of the Volcker Rule, and we ask you to support their initiative.

Key, along with other regional banks who share our view, filed a comment letter with the agencies on February 13th to explain our concerns. I am submitting a copy of our comment letter with my testimony today. I encourage you and members of your staff to

consult it to get a better understanding of the problems that we face.

I sincerely appreciate the opportunity to testify today, and I especially thank you all for coming to Cleveland. We, the regional banks, are committed to helping restore our economy and we look forward to working with you.

Thank you.

[The prepared statement of Mr. Blake can be found on page 60 of the appendix.]

Chairwoman CAPITO. Thank you.

Our next witness is Mr. G. Courtney Haning, chairman, president, and CEO of the Peoples National Bank. Thank you.

Welcome.

STATEMENT OF G. COURTNEY HANING, CHAIRMAN, PRESIDENT, AND CHIEF EXECUTIVE OFFICER, THE PEOPLES NATIONAL BANK, ON BEHALF OF THE OHIO BANKERS LEAGUE

Mr. HANING. Chairwoman Capito, Congressmen Renacci and Duffy, my name is Courtney Haning, and I am the chairman and present CEO of the Peoples National Bank of New Lexington, Ohio. I am also chairman of the Ohio Bankers League (OBL), and I am here speaking on behalf of its members.

The OBL is the only trade association in Ohio representing the full spectrum of insured depositories, including mutual thrifts, community banks, and multi-State holding companies.

Today, I am here to focus particular attention on the challenges facing community banks. While larger banks care about their customers, they do not share the same vested interest in my community that I do. In many cases, we are the only economic engine in the area we serve. If my customer is forced to leave because he cannot find a good job, I cannot follow him. So my bank must closely align with local needs. My expertise is that I am a close friend to my customers, which gives me added insight. This means I can make more loans safely than my bigger competitors that rely on mathematical models. Many successful businesses in Ohio started with a close call on a loan made by a community bank, which could say "yes," because it knew its customer well.

Unfortunately, this ability to exercise good judgment based on local market knowledge is being threatened by both recent regulatory burdens and inconsistent decisions by regulators.

Most banks in the Midwest did not participate in the underwriting practices that contributed to the recent recession. Sadly, however, we are paying for the past through costly new regulatory burdens, anxious examiners, and customers who are unwilling to borrow. These remedies are hitting all segments of our financial statements, as costs are going up, opportunities to earn revenue have been curtailed, and the amount and cost of capital we need is increasing.

I know that your subcommittee has heard a great deal about the issue of too-big-to-fail. That is an important problem. However, today, I would like to talk about whether, under the new environment, community banks have become too-small-to-survive. While we see the cumulative effect of new regulations and exam procedures, community bankers are concerned that policymakers don't

understand that we don't have the same resources to meet new compliance demands as multi-State banks.

There are numerous new recordkeeping burdens set to take effect. For example, under the rules proposed by the SEC, banks will have to register as municipal advisors just to offer the same deposit and loan services we have always provided to local governments.

The goal of the new statute was to provide oversight for advisors that fell in gaps between the banks and security regulators, not to duplicate oversight for banks that are already regulated.

Yet, the proposed rule will add to our overhead without providing additional protections for consumers.

Examiners have a hard job that is made even more challenging in difficult times. Yet, there can be no doubt that examiners are becoming more rigid, leaving less room for judgment. This is particularly detrimental for local bankers, since our competitive advantage is our knowledge of that local marketplace. If the examiners take away that flexibility through a one-size-fits-all approach, it will handicap our ability to compete.

For example, while fighting discrimination is an important goal of government, as a result of recent changes, we are now hesitant to loan to long-time customers if they do not qualify based solely on objective criteria.

Now, everyone has to fit in a box. If the customer doesn't fit, yet we approve the loan, that borrower becomes an exception. If we create such an outlier, we must justify the reasons for making the loan.

Our examiners will demand similar exceptions for outliers in a protected class or the bank risks referral to the Department of Justice for prosecution. As a result, bankers stopped making exceptions.

All banks and customers are different, so that it does a great disservice for examiners to create a one-size-fits-all approach.

Finally, I would like to thank you for introducing H.R. 3461 to restore consistency to the bank exam process. We would encourage you and your colleagues to follow through and see that the good ideas in the proposal become law.

I believe bankers and examiners still want the same thing: a healthy, vibrant, competitive banking system.

H.R. 3461, the Financial Institutions Examination Fairness and Reform Act helps all parties achieve that goal.

In conclusion, I sincerely appreciate the opportunity to testify here today, and I would like to thank the Members of Congress and their staff for coming to my home State to gather information on issues of vital importance. Banks have served this country well and will continue to provide a significant engine for economic growth and job creation if we are allowed to perform without excessive regulatory burden or inconsistent examination oversight.

We would urge the House of Representatives to continue on the path they started at the beginning of the 112th Congress. Hold bank regulators, including the CFPB, accountable for the cost of compliance and ensure that the layers of regulation do not accumulate to the point where it is no longer feasible for community banks to continue to serve their local markets.

Thank you.

[The prepared statement of Mr. Haning can be found on page 92 of the appendix.]

Chairwoman CAPITO. Thank you. Our next witness is Mr. Steve Fireman, president and general counsel, the Economic and Community Development Institute.

Welcome. Thank you.

STATEMENT OF STEVEN FIREMAN, PRESIDENT AND GENERAL COUNSEL, THE ECONOMIC AND COMMUNITY DEVELOPMENT INSTITUTE

Mr. FIREMAN. Thank you, Chairwoman Capito, and Congressmen Duffy and Renacci. Thank you very much for having us.

On behalf of the board of directors and staff of the Economic and Community Development Institute (ECDI), we want to thank you for hosting this conversation regarding the challenges faced by Ohio's community-based financial institutions.

The Economic and Community Development Institute is a 501(c)3 nonprofit economic development organization, U.S. Small Business Administration intermediary microlender, and a U.S. Treasury-designated community development financial institution.

Since 2004, ECDI has made $10.5 million in loans to around 550 local small businesses in central and southwest Ohio creating and/or retaining approximately 1,650 jobs. Because of our success in central and southwest Ohio, ECDI has recently been approached by funders and stakeholders in the Cleveland area and asked to expand our microenterprise development services to northeast Ohio. The organization will open a branch in Cleveland in July 2012.

In addition to filling the gap in the credit industry by offering loans ranging from $500 to $100,000 to small local businesses through our revolving loan fund program, ECDI addresses the needs of very small business owners in the creation and expansion of small business.

Challenges: Our challenges are quite different than some of the challenges that are being discussed today. However, our popularity is a direct result of the challenges being discussed by the witnesses today. There is no doubt about that.

First and foremost, we are faced with the challenge of demand for capital. As one of the few microlending organizations in Ohio, there has been an increased demand for ECDI to make business loans. As a young and dynamic organization, ECDI is committed to scaling up to meet the increasing demand. Since 2009, ECDI has demonstrated consistent and dramatic growth in the amount of loan capital disbursed and the businesses served.

In addition to seeing increased demand in our central Ohio market, ECDI has expanded our services from 7 counties, when we were doing business in 2009, to 49 counties currently at the request of stakeholders, including SBA, the Ohio Department of Development, and the aforementioned Cleveland Foundation. The surge in demand for small business loans, as well as the geographic expansion, has caused some challenges for EDCI.

The first challenge we have faced is keeping up with demand for capital. At the end of 2010, EDCI's loan funds were nearly 100 percent deployed. EDCI faced this challenge head-on by creating an in-

vestment instrument approved by the Ohio Securities Commission called Invest Local Ohio.

Invest Local Ohio gives community members the opportunity to invest in small business by investing in EDCI. Every dollar invested in the Invest Local Ohio fund is loaned to Ohio small businesses and leveraged with at least two more dollars from other existing ECDI loan funds. ECDI investors receive a 2 percent return on their investment for a 3-year note, and a 3 percent return on a 5-year note. Challenge number two is related, but a little bit different. It involves demand on our capacity. This challenge is caused because, in addition to outreach, assessment, training, processing, and servicing loans, ECDI's model differs a bit from the banks and credit unions in that we commit to provide ongoing technical assistance to our portfolio beginning with the loan and continuing throughout the life of the loan. We like to tell our customers that when you do a loan with us, it is like getting married; you are not going to get rid of us.

This is critical to building successful businesses and, therefore, we proactively work with clients to keep a healthy portfolio.

This is also very, very costly. As an SBA intermediary microlender, ECDI receives a yearly allocation of technical assistance funds to spend time with our clients on building strong business and capacity. This is very valuable, but 75 percent of the funding is restricted to working with the clients only after the loan is closed. Not only is this a huge compliance-related burden associated with allocating and tracking staff time, but very little of the SBA technical assistance allocation is able to be used in working with potential loan clients before the loan is closed. And none of the funding is able to be used for general loan administration such as underwriting, processing, and servicing.

Another challenge that we have is the unpredictability of Federal funding. I don't think I need to say much more about that, actually. But it is enough to say that, every year, we have to compete for our Federal funding, CDFI and SBA money, which is okay. We appreciate the competition. However, it is just a difficulty in building an organization to scale when you have to plan year-by-year, as opposed to a few years out.

Another challenge that we face, and this is very different from the other banks sitting at the witness table with me today, is that the philanthropic communities are not wired to think about small business development as a viable target for their dollars.

According to a report from the Foundation Center entitled, "Spotlight on Economic Development Grantmaking in Ohio," although the amount of dollars granted to economic development initiatives by foundations in Ohio increased by 152 percent in the period of 2005 to 2008, grants specifically targeted towards small business development decreased by a third.

Another related challenge or similar challenge has to do with State economic development initiatives. Just as traditional philanthropy is not wired to understand the importance of small business development, the majority of Ohio's sponsored economic development initiatives are not wired to understand the importance of microenterprise development. Instead, they focus time and money on

traditional economic development strategies such as attracting and retaining large corporations.

Start-up initiatives that the State does put their money into, such as Ohio's Third Frontier Program, benefit the high-growth technology sector. While this is crucial and it is very valuable, it neglects a large portion of Ohio's potential employers: small businesses that employ five or less employees.

As a result, we have to spend a lot of time screaming and yelling and trying to get in front of the Ohio Department of Development, and now Jobs Ohio people, and explain our story and why small business, really small business development is crucial for job creation. Without continued Federal support and education on the State level, microenterprise will not have the opportunity to create the jobs that we have the potential to create. As you can see, with each challenge, we try to look for creative ways to continue to meet the capital demands of Ohio entrepreneurs and microbusinesses.

Thank you for the opportunity to communicate these challenges we face in serving small business. I hope this testimony is useful as you return to Washington.

One other example I would like to give on a regulatory burden is, we were the recipient of Small Business Loan Fund dollars, SBLF dollars, a small allocation in the form of a loan, a low-interest loan, which is how we get a lot of our capital, like SBA capital and/or bank capital.

And it seemed like a good idea at the time. It was $203,000, which we deployed to small business. However, the process took approximately 6 months. We had auditors in from three different States, which is probably all good shepherding of Federal dollars, but—and then the closing. I went back and forth with the closing attorneys from New York 16 times to get to the actual deal closed.

So I can imagine that our $203,000 loan probably cost—I don't even want to think about what it cost. But it was quite an expensive deal.

I think that demonstrates some of the regulatory burden that we face, as well.

Thank you very much.

[The prepared statement of Mr. Fireman can be found on page 88 of the appendix.]

Chairwoman CAPITO. Thank you.

And our final witness is Mr. Martin Cole, president and chief executive officer of the Andover Bank.

Welcome. Thank you.

STATEMENT OF MARTIN R. COLE, PRESIDENT AND CHIEF EXECUTIVE OFFICER, THE ANDOVER BANK

Mr. COLE. Thank you, Madam Chairwoman, Congressman Duffy, and Congressman Renacci. Thank you for bringing this hearing to Ohio, and for your invitation to testify today.

My name is Martin Cole. I am present CEO of the Andover Bank. We are a rural, State-chartered community bank with $330 million in assets, which has been in existence since 1884. I have been there for 36 years. Viewed from enough distance to gain perspective, the structural flaws in our financial regulatory system are clear.

In the early 20th Century, the average consumer or small business only had one resource for financial services, a bank. Thus, policymakers viewed banks as vital to the public's interest and Congress enacted safeguards. Deposit insurance and on-site regular examination provide two examples. Please note, banks pay the entire costs for both.

The marketplace constantly innovates. Active regulation can impede innovation. If one path is blocked, the marketplace will blaze another. Significant government costs for banks pushed the marketplace to invent non-banks to avoid these costs.

Simply put, bank supervision is far more intrusive and expensive to banks than government regulation is to any of our non-bank competitors.

Let me try to reinforce the public policy importance of equivalent regulation with an Ohio example. Leading up to the collapse of the housing market, Federal mortgage lending laws theoretically applied to mortgage brokers, but in Ohio, no one enforced those laws.

As a result, Ohio suffered from rampant predatory lending as criminals and charlatans slipped through the enforcement gap. When Ohio belatedly licensed brokers, its process included criminal background checks. As I understand the numbers, an estimated 2,000 brokers, who had been operating, never applied for licenses. Of the roughly 10,000 who did, 14 percent were found to have criminal backgrounds.

My bank's primary marketplace is a single county. For my bank to prosper, I must invest in the communities we serve. As a small bank, my sustainable competitive advantage is that I can know my customers. Thus, I can safely make a small business loan that another bank, relying only on credit reports and credit scores, would rationally deny.

Across Ohio, there are thousands of successful businesses, some grown large, that exist because of the initial insights and hands-on help of a community banker. For that process to work, the regulator must allow us to use informed judgment.

Today, what I hear from peers is that they feel that bank examiners are not allowed to respect the judgment of skilled bankers.

Let me be clear that I believe the financial services industries should and must be regulated. I have enormous respect for my regulators. Their job is very important and very, very difficult.

Let me turn to consumer regulations. As a community banker, I will succeed or fail based upon my reputation. We have powerful incentive to work very hard at treating our customers fairly and helping them make decisions that are best for them. We understand there are bad guys in the marketplace and that we need consumer protections.

However, for a smaller bank, every change in a regulation imposes real cost and distracts my colleagues from our customers. That is okay if the consumer gets a benefit that outweighs the cost, but far too often, he or she does not.

The Ohio Bankers League, which represents Ohio's banks and savings and loans from the smallest to the largest, operates an online exam evaluation system. This system is new. Its purpose is to provide useful feedback to agencies to help them improve their procedures and training.

Evaluations of recent exams give cause for concern. Forty-two percent of the participating banks reported that their examiners were neither flexible nor open to the exchange of views. Less than half of the banks believe their examinations have resolved issues and recommended corrective actions in a fair and reasonable manner.

I would commit two bills pending before the House.

The first is H.R. 3461. We are encouraged by its clear focus on timely, fair, and effective examination.

Finally, while I understand that H.R. 1697 content is too diverse to be considered by a single committee, I would ask for your review of those provisions under your jurisdiction. Please understand that redundant regulation or regulation designed for larger, more complex institutions can severely harm the ability of a small bank to respond to the legitimate needs of its community.

I want to specifically thank Congress for recently raising the SEC's shareholder threshold from 500 to 2,000. That single change will make it far easier for smaller banks like mine to raise capital in the future.

We have 460 shareholders. We have a list of individuals who would like to buy our stock. We can now proceed with capital expansion plans without fearing costly additional regulatory requirements. Thank you.

In the movie, "It's a Wonderful Life," George Bailey had a crazy Uncle George who unintentionally and inadvertently almost destroyed the financial institution he loved.

I have a crazy uncle, also. His name is Uncle Sam. I believe he has inadvertently and unintentionally destroyed community banking. Maybe you can be my Clarence.

I am grateful for your interest in Ohio and its communities. I would be happy to respond now or in the future to any questions you may have.

[The prepared statement of Mr. Cole can be found on page 82 of the appendix.]

Chairwoman CAPITO. Thank you. Thank you all very much for your testimony. I think we have a good variety of witnesses here, so I think we can get some good questions. I am going to begin the question-and-answer portion.

Mr. Blake, I want to ask you about the Volcker Rule. Knowing the complications of it, and I am glad you mentioned that the Senate was making a move to postpone this, but there has been a rush to get this onto the books and sort of in the barn.

But the question I have is, you talked about safety and soundness. What are the compliance costs? You mentioned disproving a negative, so disproving that you are not engaging in this. Have you been able to calculate what the compliance costs would be to KeyBank? Have you already hired people to try to meet these challenges?

Mr. BLAKE. We have not. We are waiting for more guidance on the final rule and where it would wind up.

The proposed rule would certainly require us to, in my view, at least hire a full-time compliance officer for nothing other than the Volcker Rule.

But the reach of the Volcker Rule is so extensive that it requires significant record-keeping, significant analytical work, significant testing that the compliance program that is part of the rule has, I think, about 24 different statistical analyses that banks have to perform. Fortunately, we don't fall into the biggest category, but we still would have to do a number of those.

It is a little bit difficult without more guidance from the Federal regulators to know exactly how much it is going to cost.

But, for example, we have to identify every single trading desk, and that is every area where there would be a trade made. So we have a broker dealer, for example, that does marketing. We have a treasury group that does asset liability management. Each of those desks has to have procedures and policies. Each of the trades has to be identified and tracked. And on an after-the-fact basis, regulators will come in and let us know whether any of that activity is proprietary trading.

Chairwoman CAPITO. Thank you. There has actually been a lot of criticism, too, about the international implications of what this rule could mean to our financial institutions.

I want to get to—I think Mr. Haning and Mr. Cole mentioned this in their testimony. I was at a small bank in my district over the holiday, and this whole theory, or not theory, but, I guess—I don't want to say fear, because that might be too strong, but consequence of community banks sort of being swept under and, really, being forced to either merge or be acquired because you meet the compliance costs, is really going to, I think, endanger that one-on-one personal relationship. Your bank has gone back, what did you say, 200 years—

Mr. COLE. Since 1884.

Chairwoman CAPITO. Yes, 1884. I am sure you have relationships with probably everybody in your community and know a lot of the folks in your communities.

In my bill, in the examination bill, we are trying to get the consistency in there, the timeliness of it, the ability for you to have questions answered and to appeal certain decisions.

Have you in your experience through your examinations, tried to appeal decisions that have been made? And what has been the result of that? Not yes or no, but really, do you have any frustrations with that, I guess is what I am asking?

Mr. COLE. Not specifically in the safety and soundness area. We do in the compliance area, and we have just recently, because of the time period between examinations, the 4-year period. And my discussion with the policymakers at The Federal Reserve was that there was too much of a gap in communication, a lack of understanding of what they wanted versus what the regulations state, because there is a lot of nebulous interpretation under the guise of fair lending.

As an example, I have been forced to go out and hire a full-time compliance officer with salary and benefits of about $60,000 a year.

We are currently employing the services of a consultant at $1,200 a day. They are spending about 2 days a week in there; just coming in, assessing what we need to do, trying to interpret the—in anticipation of rules coming from the CFPB or any other agencies.

It is the uncertainty and the unknown that we most fear. And our bank is doing quite well. We are coming off of our third consecutive year of record earnings. So it is not that we are struggling in this market. The concern is the future.

This afternoon, when I return to the bank, I have an appointment with a gentleman from a much larger banking institution to discuss the possibility of merging.

So it is an option we have to consider for our shareholders. Unfortunately, it would be a huge loss for our particular area because of the services we provide.

Chairwoman CAPITO. What county are you in?

Mr. COLE. Ashtabula County.

Chairwoman CAPITO. Which is up to the east?

Mr. COLE. The very northeastern part.

And we have the number one market share in Ashtabula County. We are a significant financial institution playing a significant role in our community, and it would be a tremendous loss.

But the reality is, what we see in the headwinds of compliance, based on our size, we feel we have to generate a larger size in one fashion or another to absorb the cost just to meet regulatory compliance.

Chairwoman CAPITO. I am going to move on to Mr. Renacci. I will get back to you, Mr. Haning, in our second round.

But I am sure this will give you great comfort to know that one of the top 10 fastest-growing occupations in this country is compliance officers in the financial institutions, compliments of Dodd-Frank, I am sure.

Mr. Renacci is recognized for questions.

Mr. RENACCI. Thank you, Madam Chairwoman.

I do want to thank all of you for being here. After listening to all your testimony, it continues to reinforce some of the concerns that I have over regulations.

And, Mr. Fireman, your comments about certain unpredictability. Without uncertain predictability, things get frozen up, too. So I appreciate that.

I will open this next question up to anyone on the panel. Secretary Geithner has stated that FSOC will coordinate an interagency review to identify and eliminate regulations that are outdated, unnecessary, or unduly burdensome to insure depository institutions. Have your trade associations been active participants in this process based on the agency's work to date?

Should we be optimistic that their efforts will yield constructive recommendations for reducing regulatory burdens that your institutions face?

Again, anyone on the panel who would like to address that?

Mr. Haning?

Mr. HANING. I can't say that I have seen any efforts on our part of our association. Unfortunately, it sounds like a little bit of government rhetoric.

I am sure they don't want anything to happen that would cause undue harm to the financial institutions in Ohio or across the country, but in the efforts, obviously, from Dodd-Frank and the interpretation of much of what we have yet to see, I can't see the efforts of reducing burden, more so of it increasing.

Mr. BARNES. Congressman, if I could respond to that, also?

Our association works diligently to work with all of the agencies, whether that is reviewing new rules and regulations on behalf of credit unions and then filing comment letters with respect to all of those on potential consequences or alternatives or things like that. So, our association certainly has.

What we hope the outcome of that will be is to bring an element of common sense back into this regulatory process to eliminate those things that are of no value, that simply increase cost, and minimize the ability of local financial institutions to serve consumers, and to restore some common sense to the process.

My colleague from Andover Bank—that is $350 million, if I understand that correctly—just spoke to you about the incredible amount of effort that they have to input to comply with that. And as I said in my testimony, 65 percent of credit unions are $35 million or less. That is one-tenth of his size. So you can imagine complying with those same rules.

So, we certainly are hopeful that any process to minimize, streamline, and eliminate burdensome and duplicative regulations will be successful, and we will do anything we can to help.

Mr. RENACCI. Mr. Blake, I am going to come back to the Volcker Rule. The Volcker Rule was championed as an easy solution. Simply stop banks from taking excessive risk with federally-insured deposits and we would have all the answers. The argument was that banks could not engage in proprietary trading and financial systems would be safer. However, reinstating a 1930s regulation in today's complex financial world, of course, has proven to be very, very difficult.

When regulators went to draft the so-called easy fix, the result was a 298-page proposal that included more than 1,300 questions seeking comments on nearly 400 topics.

Defining proprietary trading is not an easy task, is it? Why is it so complicated?

Mr. BLAKE. I think it is complicated because while, in fact, I believe Mr. Volcker himself said that proprietary trading is one of those things that you know it when you see it, but, otherwise, it is very difficult to detect.

I think the difficulty is that when Congress and when regulators think of proprietary trading, they think of the larger institutions, the money center banks, the investment banks. And those institutions had proprietary trading desks. They gave their desks a certain credit limit, a certain dollar amount limit, and allowed them to trade for the firm itself. So, they were buying and selling securities, derivatives, credit default swaps, and making money or losing money for the institution.

Most banking institutions never did that. Most banking institutions focus on their core business, which is providing deposits, loans, and other traditional banking services.

Mr. Barnes used a phrase earlier that I think is really appropriate here. He called it "regulatory micromanagement." That is really what we see with the Volcker Rule. What the agencies are doing is trying to find proprietary trading in every nook and cranny.

So if we are engaged in asset liability management, for example, and we have a fixed-rate loan portfolio that we are trying to hedge, if we don't do a perfect hedge, we make money. And, oddly enough, making money is one of the indicia of proprietary trading.

So it is micromanagement, overregulation, but certainly micromanagement of the individual pieces of our business that make proprietary trading and the Volcker Rule so complex.

Mr. RENACCI. Just a quick follow-up, and you said this in your testimony. In addition to raising costs, how could the proposed rule actually increase the risk to a financial system?

Mr. BLAKE. If we are not able to do asset liability management, that leaves us exposed to risk.

And, it is an old system. We take in deposits at one rate and make loans at another rate, and the difference is the spread where we make our money.

When we make fixed-rate loans, we have to hedge against the possibility of interest rates raising. When we make variable rate loans, we expect interest rates to drop, and we may hedge that. So we have a fairly complex and fairly sophisticated asset liability management system.

What the Volcker Rule does is require us to look at that after the fact and say that, if our hedges were not perfectly correlated—the phrase that the regulation uses is "reasonably correlated to the risk." But the problem with the regulation is, it looks at it in hindsight. If we weren't able to predict the degree of increase in the interest rates or the timing of the increase in the interest rates, our hedges may actually make us money. And curiously enough, that would, again, be indicia that we are engaged in proprietary trading.

And that is why I say one of the fundamental problems with it is the regulatory micromanagement; getting into the nitty-gritty of asset liability management and looking at it on an after-the-fact basis.

Mr. RENACCI. Thank you. I yield back.

Chairwoman CAPITO. All right. Mr. Duffy?

Mr. DUFFY. Thank you.

I come from a rural part of Wisconsin. I grew up in a town that has roughly 2,000 people. The bigger Wall Street banks necessarily weren't participating in my community. We had credit unions and small community banks.

I have spent my adult life in smaller rural parts of Wisconsin, and I have had an opportunity to deal with the smaller banks, and I have had a chance to deal with the larger institutions. And the larger institutions do good work, but I guess I see the value that the smaller banks provide in the rural areas across America.

And one of my concerns is that the rules and the regulations that are coming out have a disproportionate impact on the small credit unions and the smaller banks as compared to larger Wall Street banks.

And I guess, if you look at the background as to why we are seeing all these rules and regulations, it might be from some of the bad actors that Mr. Cole referenced, but, also, some of the behavior that has taken place on Wall Street and not necessarily the behavior of the financial institutions that are before us today. But the

smaller institutions that didn't have that role in the crisis are bearing the brunt of the new rules that are now coming out.

Am I misguided in my comment or analysis on how I am seeing this?

Mr. BARNES. No. I think you are dead on, Representative Duffy. We certainly believe that what you are stating is true. You are exactly right.

Credit unions that I represent had no impact or cause or weren't a cause of the financial crisis, but, yet, we see regulations being written to the lowest common denominator.

And our credit unions have always worked—as have many community banks—with people to try to get to know them, to treat them on a one-to-one basis, to give them a fair and honest deal from the very beginning without ever beginning told to by Congress or a regulatory agency.

But the problem is, with the regulations, when they are so onerous and designed to curtail certain awful behaviors that created such a problem, that there are so many unintended consequences that we see that inhibit a small credit union's, or any credit union's ability to continue to provide that working one-to-one relationship without a huge burden of regulatory experience.

So we believe you are right on target.

Mr. HANING. Congressman Duffy, I agree wholeheartedly.

I am from southeastern Ohio. My financial institution is $110 million, so I am about a third of the size of these guys to my left and right.

I also had to go to a full-time compliance officer, $50,000 plus benefits, which, prior to 5 to 7 years ago, was about a third to a half position. Twenty hours a week would be max for compliance, and now I have a full-time compliance person. Plus, I pay for an outside audit to check the rules and regulations.

Unfortunately, community banks get caught in the trickle-down effect of rules and regulations that are set for larger financial institutions. They have a rule.

They have a good position.

I have a large institution one block to the left of my main bank, and a large institution one block to the right of my main bank.

They both offer the same products that I do. They are mandated by law. They set the price for lower standards or lower pricing. Where is your customer going to go? Is he going to go to the big buy at the lower price or come and see you and pay more?

So we, in effect, through trickle down, have to comply with rules and regulations that are set for all financial institutions.

A good examples of that is the debit card fee structure. We were mandated in the amount that we could charge for processing debit card transactions. We complied. We made some noise and squirmed a little bit, but we complied. With some mediation, we got the price upped a little bit, but still below the cost of doing business. The merchant has taken that and run.

Home Depot and Fortune 500 companies are announcing to their shareholders that they are going to have increased earnings from debit card fees. They are not passing it onto the consumer.

So while the middle man had good intentions, it never got to the bottom-line consumer. Those are issues.

We also have the same issues with the examination process. My bank is on an 18-month cycle. Over the last three exams, I have seen a force of examiners come in. Completely different, new faces. I had some disagreements.

We are a highly-rated, well-capitalized financial institution. My earnings have stayed the same over the last 3 years because of increasing expenses.

I had the opportunity to have to call a district office. I had some discussions with them, didn't get the answer that I wanted or I thought was appropriate. Finally, I ended up talking to the people in Washington. So, the next exam came in. I had a whole new team. We had a wonderful examination and—but some consistency, I guess, is where I am going with that. I think the biggest problem we face is not knowing what to expect when they walk in the door, and then sitting there not knowing when we are going to get the report back.

Mr. DUFFY. I have heard the same thing in Wisconsin.

But to the point of—if you look at the small institutions and the impact that it has on that institution, the new rules and regulations, as compared to a larger financial institution, is it fair to say the larger institution has a broader base to defray those costs over, as opposed to a smaller institution and, therefore, the burden isn't equally worn by the larger and the smaller institutions? It is unfairly placed on the smaller institution. Is that not right?

Mr. COLE. Absolutely. And your presumption of what exists out there is exactly right. Many legislative individuals have indicated that same thing to me.

And even at the beginning of the crisis, my own Representative, my own Senator told me, "Marty, we understand you are not the cause of it. We will make sure that this doesn't impact you."

We were in Washington last month. We spoke with Governor Raskin of the Federal Reserve. She also indicated her understanding and sensitivity to the community banking industry.

I have read many articles about—stating, again, this sensitivity to the community banking industry.

I think there is a feeling of sensitivity towards our industry and, again, an appreciation and, I think, truly a love for our industry by the public and, I feel, by Washington.

The disconnect is in its execution. The policymakers, I think, in theory believe that there should be some kind of different regulatory system for large and small institutions. They don't know how to execute it, quite frankly.

And my complaint to Governor Raskin, my complaint to the policymakers here at the Cleveland Fed is the lack of understanding of the theoretical application of policy and the execution in the field. Again, the intention is not being carried out.

My compliance examiner bragged about his years of experience of working as a compliance individual for a large bank. He was already biased by what he had known and seen at a larger institution and was expecting the same from us and, I think, was surprised at the lack of sophistication that we displayed. He didn't have the understanding of the differences in the different institutions.

Many of the examiners, again, just don't understand how we can operate the way we are—safely, soundly, profitably—without the sophistication. And quite frankly, it is challenging, but we are able to do it because it is different.

I think that theory and philosophy is where it gets disconnected through the system because, obviously, it is a bureaucratic system.

Mr. DUFFY. To that point—I know I have to yield back in one second. But I think we do—it is true. There is an affinity for the smaller financial institutions.

And I think we have seen the difficulty in saying, "How do you structure one set of rules for a smaller institution as opposed to a larger institution?" I think that can be problematic and there is a lot of struggle with that.

But I think it then goes to the point that, if you continue to overregulate and have all of these different rules and do not use a scalpel to make sure you have reforms in place that actually address the lessons of the crisis, but, instead, you use that crisis to wildly expand government into this sector, the net impact is borne by the smaller institution, and I think that is what we are seeing, and trying to make sure we have a structure in place that allows that weight to be lifted off everybody.

I think it allows you all to compete more effectively.

I know my time is up. I will yield back.

Chairwoman CAPITO. If you don't mind, we will do another round. I have a couple more questions.

I wanted to ask, Mr. Fireman, you have mentioned in your testimony the unpredictability of the Fed funds, and then you mentioned two funds that you get funds from, the CDFI, and was the other one SBA?

Mr. FIREMAN. Yes. SBA. We are a microlending intermediary, so we borrow money from SBA. And the uncertainty there is not necessarily the ability to borrow funds. That has been fairly consistent. As an intermediary, each organization or agency at any one time can borrow up to $5 million. That just got raised, as did the definition of a microloan from $35,000 to $50,000. So that has not been—knock on wood—the issue.

The issue, though, is, a year later—each year, you apply for SBA technical assistance money. That is what I was referencing, concerning our ability to take care of our portfolio, other than unrestricted funds that we generate ourselves or raise or get invested.

We have to apply—we use money that is a formula based upon dollars on the street, average size loan, and performance of the portfolio, all of which are fine.

However, there are 180 of us applying for a certain amount of money, also. So that is what I was—

Chairwoman CAPITO. Okay. I am interested in the economic development issues that you stated. Just briefly, what is the unemployment rate in Ohio? I know it is above the national average, correct?

Mr. FIREMAN. It is somewhere around 8.5 percent.

Chairwoman CAPITO. What kinds of businesses are you seeing expanding? I am certain they are all small, obviously. And are any of these—how does it shake out? Woman-owned businesses? Are

there more woman-owned businesses growing? I am just kind of wondering if you have noticed anything like that.

Mr. FIREMAN. Our portfolio consists of 44 percent woman-owned businesses. We work with main street businesses. We don't work with tech companies.

Chairwoman CAPITO. So, retailers mostly.

Mr. FIREMAN. Retail, a lot of food-based businesses, local food-based businesses, transportation, home healthcare.

Chairwoman CAPITO. It also has to do with healthcare.

Mr. FIREMAN. And, some like tech service, business-to-business service industries in general.

Chairwoman CAPITO. Are there one or two of those that seem to have more growth potential in your mind?

Mr. FIREMAN. We have seen some growth potential. A couple of our home healthcare companies have gone from 3 or 4 people to 60 or 70 jobs. And then some of the restaurants have grown to multi-location chains or the same owner who has several businesses, employing 40, 50, 80 people, as opposed to 5 or 6 people.

Chairwoman CAPITO. Let me just make a statement, and then I will ask you all to react to it. The CFPB was created, and Dodd-Frank itself was created to protect consumers, those who had been harmed. And Mr. Cole talked about some of the unscrupulous lending behavior, subprime loans, so we are certainly aware of that.

My fear with everything that I have heard today, and I am seeing it in my district, Mr. Haning said you are no longer, or at least you are hampered now sometimes in the lending to your long-time customers because of the way they are rated or because of other issues.

In the pursuit of extending consumer protection, we are really hurting or have the potential to harm those people who are falling in the questionable category. There are more of them. There is less availability of credit. Credit has tightened up.

If you are spending $50,000 and you are spending $60,000 for a compliance officer, that is $50,000 or $60,000 you are not lending on a car loan or a small business loan or whatever.

And so, obviously, in the examination process, the riskier loans and the riskier consumer is going to be the one who is going to get shut down first because it is going to make your balance sheets and everything else in your exams look less favorable if you keep engaging in those kinds—am I going down the right path here? This is something I am very concerned about. And I am starting at the credit union, and we will just go down the line quickly, if you all want to make a quick statement.

Mr. BARNES. Yes, ma'am. Certainly.

Chairwoman CAPITO. If you have an anecdotal issue, that would be helpful to us.

Mr. BARNES. Sure. As was referenced before, when certain loans don't fit inside of a box, those become exceptions.

Our credit union has worked very hard over the last 7 or 8 years to remove a lot of barriers in our lending policies to really reach out and serve every member in our community. We really take seriously the credit union mission to serve people of small means.

Chairwoman CAPITO. Right.

Mr. BARNES. But many times, those loans, and you can't have all of those. There has to be a balance. So we have developed a lending program that has allowed us to enter in and engage in that type of lending.

But the issue for us is, the relationship we have with our examiner currently is positive. However, that can change. And with this not-on-my-watch mentality that exists amongst so many regulators when they come in, that is in jeopardy.

I would hate to think of what Stark County, Ohio, would be like if it weren't for CSE doing the kind of lending that we are doing. We do it safely, we do it soundly, and we do it profitably. But when the rules change, or we don't know what those rules will be in the future, that certainly—

Chairwoman CAPITO. Mr. Blake, I know you have a larger institution. Certainly, you have seen this?

Mr. BLAKE. Yes. I would add, I think, one thing from our perspective of the larger institutions. We go through the CCAR process, the Comprehensive Capital Analysis and Review, which are those stress tests that are generating so much publicity.

The stress tests apply a reverse economic scenario as to our existing loan portfolios and predict losses in the future. To the extent that our portfolio includes the lower-quality loans, the regulators project larger losses. Larger projected losses impact our ability to pay dividends or potentially pay dividends, to share buybacks or take other capital action that we think are necessary.

So like the smaller institutions, we also feel the same pressure.

Chairwoman CAPITO. Mr. Haning?

Mr. HANING. Madam Chairwoman, a couple of issues. Number one, we do have money to loan. I know you have heard that on the trail, too. What we lack is consumer confidence.

There are consumers out there who still don't have great confidence in the economy yet and they don't come in, or there are those people who just don't qualify. We have not increased our lending standards. They are the same as they were. We were conservative 7 or 8 years ago. We still are. It is just, the standards have not changed, therefore, less people qualify.

The interpretation of the rules from legislators to regulators to the bank is an issue, which gets me to the point, you saw me shaking my head, of not-on-my-watch. We have Federal regulators from the OCC, now the CFPB, the Federal Reserve, the FDIC, who were jockeying for position at one time, so they were a little more stringent in their examination procedures, which causes you to pull in the reins a little bit.

And the issues are such that, if we can't make loans, we can't make a return, we can't get the money to the capital line to grow the bank and to make mortgage loans.

Chairwoman CAPITO. Mr. Fireman?

Mr. FIREMAN. Our business—we were formed, and our mission is to help underserved, underbanked, and unbanked communities and make them bankable.

What has happened over the last couple of years is our portfolio, or our originations, have gone from 70 percent start-up to 70 percent existing business. All of the things that the gentlemen are talking about have led to our bank partners, credit union partners,

community bank partners referring us more and more of the customers who, historically, wouldn't have been exceptions, or maybe it would have made sense for them to work with, so they come to us. And what that does is, it has the unintended consequence for those who were actually formed to serve getting pushed out of the credit marketplace.

We are in the business of providing opportunity and accepting risk, and that is why we get paid to do the technical assistance, that hand-holding that we do. And we still do that.

It doesn't mean that all of the customers being referred are cherries or gems, but, by the same token, it does have an adverse impact on those we used to serve. So that is kind of how we see this whole—

Chairwoman CAPITO. Mr. Cole, did you have anything to add?

Mr. COLE. Yes. I just wanted to state that you are 100 percent correct in that I think the intentions of the CFPB and others that are wanting to protect the consumer are going to have unintended consequences of the opposite.

And, I believe that community banks operate very much, as my colleague from the credit union is. We are very similar. And I am very aware—my sister is the president and CEO of the largest credit union in our marketplace. We compete head-to-head.

Chairwoman CAPITO. That must make for great family relations.

Mr. COLE. Interesting Thanksgivings.

But, actually, we share a common goal, and that is to improve the quality of living in our county, which we both were raised and grew up in. We both dearly love it, and we both contribute back, her, in her way, and me, in my way.

So I am very familiar with the credit unions and how they operate. We are very, very similar. Our focus is on everyone in that community, especially the underserved.

And when you look at regulations, like the Community Reinvestment Act, the credit unions do not have to comply because they recognize that it is not necessarily given, how they function, but we have to comply. And, again, it is overburdensome because, again, the way we operate, we have to reinvest back in our communities. There are many regulations out there that simply do not apply to us by our inherent nature.

And my recommendation would be—not that I want another regulator, God forbid, but instead of the CFPB—and Congress and Washington recognize the distinctive difference between the size of banks when they come out with $10 billion. I don't know if that is the number. But since I am trading under $30 billion, I am okay with $10 billion. But, anything less than $10 billion should be treated differently.

Now, our concern is that the rulings coming out of the CFPB are going to become best practices, just like the stress test of larger banks, are going to become best practices. Examiners are going to see these as best practices and apply them to us, as well.

My recommendation would be: the establishment of a community bank regulator; that banks of a certain size are regulated by people who understand community banks; that we are not subject to the other regulations, but those established by a community bank regu-

lator, made of panels and advisories of community bankers who can work through these execution issues and policy issues.

Chairwoman CAPITO. I appreciate that. Before I turn the microphone over, I want to reiterate that consumer protection is a huge issue for all of us and for everybody sitting here, and you wouldn't still be in business if you didn't try to engage in good consumer protection. Striking that right balance is going to be difficult.

Mr. Renacci?

Mr. RENACCI. Thank you, Madam Chairwoman.

And it is interesting. Mr. Cole, I was listening to your comments, and I agree wholeheartedly. We had issues with the big banks, the big Wall Street banks, and what we have done is, we have thrown a blanket over everybody, which also includes some of the smaller institutions, which just isn't fair.

So I kind of want to put a human face on this issue.

There are some who say regulatory relief is really just shorthand for the desire of financial institutions to cut costs or avoid burdensome regulations.

I remember 28 years ago when I came to Ohio, I went to a small institution. I had a good credit history. And I borrowed some money and started a business, and grew that business because a small institution believed in me and they believed in my background. They believed in my experience.

So I question, for example—let's talk about the customers for once. How are we affecting Mr. Barnes and Mr. Cole and maybe Mr. Haning? Put a human face on that.

Do you have those people, like I was 28, 29 years ago, who come to your institutions looking for that first step to employ people, to start a business, to engage in entrepreneurship and, all of a sudden, these regulations are stopping you from helping them?

Mr. COLE. Absolutely. I, myself, own a business. I am a small business. Our bank is a small business. I am an entrepreneur.

Before I became president and CEO, I was a commercial lender. I can tell you stories of many people who came to us, just like yourself, and we started them, and now are successful businesses employing numbers of people who wouldn't have gotten the start otherwise because other institutions wouldn't have seen the person and the character and what is behind the numbers. So as a community banker, growing up in the community and knowing people, there is a value there that extends beyond the numerical evaluation. So, yes.

We have people coming today, and because of the way we have to rate loans—and I am still part of the credit committee. And I, as a former commercial lender, struggle when I hear my credit analyst and my loan people and my person in charge of loan administration say, "Well, you know, if we make this loan, it is going to be immediately classified and we will have to reserve."

Seriously? And, yes.

And so we struggle. We struggle with that. And given economic factors, we may not make that loan that, in my heart, in my day, had I been making that—I would have made that loan all day long.

So, yes. That situation does exist.

Mr. RENACCI. I am sure my first loan would have been classified, too. That is the problem.

Mr. Barnes, any comments?

Mr. BARNES. Congressman, yes. Thank you.

We do see many people with business opportunities who come to us looking for financing, who have been turned down by either banks or have had lines of credit terminated.

Our credit union does do some business lending, but we are not involved at a huge level. So what we usually do is try to pass those referrals onto credit unions in our area that do provide that.

But they all come with a similar story; they have gone elsewhere and they have either had lines of credits terminated or they are not able to get a loan, or what did qualify at one time no longer meets certain criteria or fits in that box. So, certainly, from the business standpoint, we see that.

We also see it on the personal side, especially with residential mortgages. And I don't mean any disrespect to anybody on the panel, but sometimes some of the larger institutions don't have an interest in doing small mortgages.

And a lot of it comes down to regulation. There is a ton of regulation and compliance that is involved in executing a mortgage for a member. And that cost and that level of compliance is the same on a $200,000 mortgage as it is on a $25,000 mortgage. So, we see many members coming to us with small mortgages. In Stark County, Ohio, there are a lot of repossessed homes that can be purchased for that amount of money.

One example in particular, it was a young kid, 26 years old, no credit, but he was a good kid. In fact, my dad was an elementary school principal, and his mom taught school for my dad. This was a kid that she had, and my dad knew him from years ago. We were able to help him because of the personal relationship, which anywhere else, I don't know if that would have happened.

Mr. RENACCI. Mr. Blake, do you agree with that? I am going to put you on the spot, seeing that you are a bigger bank.

Mr. BLAKE. I think, because of our size, we tend to be more statistically driven when it comes to making loans because our regulators tend to look at us and drive us statistically.

We certainly try in our community branches to be the kind of personal lender that my compadres over here are, but, obviously, because of the size of the institution, we aren't always able to do it as well as they are in those kind of situations.

Mr. RENACCI. Mr. Haning, Mr. Cole, financial institutions often tell me they have no recourse when they have a dispute with the regulator, be it the FDIC, the OCC, or the Federal Reserve. In other words, the regulator is the judge, the jury, and the executioner for any dispute or disagreement in a regulatory examination.

How could the appeal process be improved in your mind or your thoughts? And could the office also be strengthened to give it more substantial power?

Mr. HANING. Congressman Renacci, I have a tendency to want to agree with that assessment, but I also feel like there is a process in place. The Ohio Bankers League also has a procedure in which we can do some things anonymously and have the association pass on the rule and regulation.

It comes down to the point of, we need to make a conscious decision, is it worth the time and effort and possible retribution of dis-

agreeing with an examiner, what the outlying results would be if we just let it go and try to comply. But having an opportunity or a process that understands is very critical. I think they have those things in place.

I have not taken that process, so I can't address that specifically, but it is needed. There does need to be an avenue to share your findings without a specific name and number.

Mr. RENACCI. Just a quick follow-up, because you said something that is very important, possible retribution. Do you believe banks fear that, possible retribution? I know, a lot of times, they don't want to appear in front of a panel because of possible retribution, so—

Mr. HANING. I don't think it is anything, yes.

They will come in and they may dig a little deeper. They may find a particular area that they want to drill down on and find possible issues. So it is a possibility. I think, in general, it is not something that happens on a regular basis, but that is always a concern.

Mr. RENACCI. Mr. Cole?

Mr. COLE. I think it depends on, from my perspective, who the regulator is.

We are a State-chartered bank, so, thereby, we are regulated by the State of Ohio. John, who is in the audience, who is director of the department of financial institutions, individual financial institutions, we have a great relationship with him. If I have issues, I can pick up the phone and call John. So I think the relationship there is different than it is on the national level. From what I have heard from my peers, the SEC is a little different.

I also have a good relationship with the Federal Reserve Bank here in Cleveland, and I know policymakers, and I can pick up the phone and call.

If you are not—unfortunately, the way the system works, I think it is a matter of who you know.

Also, the issue is, is there blood in the water?

Unfortunately, what I have seen over my career is, once there is blood in the water in a bank, there is very little motive for the regulator to not be more aggressive. They are not rewarded on the basis of public interest in terms of making loans. They are not rewarded to see that banks—how much banks do in the community. They are rewarded on the—and I think they have gotten unfairly punished on this last crisis, so I think they took a beating. And so if I am in their shoes, what am I going to do? I am going to err on the side of being overly conservative because I am not rewarded to do otherwise.

So if there is a situation out there where there are potential problems, I don't want my regulators walking away from that and not identifying everything.

When there is blood in the water, yes, I think they can get overly aggressive, and I think the options for the individual banks are very limited. And, yes, I do think they fear that. At that point, having not been a CEO in that situation, but just surmising, if that were to occur, I would be very compliant.

Mr. RENACCI. That is an interesting analogy, blood in the water. I will remember that one. Thank you so much.

I yield back.

Chairwoman CAPITO. Mr. Duffy?

Mr. DUFFY. In regard to retribution, I hear a lot of my institutions telling me stories, but saying, "Make sure you do not use my name. I don't want my name out there associated with the story I am telling you, and I don't want to go public. You can use it, but put a different name to it or leave it out."

Just maybe a little follow-up on the ability to make this—is it a character loan, or is it, you said, informed judgment, and how that is now scrutinized. And I think Mr. Renacci made a good point. You had someone who was willing to make an informed judgment or look at his character and take a little larger risk on him. And I imagine, in all of our communities, our financial institutions being willing to make that kind of call have bred more success than failure, I would imagine. That is why you can do it and there are factors you can look at.

I think that is one of the concerns that I continuously hear; you can't use your judgment as a banker to invest in a business where the owner has good character and is a good risk, because when the regulators come in, it will be classified.

Is that basically what your point was, Mr. Cole?

Mr. COLE. Yes. I did commercial lending for 20 years, and I think maybe I was luckier than I was good, because I had a lot of success. In the whole 20 years, I only had a few loans go bad, and I had many businesses prosper.

And, yes, I used a lot of intuitive judgment and was given the flexibility at that time to do that, as long as I had a good rationale to support the loan.

Today, it is not that way. The same loans that I made then, I would not be allowed to do today. And the document has to be supported numerically. Again, there is a grading system.

And there is a heavy, heavy emphasis, a flawed emphasis, on collateral and collateral values that, to me, is a whole other subject in how this appraisal process is working.

But, again, my evaluation of collateral in my community, which I probably know better than anyone, would not be able to be used.

So there are a lot of things that have changed, and we have become more sophisticated. There is modeling that must be done, which has been going on in all aspects of the banking industry. And we saw in the crisis that these models fail. These models should never have replaced intuitive judgment, should never have replaced human intelligence. Unfortunately, those models are being used as the only intelligence.

Mr. DUFFY. Maybe just one other thought, and I will then yield back. Switching gears to the CFPB and consumer protection.

One of the concerns we have had on our committee is, we have our basic standard of safety and soundness, and then, here, we have the CFPB with a different standard of consumer protection and, at some point, those may sing in unison, but at some point, they may be contradictory, which has led us to have, I think, a lot of concern as to how we are going to deal with safety and soundness and consumer protection.

Maybe if I can, again, echo what somebody else said earlier, if you don't protect your consumers, if you are working your con-

sumers over and treating them unfairly, they will go across the street to another bank or credit union and you do not stay in business for very long, unless you are one of the bad actors who are able to set up shop on the corner and engage.

Have you thought through the consumer protection regulation side as opposed to safety and soundness? Has that had any points of concern for any of you?

Mr. BARNES. It certainly has been a concern for credit unions. With respect to the CFPB, generally, credit unions support their mission. Taking care of and making sure consumers get a good deal is at the heart of what we do, what we have always done. So, we want to see that continue.

And we also feel that the Director—certainly, we, in Ohio, have a good relationship with Mr. Cordray and we believe that he certainly intends to do the right thing.

With that said, however, there are issues and concerns that we do have about the Consumer Financial Protection Bureau. First of all, the existence of a single director is troublesome for us. We would prefer to see a panel, similar to the NCUA board, and appropriate congressional oversight. We feel that is important.

The other thing that we see about the Consumer Financial Protection Bureau is this: Credit unions have always given their members a good deal. I will say that over and over. And that is what the Consumer Financial Protection Bureau is in place to ensure.

So, as they are looking at rules and regulations and processes, even though they are not in charge of the enforcement of the majority of credit unions, we still have to follow their rules. And any time rules change, while the outcome may be the same, and consumers, our members, still get a good deal, those new rules come along with an increased cost of compliance.

And then the second thing is, we just don't want to see mission creep. We want to make sure that the Consumer Financial Protection Bureau really does what it was intended to do, and that is, take over the administration and enforcement of those rules and regulations, as opposed to adding new ones to the mix.

So we are concerned about that, and we are keeping a close eye on it. But that is our position on that, sir.

Mr. DUFFY. Mr. Fireman?

Mr. FIREMAN. I was just going to say, with regard to the CFPB, I had meetings last month with the Director and I discussed with him, not as related to us, but just concerns in various sectors that I have heard about the agency, fear. And his message was, "Have them come talk to me. I am a reasonable guy." And I think everybody knows that he is. So, I just wanted to send that message.

Mr. DUFFY. And I have heard a lot of positive comments that the concern, when you set up an agency, will he be a lifetime appointee? Probably not. You will see other heads of the agency, which has raised some concern. But I think—is he in Mr. Stivers' district? Maybe I am wrong on that.

And one of the other concerns that we brought up in a bill that I introduced was the fact that, if there is going to be a rule that comes up from the CFPB that is undermining safety and soundness, it can be overturned by FSOC with a supermajority vote.

I just have a hard time believing that Mr. Barnes or Mr. Cole could make that appeal to FSOC; that a rule that affects you two negatively will then, therefore, affect safety and soundness in the country. I don't know if they are going to listen to you.

But, in essence, if you are a bigger—and, Mr. Blake, maybe not even you. I think if you have a larger Wall Street bank, though, no doubt, they can make that argument.

And, again, you have empowered those institutions that did not necessarily have other—those institutions that were involved in the crisis and have left voiceless those who didn't have any real role in the crisis with this agency that was supposed to address consumer protection.

So, I appreciate you all coming in. And I don't know that I will get another chance to question you, but I appreciate your honesty and your willingness to share with us.

I yield back.

Chairwoman CAPITO. Thank you.

Do you have any other further questions, Mr. Renacci? Would you like to make any comments?

Mr. RENACCI. Thank you. I am going to go back to the CFPB because I did ask Mr. Cordray, and Mr. Cordray is a good man, but I asked him a question last week or 2 weeks ago in a hearing, that he is walking into all of these examinations with an attorney. Can you all tell me what your thoughts are when the CFPB walks into your establishment—if they have, or if they haven't yet—with an attorney?

Mr. HANING. Congressman Renacci, I would like to address that.

I also met with Director Cordray last month in Washington, and I talked with one of their newly-hired employees who said their count was up to 100, and 87 of them were attorneys. So everybody in his group has a legal background.

He also assured us that, for the best of the order, their regulation wouldn't affect community banks, but that is not the case, because what the examiners hear in the way of review trickles down to us in the terms of best practice.

They don't need to learn six or seven different ways of reviewing the same type of loan, so they are going to use a best practice.

And although we have a good relationship with Mr. Cordray and, once again, as my colleagues here said, we are not on board with their method of reporting, we do have concerns. We do have compliance issues. And if the best practice comes down, I think we are all going to be looking at the same regulations.

Mr. COLE. Here is the analogy I would like to draw, in that I think you all remember when the Cuyahoga River was on fire and we couldn't fish out on Lake Erie, couldn't drink or swim in Lake Erie. And so, there was a need for an intervention by the government to put safeguards in place to protect the citizens. And having grown up in this area, I was all in favor of it. And now we have an opportunity with drilling in Ohio, to have a significant economic boom in my area. And we want to make sure that the EPA, again, acts responsibly to safeguard the citizens, and at the same time, allow for economic development.

I see that same application as it applies to the CFPB, as the new EPA of the financial word. It has a purpose. There was damage

that was done. There were consumers who were harmed. And I think we all want to see that fixed and corrected, but at the same time, we have to make sure that it doesn't impede economic development, because, of those same citizens that they are protecting, they are going to be harming.

Mr. RENACCI. I would always use the analogy, and I have used it many times, I was a fireman at one point in time, and everybody thought that the way to save the building was to throw more water on it. Sometimes, when you throw more water on it, the building burns faster. Keep that in mind as we talk about regulations going forward.

But I do also want to thank all of you. You have been very honest, and I appreciate your comments. I look forward to working with you over the rest of this year and into the future.

Thank you.

Chairwoman CAPITO. I want to thank our panelists and our audience. And I think we have gotten some excellent testimony. I want to thank you for taking time out of your busy days, particularly on a Monday, to come before us.

The Chair notes that some Members may have additional questions for this panel, which they may wish to submit in writing. Without objection, this 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 adjourned.

[Whereupon, at 11:45 a.m., the subcommittee was adjourned.]

A P P E N D I X

April 16, 2012

Testimony
House Committee on Financial Services
Subcommittee on Financial Institutions and Consumer Credit

"An Examination of the Challenges Facing Community Financial Institutions in Ohio"
April 16, 2012 – 10:00 a.m.
Carl B. Stokes U.S. Courthouse – Cleveland, Ohio
Stan Barnes, President and Chief Executive Officer, CSE Federal Credit Union

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

Thank you for this opportunity to represent Ohio's 377 credit unions and 3 million credit union members, and to share with you, on their behalf, the difficult circumstances facing community-based credit unions in the form of over-burdensome regulation and examination transparency, and to update you on the current and future role of the Credit Union Movement.

My name is Stan Barnes, and I am President and Chief Executive Officer of CSE Federal Credit Union in Canton, Ohio. CSE is a $150 million financial cooperative, proudly serving 30,000 members in Northeast Ohio. And like every credit union, we do so under thebusiness philosophy of "Not for profit, not for charity, but for service."

Regulatory Burden

Regulatory burden and the required cost of compliance is the number one concern among Ohio credit unions.

Attached to my testimony (***Exhibit A***) are the federal regulatory requirements of both banks and credit unions, which should put into some perspective the time, effort, and costs tied to compliance. In many cases, when credit unions should be dedicating their resources to the financial livelihood and betterment of their members, they are instead challenged with the increasing burden offollowing far-reaching rules and regulations.

These regulations are particularly onerous onsmaller-asset credit unions, which are subject to the same regulations, but struggle to adhere to these guidelines due to thin operating margins. In fact, the vast majority of Ohio credit unions (65%) are small credit unions (under $35 million in assets).

To give you a sense of the increasing regulatory burden, since 2008, Ohio credit unions have been subjected to more than 160 new rules and regulations from 27 different federal agencies. Additionally, there are at least 27 rulemaking proposals pending at various agencies, including the National Credit Union Administration (NCUA), the Federal Reserve, the Consumer Financial Protection Bureau (CFPB), the Department of Housing and Urban Development, the Federal Housing Finance Agency, the Financial

Accounting Standards Board, the Internal Revenue Service, the Department of Treasury's FinCEN, and the Federal Trade Commission - - among others.

Unfortunately, even though natural person credit unions did not cause the financial crisis, they have been subjected to a flood of regulations that create an unnecessary burden without any measure of the effectiveness of these changes.

Examination Standards and Inconsistencies

The experience of the majority of Ohio credit unions is that the high standard of transparency and accountability expected of financial institutions is underwhelmingly practiced by the National Credit Union Administration during the examination process.

Credit unions have voiced to the NCUA that their examiners are practicing regulatory micromanagement and overreach. Quite simply, regulators are dictating the business of operating a credit union. It is important that examiners not over-regulate or exceed their authority and substitute its judgment for that of the volunteers and executives in the governance, management, and operations of credit unions.While the relationship I have with my examiner is transparent, professional, and rooted in mutual respect, colleagues of mine have experienced the opposite.

I urge the committee to consider improvements in the examination process. H.R. 3461, sponsored by Chairman Capito and Ranking Member Maloney, addresses the examination process and would be a positive step in balancing the relationship between the regulated and the regulator. It also provides for a more transparent and consistent examination process. I know the Credit Union National Association, of which CSE Federal Credit Union is a member,supports the legislation, and is working closely with the NCUA to incorporate examination enhancements and transparency.

CUNAhas also urged the NCUA to take several steps to improve the regulatory process and relieve credit unions' regulatory burden. I have submitted a copy of a letterfrom CUNA to NCUA Chairman Debbie Matz (***Exhibit B***) that recommends immediate actions to relieve overwhelmed credit unions.

Credit unions have called on the NCUA to impose a moratorium on new regulations for at least the next six months; and, have suggested the agency reinstate the Regulatory Flexibility Program, which provides well-managed and well-capitalized credit unions an exemption from regulations that are not statutorily required.

Role of Credit Unions in the State and the Future of Credit Unions as Community Financial Institutions

Despite the issues caused by regulatory overreach and examination transparency, I am proud to say that credit unions continue to serve their members with responsible and affordable financial products and services.

Over the years, credit unions have grown considerably and play an important role in the local community.

In fact, research by the Credit Union National Association finds that credit unions save Ohio members $132 million annually by offering better priced, conservatively managed products and services. The not-for-profit cooperative model is working, and in my opinion is best suited to meet the needs of all Ohioans. I have submitted as part of my written testimony (***Exhibit C***) examples of the credit union difference in action and how credit unions are helping Ohioans in today's economy through financial education (***Exhibit D***).

But credit unions can do more. With common-sense legislation that would essentially double the arbitrary cap on credit union small business lending, credit unions can infuse $13 billion in new capital to small businesses and help create up to 140,000 jobs. We ask for your support of S. 2231 and H.R. 1418.

Similarly, H.R. 3993 would allow well-capitalized credit unions to receive Supplemental Capital, a much-needed financial resource as credit unions face a difficult revenue-building environment and increased pressure to perform by regulators. Again, we ask for your support of this measure.

Conclusion

We look forward to continuing to work with Congress to resolve issues facing community-based financial institutions, and ask that as you consider legislation in this arena, you regularly consult credit unions in your districts. We want to be a solution to the economic issues facing our state and country, and we are here to help.

Thank you for the opportunity to present to you this morning, and I am happy to answer any questions you may have.

EXHIBIT A

Bank and Credit Union

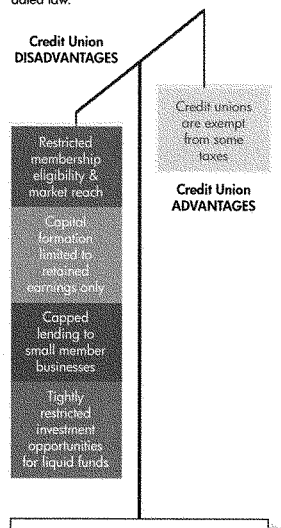
FEDERAL REGULATORY REQUIREMENTS

Regulatory burden and the required cost of compliance are among Ohio credit unions' greatest concerns. As the chart below indicates, credit unions must meet federal regulatory requirements equal to banks from a long list of federal agencies.

General Regulations for Financial Institutions
Issuing Agencies: National Credit Union Administration, Consumer Financial Protection Bureau (CFPB), Federal Reserve Board (FRB), Federal Trade Commission, U.S. Department of Housing and Urban Development, U.S. Department of Treasury

Regulation	Banks	Credit Unions
Regulation B - Equal Credit Opportunity	Yes	Yes
Regulation C - Home Mortgage Disclosure	Yes	Yes
Regulation D - Alternative Mortgage Disclosure (CFPB)	Yes	Yes
Regulation D - Reserve Requirements (FRB)	Yes	Yes
Regulation E - Electronic Funds Transfer	Yes	Yes
Regulation F - Fair Debt Collection Practices	Yes	Yes
Regulation G - SAFE Act	Yes	Yes
Regulation I - Depository Inst. Lacking Federal Deposit Insurance	Yes	Yes
Regulation J - Collection of checks (CFPB)	Yes	Yes
Regulation J - Interbank Liabilities	Yes	Yes
Regulation M - Consumer Leasing	Yes	Yes
Regulation N - Mortgage Acts and Practices	Yes	Yes
Regulation O - Mortgage Assistance Relief Services	Yes	Yes
Regulation P - Privacy of Consumer Financial Information	Yes	Yes
Regulation U - Margin Loans	Yes	Yes
Regulation X - Real Estate Settlements/Escrow	Yes	Yes
Regulation Z - Truth in Lending	Yes	Yes
Regulation CC - Expedited Funds Availability	Yes	Yes
Regulation DD - Truth in Savings	Yes	Yes
Regulation GG - Unlawful Internet Gambling Act	Yes	Yes
Regulation II - Interchange fees and routing	Yes	Yes
Advertising rules - Federal and state	Yes	Yes
Check Collection thru Fed	Yes	Yes
Community Reinvestment	Yes	No
Credit Practices	Yes	Yes
Credit on Securities	Yes	Yes
Children's Online Privacy Protection Act	Yes	Yes
Discount Window Access	Yes	Yes
Fair and Accurate Credit Transactions Act	Yes	Yes
Fair Housing Act (FHA)	Yes	Yes

WHAT'S MORE:
Credit unions face a number of disadvantages that aren't outweighed by their tax status. The disadvantages listed have nothing to do with safety and soundness issues, simply outdated law.



INTERESTING FACT:
The government-estimated $600 million tax expenditure (credit union tax exemption) in 2010 provided **$10 billion in direct financial benefits to consumers**, through better rates, fewer and lower fees, and more.

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Where people are worth more than money.™

OHIO CREDIT UNION LEAGUE
10 W. Broad Street
Suite 1100
Columbus, OH 43215
(800) 486-2917
www.OhioCreditUnions.org
Created March 2012

FHLB Membership	Yes	Yes
Field of Membership	No	Yes
Holder-in-Due Course	Yes	Yes
International Banking Operations	Yes	Yes
Loan to Officials	Yes	Yes
Management Official Interlocks	Yes	Yes
Netting Eligibility	Yes	Yes
Private Mortgage Insurance	Yes	Yes
Permissible Investment Activities	Yes	Yes
Reclamations	Yes	Yes
Record Retention	Yes	Yes
Right to Financial Privacy Act	Yes	Yes
State Fiduciary/Trust Requirements	Yes	Yes

Tax Reporting Regulations
Issuing Agency: Internal Revenue Service

Regulation	Banks	CUs
Backup Withholding and Depositing	Yes	Yes
Tax Filing	Yes	Yes
Individual Retirement Accounts	Yes	Yes
IRS Form 1098 and 1099	Yes	Yes
IRS Form 990	Yes	Yes
IRS Levies and Summons	Yes	Yes
Magnetic Media Reporting	Yes	Yes
Mortgage Interest Reporting	Yes	Yes
Original Issue Discount	Yes	Yes
Real Estate Transactions	Yes	Yes
Unrelated Business Income Tax (UBIT)	Yes	Yes

Other Federal Regulations

Regulation	Banks	CUs
Access to Capital	Yes	Yes
ACH/Electronic Payment Standards	Yes	Yes
Affirmative Action	Yes	Yes
Allowance for Loan and leases (ALLL)	Yes	Yes
Americans with Disabilities Act (ADA)	Yes	Yes
Appraisals	Yes	Yes
Anti-Discrimination Data Collection	Yes	Yes
Bankruptcy	Yes	Yes
Bank Secrecy Act	Yes	Yes
Bank Bribery Act	Yes	Yes
Child Support Data Matching	Yes	Yes
Consolidated Omnibus Budget Reconciliation Act (COBRA)	Yes	Yes
Criminal Referral Report	Yes	Yes
Currency Transaction Report	Yes	Yes
Defense Dept. Operating Rules	Yes	Yes
Employee Tax Withholding Rules	Yes	Yes
Employment Practices Records	Yes	Yes
Environmental Lender Liability	Yes	Yes
Equal Employment Opportunities	Yes	Yes
Employee Retirement Income Security Act (ERISA)	Yes	Yes
Fair Labor Standards Act (FLSA)	Yes	Yes
Family and Medical Leave (FMLA)	Yes	Yes
Fed Payments via ACH	Yes	Yes
Federal Financial Institutions Examination Council (FFIEC)	Yes	Yes
Generally Accepted Accounting Principles (GAAP)	Yes	Yes
Guarantee Student Loans	Yes	Yes
Identity Theft	Yes	Yes
Information Security Program	Yes	Yes
Member Business Lending Rules	No	Yes
Minimum Wage/Overtime Rules	Yes	Yes
Occupational Safety and Health Administration (OSHA)	Yes	Yes
Office of Foreign Assets Control (OFAC)	Yes	Yes
Patient Protection and Affordable Care Act (PPACA)	Yes	Yes
Polygraph Protection	Yes	Yes
Prompt Corrective Action	Yes	Yes
Signature Guarantees Standards	Yes	Yes
SBA Small Business Loans	Yes	Yes
Servicemembers Civil Relief Act (SCRA)	Yes	Yes
Tax and Loan Accounts	Yes	Yes
Uniformed Services Employment & Reemployment Rights Act	Yes	Yes
Whistle Blower Laws	Yes	Yes

EXHIBIT B

CUNA
Credit Union National Association
cuna.org

BILL CHENEY
President & CEO

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October 25, 2011

The Honorable Debbie Matz
Chairman
National Credit Union Administration Board
1775 Duke Street
Alexandria, VA 22314

Dear Chairman Matz:

As we have discussed on numerous occasions with you, other Board members, and senior staff at the National Credit Union Administration, regulatory burdens are at the top of virtually every credit union's list of operational concerns. Credit unions are simply overwhelmed by the regulatory requirements under which they currently operate and are quite concerned about any new requirements they may have to manage, including those from NCUA, the new Consumer Financial Protection Bureau, the Federal Reserve Board and other agencies. Having to devote so many resources to regulatory requirements diverts credit unions from serving their members, managing their operations, being able to identify additional ways to meet members' financial needs, and planning for the future.

I. Introduction

A. Development of CUNA's List of Recommendations

In light of credit unions' growing anxieties about their regulatory burdens, the Credit Union National Association has assembled a list of rules and agency actions we believe NCUA should address that would provide meaningful relief to credit unions without undermining, either individually or collectively, the agency' primary function of overseeing credit unions' safety and soundness. By way of background, CUNA is the largest advocacy organization in this country for credit unions. We represent about 90% of the nation's 7,200 state and federal credit unions, which in turn serve approximately 93 million members.

The recommendations in this letter were developed based on issues raised by credit union officials, league staff, and members of CUNA subcommittees, committees and other leadership groups, including our councils. CUNA also surveyed credit unions on the issue of regulatory burdens, and this letter reflects those responses as well.

We recognize that many regulations simply implement provisions created by Congress. We are working with Congress to recognize credit unions' regulatory burdens and to advance legislative measures that will minimize regulatory burdens.

AMERICA'S CREDIT UNIONS
PO Box 431 | Madison, WI 53701-0431 | 5710 Mineral Point Road | Madison, WI 53705-4454 | PHONE: 608 231-4000

B. NCUA's Efforts to Contain Regulatory Burdens

Before addressing CUNA's recommendations, I want to acknowledge your Regulatory Modernization Initiative. Elements of the initiative include the agency's strong and continuing support for legislation to raise the ceiling on member business lending and to allow credit unions to include supplemental capital in their net worth. We also support legislation to allow any federal credit union to include one or more underserved areas within its field of membership as NCUA Executive Director Dave Marquis urged during his testimony September 22, 2011 before the House Financial Services Subcommittee on Financial Institutions and Consumer Credit. Agency efforts to facilitate the process for more credit unions to be designated as "low income" are also commendable.

There are other steps the agency has undertaken to address credit unions' regulatory burdens that should be recognized. These include:

- Efforts to reconsider the proposal on credit union service organizations (CUSOs. We felt the meeting we had with your staff September 29, 2011 to discuss our concerns was very productive).
- The review of the definition of "small" credit unions.[1]
- Tailoring proposals such as the one on Interest Rate Risk (IRR) management to exclude credit unions with assets of $10 million or less and to limit the impact on credit unions with assets of up to $50 million.[2] We did not support the proposal but do agree that finding ways to limit the applicability of regulations is appropriate.
- The proposed use of certain derivatives to hedge against interest rate risk.
- Efforts to revitalize the Regulatory Flexibility Program, including the waiver process.
- Your announcement October 6, 2011 that the agency would review its policies regarding troubled debt restructurings (TDRs).
    - A number of credit unions are working with their members to modify their loans and help them stay current on their payments, including their mortgages, in the face of changed economic situations. However, two major issues have arisen regarding TDRs.
    - One is that some examiners discourage credit unions from modifying loan terms when members experience reduced economic circumstances.

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[1] CUNA's Small Credit Union Committee, chaired by Frank Michael, President and CEO of Allied Credit Union, California, will be following up with the agency to provide recommendations on the definition of "small credit unions." The current definition contained within 12 U.S.C. § 1790d(f)(2) (Section 216 of the FCU Act) of $10,000,000 is not comparable to other financial regulators' definitions of small institutions. For instance, for banks, the level is $175,000,000.

[2] However, the overall interest rate risk proposal as drafted represents a stark example of regulatory overkill, as it would tie National Credit Union Share Insurance Fund coverage to compliance with the new IRR rule, once it is in effect.

- Second, regulatory and reporting requirements for TDRs are overly cumbersome. Credit unions must segregate TDRs from other loan modifications and manually track loan payments generally for the first six months after the modification. CUNA would like to work with NCUA to improve the reporting process for TDRs and to facilitate the ability of more credit unions to work with their members who can repay their debts but need additional assistance through a loan restructuring to be able to do so.

These positive developments demonstrate that the agency has many options for minimizing the impact of its regulations. However, we urge the agency to consider what additional steps can be taken to alleviate credit unions' regulatory burdens to a much greater extent, as outlined in the recommendations below.

II. CUNA's Recommendations to Improve the Regulatory Process and Relieve Credit Unions' Regulatory Burdens

A. NCUA Should Consider a Moratorium on New Regulations

A number of credit unions have urged NCUA to announce a regulatory moratorium on new requirements for a set period of time, of for example, six months. There is considerable merit in this idea, especially as there are no new, material systemic problems within the credit union system, current safety and soundness concerns within natural person and corporate credit unions seem to be manageable, and the number of Camel Code 1 and 2 credit unions (based on the September 2011 NCUSIF report to the NCUA Board) has actually increased, although slightly. Also, the percentage of insured shares in CAMEL Code 4 and 5 credit unions has decreased from 5.72% in December 2009 to 3.96% in August. (This is also down from 5 .04% in January 2011 and from 4.57% in July of this year.)[3]

In light of the current health of the credit union system, we urge the agency to consider a regulatory moratorium for at least six months. (The NCUA Board would, of course, be able to issue rules during this time period to address any significant safety and soundness concerns or technical matters, as determined by the agency.)

B. The Regulatory Process Can Be Improved

Credit unions have raised a number of concerns about the regulatory process generally. Because there is a direct connection between the process for developing rules and the regulatory burden credit unions must shoulder, we urge the agency to consider ways to improve the rulemaking process, such as by incorporating the following characteristics and principles into every rulemaking.[4] These

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[3] Report to the NCUA Board on the National Credit Union Share Insurance Fund, September 22, 2011.

[4] While some of these steps are performed in some fashion by NCUA, not all are consistently followed with every rulemaking.

recommendations are fully consistent with the recent Executive Order from President Barack Obama regarding the regulatory process at independent agencies.[5]

- Unless required by statute, regulations should generally be limited to addressing material safety and soundness problems.
- Such rules that seek to address problem areas should apply only to those credit unions that engage in activities that directly cause the problems in question, unless otherwise directed by Congress.
- Whether under the auspices of the Regulatory Flexibility Program or a new initiative, NCUA should reinstate and expand the list of regulatory requirements (those that are not mandated by Congress) that well-managed credit unions do not have to follow.
    - Examples of this would be to exempt well-managed, well-capitalized credit unions from some of the requirements in the member business loan rule, such as personal borrower guarantees, loan- to-value ratios and others, that are not required by the Federal Credit Union Act (FCU Act).
- Before issuing any new proposal, the agency should, as a general rule, solicit input on the problems the proposal would address.
    - Input should be sought on whether a new rule is needed to address such problems or whether other approaches would be reasonable.
    - The feedback should include views from credit unions and credit union advocacy organizations in meetings and conference calls with NCUA officials, responses through the agency's website, and comments to an advance notice of proposed rulemaking or through all of these vehicles.
    - NCUA should publish on its website a list of the groups that have provided feedback and a summary of their recommendations.
    - The Consumer Financial Protection Bureau is following such an approach of soliciting input prior to a rulemaking, and it seems to be working very well.
- Any new proposal should include a discussion of the input and why the agency is proceeding with a proposal.
    - If there is an existing rule or policy already covering the problem, the agency should address why more regulation is needed. The agency should also address replacement of the existing rule.
- Any new proposal should be supported by sufficient data and information that fully explains the nature and extent of the problem being addressed by the proposal.
    - This should include the harm to the National Credit Union Share Insurance Fund.
    - Commenters should be encouraged to comment on the agency's data and provide their own analysis.

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[5] Executive Order 13563, January 18, 2011; White House Press Statement, "Executive Order – Regulation and Independent Regulatory Agencies," July 11, 2011.

- Any new proposal should include the legal basis for the proposal, and commenters should be encouraged to comment on whether they support or disagree with the legal analysis.
- Any new proposal should include an accurate cost-benefit analysis that is fully explained, as well as an accurate paperwork and regulatory burden assessment. All such analyses should address the impact of the proposal on complex credit unions as well as on small ones.
- Any final rule should more completely explain significant concerns and disagreements presented by commenters and why the agency is following or disregarding those comments.
    - This should include the agency's data, costs/benefits review, regulatory burden assessment, and legal analysis.
- No final rule should include specific provisions that make compliance with its requirements a condition that credit unions must meet in order to obtain and continue National Credit Union Share Insurance, unless required by statute.
    - The agency already has sufficient authority to compel compliance without adding such provisions that seem harsh and unnecessary.
- Commentaries should be developed by NCUA and provided with major regulations. This would be similar to commentaries issued by the Federal Reserve Board, which are processed as a regulation with comments from stakeholders.
- NCUA should improve its process for seeking comments on the agency's annual regulatory review by providing a report on its website each year on how it plans to address recommendations received and by providing a synopsis of the comments.
- With regard to proposals and recommendations from the Federal Financial Institutions Examination Council, NCUA seems to have an understanding with the FFIEC that its rules will be automatically adopted by NCUA. However, we question whether this approach is always appropriate.
    - A thorough analysis of all such FFIEC rules should be conducted to determine the impact on all insured credit unions prior to adopting such rules.
    - NCUA should look for ways to make modifications that reinforce and take credit union characteristics into consideration.
        - An example of this is the recent joint proposal on executive compensation. While there is a requirement under Dodd-Frank for NCUA to develop a rule with the other federal financial regulators, there was no recognition in the proposal or supplementary information that distinguished credit unions, which have not generally developed inappropriate executive compensation practices, from banks and others that have.

C. NCUA Should Address Examination Issues

While issues regarding the examination process and examiners are perennial, the number of concerns credit unions have raised regarding examinations increased appreciably with the onset of the current economic crisis. Working with our Examination and Supervision Subcommittee, and your staff at the agency, CUNA produced last year a guide to the examination process, including a list of principles credit unions may rely on when disputes with examiners arise. We appreciated the agency's review of the CUNA guide, which credit unions continue to report they find very useful. We have made the guide widely available at no cost to leagues and member credit unions.

While the number of complaints about examinations seems to have leveled off in some areas, there are improvements in financial reporting and the examination process that we urge the agency to undertake. These include:

- Make every effort to resolve disagreements with credit union officials before issuing a DOR or LUA.
  - We are aware of the recent NCUA Office of Inspector General's (OIG) report raising concerns about the lack of implementation and enforcement of DORs.
  - We agree that when well-documented and substantiated material safety and soundness problems necessitate a DOR, steps should be taken to ensure such problems are addressed in a timely manner by the affected credit union as well as by examiners. Nonetheless, there is a real concern that the OIG report will be used by examiners to become inappropriately aggressive in some situations in following through on DORs.
  - In any event, examiners should not rush to issue documents of resolution and letters of understanding and agreements before first trying to work issues out with credit unions.
  - Also, examiners should use their regulatory flexibility to allow credit unions to develop their own solutions before imposing harsh requirements.
  - In addition, we are concerned that some examiners are inserting "standard business practices" into DORs and LUAs, which are then treated as pseudo regulation outside of the rulemaking process.
- Clarify and make more information available to credit unions regarding the role of the agency's ombudsman in addressing certain examination issues and the agency's appeals process for challenging examiner findings and directives.
  - NCUA has provided some information to credit unions on these issues, but confusion remains about how credit unions may appeal examiner decisions and whether such challenges will receive fair consideration.
  - NCUA should provide an annual report on the activities of the ombudsman, and the frequency of use by credit unions of the appeals process (including data on the nature of the issues appealed and the extent to which such appeals are successful).

- NCUA should establish a confidential process in which credit union leaders can discuss with the ombudsman specific, constructive suggestions or concerns on CAMEL ratings and other exam issues.

- Direct examiners to stop enforcing agency guidance as if they are regulations.
- Direct examiners to refrain from interpreting regulations that credit unions must follow but that are implemented by other agencies, such as Truth-in-Lending.
- Reinforce to examiners that their directives must be based on board regulations or policies and that their interactions with credit union officials must be respectful at all times.
  - Examiners should provide the legal authority to the credit union for all directives.
- Allow credit unions, working with their accounting practitioners, to determine the adequacy of their Allowance for Loan and Lease Loss accounts.
  - Examiners should not require credit unions to increase their provisions for these accounts without specific facts and data that the account is deficient.
- Give full consideration to reinstating the 18-month exam cycle for CAMEL Code 1 and 2 credit unions.
  - The agency has not provided any report to the credit union system on why the 12-month examination cycle is necessary for the healthiest of credit unions.
  - In light of that, the 18-month cycle seems to be more efficient, especially since there is ongoing reporting by credit unions between examinations.
- Clarify the role of state and federal examiners in joint exams. Once clarified, NCUA should more carefully maintain the relationship between state and federal examiners.
- Review the entire 5300 form and reporting process.
  - While the agency does seek comments on proposed changes to the form, the agency should consider seeking comments on the entire 5300 report to solicit recommendations on improving every aspect of the form.
- Allow credit unions to continue providing multi-featured open-ended lending programs. (This relates to the discussion on the following page of agency interpretations of rules it enforces but does not write.)
  - Until the issue of compliance with Regulation Z, Truth-in-Lending, for multi-featured open-end lending programs can be resolved with the Consumer Financial Protection Bureau, examiners should not direct credit unions to stop using these programs.
  - CUNA and CUNA Mutual are pursuing this matter with the CFPB currently.
- Refrain from issuing CAMEL scores for FISCUs; this is best left up to the state regulator. Multiple CAMEL scores create confusion and unnecessary work for a FISCU that disagrees with and chooses to challenge its score.
- Clarify the criteria that examiners look at for each of the CAMEL score components, as well as ensure such criteria are consistently applied by examiners. For example, the manner in which examiners critique the Management of a credit union may, and in some reported cases has, focus more

on measuring risk aversion and regulation compliance than the quality of management.

D. NCUA Should Not Apply Rules and Procedures Designed for Largest Banks to Credit Unions

Among the numerous provisions in the Dodd-Frank Act that impact credit unions, one that has not received much attention outside of the agency is the provision that includes NCUA on Financial Stability Oversight Council. It is appropriate that NCUA be included on the Council, which has the authority to override regulations from the CFPB. Including NCUA on the Council should also help insure that the agency will have early warnings of any major problems involving mega banks that might affect credit unions. Yet, there is a concern that regulations and guidance developed by the FSOC to address problems within the largest financial institutions in the world will, in some form or another, find their way into proposals developed by NCUA for credit unions. We strongly encourage NCUA to maintain a bright line between rules that are appropriate for the largest players in the financial marketplace and regulations that fit the risk profile of credit unions.

III. CUNA Recommendations to Relieve Specific Burdens That Do Not Require Statutory Changes

A. Excess Net Worth Standards Should be Curtailed

For quite some time, credit unions have been concerned that examiners expect them to maintain net worth ratios far in excess of the 7% plus any risk-based requirements necessary under the FCU Act to be well- capitalized. Compelling credit unions across the board to meet arbitrary standards beyond what the FCU Act and the agency's own rules direct is unwarranted and superfluous, in light of credit unions' overall risk profile.

We urge NCUA, at least in the case of healthy credit unions, to allow them to manage their own risks by determining for themselves, (under appropriate rationale and justification) how much net worth, if any, is needed beyond what is required by the agency's rules.

B. MBL Regulatory Requirements Should Be Streamlined

You have championed credit unions as an important source of funding for small businesses and have consistently recognized that such activity benefits not only the individual businesses but also their communities and the broader economy. As you have already stated to Congress, credit union member business lending is generally a safe and prudent endeavor. Net charge-off rates for member business loans (MBLs) at credit unions are lower than for all other loan types combined. Also, MBLs at credit unions have lower delinquency rates than commercial loans for banks.

Your testimony of October 12, 2011 in support of raising the 12.25% of assets cap on credit union member business lending provided clear and convincing data that will be very useful in refuting the erroneous claims of banker groups that such loans carry undue risks. We believe that with the support of the Obama Administration, NCUA, and key members of Congress, the opportunity for advancing the legislation to raise the cap on member business lending has never been greater.

Meanwhile, we believe there are some regulatory changes that the agency could undertake to facilitate MBLs at some credit unions.

- As we have stated in the past, we believe that loan-to-value ratios for MBLs should be higher.
- We also think, unless addressed in the upcoming Reg-Flex changes, that the waiver process for MBLs to avoid certain regulatory requirements, such as the LTV limits, can be vastly improved.
    - For example, there should be more specific guidance provided to credit unions on what data they should include to support their application and the timetable under which the agency will let the credit union know whether the application is approved.

C. Certain Current Proposals Should Not Be Finalized

In addition to the CUSO and the IRR management proposals, which we have urged the agency not to adopt as issued for comments, the executive compensation proposal should also be substantially revised before it is approved in final form. In addition to concerns about this this proposal already raised in this letter, the cutoff level for compliance with the "special requirements" for larger institutions we believe is too low for credit unions. The level for banks will be at $50 billion while the level for credit unions will be at $10 billion. Banks, which did have such arrangements, should not have a higher threshold for escaping requirements, than credit unions, which did not provide such compensation. We realize that few credit unions are likely to be covered by the final rule, but leaving the impression that credit unions need a lower threshold than banks, which did provide compensation packages to officials based on undue risk-taking we feel is unfair and inappropriate.

D. "Underserved Area" Definition Should Be Revised

In 2008, NCUA adopted changes that clarify the process for demonstrating that an area is "underserved" and thus eligible for credit union service on that basis. CUNA urged clarifications in the process but believe the agency's field of membership requirements could be further streamlined to help both communities without adequate financial services and credit unions that want to provide services to those communities. We think that the provisions on economic distress criteria, significant unmet needs and whether an area is underserved by other depository institutions

could be further simplified and we urge the agency to review the regulation for ways to enhance credit union service to underserved eras.

E. Additional Credit Union Activities and Flexibility Should be Permitted

Incidental Powers – Using its "incidental powers" provided in the Federal Credit Union Act, NCUA should approve several new activities or authorities for federal or federally insured credit unions. These include:

- Allowing well-managed federal credit unions to engage in incidental activities authorized for state credit unions in the state or states in which the federal credit union operates.
  - Any activities prohibited by or inconsistent with the FCU Act for a federal credit union would not be permitted.
  - CUNA is undertaking a review of statute statutory provisions that are more flexibility for credit unions than the FCU Act and will share our review in the coming weeks.

CUNA also recommends that NCUA take other steps to support reasonable credit union activities that would enhance their ability to serve their members. These include:

- Facilitate the ability of federally insured credit unions to offer Interest on Lawyers Trust Accounts (IOLTAs) by basing NCUSIF insurance coverage on the clients whose funds are in the account, as opposed to the attorney.
- Permit federal credit unions to accept pre-paid funeral home accounts under the Trustee or Custodial Services category.
- Allow federal credit unions to manage repossessed residential properties for other credit unions.
- Authorize foreign currency investments under a pilot program, as recommended in CUNA's October 29, 2007 comment letter.
- Permit credit unions to determine for themselves whether they need to obtain a fill assignment of a lease, consistent with what the Office of the Comptroller of the Currency provides for national banks. Also, under current leasing rules for federal credit unions (FCUs), the estimated residual value may not exceed 25% of the original cost of the leased property, unless the amount above 25% is guaranteed. We believe these limits are too restrictive and place credit unions at a competitive disadvantage with other financial institutions.

CUNA is following up on these issues with NCUA's Office of General Counsel.

F. Bank Secrecy Act Compliance Should Be Facilitated

Bank Secrecy Act (BSA) requirements under Part 748 of NCUA's regulations supplement BSA regulations from the Department of the Treasury's Financial Crimes

Enforcement Network (FinCEN). Compliance with BSA requirements remains one of the top regulatory issues for a number of credit unions.

We encourage NCUA to consider working with other federal financial regulators to provide additional guidance on BSA compliance and to minimize overlap with FinCEN's regulations.[6] For example, an area of concern with Part 748 relates to Appendix B. This document includes NCUA's guidance on credit union response programs for unauthorized access to member information. CUNA frequently receives questions from credit unions about their responsibilities following a merchant data breach. In particular, the questions relate to whether a credit union needs to send a member notice and/or notify NCUA when a merchant's breach impacts cards issued by that credit union. Based on inquiries from credit unions, there appears to be a lack of clear guidance on notice requirements when there has been a security breach. We ask NCUA to expand the guidance included in Appendix B to provide more practical information that will assist credit unions.

IV. NCUA Should Work with the CFPB to Encourage a Review of Key Rules and Requirements

As we understand it, NCUA is working with the Consumer Financial Protection Bureau in number of areas, particularly since the CFPB has assumed responsibility for the 19 consumer protection laws that were transferred to it July 21, 2011 under the Dodd-Frank Act.

One overarching concern that credit unions have raised is how the CFPB and NCUA will coordinate regarding the implementation of consumer financial protection laws. There are also concerns about whether credit unions will be subjected to burdensome data collection requirements and how NCUA's own Office of Consumer Protection fits into the consumer protection regulatory regime.

Under the Dodd-Frank Act, the CFPB will write such regulations for all covered entities, including credit unions, and enforce them for institutions with assets of more than $10 billion, which includes the three largest credit unions. NCUA and state regulators will retain supervision and enforcement authority over federally insured credit unions with assets of $10 billion or less.

We urge NCUA to weigh in with the CFPB so that CFPB examinations of the largest credit unions are reasonable and manageable. We also urge NCUA to resist the temptation to apply examination standards and tactics to credit unions that the CFPB

[6] In addition, we urge NCUA and the other federal financial regulators to support legislative changes to increase the threshold for current transactions from the $10,000 level established decades ago to $20,000 and at least doubling other key thresholds, such as the $3,000 trigger for reporting wire transfers and the $5,000 threshold for filing a Suspicious Activity Report (SAR).

may need to employ for the largest banks or institutions that have heretofore been unregulated.

The CFPB has asked CUNA for its priorities in terms of the work of that agency, and we will be sending a letter to that agency very shortly outlining our recommendations for the CFPB. In addition to helping to streamline all consumer financial protection rules generally to help minimize their impact on credit unions, there are three regulatory areas we will urge the CFPB to review. We encourage NCUA to help persuade the CFPB to undertake these reviews as soon as possible.

Review of Mortgage Loan Disclosures and Mortgage Loan Rules – Given all the disclosures that lenders must provide to borrowers, consumers often indicate that they find the home loan and home equity line of credit approval processes confusing if not intimidating. Likewise, given the complex and numerous legal requirements imposed on them, mortgage lenders are also frustrated.

The CFPB's efforts to integrate certain Real Estate Settlement Procedures Act (RESPA) and Truth-in-Lending mortgage loan disclosure forms, as required by the Dodd-Frank Act are well underway. However, concerns about the process go far beyond these forms to include, for examples, the vast range of TILA minutia that apply to mortgage lending and related products as well as requirements under the Secure and Fair Enforcement of Mortgage Licensing Act (SAFE Act). CUNA has urged the CFPB to undertake a far more robust review of all mortgage loan disclosures and other legal requirements for lenders, including credit unions. The goal of such a review would be to remove simply [this adverb seems to be in the wrong place] requirements for lenders while streaming information for consumers. We urge NCUA to help encourage the CFPB engage in this review.

Notices on ATMs (Electronic Fund Transfer Act, Regulation E) – Under the Electronic Fund Transfer Act (15 U.S.C. § 1693) an ATM operator is required to provide a notice that a fee will be imposed for using the ATM and disclose the amount of any fee before the fee is imposed. The notice is required to be on the ATM screen, or on a paper issued by the ATM before the consumer is irrevocably committed to completing the transaction. A notice must also be provided in a prominent and conspicuous location on or at the ATM.

Failure to comply with these requirements may subject an ATM operator to damages suffered by a consumer as a result of the failure to comply and a statutory penalty of $100-$1000. Violations may also be the subject of a class action and an ATM operator may be liable for the lesser of $500,000 or 1% of the net worth of the operator, in addition to court costs and reasonable attorneys' fees.

It is sometimes impossible to ensure that the notice posted on or at the ATM will remain in place. There are concerns that some notices are being removed in order

that lawsuits alleging noncompliance with those notice requirements may then be filed.

Credit unions that are making every effort to comply in good faith with the EFT requirements are nonetheless the target of some of these lawsuits. While the notice requirements are statutory, the CFPB has authority under the EFT Act to exempt institutions from certain requirements under the Act. We are urging the CFPB to use that authority to eliminate redundant ATM disclosures, which are of questionable utility to consumers and are subjecting credit unions to needless costs and potential lawsuits. It would be very useful for NCUA to work with the CFPB to encourage the agency to consider this step.

Other Regulations: Privacy and FACT Act – Over the past several years, numerous rules have been issued under various laws with which credit unions must comply. These include regulations under the Fair Credit Reporting Act, as amended by the Fair and Accurate Credit Transactions (FACT) Act and the Privacy of Consumer Financial Information rules under the Gramm-Leach Bliley Act. Under these rules, a number of regulatory burdens have been imposed on credit unions. We are urging the CFPB to conduct a review of these requirements for financial institutions as soon as possible to determine how such requirements can be streamlined. We urge NCUA to support these review efforts.

Conclusion

Nothing in this letter should be construed as supporting lax regulation or urging the agency to ignore problem situations or issues. The regulation of federal credit unions and the oversight of the safety and soundness of all federally insured credit unions is what Congress directed NCUA to do and CUNA supports that. Moreover, when the agency performs its job effectively and efficiently, the credit union system is strengthened and credit unions and their members benefit.

However, if current regulatory burdens are not contained and a process is not developed for minimizing future requirements, credit unions will continue to struggle under the weight of too many requirements. Moreover, they will experience increased difficulties as they endeavor to respond to changes in the financial market place and the needs of their members. As a result, credit union members will feel the effects through reduced service in many instances.

Credit unions, leagues, and CUNA support the agency's ability to perform its job in a reasonable, appropriate manner, but credit unions need to be able to do their jobs as well—and without unnecessary interference from regulations or examiners.

We would welcome the opportunity to work with the agency to help achieve as much regulatory relief as possible for credit unions, consistent with statutory requirements and reasonable safety and soundness objectives. I urge you to consider these

recommendations to improve the regulatory environment for credit unions, which will benefit them, their members, and their communities.

Best regards,

Bill Cheney
President & CEO

EXHIBIT C

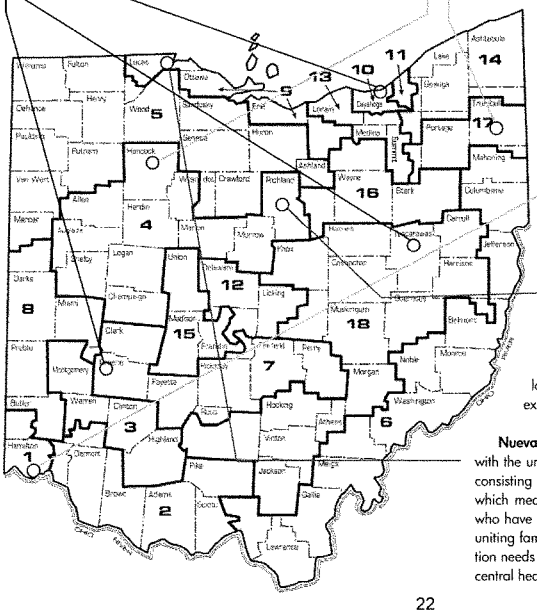
OHIO CREDIT UNIONS: The Credit Union Difference in Action

For People, Not For Profit

Since 2008, **Wright-Patt Credit Union (Fairborn)** has paid excess earnings back to its members. Most recently, the credit union's 210,000 members shared a dividend of more than $5 million, bringing the four-year total returned to the membership to more than $16 million.

Dover-Phila Federal Credit Union (Dover) issued a $1.6 million year-end bonus dividend to more than 35,000 members, for the 17th consecutive year. The $324-million credit union awarded a 50% bonus dividend and an 8% interest rebate.

Ohio's First Class Credit Union (Cleveland) declared a loan interest rebate and bonus dividend for the fifth consecutive year. Members with loans received a 5% rebate on the interest they paid during 2011. In addition, the credit union paid a 25% dividend to members with savings accounts.



Providing Affordable Financial Products

Hancock Federal Credit Union (Findlay) began asking members about their existing loans at other financial institutions and suggesting how they could save money by receiving a lower interest rate or shorter-term loan at the credit union. Lending officers developed an illustration that showed members how much they could save over the life of their loan -- and members took advantage. To date, the credit union has saved its members more than $400,000 in interest.

Seven Seventeen Credit Union (Warren) instituted the Simplify and Save program, which provided tools, tips and resources to help members get the most out of their money. The credit union created a goal to help members save $1 million through paying down debt and refinancing existing loans.

Classic Federal Credit Union (Amelia) and **Cincinnati Central Credit Union** work individually with members to help them survive economic hardships. Classic recently helped a family who had mounting debt as a result of unemployment, allowing them to consolidate their debt into an affordable monthly payment at a lower interest. A member of Cincinnati Central was left to file bankruptcy after a traumatic life event, and although her credit history made her an unlikely candidate, the credit union was able to offer her a car loan so she could get back on her feet.

Serving the Underserved

GROhio Community Credit Union (Mansfield) works closely with less-than-prime members, believing this consumer market typically avoided by larger financial institutions is how the credit union can best serve the community, while still lending responsibly. For example, the credit union offers a $500 unsecured loan option which members utilize for everyday living expenses such as tires, insurance, and real estate taxes.

Nueva Esperanza Community Credit Union (Toledo) works with the underserved members of the South Toledo community, consisting of many Latino immigrants. The credit union's name, which means 'New Hope' in English, provides loans to many who have been turned down by the few banks in the area, reuniting families through immigration loans, fulfilling transportation needs through car loans, and even helping members install central heating in homes.

EXHIBIT D

OHIO CREDIT UNION FOUNDATION

Credit unions are helping Ohioans in today's economy

The National Credit Union Foundation conducted a financial education survey among Ohio's not-for-profit cooperative credit unions to measure the amount of financial education that they provide to their members. Please see results below.

93% *of Ohio's credit unions spent a total of $674,000 to provide financial education in 2010.*

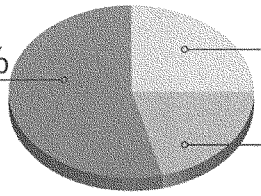
Ohio credit unions provided

2,675 HOURS of formal financial counseling and

33,218 HOURS of financial advice to their members in 2010.

FINANCIAL COUNSELING FOR ADULTS

54% provided financial advice at the credit union



25% provided formal financial counseling at the credit union

21% referred members to formal financial counseling services

Ohio credit unions worked with their members in financial trouble to help them avoid bankruptcy, foreclosure, and overwhelming debt. As a result:

2,206 Members entered debt management plans

463 Members established mortgage workouts

MOST POPULAR COUNSELING TOPICS

1. **Credit Report Reviews** — **82%** of credit unions reviewed credit reports with their members
2. **Money Management**
3. **Debt Management**
4. Savings Accumulation
5. Foreclosure Prevention/Loss Mitigation
6. Mortgage Delinquency/Default Resolution
7. Home Equity Loans
8. Pre- and Post-Homebuyer Counseling
9. Retirement and Estate Planning
10. Pre-Bankruptcy Filing
11. Small Business Planning

A variety of groups benefit from Ohio credit unions' free financial education

GenX • Military Families • Parents • Teens
Boomers • Minorities • Senior Citizens
College Students • Pre-Teens • Homebuyers
Immigrants • Small Business Owners
GenY • Teenagers • Preschoolers

BREAKING THE CYCLE OF DEBT

To treat the cause (not the symptoms), many credit unions require members to complete financial education or counseling for:

- Excessive Overdrafts
- Loan Workout Plans
- Habitually Delinquent Accounts
- Dependence on Payday Loans
- Certain Loans

Data is based on responses from 76 Ohio credit unions that serve 47.3% of all Ohio members (1,270,908 out of 2,684,326 on 6/30/11). The credit union with the smallest membership that responded has 128 members, while the largest credit union has 198,742 members. Credit unions were asked to report data for calendar year 2010.

OHIO CREDIT UNION FOUNDATION • 10 WEST BROAD ST., SUITE 1100, COLUMBUS, OHIO 43215 • 800.486.2917 • www.OhioCreditUnionFoundation.or

OHIO CREDIT UNION FOUNDATION

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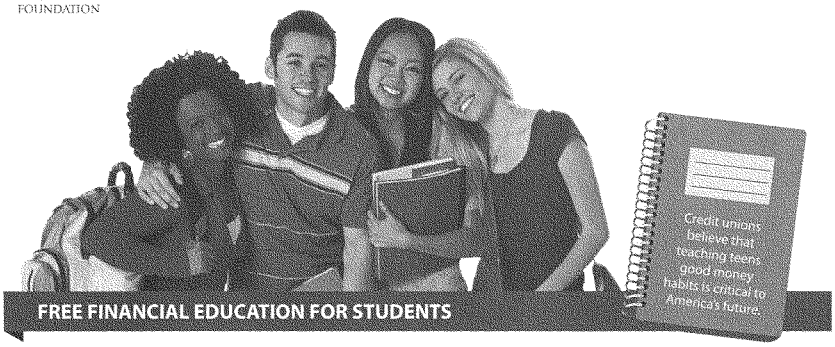
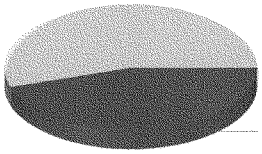


FREE FINANCIAL EDUCATION FOR STUDENTS

8 Ohio credit unions have in-school branches (staffed by 76 student workers).

These branches in elementary and high schools serve more than 575 student members with $57,000 on deposit.

55% of credit unions provide online resource centers for students and educators



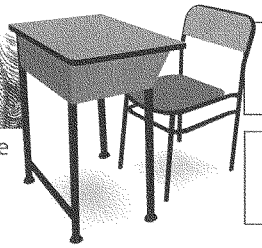
45% of credit unions provide classroom financial education to students

21 Credit unions hosted *experiential learning programs* (reality events) to students, providing opportunities to practice real-world financial decision-making

14,300 Students Attended

319 Reality Events

25% of credit unions provide online educational games or simulations



Ohio credit unions provided **2,274** CLASSROOM PRESENTATIONS in Ohio schools and youth group meetings

57,500 STUDENTS PARTICIPATED in the credit unions' classroom presentations

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Testimony of

William J. Blake
Deputy General Counsel
KeyBank, Cleveland

On behalf of KeyBank National Association, as representative of the Regional Banking Group

Before the
United States House of Representatives
Subcommittee on Financial Institutions and Consumer Credit
Field Hearing on
"An Examination of the Challenges Facing Community Financial Institutions in Ohio"

April 16, 2012
Cleveland, Ohio

Thank you Chairwoman Capito, Congressman Renacci and Congressman Stivers. My name is Bill Blake and I am a Deputy General Counsel of KeyCorp. It's a privilege for me to be invited to talk to you today about the impact of the Volcker Rule and the proposed regulations implementing the Volcker Rule.

KeyBank is part of a regional banking group that submitted a joint comment letter on the proposed regulation. Our group consists of Branch Banking and Trust Company, Capital One Financial, Fifth Third Bancorp, KeyCorp, The PNC Financial Services Group, Regions Financial, Suntrust Banks and US Bancorp. Our primary mission is to serve our local communities by providing traditional banking services—deposits, loans, and trust and asset management services—to millions of households and businesses of all sizes.

We are regional banking organizations who share the same concerns on the proposed Volcker Rule regulations. We are *not* the complex or globally

interconnected financial firms that much of the Dodd-Frank Act was intended to address. Our organizations do *not* engage in the proprietary trading activities that the Volcker Rule was intended to ban, nor have we been engaged to any significant extent in running hedge funds or private equity funds. Congress did *not* intend the Volcker Rule to unduly restrict traditional banking and customer-facing activities or impose substantial compliance burdens on banking organizations primarily engaged in traditional banking activities.

The proposed implementing regulations by the Federal Reserve, OCC, FDIC, SEC and CFTC too often take a "one size fits all" approach that results in detrimental unintended consequences. In today's testimony, I want to highlight four areas in which the rule negatively affects our ability to serve our customers, manage risk, control costs and avoid losses. We are concerned that the proposed regulation will actually increase, rather than decrease, the risks to the safety and soundness of banking organizations.

First, the proposal hampers banks' ability to meet the liquidity needs of their customers, especially small and middle-market companies. We have long provided liquidity to our small and middle-market customers through our market-making operations. Small and mid-market companies have issuances that are smaller in size and traded less frequently than large companies.

We are concerned that under the proposed rules, legitimate market-making activity in these less liquid securities will be improperly viewed as illegal proprietary trading. The implementing regulations need to ensure that issuances

of small and middle-market companies are not disadvantaged as compared to larger companies.

Second, effective hedging and asset-liability management (ALM) activities are critical ways that banking organizations manage risk and ensure safety and soundness. The proposal fails to clearly protect bona fide hedging and ALM activities. Banking organizations like ours will operate in a continuous zone of uncertainty – unsure whether bona fide hedging and ALM activities and trades will on a post-hoc basis be determined by an agency to constitute impermissible proprietary trading. There is no reason why the implementing regulations should shroud core risk-mitigating activities in uncertainty. Without the ability to execute critical ALM activities, banks may scale back even traditional lending if associated risks cannot be appropriately hedged. Small and middle-market businesses as well as municipalities would see a reduction in lending and/or an increase in borrowing costs.

Third, our organizations are committed to maintaining strong and effective compliance programs that are appropriate to the size, nature and complexity of our organization's activities. However, the costly, detailed "programmatic" compliance requirements (including metrics reporting) of the proposal go far beyond what is appropriate for regional banking organizations that have not engaged in any meaningful way in the type of trading sought to be prohibited by the Volcker Rule. We do not believe our organizations need such detailed programs to "prove the negative," i.e. that we are not engaged in activities that we do not conduct.

Instead, we strongly believe that the dollar threshold triggering the need for a "programmatic" Volcker Rule compliance program should be raised from $1 billion to $10 billion in average trading assets and liabilities. Raising the threshold to *$10 billion* (or even $15 billion) would still capture more than *97% of the total average trading assets and trading liabilities of all U.S. banking organizations.*

Finally, the statute requires banking organizations to divest existing, legacy investments in private equity funds subject to certain extensions, including an extension of up to 5 years for 'illiquid' funds. The purpose of this extended period was to allow banks to unwind these investments—most of which provide capital to small- and middle-market companies—in an orderly fashion without the need for "fire sales."

All of these investments were legally made at the time they were acquired. The Volcker Rule now requires us to dispose of all of them. The rules as written will likely result in forced sales of private equity fund interests at distressed prices, transferring significant value from the regulated banking industry to private investors. The proposed rules essentially negate the availability of the 5-year transition period for existing illiquid fund investments.

The Volcker Rule provisions in Dodd-Frank are scheduled to go into effect on July 21, 2012, little more than three months from now. The proposed rules generated over 17,000 comments from academia, members of Congress, trade groups, public interest groups and other interested parties. We and a growing chorus of other interested parties believe that substantial revisions to the

proposed regulation are necessary. Accordingly, the final point I'd like to make is that our regional bank group strongly supports efforts being made by a bipartisan group of Senators, including Senators Crapo and Hagan, to delay the effective date of the Volcker Rule and we ask you to support their efforts.

We, along with other regional banks who share our views, filed a comment letter with the agencies on February 13 to explain our concerns. I am submitting a copy of our comment letter with my testimony today and encourage you or members of your staff to read it to get a better understanding of the issues and problems we see with the proposed regulation.

I sincerely appreciate the opportunity to testify today, and thank you for coming to Cleveland to discuss our concerns regarding the Volcker rule. Regional banks are committed to helping restore our economy, and we look forward to working with you.

February 13, 2012

Ms. Jennifer J. Johnson, Secretary
Federal Reserve System
Board of Governors of the
20th Street and Constitutional Avenue NW
Washington, DC 20551

Office of the Comptroller of the Currency
250 E Street SW, Mail Stop 2-3
Washington, DC 20219

Mr. Robert E. Feldman, Executive Secretary
Federal Deposit Insurance Corporation
Attention: Comments
550 17th Street NW
Washington, DC 20429

Ms. Elizabeth M. Murphy, Secretary
Securities and Exchange Commission
100 F Street NE
Washington, DC 20549-1090

Mr. David A. Stawick
Secretary of the Commission
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

By Electronic Mail

Re: Restrictions on Proprietary Trading and Certain Interests in, and Relationships with, Hedge Funds and Private Equity Funds Docket No. R-1432 (Federal Reserve); Docket No. OCC-2011-0014 (OCC); RIN 3064-AD85 (FDIC); File No. S7-41-11 (SEC); RIN 3038-AC[*] (CFTC)

Ladies and Gentlemen:

The undersigned regional banking organizations appreciate the opportunity to comment on the proposed regulations issued by the Board of Governors of the Federal Reserve System ("FRB"), the Office of the Comptroller of the Currency ("OCC"), the Federal Deposit Insurance Corporation ("FDIC"), the Securities and Exchange Commission ("SEC"), and the Commodity Futures Trading Commission ("CFTC") (collectively, the "Agencies") to implement the so-called "Volcker Rule" in Section 619 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank").[1] Our organizations[2] employ more than 250,000 Americans and have more than 16,000 branch offices throughout the country. We are committed

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[1] Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds, 76 *Federal Register* 68,846 (Nov. 7, 2011) (FRB, OCC, FDIC and SEC) and http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/federalregister011112c.pdf (CFTC rule to be published in the *Federal Register*) (collectively, "Proposed Rule").

[2] We are U.S. bank holding companies that have more than $50 billion in consolidated assets, but that are predominantly composed of one or more insured depository institutions, are not globally interconnected, and have limited nonbanking operation. Thus, our organizations pose little, if any, systemic risk.

to providing traditional banking services—deposits, loans, and trust and asset management services—to millions of households and businesses of all sizes. A number of our organizations are also providers of commercial and investment banking services to domestic companies and institutions, most of which are small and middle-market companies. Our primary mission is to serve our local communities and we are not the complex or globally interconnected financial firms that much of Dodd-Frank was intended to address.

We do not believe that Congress intended the Volcker Rule to unduly restrict the traditional activities conducted by our organizations or impose substantial compliance burdens on regional banking organizations. While not all of the undersigned organizations engage in all of the trading or fund activities discussed in this letter, the proposal as written will cause each of our organizations to comply with many, if not all, of the same requirements applicable to the largest financial firms with substantial trading volume and covered fund investments. One paramount initial concern is that the proposal would require each of our organizations in extremely short order to develop and implement compliance, internal controls, record-keeping and reporting regimes simply to "prove a negative" that we are not engaged in impermissible proprietary trading or funds activities. We also are greatly concerned that the proposal would hamper the ability of our organizations to meet the liquidity needs of our customers, including small, middle-market and municipal customers, and would reduce liquidity more broadly in the marketplace. Furthermore, we are concerned that the proposal would actually increase, rather than reduce, the risks to the safety and soundness of banking organizations.

While the Agencies have attempted in places to temper the burden and unintended consequences of the statutory requirements of the Volcker Rule, we believe that substantial revisions to the proposed regulations are necessary. We highlight in this letter several of the issues of particular importance to our organizations. We believe the changes described below would help avoid unintended consequences and provide for a more appropriate and tailored compliance regime for organizations, like ours, that were not the principal intended focus of the Volcker Rule. Importantly, we believe the Agencies have the discretion under the statute to address each of these concerns. In this regard, our organizations strongly support the view that the Agencies have the authority under the Volcker Rule to define, by rule, those funds that rely on sections 3(c)(1) and 3(c)(7) that should be treated as "hedge funds" or "private equity funds" for purposes of the Volcker Rule. Interpreting the statute in this manner is critical to avoiding an overbroad application of the statute and fulfilling Congress' expressed desire that the Agencies appropriately limit the scope of the terms "hedge fund" and "private equity fund."[3]

Our organizations have worked with the American Bankers Association ("ABA"), the Financial Services Roundtable("FSR"), the American Securitization Forum ("ASF"), the Securities Industry Financial Markets Association ("SIFMA"), and The Clearing House Association ("TCH"), in the development of their comprehensive comment letters. The recommendations in this letter are intended to supplement the comments submitted by those associations.

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[3] *See* Colloquy between Representative Barney Frank, Chairman of the House Financial Services Committee, and Representative Jim Himes, 156 Cong. Rec. H5223-02, 2010 WL 2605433.

1. **The Proposal Threatens Traditional Banking Practices and Customer Liquidity**

We are concerned that the standards included in the proposed rules would prohibit, or cast substantial doubt on the continued permissibility of, legitimate customer-facing activities, such as market-making, and core risk management activities of banks, such as hedging and other asset-liability management ("ALM") activities. Because the proposed rules fail to clearly protect such *bona fide* activities, banking organizations like ours will operate in a continuous zone of uncertainty—unclear whether legitimate activities and trades will on a *post-hoc* basis be determined by an Agency to constitute impermissible proprietary trading. This uncertainty and its consequent effects on the ability and willingness of banking organizations to provide liquidity to customers, or engage in hedging and ALM activities, also will have important implications for safety and soundness and the functioning of the financial markets.

We share the concerns of many market participants about the adverse effect the proposal could have generally on liquidity in the market place and the ability of banking entities to provide liquidity to customers, including, holding inventory at levels sufficient to meet investor demand.[4] We are particularly concerned about the impact that this loss of liquidity would have on our small and middle-market customers. Because the issuances of these customers typically are smaller in size and less liquid than those of large corporations, banking organizations like ours often help provide liquidity in the market for the securities issued by these customers. However, because these issues are less liquid, and the trading volume of our market-making operations is significantly less than that of the largest banks, we are concerned that our *bona fide* market-making activities in these types of securities are more likely to be inappropriately characterized as impermissible proprietary trading under the standards in the proposal as compared to market-making activities in more liquid instruments or conducted by firms with larger trading volumes. This not only will have an adverse effect on our operations, but also poses the real danger that small and middle-market businesses will not have sufficient access to liquidity.

Banking entities inherently assume some degree of risk with nearly every financial transaction they engage in. Robust and effective risk management is critical to maintaining a strong and stable financial system going forward. Undue constraints on this process in an effort to curtail the apparent risk represented by "proprietary trading" will either lead to more overall risk to the system or, perhaps more likely, a reduction in the amount of risk banking entities will be willing to take in their customer transactions. This latter impact, in turn, will have a negative impact on the ability of small and middle-market companies to access sources of financing and may also increase their cost of capital. We do not believe Congress intended the Volcker Rule to

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[4] *See, e.g.*, Alexander Marx, Head of Global Bond Trading, Fidelity Investments, Before the Financial Services Subcommittee on Financial Institutions and Consumer Credit and the Financial Services Subcommittee on Capital Markets and Government Sponsored Enterprises, at 6 (Jan. 18, 2012) (stating that the "proposal would restrict the ability of banks and their affiliates to hold an adequate inventory of securities"); Oliver Wyman, The Volcker Rule: Considerations for implementation of proprietary trading regulations (estimating that limits on the ability of banks to facilitate trading, hold inventory, and participate in the corporate bond market imposed by the Volcker Rule will result in as much as $43 billion a year in increased borrowing costs over time, as investors demand higher interest payments as a result of reduced liquidity in the market).

impose such constraints on these types of financial activities conducted on behalf of our customers and consistent with traditional banking practices.[5]

A critical way banking entities manage and mitigate their risks is through principal trading activities. In adopting the Volcker Rule, Congress recognized the importance of this activity by including exemptions to the proprietary trading prohibition for principal transactions done for the purpose of hedging and other risk mitigating activities. Moreover, the FSOC Study indicates that the hedging exemption should be applied in a way that recognizes "that risk exposure is not synonymous with position or transaction: much of hedging is done on a portfolio basis."[6] The study also endorses an approach to implementing the Volcker Rule that would preserve ALM activities.[7]

We are greatly concerned, however, that the approach taken by the Agencies to implement the statute creates significant doubt as to whether *bona fide* ALM activities are permissible. Under the proposal, banking entities that are entering into trades as part of their risk mitigation activities must choose trades based on whether a metric or perception *ex post* may potentially "flag" the trade as illegal proprietary trading. We are concerned that this proscriptive approach will unduly cloud a banking entity's decision to enter into a risk mitigating transaction so that the entity will focus more on proving a negative—that the transaction does not run afoul of the Volcker Rule—rather than the risk-mitigating effects of the transaction.[8]

The conditions placed on risk-mitigating hedging in the proposed rule and issues discussed in the preamble only serve to heighten our concerns. For example, the indication that a risk-mitigating hedge may be entered into only "slightly before" the related risk exposure occurs could well limit the ability of banks to engage in the type of dynamic hedging activities crucial to sound risk management.[9] In addition, we disagree with the notion reflected in the *Federal*

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[5] As the opening sentences of the study issued by the Financial Stability Oversight Council ("FSOC") on the Volcker Rule state: "The Dodd Frank Act is intended to strengthen the financial system and constrain risk taking at banking entities. Section 619 of the Dodd-Frank Act, also known as the Volcker Rule, is a key component of this effort." Financial Stability Oversight Council, *Study & Recommendations on Prohibitions on Proprietary Trading & Certain Relationships with Hedge Funds & Private Equity Funds*, at 1, January 2011 ("FSOC Study").

[6] *Id.* at 30.

[7] "All commercial banks, regardless of size, conduct [ALM] that help the institution manage to a desired interest rate risk and liquidity risk profile. This study recognizes that ALM activities are clearly intended to be permitted activities, and are an important risk mitigation tool. . . . A finding that these are impermissible under the Volcker Rule would adversely impact liquidity and interest rate risk management capabilities as well as exacerbating excess liquidity conditions. These activities also serve important safety and soundness objectives." *Id.* at 47.

[8] Our concerns are compounded by the fact that multiple agencies must administer the Volcker Rule and their interpretation as to what constitutes a permissible activity could vary significantly. As the Agencies draft the final rules, we ask that they adopt and announce a coordinated approach to supervision relating to Volcker Rule compliance in order to ensure consistent application and interpretation across banking entities and across the various regulated entities within a single banking entity..

[9] The preamble to Proposed Rule states that "the hedging exemption would be available in certain cases where the hedge is established slightly before the banking entity becomes exposed to the underlying risk if such anticipatory hedging activity: (i) is consistent with appropriate risk management practices; (ii) otherwise meets the terms of the hedging exemption; and (iii) does not involve the potential for speculative profit." 76 *Federal Register* at 68,875.

Register notice (but not the rules themselves) that a proper hedge may be viewed as impermissible proprietary trading solely because the hedge may result in appreciable profits.[10] The statutory text of the exception for risk-mitigating hedges does not suggest that hedges are impermissible if they are profitable and, in fact, does not refer to profits at all. Rather, the proper focus should be on whether the hedge is reasonably correlated to the underlying risks being hedged—in other words, the primary determination should be whether the hedge is *effective* in mitigating risk. If a banking entity is able to enter into hedging transactions that are reasonably correlated with the underlying risks, the fact that it managed to do so in a manner that also provides a profit to the organization *promotes*—rather than jeopardizes—the safety and soundness of the entity.

In similar fashion, we believe that the exclusion from the definition of "trading account" for *bona fide* liquidity risk management activities is unnecessarily narrow.[11] For example, the requirements that these activities must meet "near term" funding needs, be "highly liquid" and not give rise to "appreciable profits," will have the potential to exclude legitimate ALM practices in which our organizations have long engaged in order to effectively manage our liquidity.

For these reasons, we believe substantial revisions are necessary to the aspects of the proposed regulations relating to market-making and hedging. In particular, we support broadening the proposal's liquidity risk management exclusion from the definition of trading account to include all *bona fide* ALM activities, along the lines suggested in the joint comment letter from TCH and the ABA.[12] In addition, we support revisions to the market-making and hedging exemptions expressed in the joint comment letter on proprietary trading activities from SIFMA, ABA, TCH and FSR.[13] For example, we believe that the final regulations should expressly state that risk-mitigating hedging is permitted and encouraged and that the hard-coded criteria in the proposal for meeting the hedging exemption be treated as guidance that banking entities should follow in adopting their own risk limits and policies and procedures to ensure that their hedging activities do not become impermissible proprietary trading. Furthermore, we believe the Agencies should permit banking entities to engage in market-making-related activities as long as they satisfy customer liquidity needs in compliance with reasonably-designed policies and procedures that banking entities themselves develop and implement. The hard-coded factors in the proposal's market-making exemption should be incorporated in a more flexible manner into guidance that banking entities use to develop these policies and procedures. A banking entity's trading desk should be presumed to be engaging in *bona fide* market-making

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[10] In discussing the limits of the "reasonable correlation" prong of the hedging exemption in section __.5(b)(2)(iii), the Agencies state in the preamble to the Proposed Rule: "[r]egardless of the precise degree of correlation, if the predicted performance of a hedge position during the period that the hedge position and the related position are held would result in a banking entity earning appreciably more profits on the hedge position than it stood to lose on the related position, the hedge would appear likely to be a proprietary trade designed to result in profit rather than an exempt hedge position." *Id.*

[11] Proposed Rule § __.3(b)(2)(C)(iii).

[12] Comment Letter on Proposed Rule from TCH and the American Bankers Association Securities Association, February 13, 2012, concerning ALM activities.

[13] Comment Letter on Proposed Rule from SIFMA, ABA, TCH and FSR, February 13, 2012, concerning proprietary trading activities.

as long as it is satisfying customer liquidity needs and the quantitative metrics the banking entity develops to help monitor such activity are appropriate for the specific asset class in question and the nature of the entity's operations.

2. **Public Welfare Funds**.

We appreciate that the Agencies provided in section __.13(a) of the proposed regulations that banking entities may both invest in and sponsor covered funds for public welfare purposes.[14] We believe that construing the exception in subsection (d)(1)(E) to cover both investing in and sponsoring a public welfare fund is appropriate and consistent with congressional intent to avoid disruptions of the public welfare activities of banking organizations. This will allow banking entities to continue to be a strong source of equity to, and provide important organizational and administrative support for, funds that (i) are organized as small business investment companies ("SBICs"), as defined in section 102 of the Small Business Investment Act of 1958 (15 U.S.C. § 662); (ii) are designed primarily to promote the public welfare of the type permitted by 12 U.S.C. § 24(Eleventh), such as investments and funds that qualify for low-income housing tax credits ("LIHTC") or New Markets Tax Credits ("NMTC"); or (iii) qualify for Federal historic tax credits ("HTC") or similar state HTC programs ("HTC funds") (collectively, "permissible public funds"). These funds have long served as important mechanisms for delivering support to small businesses, low-income and other community housing projects and community preservation. Banking entities provide important support to and investment in these funds and we appreciate that the Agencies have made it clear that the Volcker Rule will not serve as a barrier to banking entities investing in and sponsoring these funds.

However, under the proposed regulations, all of these funds would still be considered "banking entities" if another banking entity sponsors or serves as general partner of the fund. As a result, a permissible public fund controlled by a banking organization would itself be prohibited from investing in or sponsoring another covered fund—including another lower-tier permissible public fund. For these reasons we believe that permissible public funds that are controlled by a banking entity pursuant to the exception in subsection (d)(1)(E) should be excluded from the definition of a "banking entity"–just as the Agencies have excluded funds held under the asset management exception in section __.12 of the Proposed Rule from the definition of a "banking entity."

We also believe that transactions between a banking entity and a permissible public fund sponsored or advised by the banking entity should not be subject to the so-called Super 23A restrictions implemented in section __.16 of the proposed rule.[15] Application of these restrictions to permissible public funds will impede the ability of banking organizations to provide financing to permissible public funds that support affordable housing, small businesses, and jobs for low- and moderate-income individuals. For example, banks involved in syndicating

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[14] *Id.* at § __.13(a).

[15] Proposed Rule §__.16. Subsection (f)(1) of the Volcker Rule prohibits a banking entity and any of its affiliates from entering into any "covered transaction" (as defined in Section 23A of the Federal Reserve Act) with a "hedge fund" or "private equity fund" that the banking entity sponsors or for which it serves as investment manager or investment adviser. Subsection (f)(2) of the Volcker Rule also makes the provisions of Section 23B of the Federal Reserve Act applicable to transactions between a banking entity (and its affiliates) with sponsored or managed "hedge fund" or "private equity fund" as if the bank (or affiliate) were a "member bank" and the fund were its "affiliate." These restrictions are collectively referred to as "Super 23A."

or selling public welfare investments to other investors may no longer be able to provide guaranties or other support for the permissible public funds they sponsor if the Super 23A were to apply to such funds. Without the guaranty of a creditworthy banking organization, many investors would not be able or willing to make these types of public welfare investments, resulting in the loss of a large source of equity for these vital programs in our nation's communities.

The Agencies could use their authority to exclude permissible public funds from the definition of a "hedge fund" or "private equity fund." Alternatively, the Agencies could use the exemptive authority in subsection (d)(1)(J) of the Volcker Rule[16] to exclude permissible public funds from the Super 23A restrictions. Doing so would allow banking organizations to continue to provide other forms of financing and support to these types of entities.

3. **Securitization Activities and Vehicles**

Securitization trusts and asset-backed commercial paper conduits are an important source of funding and liquidity to both banking organizations and a wide range of industrial and commercial businesses. In light of this, the Volcker Rule expressly provides that "[n]othing in [the Volcker Rule] shall be construed to limit or restrict the ability of a banking entity . . . to sell or securitize loans in a manner otherwise permitted by law" (the "Statutory Securitization Exemption").[17] We recognize that the Proposed Rules would permit a banking entity to have an investment in and sponsor a securitization vehicle the assets of which are limited to "loans" and certain derivatives.[18] Nevertheless, we are concerned that the Proposed Rules would in fact disrupt the securitization process that Congress sought explicitly to protect through the Statutory Securitization Exemption.

We believe the Proposed Rules should be modified to make clear, in accordance with the Statutory Securitization Exemption, that (i) banking entities may own and sponsor securitization vehicles (including asset-backed commercial paper ("ABCP") conduits) notwithstanding the limitations in subsection (a)(1) of the Volcker Rule, and (ii) a bank-sponsored securitization vehicle will not be considered a "banking entity" for purposes of the Volcker Rule. In addition, we believe that the Agencies' final rules should exclude all securitization vehicles (including ABCP conduits) that fall within the scope of the Statutory Securitization Exemption from the Super 23A restrictions in subsection (f) of the Volcker Rule. Doing so is, in our view, mandated by the Statutory Securitization Exemption, which provides that *nothing* in the Volcker Rule shall limit the loan securitization activities of a banking entity.

4. **Municipal Securities**

Municipal securities provide vital funding to State and local governments and their agencies and instrumentalities. Municipal securities also are a critical source of funding for a wide range of State and local government-sponsored projects, such as infrastructure development, affordable housing projects, university construction, and health care facilities. Our organizations are concerned that the proposal could have a detrimental effect on the market for

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[16] 12 U.S.C. § 1851(d)(1)(J).

[17] 12 U.S.C. § 1851(g)(2).

[18] *See* Proposed Rule at §__.14(a)(v).

municipal securities and the ability of State and local governments, agencies and instrumentalities, as well as the numerous issuers that participate in programs sponsored by such entities, to obtain essential financing at reasonable costs. This, in turn, could have a significant negative impact on the cost and availability of critical government or government-supported services, including healthcare and other social services, affordable housing, schools and universities, and public infrastructure (such as roads and sewers).

Specifically, the Proposed Rules would permit a banking entity to trade only in "obligation[s] of any State or political subdivision thereof."[19] Thus, the Proposed Rules would not appear to allow banking entities to trade in the wide range of tax-exempt municipal securities that are issued by agencies or instrumentalities of a State or local government, or the issuers of debt through state or local agencies or municipalities to finance healthcare, educational or infrastructure projects. We believe the exception in section 1851(d)(1)(A) of the Volcker Rule (12 U.S.C. § 1851(d)(1)(A)) was intended to encompass the wide range of tax-exempt securities that are issued by or through State or local governments, or the agencies and instrumentalities of those governmental bodies. Otherwise, the Volcker Rule would limit an important source of liquidity for thousands of issuers of tax-exempt municipal debt—an outcome that Congress likely did not intend. Reduced liquidity would raise the financing costs for these issuers and, ultimately, increase the cost and reduce the availability of a wide range of government or government-supported services. Reduced liquidity would also have the unintended consequence of lowering the value of outstanding municipal securities that did not qualify for the unduly narrow exception in the Proposed Rules. For these reasons, we believe that the Agencies can and should modify the Proposed Rules to allow banking entities to trade in any security that qualifies as a "municipal security" under the Securities Exchange Act of 1934 ("1934 Act").[20] We also note that with the Municipal Securities Rulemaking Board has supported a similar expansion in its letter, dated January 31, 2012, that the Agencies should define "municipal security" consistent with the 1934 Act.[21]

5. **Compliance Program Requirements Should be Tailored in Several Respects**

Section __.20(a) and (b) of the proposed regulations requires each banking entity engaged in proprietary trading and covered fund activities to have a compliance program that is "reasonably designed to ensure and monitor compliance" with the restrictions of the Volcker Rule and "appropriate for the size, scope and complexity of the activities and business structure of the covered banking entity."[22] Our institutions agree that banking entities should implement compliance programs that are reasonably designed to meet the requirements of the Volcker Rule and its implementing regulations. Section __.20(b) of the proposed rule says that a compliance program must include, at a minimum, (i) internal written policies and procedures reasonably designed to ensure that the banking entity's activities comply with the Volcker Rule and the

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[19] Proposed Rule at §__.6(a)(1)(iii) and (2).

[20] *See* 15 U.S.C. § 78c(a)(29). We believe the Agencies have the authority to interpret the exception in 12 U.S.C. § 1851(d)(1)(A) in this manner. However, section (d)(1)(J) of the Volcker Rule (12 U.S.C. § 1851(d)(1)(J)) also clearly provides the Agencies the authority to ensure that banking entities may continue to provide liquidity to all issuers of tax-exempt municipal securities in light of the important public benefits provided by such activities.

[21] Comment letter to the Agencies from the Municipal Securities Rulemaking Board, dated January 31, 2012.

[22] Proposed Rule at §__.20(a).

agencies' implementing regulations; (ii) a system of internal controls reasonably designed to identify areas of potential noncompliance and prevent violations; (iii) a management framework that clearly delineates responsibility and accountability for compliance; (iv) independent testing of the effectiveness of the entity's compliance program; (v) appropriate training; and (vi) the maintenance and retention, for five years, of records sufficient to demonstrate compliance. We agree that these are all important hallmarks of an effective compliance program and we would put these in place in the ordinary course of our operations in order to comply with the Volcker Rule requirements.

However, we strongly believe that the requirements of section __.20(a) and (b) are *sufficient* to ensure that organizations like ours have appropriate compliance programs to comply with the Volcker Rule. The "programmatic" compliance requirements in Appendix C and the trading reporting requirements in Appendix A are unnecessary for organizations, like ours, that traditionally have not engaged to any meaningful degree in the types of proprietary trading activities that the Volcker Rule was intended to prohibit, or held substantial investments in hedge funds or private equity funds that would be prohibited under the Volcker Rule.[23] In fact, we maintain that requiring us to follow these proscriptive requirements goes beyond the standards the Agencies establish in section __.20(a). We do not believe that the detailed and extensive metrics in Appendix A and the proscriptive aspects of the compliance program in Appendix C are reasonably designed to establish compliance with the Volcker Rule at organizations like ours and we think those requirements go beyond what is appropriate for the size, scope and complexity of our organizations' activities.

a. **Threshold for Trading Assets Compliance Program Should be Increased to $10 billion.**

The proposal provides that any banking entity with average gross trading assets and liabilities of more than $1 billion must comply with the metrics in Appendix A and the compliance program as required in Appendix C.[24] We believe that it is entirely appropriate to raise this limit to at least $10 billion. We expect that the costs of establishing and maintaining the detailed and extensive "programmatic" compliance program required by Appendix C, and the trading reporting and recordkeeping requirements in Appendix A, will be substantial even for regional banking organizations that do not engage in the type of proprietary trading sought to be prevented by the Volcker Rule. Unlike the largest firms engaged in extensive trading activities, our organizations will not be able to spread the costs resulting from these compliance requirements over a large trading base. Accordingly, applying these extensive compliance requirements to entities like ours may have the unintended effect of encouraging more trading volume to migrate to the firms with the largest trading volumes.

Importantly, even if the dollar threshold were raised to $10 billion, an overwhelming percentage of the trading assets and liabilities in the banking industry would remain subject to the heightened compliance and reporting requirements of Appendix A and Appendix C. In fact, as the below chart illustrates, raising this dollar threshold to $10 billion would still capture banking organizations that control more than 98 percent of the total average trading assets, and

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[23] Proposed Rule at §__.7 and §__.20(c).

[24] *Id.*

more than 97 percent of total average trading liabilities, of all U.S.-based bank holding companies, commercial banks, and savings banks during this period (see chart below).

Combined Average Trading Assets and Liabilities for All Banking Organizations*

	Percentage of Combined Average Trading Assets of All Banking Organizations	Percentage of Combined Average Trading Liabilities of All Banking Organizations
Banking Organizations with Combined Average Trading Assets and Liabilities of **$10 billion or More**	98.21	97.60
Banking Organizations with Combined Average Trading Assets and Liabilities of **Less Than $10 billion**	1.79	2.40

* Source SNL Financial. Average trading assets and trading liabilities determined based on reported trading assets and liabilities reported as of September 30, 2010, and March 31, June 30, and September 30, 2011. Banking organizations include U.S. bank holding companies, commercial banks, and savings banks.

Actually, our data show that this would remain the case even if the Agencies raised the threshold to $15 billion, as there is no U.S. based bank holding company, commercial bank or savings bank that had average trading assets and liabilities in the $10 billion to $15 billion range over the quarter period ending September 30, 2011. We believe that the costs of requiring the proscriptive compliance regime on our organizations as would be required by the proposal greatly outweigh any potential benefits of those requirements given that such a small percentage of average trading assets and liabilities flow through our organizations. Although we appreciate that the Agencies have taken a tiered approach in mandating adherence to the requirements in these appendices, we think the statistics presented here provide powerful support for revising the tiering proposed by the Agencies. Accordingly, we respectfully request that the limit be raised to at least $10 billion.

b. Threshold for Compliance Program should Exclude Permissible Investments and Investments that Will be Terminated During Conformance Period.

As discussed above, we believe that the Agencies have the authority to determine that permissible public funds, *i.e.,* SBICs, LIHTC, NMTC, and HTC funds should not be considered a "hedge fund" or a "private equity fund" for purposes of the Volcker Rules. Should the Agencies not follow this approach, we believe that, at a minimum, the $1 billion threshold for being subject to the Appendix C compliance program for covered fund investments in §__.20(c)(2)(ii) should *not* include the amount of investments in, or assets of, these types of funds. Investments in, and sponsorship of, each of these types of funds are permitted by the statute itself[25] precisely because of the substantial public benefits associated with these types of

[25] *See* 12 U.S.C. § 1851(d)(1)(E).

investments and funds. Including these investments and funds in the dollar thresholds that trigger the programmatic compliance requirements of Appendix C, however, provides banking entities a powerful *dis*incentive to invest in or sponsor these funds if doing so could cause the organization to become subject to these burdensome requirements.

Moreover, investments in, and the assets held by, loan securitization funds also should not be included in these thresholds, consistent with the direction of section 13(g)(2) of the Bank Holding Company Act that nothing in the Volcker Rule shall restrict or limit the ability of banking entities to securitize loans.[26]

Finally, investments in, and relationships with, a covered fund that a banking entity is required by the Volcker Rule and the Agencies' implementing regulations to divest or terminate also should *not* count towards the dollar thresholds that trigger compliance with Appendix C. It makes no sense to apply the costly programmatic compliance regime mandated by Appendix C to investments in and other relationships with funds that will be divested or terminated. If this is the case, many banking entities are likely have to go through the significant expense of developing and implementing an Appendix C-compliant program only to terminate it once the statutory conformance period ends. Such a requirement would not give banking entities the benefit of the conformance period.

In a similar vein, we believe that trading activities in U.S. government obligations should not count toward the calculation of whether a banking organization meets the trading threshold triggering Appendix A or Appendix C. Congress recognized that the Volcker Rule prohibitions should not apply to this important activity and trading in obligations issued or guaranteed by a U.S. agency or government-sponsored enterprises, which include Fannie Mae and Freddie Mac, pose little risk to banking organizations. Moreover, we believe that other positions or transactions that are not "covered financial positions" and which may constitute trading assets or liabilities, such as loans, should be excluded from the thresholds for determining the applicable compliance regime. We see no reason why these exempt activities should have a bearing on whether an organization must implement a prescriptive compliance program. Doing so will serve as a disincentive to banking entities nearing the threshold to engage in such trading activities and, in the case of loans, may limit or restrict the ability of banking entities to sell or securitize loans in contravention of section 1851(g)(2) of the Volcker Rule.

c. **Compliance Program Requirements Should be Based on the Activities that Trigger Such Requirements**

Under the Proposed Rules, a banking entity that trips the thresholds for *either* trading assets and liabilities or covered funds activities must implement compliance programs for both covered trading assets and liabilities and covered funds. *This is the case even if the entity is below one of the thresholds.*[27] A banking entity that exceeds the thresholds established by the final rules for trading assets and liabilities, on the one hand, or covered fund relationships, on the other hand, should be subject to only those aspects of Appendix C that relate to the entity's proprietary trading activities or covered fund activities, respectively.

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[26] *See id.* at § 1851(g)(2).

[27] *See* Proposed Rule at § __.20(c)(2).

6. **Compliance Program Requirements Should be Consistent with the Divestiture Period**

The proposal requires banking entities to have in place all the elements of the required compliance program by July 21, 2012. We recognize that the statute has an effective date of July 21, 2012, but we do not believe the statute compels the Agencies to require banking entities to develop, approve through appropriate management, and fully implement complete compliance programs by that date. This time frame is not feasible given that the final regulations are, at best, not likely to be adopted until months or days before July 21st. Moreover, it is inconsistent with the conformance period granted by Dodd-Frank, which gives banking entities at least two years to bring their activities into conformance with the requirements of the Volcker Rule. We urge the Agencies to provide banking entities with at least one year after the final rules become effective to implement compliance programs.

7. **Definition of "Illiquid Fund"**

The statute provides an extended divestiture period (potentially out to 2022) for investments in "illiquid funds."[28] As both Senator Merkely and the Federal Reserve Board have recognized, the purpose of this extended transition or "wind-down" period for investments in an illiquid fund is to minimize disruption of existing investments in illiquid funds and permit banking entities to fulfill existing obligations to illiquid funds while still steadily moving banking entities toward conformance with the prohibitions and restrictions of the Volcker Rule.[29]

However, the definition of an "illiquid fund" in the proposal eliminates for all practical purposes the availability of this extended conformance period for virtually all of the pre-existing, legacy private equity and venture capital fund investments of banking organizations. Thus, the proposed rules will have precisely the effect that the extended transition period was intended to prevent—the forced liquidation at "fire sale" prices of legally acquired, pre-existing private equity and venture capital fund investments. [30]

Specifically, the Proposed Rules provide that, if a banking entity has the right to sell or redeem its interests in a fund with the consent of the general partner, the banking entity may not take advantage of the extended transition period unless (i) the banking entity uses all reasonable efforts to obtain the general partner's consent, and (ii) the general partner has denied such a request.[31] However, virtually all fund agreements permit a banking entity investor to sell its interests with the consent of the general partner, or request a redemption (subject to general

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[28] 12 U.S.C. § 1851(c)(3).

[29] *See* 156 Cong. Rec. S5899 (daily ed. July 15, 2010) (statement of Sen. Merkley); 76 Federal Register 8265, 8267 (Feb. 14, 2011).

[30] By contrast, hedge funds typically invest in stocks, bonds, derivatives and other investments that can be liquidated in an orderly manner over a relatively short time to meet redemption requests by investors. Consequently, the terms of hedge funds generally provide for a one-year lockup for a new investor, but otherwise allow investors to redeem their interests, in whole or in part, on a quarterly basis thereafter, subject to sufficient liquidity being available and subject to a hold back of some percentage of distributions pending the annual audit of the fund. With the exception of funds that have an illiquid or 'side pocket' investment that cannot be sold, banking entities should be able to dispose of their hedge fund interests by the end of the conformance period on July 21, 2014.

[31] *See* proposed 12 C.F.R. § 248.31(b)(3)(iii)(B).

partner approval) if continued ownership of the interest in the fund would violate a legal requirement applicable to the investor.[32]

The practical effect of this narrow interpretation of what may qualify as an "illiquid fund" for purposes of the Volcker Rule will force banking entities to divest their legacy investments in private funds in a rapid manner *before* the end of the general conformance period. Forced liquidations at depressed or even fire sale prices of legally acquired investments are inconsistent with the purpose of the Volcker Rule to foster the safety and soundness of banking organizations, and could result in unnecessary value transfer to the shadow banking system. Historically, the illiquid nature of private equity funds' investments and lack of a secondary market for investor interests in private equity funds combined to result in investor interests typically selling at a significant discount (15-30 percent) to their net asset value ("NAV") when sold in the secondary market. In the past, when a substantial number of private equity interests hit the market, the typical 20 percent or so discount to NAV rose, with buyers obtaining even more favorable pricing. Instead of preserving bank capital and insulating banks from harm that may result from fire sales, as Dodd-Frank intends, we are concerned that the proposal will result in banking entities incurring substantial, *actual* losses that could be avoided. For example, if fire-sales result from a narrow interpretation of the Volcker Rule's extended transition period for illiquid funds, banking entities could be forced to accept discounts of 50 percent or even more to NAV.[33] Forced liquidations of existing investments also will result in an increase to the cost of new equity financings for start-up and other companies that traditionally rely on venture capital or private equity funds for capital. This is because as the price of existing investments decline, and their risk-adjusted returns increase, the risk-adjusted returns on new financings also will rise to be able to compete for funding from capital sources.[34]

Thus, we believe the Agencies should take all necessary steps to ensure that banking organizations are able to take advantage of the statute's extended conformance periods for exiting investments in private equity funds. At a minimum, the Board should establish a presumption that a banking entity will be deemed to be "contractually committed" to remain invested in a legacy illiquid fund (and thus qualify for the extended transition period for an illiquid fund) if—

1. The banking entity has used its reasonable best efforts to exit its ownership interest in the fund, including requesting the consent of the general partner of the fund (where such consent is required) to transfer the banking entity's interest in the fund to another person and/or to withdraw from the fund; and

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[32] The standard disclosures given to investors in private equity funds reflect the illiquid nature of a private equity fund interest. Investors are informed that (i) there are no established trading markets for private equity fund interests and none is likely to develop and (ii) an interest in a private equity fund is illiquid and investors must be prepared to hold the investment for the life of the fund (typically 10-15 years). Indeed, the Federal Reserve Board's merchant banking rules reflect these concepts because investments in private equity funds are permitted to be held for the life of the fund, up to 15 years, notwithstanding that other merchant banking investments must be disposed of within 10 years.

[33] In the 2008-2009 depressed market, for example, sellers were having difficulty even finding buyers who would take a 'walk away' price (i.e., no payment to the seller but an assumption of the seller's obligation to make future capital contributions).

[34] *See* S. Hanson, A. Kashyap and J. Stein, "A Macroprudential Approach to Regulation," 25 Journal of Economic Perspectives at 5-6 (2011).

2. An unaffiliated general partner of the fund has—
    - Withheld its consent to a transfer by the banking entity of its ownership interest in the illiquid fund and/or withdrawal from the fund; or
    - Consented to a transfer or redemption of the banking entity's ownership interest in the illiquid fund, but only subject to conditions that--
        - Would cause the sale or transfer to not constitute an effective divestiture of the banking entity's ownership interest;
        - Would require the banking entity to remain liable for any unfunded commitment if the purchaser of the banking entity's interest fails to meet such commitment; or
        - Would require the banking entity to indemnify the fund for any breach of a representation or warranty provided by the purchaser of the banking entity's interest; or
3. The sale or redemption of the banking entity's ownership interest would violate a fiduciary duty owed by the banking entity to one or more unaffiliated persons; or
4. A person eligible to acquire the banking entity's ownership interest in the illiquid fund under the terms of the fund's governing documents cannot be located or offers to purchase the interest only at a "fire sale" price that is substantially below the net asset value of the interest.

* * *

The undersigned organizations appreciate the opportunity to comment on this proposal. If you have any questions regarding this letter, please do not hesitate to contact the appropriate representative listed in the attachment.

Sincerely,

The PNC Financial Services Group, Inc.
U.S. Bancorp
Capital One Financial Corporation
SunTrust Banks, Inc.
Branch Banking and Trust Company
Fifth Third Bancorp
Regions Financial Corporation
KeyCorp

cc: Jeremy R. Newell
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Written testimony of Martin R. Cole, President & Chief Executive Officer of the Andover Bank before the U.S. House Financial Institutions and Consumer Credit Subcommittee April 16, 2012

Madame Chair, Members of the Subcommittee, Congressmen:

Background
My name is Martin Cole. I am president of the Andover Bank. We are a state chartered community bank with 330 million dollars in assets. I have 105 colleagues in the bank. We operate eight branch offices. Seven of those branches are in Ashtabula County which borders Lake Erie and Pennsylvania.

I very much appreciate your coming to Ohio to hold this hearing and for your invitation to testify today. My theme will be the need to find the regulatory balance that best serves the public. My premise is that today's bank regulatory scheme, particularly for community banks, is very much out of balance seriously damaging both the industry and the communities we serve.

I will try to offer two perspectives of damaging distortion to the U.S. financial services marketplace.

Regulatory structure is inconsistent and outdated
Viewed from enough distance to gain perspective, it becomes apparent that our federal financial regulatory structure remains seriously flawed. A brief look at history may offer insight. At one time the average consumer or small business essentially had only one resource for financial services, a traditional bank or savings & loan. As a consequence, policy makers viewed banks as vital to the public's interest and Congress enacted a series of attempted safeguards. Deposit insurance and on-site regular examination provide two examples. It is important to recognize that banks pay the entire cost for both. The taxpayer does not pay a cent.

As we know though, the marketplace constantly innovates. Active regulation can block or slow innovation. If one path is blocked it will blaze another. It will invent more efficient delivery systems. Significant government costs for banks, both explicit and operational, pushed the marketplace to invent non banks to avoid those costs. The marketplace has radically changed. Our system of protecting the consumer has not kept pace. By failing to apply similar standards to functionally equivalent products and services, government effectively subsidized bank competitors.

This cost discrimination against banks continues. Let me give two examples. Under the new Consumer Financial Protection Bureau regime, banks will continue to pay for their examinations. On the other hand, the Federal Reserve is mandated to pay for supervision of those non banks the CFPB will regulate. Many of our competitors remain exempt from CFPB jurisdiction.

Another subsidized competitor is the credit union. My understanding is that Congress codified the exemption from federal and state taxation based on service to the economically disadvantaged. Yet today, Ohio's average credit union customer enjoys a family income substantially greater than that of the average bank customer. Credit unions are not subject to the Community Reinvestment Act and its requirement to meet the credit needs of low and moderate income communities. Credit unions argue they should not be taxed because they are non-profit. Mutual savings & loans are non profit. They are owned by their customers. Ohio has more mutual thrift institutions than any other state. They are taxed. Food and farm co-ops are taxed.

Importance of consistency

To evaluate the adequacy of our federal financial regulatory structure, you must consider the convergence of the larger financial services industry. Congress recognized that with the Gramm, Leach, Bliley Act. What Congress did not do then, and did not do in the Dodd Frank Act, is to establish the principal that functionally equivalent financial products and services should be similarly regulated. Simply put, bank supervision is far more intrusive and expensive to banks than government regulation is any of our non-bank competitors. My point is that competition is the best protection to the consumer if rules requiring fair treatment of customers are well crafted and if they apply equally to all competitors.

Let me try to reinforce the importance to the public of equivalent regulatory oversight with a painful Ohio example. In the years and months leading up to the collapse of the mortgage market and home prices, federal mortgage lending laws theoretically applied to mortgage brokers. But since here in Ohio they were unregulated, no one enforced the laws.

Those of you from Ohio know all too well the result. We suffered from rampant predatory lending as criminals and idiots slipped through the gap in enforcement. When Ohio belatedly decided to license brokers, its process included criminal background checks. As I understand the numbers, an estimated 2,000 brokers who had been operating never applied for licenses. Of the roughly 10,000 who did, 14% were found to have criminal backgrounds. It is worth noting that the announced non-bank focus of CFPB is big companies. These mortgage brokers were generally small but there were a lot of them and the wreckage the corrupt ones created was huge.

Bank examinations are too insular.

I am a community banker. My bank's primary marketplace is a single county. For my bank to prosper, my customers need to have jobs with a future and they need to see a quality of life in this county that makes them want to remain and help build our community.

Let me start with safety and soundness exams. As a small bank, my sustainable competitive advantage must be that I know my customers and my community. I know my customers' abilities. I know their histories. Thus I can safely make a loan that another bank, because of its distance from the customer has to rely solely on credit reports and

scores would rationally deny. Across Ohio there are thousands of successful businesses, some have grown large, that exist only because of the initial insights and hands-on help of a community banker. For that process to work, I and my colleagues must be skilled. Equally important, the regulatory process must allow us to use those skills in the exercise of informed judgment. Congress must not allow unnecessary, redundant rule or regulation to cripple my ability to respond quickly and efficiently to legitimate needs of my customers.

Today, what I hear from peers is they feel that bank examiners are not allowed to respect the judgment of skilled bankers. Perhaps examiners are reluctant to use their own judgment for fear of being criticized by their supervisors or by Congress. Whatever the cause, the consequence is that bankers face a barrier against working with struggling customers. I understand why it is attractive to an examiner to rely on objective evidence, for example a third party appraisal, to conclude a loan is substandard. We ask a lot of an examiner to look through a banker's eyes to judge whether a business can survive with a helping hand. However, when that does not happen we kill businesses that might otherwise survive.

Let me be clear that I believe the financial services industry should be regulated. I have enormous respect for my regulators, the Ohio Division of Financial Institutions and the Federal Reserve, and for their examiners who regularly come into my bank. Their job is very important and very, very difficult. Congress, bankers, and bank examiners share the same goal - a safe, sound bank serving its customers and community well. My bank examiner has an almost impossible job today. The system is broken. Forgive me for being blunt, but I believe some of the blame is Congress'.

Leading up to this economic crisis our country had a regulatory structure riddled with holes and inequalities. Dodd Frank has not fixed much and it is bringing me huge new burdens aimed at problems I didn't have. Moreover, the Congressional hearings probing the causes of the crisis had unintended consequences. While the banking agencies all made mistakes, most examiners in most cases did admirable work during extraordinarily difficult economic conditions.

Understand that sometimes, when a banker works with a troubled business that business still fails. However, if a regulator forces the bank to pull the plug when the bank thinks the business might be saved, it becomes certain that business will fail. When Congress fails to commend a talented regulator taking measured risks in the public's interest how can we fairly expect examiners to take any risk not matter how important to the public? Many examiners, despite the disincentives, deserve medals for working with banks to help their customers survive. I don't remember any examiner getting one.

One result of the mixed message Congress sends the agencies is inconsistent messages examiners give to banks. The regulators tell us to help our problem borrowers but then they classify performing loans because an appraisal shows lower collateral value.

Consumer Compliance Examinations

Let me turn to consumer services. As a community banker I will succeed or fail based on my reputation. I will also maximize my profit with a lifetime relationship with a customer. We work very hard at treating our customers fairly and in helping them make decisions that our best for them. We understand there are "bad guys" in the marketplace. The public does need consumer protections. However, for a smaller bank every change in the rules is expensive. Even a small change requires me to reprint forms and marketing materials, collect and destroy old ones, reprogram computers, and train employees. That's fine if the consumer gets a benefit that outweighs that cost. Far too often he or she does not.

Please understand how extraordinarily complex compliance has become. I'll offer just one example. We recently opened a new branch about ten miles across the county line. Being in Lake County means I now have to file Home Mortgage Disclosure Act reports. I wish I had understood that before I built that branch.

We had 72 HMDA reportable files audited. There are 25 fields per file which have to be reported. Consequently, there were 1800 fields which had to be completed. We work very hard to be careful and accurate. We are allowed a maximum of 7 errors total. The standard is 99.6% accuracy even if the mistakes have no negative impact. Failing that standard is very expensive because everything has to be re-filed.

Now consider that I have always had full, regular, on-site compliance examinations. Examiners have full access to my files. They look at applications, denials, and all the data I have on the applicant. Thus, they have everything needed to detect any discrimination. A HMDA report cannot include information that can prove illegal discrimination. Yet, I am required to file it because I built one branch. And now I am told I will have to geo-code my small business loans too. I have key people filling out reports instead of working with customers.

As a result of our last compliance exam and the onslaught of what we believe to be additional regulation coming, we have hired a full time compliance officer (about $60,000 with salary and benefits) plus we are paying a consultant $1200 per day for about 2 days per week to help us with compliance issues. We anticipate even more costs in the future.

We have been assured by "policy makers" at the Federal Reserve, Richard Cordray of the CFPB and even in the writings and speeches of Chairman Ben Bernanke, that they are "sensitive' to the concerns of the smaller community banking institutions and claim to recognize the difference in "how we do business" from the bigger financial institutions. They also claim to realize that we were not the cause of the "mortgage crisis". However, at the "field level" we are not experiencing the "sensitivity". The increasing burden is already crushing. It will drive smaller financial institutions to merge into larger organizations with the resulting loss of diversity and competition.

Loan evaluation system
The Ohio Bankers League, which represents Ohio banks and savings & loans from the smallest to the largest, operates on-line exam evaluation system. It is new. Its purpose is to provide useful feedback to the agencies to help them improve their procedures and training. The on-line system preserves banker anonymity to gain their candor.

Evaluations of recent exams should give us all cause for concern. 42% of the participating banks reported that their examiners were neither flexible nor were open to the exchange of views with their staffs. 13% reported examiners applied supervisory standards or economic assumptions that had not been shared with the bank prior to the examination. Less than half of the banks believed their examinations had resolved issues and recommended corrective actions in a "fair and reasonable" manner.

As one specific example, I highlight a complaint I regularly hear from other bankers. When a banker changes terms of a loan to help a customer recover, the result is the loan being classified as a TDR, which stands for temporary debt restructuring. Reserves are increased to recognize the possibility of failure. But when our efforts work, when the business or consumer gets back on its feet, the TDR classification today will still remain in place tying up money no longer needed in reserves and urgently needed in the communities we serve. It seems the regulators forget that the "t" stands for temporary. Consider the inconsistent message. Bankers hear "Work with your customers". Yet, they can be penalized if they do.

Financial Institutions Fairness and Reform Act
In closing I would commend two bills to your attention. The first is sponsored by the chairwoman and ranking minority member of this subcommittee, H.R. 3461. We are encouraged by its clear focus on timely, fair, effective examination. In the interest of time, I will comment on only two of its provisions: a new more practical mechanism to appeal examination decisions, and a requirement for timely feedback from examiners to banks.

Each of the bank agencies has made a good faith effort to create an appeal process to identify and overturn bad decisions in individual exams. Nevertheless, each is fatally flawed because its appeal process is entirely internal. Each regulator tells its banks we should not fear reprisal if we appeal. I am sorry but since the reviews are internal, we all do fear reprisal, and vitally important oversight does not take place.

Your proposed Office of Examination Ombudsman would create at least two significant benefits. It provides a process where reviewers are completely independent of the examiners. Reprisal against a whistle blower would be illegal. As a result, I believe bankers would be much more willing to file an appeal when one was justified. A better flow of information, and an independent review, will make exams better. This new ombudsman would create a mechanism to effectively detect and eliminate enforcement differences between agencies. It could identify and spread best practices.

I have read testimony by the regulators opposing this provision. I confess I find it a bit ironic that these agencies, which exist because of the importance to the public of independent review of the actions of banks, object to independent review of their actions.

The bill's provisions requiring timely reports of exam findings to banks are needed. I will provide an example of the problem. Dodd Frank transferred the supervision of the federal thrift institutions to the OCC. Working with a new agency, those exam reports are particularly critical to these banks, yet final reports often come six months or more after the examiners have left the bank. Thus a bank is left little time to learn from the final report findings before they face a new exam.

The Community First Act
And finally, while I understand that H.R. 1697's content is too diverse to be considered by a single committee, I would ask for your review of those provisions under your jurisdictions. We must get much more rigorous in detecting where redundant regulation or regulation designed for larger, more complex institutions severely harms the ability of a small bank to respond to the legitimate needs of its community. We need regulation tailored to help small banks use their strengths to serve their customers well.

I would like to conclude with a comment from the exam evaluation system. As I mentioned the system protects anonymity so I don't know who this banker is. However, many Ohio community bankers will identify with what he or she wrote.

"It would appear that the mandate is elimination of community banks. We were not responsible for the banking crisis. If anything we were responsible for working to help communities across the country survive it. One size cannot fit all. There must be common sense used when a community bank is examined. Our bank has never lost money nor had a deficient loan loss reserve. We are not perfect but we have an experienced management team with a history of taking care of the communities we serve. We along with similar community banks do not deserve 'gotcha' examinations. We should be able to see our regulators as partners not adversaries."

In closing, I want to specifically thank Congress for raising the shareholder threshold for being considered by the SEC a public company. That single change will make it far easier for smaller banks like mine to raise capital in the future. We are at 460 shareholders. We have individuals on a list that would like to buy our stock. We can now proceed with capital expansion plans without fearing additional costly regulatory requirements.

I am grateful for your interest in Ohio and its communities. I would be happy to respond now or in the future to any questions you might have.

Date: *Monday, April 16, 2012*

Hearing: *An Examination of the Challenges Facing Community Financial Institutions in Ohio*

Hearing Host: *The Subcommittee on Financial Institutions and Consumer Credit*

Planned Testimony: *Steven H.O. Fireman, President and General Counsel of the Economic and Community Development Institute*

On behalf of the Board of Directors and staff of the Economic and Community Development Institute, welcome to Ohio. Thank you for hosting this conversation regarding the challenges faced by Ohio's community-based financial institutions.

The Economic and Community Development Institute (ECDI) is a 501(c)3 nonprofit economic development organization, a U.S. Small Business Administration intermediary microlender, and U.S. Treasury designated Community Development Financial Institution (CDFI). **Since 2004, ECDI has made $10.5 million in loans to around 550 local, small businesses in Central and Southwest Ohio, creating or retaining 1650 jobs.** Because of its success in Central and Southwest Ohio, ECDI was recently approached by funders and stakeholders in Cleveland, and asked to expand its microenterprise development services to Northeast Ohio. The organization will open a branch office in Cleveland in July 2012. In addition to filling a gap in the credit industry by offering loans ranging from $500 to $100,000 to small local businesses through its revolving loan fund program, ECDI addresses the needs of very small business owners in the creation and expansion of small businesses. Our programs provide valuable services to entrepreneurs, including small business development training, one-on-one technical assistance, and industry specific training and access to markets through the Growing Entrepreneurs Initiative business incubation program. Every business and job created or retained equates to state and local tax dollars. In addition, ECDI has brought millions of federal dollars into the local economy in the form of loans and grants, and has helped keep those dollars circulating locally through small business capitalization.

Challenge #1: Keeping up with Demand for Capital

In the United States, small businesses "employ just over half of all private sector employees, pay 44% of total U.S. private payroll, and have generated 64% of net new jobs over the last 15 years."[1] In Ohio, as of 2008, the microenterprise sector, a subset of the small business sector defined as employing 5 or less employees, made up 87.95% of all businesses and accounted for 21.1% of all total nonfarm private employment. [2] This sector has been and will continue to be integral to the country's economic recovery.

[1] http://www.lendio.com/blog/visual-funding-infographic/; accessed on 10/24/11
[2] http://aeoworks.org/images/uploads/pages/US-MEBS-2008%20rev.pdf, http://aeoworks.org/images/uploads/pages/US-MEES-2008%20rev.pdf; accessed on 10/25/11

While there is room to increase the number of microenterprises and to ultimately create new jobs and tax revenue in Ohio, there is a financing gap that few local community economic development organizations have the capital or capacity to address. According to a recent report titled *Cuyahoga County Microcredit Supply and Demand Analysis,* in Cuyahoga County MSA alone, "there is an estimated $38 million of unmet loan demand in the County that isn't being provided by commercial banks."
This financing gap for small businesses is a national problem, visually articulated in an Infographic article *A Visual Look at Funding – Comparing Equity vs. Debt Financing,* which says that 62% of small businesses would be unable to qualify for a bank loan right now." Since the economic downturn in 2008, the small business sector has found it difficult to obtain financing from traditional sources. Banks have tightened their credit standards and have become less likely to lend in amounts under $250,000. To make matters even more difficult, alternatives to small business lending such as home equity or lines of credit are no longer viable options due to the collapse of home values.

As one of the few microlending organizations in Ohio, these factors have lead to an increased demand for ECDI's small business loans. As a young and dynamic organization, ECDI is committed to scaling up to meet the increasing demand it is facing for its financial products. Since FY 2009, ECDI has demonstrated consistent and dramatic growth the amount of loan capital disbursed and businesses served. ECDI funded $1,456,578 in loans to 97 clients in FY 2009, and $1,760,719 to 86 clients in FY 2010. In FY11, ECDI disbursed $2,409,118.16 in loans to 85 clients, showing consistent year-to-year growth. In addition to seeing increased demand in our Central Ohio market, ECDI has expanded its service area from 7 counties at the beginning of 2009 to 49 counties currently at the request of stakeholders including the SBA, Ohio Department of Development, and The Cleveland Foundation.

This surge in demand for small business loans as well as the geographic expansion has caused two challenges for ECDI. The first challenge we have faced is keeping up with a demand for capital. At the end of 2010, ECDI's loan funds were nearly 100% deployed. We knew that if we were going to keep up with the demand for loan dollars, we not only needed to maintain our current sources of federal, local and private capital, we would also have to find new dollars to lend. ECDI faced this challenge head-on by creating an investment instrument approved by the Ohio Securities Commission called Invest Local Ohio. Invest Local Ohio gives community members the opportunity to invest in small businesses by investing in ECDI. Every dollar invested in the Invest Local Ohio fund is loaned to an Ohio small business and leveraged with at least two more dollars from other existing ECDI loan funds. ECDI investors receive a 2% return on their investment if they sign a 3 year note and a 3% return on a 5 year note.

Challenge #2: Keeping up with Demand on Capacity

The second challenge caused by increased demand for small business loans relates to capacity. In addition to outreach, assessment, training, underwriting, processing and servicing loans, ECDI's model differs from banks in that we commit to provide ongoing technical assistance to our portfolio clients beginning with loan application and continuing throughout the life of the loan. This is critical in building successful business and, therefore, proactively working with clients to keep a healthy portfolio. This is also costly. As an SBA intermediary microlender, ECDI receives a yearly allocation of technical assistance funds to spend time with clients on building strong businesses. This is valuable, but 75% of the funding is restricted to working with clients only after the loan is closed. Not only is there a huge compliance-related burden associated with allocating and tracking staff time, very little of the SBA technical assistance allocation is able to be used to work with a potential loan client before the loan is closed and none of the funding is able to be used for general loan administration such as underwriting, processing, servicing, and collections.

Challenge #3: Unpredictability of Federal Funding

The demand for capital has surged, and ECDI's portfolio has consistently grown. Because we have a track record of impact in the form of business and job creation, we have been fortunate to remain competitive on a national level and, therefore, maintain federal support from the SBA, U.S. Treasury, and several Health and Human Services-funded programs. Because of the competitive nature of this funding, ECDI is forced to reapply for federal dollars on a regular basis. U.S. Treasury CDFI funding, in particular, requires a yearly reapplication process. While we understand the importance of competition in ensuring that federal dollars are being used effectively and efficiently, we want you to understand that the unpredictability of this funding makes it difficult to budget, plan, and scale our operations.

On a local level, since its inception, ECDI has experienced tremendous and consistent local support through City and County Economic Development departments, funded by federal CDBG dollars. Since 2009, this funding has been reduced in an effort to balance the federal budget. To date, our track record has been strong enough to maintain local support, but we know that we cannot count on this support to continue if the CDBG budget continues to experience significant cuts.

Challenge #4: Traditional Philanthropy Does Not Understand the Importance of Supporting Small Business Development

Philanthropic communities are not wired to think about small business development as a viable target for their dollars. According to a report from the Foundation Center entitled "Spotlight on Economic Development Grantmaking in Ohio," although the amount of dollars granted for economic development initiatives by foundations in Ohio increased by 152% between 2005 and 2008, grants specifically targeted toward Small Business Development decreased by a third. The vast majority of funding was directed toward employment and training services. The Cleveland Foundation has taken a lead in both advocating for and funding microenterprise development initiatives in Northeast Ohio, and Invest Local Ohio is serving a dual purpose of raising awareness about the importance of supporting local small businesses, but there is still work to do in this area.

Challenge #5: Limited Support from State Economic Development Initiatives

Just as traditional philanthropy is not wired to understand the importance of small business development, the majority of Ohio-sponsored economic development initiatives aren't wired to understand the importance of microenterprise development. Instead, they focus time and money on traditional economic development, such as attracting and retaining large corporations. The start-up initiatives that the State does put money into, such as Ohio's Third Frontier program, benefit the high-growth technology sector. While this type of economic development is valuable, it neglects a large portion of Ohio's potential employers – small businesses that employ 5 or less employees. In recent years, businesses employing 20 employees or less have been responsible for 100% of net-new job creation. According to "The Small Business Economy: A Report to the President":

> "During these two past recessions [1990-1991 and 2001], firms with fewer than 20 employees were the only ones with positive net job growth; the larger category of small businesses with fewer than 500 employees, as well as large firms with 500 or more employees both experienced net employment losses"[3]

[3] "The Small Business Economy: A Report to the President," Small Business Administration, see http://archive.sba.gov/advo/research/sb_econ2009.pdf; accessed on 4/12/12

Without continued federal support and education on the state level, microenterprises will not have the opportunity to create the jobs that they have the potential to create.

As you can see, with each challenge, ECDI has looked for creative ways to continue to meet the capital demands of Ohio's entrepreneurs. Thank you for the opportunity to communicate the challenges we face in serving small businesses. I hope that this testimony is useful as you return to Washington and continue to do the work of shaping legislation that drives the economic recovery.

U.S. House Financial Services Committee
Financial Institutions & Consumer Credit Subcommittee Field Hearing
Cleveland, Ohio
April 16, 2012
G. Courtney Haning
Opening Statement

Introduction

My name is G. Courtney Haning, and I am the Chairman, President & CEO for the Peoples National Bank, in New Lexington, Ohio. I am also currently the Chairman of the Ohio Bankers League and I am here today speaking on behalf of OBL and our member institutions. We thank you madam chair for bringing this hearing to Ohio and making a special effort to gather information on the state of banking in the nation's heartland.

The OBL represents the interests of Ohio's commercial banks, savings banks, savings associations as well as their holding companies and affiliated organizations. We have over 200 members, which represents the overwhelming majority of all depository institutions doing business in this state. OBL membership represents the full spectrum of FDIC insured depository institutions, from small mutual savings associations, community banks that are the quintessential locally owned and operated businesses, up to large regional and multistate holding companies that have several bank and non-bank affiliates conducting business from coast to coast. Ohio depository institutions directly employ more than 130,000 people.

The Role of Community Banks

I am proud to be a community banker, and today I am here to focus particular attention on the challenges of this segment of banking. While larger financial institutions care about their customers, they do not share the same vested interest in an individual community that I do. That doesn't make big guys bad. It does mean community banks bring a special focus to economic redevelopment in our communities. In many cases we are the only economic engine in our local communities. As a community bank I also have a vested interest in the economic and social health of my local market. If my customer cannot find a good job in my community and leaves, I cannot follow him. So my bank's operations must closely align with local needs.

Like many community banks, my expertise and my competitive advantage is that I am close to my customers which gives me added insight into both their needs and their ability to repay. This extra insight means I can make more loans safely than my bigger, more distant competitors that are more reliant on mathematical models. Many successful small businesses in Ohio, including those that have grown to be large, started with a close call on a loan, made by a community bank which could say yes safely because it knew its customer very well. Unfortunately, this ability to exercise good judgment based on local market knowledge is being threatened both by recent regulatory burdens heaped on banks by Washington, and by inconsistent decisions made by our regulators.

The Challenges Facing Community Banks

New & Growing Regulatory Burdens

Most banks here in the Midwest did not participate in the underwriting practices that contributed to the recent recession. Sadly however we are paying for the mandated solutions through additional regulatory burdens, anxious examiners and customers that are not willing to borrow to grow their businesses. These remedies are hitting all segments of our financial statements: our costs are going up, our opportunities to earn revenue providing services our customers want have been curtailed, and both the amount and cost of capital we need to operate in a safe and sound manner is increasing.

I know that your subcommittee has heard a great deal over the past several months about the issue of "to big to fail." That is an important economic problem that is worthy of your attention, however today I would like to talk about the flip side of that issue. My colleagues and I spend more time worrying whether under the new environment we have become "too small to survive." When we see the cumulative effect of new regulations and new exam procedures, those of us that have dedicated our career to bringing financial services to small towns and rural areas are concerned if national policy makers understand that smaller banks don't have the same resources to bring to bear on compliance as the big regional and multistate banks. Let me give you a few examples.

Let me use the recently adopted price controls on debit cards as an example of the problems we face. I know the intent of Dodd – Frank was to exempt community banks from the rule that set a price below my cost of providing this service, however, the retailer will get to choose the transaction processor. Processors competing for business will drive down the price all debit card issues are paid, so in the real world, the exemption will not work. Community banks are already seeing interchange revenue decline. This is income we have spent on benefits we hope will attract customers, such as free checking, convenient branches and more ATMs. Now my debit account income will be far less than my expense. Since Home Depot and other Fortune 500 retailers are telling financial analysts my loss will translate into millions in an annual windfall profits to its shareholders, I truly doubt that consumers will ever see a benefit from this government intervention in the marketplace.

There are also numerous new recordkeeping burdens that will be heaped on banks in the coming months, but I will highlight only one for you today. Under the rules as currently proposed by the SEC, banks will have to register as municipal advisors just to provide the same deposit and loan services we have traditionally provided to local governments. The goal of the underlying statute was to provide some oversight for advisors that fell in gaps between bank and securities regulators, not provide additional oversight to already regulated financial institutions. Yet the rules proposed by the SEC will add to our overhead, without providing additional protections for consumers. It sometimes seems like the right hand doesn't know what the left hand is doing.

Another example of regulatory overkill is the new overdraft protection rules. Last year, the Federal Reserve, FDIC and OCC all drafted their own guidance and rules to regulate overdraft protection programs. Many banks incurred significant costs developing new forms, operating systems and disclosures not to mention the new training necessary to create an opt in requirement to give consumers a well informed choice regarding this service. Customers have complete control over this service and can revoke their opt in decision at any time. Yet, CFPB has initiated new inquiries into these same programs. This will lead to additional rules and compliance costs. I am worried it could lead to price controls or an arbitrary limit on the number of transactions permitted.

Evolving Exam Standards

Examiners have a hard job that is made even more challenging in difficult economic times. Most are diligent and professional about the way they approach their responsibilities. Yet there can be no doubt that there has been a change in the way examiners in the field are approaching their job. Examiners are becoming more rigid in their approach, leaving less room for judgment by the local community banker. This is particularly detrimental for local bankers, because as I mentioned previously, our competitive advantage is our knowledge of that local marketplace and local borrowers. If the examiners take away that flexibility through a one size fits all approach, it will handicap our ability to compete.

Let me give you an example to illustrate how the best of intentions can go wrong in the real world and community banks are left with the costs and consequences. Community banks in Ohio are committed to non discriminatory lending; however examiners have become more ridged in the interpretation and application of fair lending laws. Community banks have been forced to defend themselves against charges of racial discrimination based on statistical analysis alone. Let me assure you, the last thing a bank wants to do is violate fair lending standards. Not only is there the risk to our reputation, but any deviation from standards will lead to a referral to the Department of Justice.

Once a referral is made, it seems like the bank is guilty until proven innocent. Referral will freeze any pending applications, causing regulatory limbo until the case is resolved, which can take months. In addition, the community bank will have to hire the enormously expensive outside experts necessary to refute an accusation of discrimination.

While fighting discrimination is an important goal of government, let me tell you the ramifications of the current regulatory regime. We are very hesitant to loan to long time customers if they do not qualify based solely on objective criteria such as their credit scores or their debt-to-income ratio. Some of these customers have had a long term relationship with the bank, but now everyone has to fit into a box. If a customer doesn't fit yet we approve the loan, that borrower will become an exception. If we make an exception, we create an outlier and must justify the reasons for making the loan and our examiners will want to see similar exceptions for outliers in a protective class, or the bank risks the dreaded referral to the DOJ. The result? There is a real chilling effect, so bankers are tempted to stop making exceptions. This takes away one of the key

advantages of being a community banker. All banks are different and all customers are different: it does a great disservice for examiners to create a one-size-fits-all box for us all to live in.

Continuing Pressure from Tax-favored Competitors

As a representative of all Ohio banks, I have to take a brief moment to mention the continuing concerns we have regarding the efforts of the credit unions to expand their commercial lending authority and to sell additional capital to the public: in short, become more like banks, without taking on the responsibility of paying taxes.

HR 1418 will permit credit unions to invest up to 27.5% of their assets in commercial loans *in addition to* the SBA loans and loans of less than $250,000 neither of which would even count against the cap. If enacted, there will be credit unions that will evolve into institutions that exclusively make commercial loans. As a policymaker, you have to ask yourself if that was the rational behind making all credit unions tax free.

We are not sure why credit unions even need this legislation at this time. They routinely evade the current 12.25% cap that is in place today by using credit union service organization to participate out just enough of the loan to comply with current law.

I know this isn't the focus of your hearing, but you need to be aware that this is becoming an issue of survivability for those community banks that are trying to do business in the shadow of the large credit unions that bring millions of dollars of capital to the marketplace and are supported by huge advertising budgets. We will compete against anyone, but it is difficult when our competitors have a 40% cost advantage as a result of a free pass on federal income taxes and state franchise taxes. Whether or not it has made a conscience choice, if Congress chooses to expand credit union powers without addressing the tax advantage, it will be choosing winners and losers in the marketplace.

What Congress can do to help

First, I would like to thank you for introducing HR 3461 to restore consistency to the bank examination process. We would encourage you and your colleagues to follow through and see that the good ideas in that proposal become law. I believe bankers and examiners still want the same thing: a healthy, vibrant, competitive banking system. The Financial Institutions Examination Fairness and Reform Act help both parties achieve that goal.

Finally, I hope your committee will also consider HR 1697, the Communities First Act. This bill contains numerous good ideas that merit your careful review. Even if this bill is too large or diverse to be considered in its entirety, we hope the best ideas can be considered and adopted as amendments to other pending House bills. Issues that would result in immediate savings to your constituents include the following:

- An amendment to the Sarbanes-Oxley Act of 2002 to exempt depository institutions smaller than $1B from the annual management assessment of internal controls requirements;

- An amendment to permit certain insured depository institutions smaller than $10B to submit a short form report of condition; and
- An amendment to the Equal Credit Opportunity Act to exempt certain businesses with less than $1B in assets from a mandatory collection of business data;

Conclusion

I sincerely appreciate the opportunity to testify here today and I would like to thank members of Congress and their staff for coming to my home state to gather information on issues of vital importance.

Banks have served this country well and will continue to provide a significant engine for economic growth and job creation if we are allowed to perform without excessive regulatory burden or inconsistent examination oversight. We would urge the House of Representatives to continue on the path they started at the beginning of the 112th session of Congress. Hold bank regulators, including CFPB, accountable for the cost of compliance and ensure the layers of regulation do not accumulate to the point where it is no longer feasible for community banks to continue to serve their local markets.

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