H.R. 1697, THE COMMUNITIES FIRST ACT

JOINT HEARING

BEFORE THE

SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT

AND THE

SUBCOMMITTEE ON CAPITAL MARKETS AND GOVERNMENT SPONSORED ENTERPRISES

OF THE

COMMITTEE ON FINANCIAL SERVICES
U.S. HOUSE OF REPRESENTATIVES

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Wednesday, November 16, 2011

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H.R. 1697, THE COMMUNITIES FIRST ACT

Wednesday, November 16, 2011

U.S. House of Representatives,
Subcommittee on Financial Institutions
and Consumer Credit, and
Subcommittee on Capital Markets and
Government Sponsored Enterprises,
Committee on Financial Services,
Washington, D.C.

The subcommittees met, pursuant to notice, at 2 p.m., in room 2128, Rayburn House Office Building, Hon. Shelley Moore Capito [chairwoman of the Subcommittee on Financial Institutions and Consumer Credit] presiding.

Members present from the Subcommittee on Financial Institutions and Consumer Credit: Representatives Capito, Renacci, Royce, Pearce, Westmoreland, Luetkemeyer, Huizenga, Duffy, Canseco, Grimm; Maloney, Watt, Hinojosa, Baca, Scott, and Carney.

Members present from the Subcommittee on Capital Markets and Government Sponsored Enterprises: Representatives Garrett, Schweikert, Royce, Neugebauer, Pearce, Posey, Fitzpatrick, Hayworth, Hurt, Grimm, Stivers, Dold; Waters, Sherman, Hinojosa, Perlmutter, Donnelly, Carson, and Green.

Ex officio present: Representative Bachus.

Also present: Representative Fincher.

Chairwoman Capito. This hearing will come to order.

And I would like to alert Members that we are expecting a series of votes around 5:00. I am not certain we will be here that long, but it is my intent to finish the hearing before we go for votes. If that is not possible, we will have to resume this hearing after the last vote, but I think we can manage this.

H.R. 1697 is a large bill. It has been referred to not only the Financial Services Committee but also the Ways and Means Committee and the Agriculture Committee. Today's hearing will focus on the sections of the bill that are relevant to the Financial Services Committee.

I would like to thank Chairman Garrett for co-hosting this hearing with me. He is the chairman of the Capital Markets and Government Sponsored Enterprises Subcommittee, and this bill has been referred to his subcommittee as well. I would also like to particularly thank Mr. Luetkemeyer for offering the bill before the subcommittee today.

The Communities First Act is a thoughtful attempt to reduce regulatory paperwork and tax burdens on small financial institutions across this country.

Mr. Luetkemeyer has been a terrific advocate for his constituents with his service on the Financial Institutions and Consumer Credit Subcommittee. And his experience as both a banker and a bank regulator before becoming a Member of Congress allows him to provide critical insight into matters before the subcommittee, and I value his insight. I commend him on the good work he has done in drafting this legislation and for tackling the issue of regulatory relief for small financial institutions.

Over the last 10 months, this subcommittee has heard testimony and anecdotal comments from community bankers from across the country, and one constant theme has been the increased regulatory burden on our community banks. The recent financial crisis did not emanate from small financial institutions, yet these same institutions are having to devote more and more resources to comply with the ever-growing regulatory burden facing small financial institutions.

During the first hearing of the Financial Services Committee this year, a community banker from West Virginia raised this question: "How can I be out in my community helping individuals improve their quality of life or helping small businesses grow if all I end up doing is dealing with the aftermath of problems that I did not create?"

This raises an important question. In order for our community to get back on track, we need to have small financial institutions lending to small businesses in our communities. However, if small financial institutions are forced to devote more and more resources to comply—which they say they are—with Federal regulations, then they have fewer resources to devote to lending in their home communities.

The bill before the committee today raises a number of issues that are facing small financial institutions across the country, and I look forward to hearing from our witnesses to learn more about their thoughts or concerns on the Communities First Act.

At this point, I would like to recognize Mrs. Maloney, the ranking member of the Financial Institutions and Consumer Credit Subcommittee, for the purpose of making an opening statement.

Mrs. MALONEY. I thank Chairwoman Capito and Chairman Garrett and also Ranking Member Waters for working on this hearing. And I certainly welcome all of the witnesses and look forward to your testimony.

I certainly understand that small institutions are concerned about regulatory burden and their ability to comply with regulations while still being able to provide their customers with a wide range of services, most importantly lending. We know how important small bank lending is to small communities or to any community, to businesses and to helping businesses grow and create jobs.

And there are some things in this bill that I can support. For example, the bill strikes annual privacy notices and would only require them when a bank shares consumer information. I think that is something we can all agree would reduce paperwork burdens on small banks.

However, many of the provisions in this bill are provisions that were enacted in the wake of financial accounting scandals such as Enron, and in the wake of certainly the worst economic crisis in my lifetime. Provisions such as the Sarbanes-Oxley 404(b) exemption increase, the shareholder threshold for banks that trigger SEC registration, the SEC cost-benefit analysis provision, and the Financial Stability Oversight Council (FSOC) review standard provision are all things that the Financial Services Committee is examining separately in separate bills.

I certainly would oppose, as I have on the Floor and in this committee previously, the provision that would lower the threshold for the FSOC to veto a Consumer Financial Protection Bureau (CFPB) rule. The Consumer Financial Protection Bureau is the only regulatory entity whose rules are subject to review in this matter, and the threshold should be high for that review.

I am also concerned, as is the FDIC, about Sections 205 and 206, both of which would have the effect of allowing smaller institutions to hold less capital and to delay the ability of the FDIC to work with these institutions before the situation becomes more difficult. They see this as a possible threat to their power to prevent economic downturns and to preserve the safety and soundness of our financial institutions.

I believe that these provisions, in some cases, fly in the face of our efforts to make our markets more transparent and accountable to the public and to secure our financial institutions and to strengthen their capital reserves. Many say that we had this downturn because we did not have strong capital reserves, that we did not have strong transparency and oversight. I understand that both of these provisions are written as studies in the Senate version of the bill, and I think that is probably a wise direction to move in.

I know that these two sections are top concerns for the FDIC, and there are a number of other provisions in the bill that I hope we can explore today that I am concerned with. So I also look forward to the witnesses' testimony.

I yield back the balance of my time and I thank you for what you are doing every day to help our financial institutions to get capital out to people who need it and to grow our economy.

Thank you.

Chairwoman CAPITO. Thank you.

I would like to recognize Chairman Garrett for 2 minutes for the purpose of making an opening statement.

Chairman GARRETT. I thank the gentlelady. And I thank the gentlelady for her leadership on this issue, as well.

I thank all the members of the panel that we are about to hear from shortly.

I also would like to turn my attention to Congressman Luetkemeyer and thank him, as well, for his efforts on this legislation and for being here today.

He has been an outstanding addition to our committee and to this Congress, as well. We are blessed to have him because of the experience that he brings in a couple of different fronts, both in the banking industry per se and on the regulator front, as well. So you might say that he is uniquely positioned, I guess, to be leading the charge in putting together this important legislation that we are dealing with. And that is, as we say, dealing with perhaps the overregulation of our financial services industry, particularly the smaller, community-based institutions, those who are particularly ill-affected by the legislation that has come recently.

Whenever Congress has an opportunity to review ways to reduce the regulatory burden on financial institutions specifically or businesses in general on Main Street, I think that is a good thing. It is an even better day if we are also looking at ways to facilitate small business capital formation, which is another way of saying, trying to create jobs.

So, again, I congratulate the Congressman for his legislation, for this bill, and I look forward to what will probably be a lively discussion in the area of financial institution regulation.

I yield back.

Chairwoman CAPITO. Thank you.

I would like to recognize Mr. Carson for 1 minute for the purpose of making an opening statement.

Mr. CARSON. Thank you, Madam Chairwoman.

During the recess last week, I had the opportunity to meet with my local community bankers in Indianapolis. We discussed how economic conditions are still very weak, with few positive trends in the residential housing recovery and employment growth. While low interest rates and an unprecedented Federal stimulus has had some positive impact, it has not resulted in anticipated economy growth. I am interested in how H.R. 1697, the Communities First Act, will help community banks foster economic growth and better serve their communities.

However, I believe missing from this discussion is the commercial real estate crisis on the horizon. This is an incredibly difficult challenge, with many negative consequences on communities, small businesses, and individuals. Many commercial real estate loans are underwater, vacancy rates are up, and rents are down, further driving down the value of these properties.

If there is a collapse in the market, our community banks will be particularly vulnerable. As we discuss helping our community banks lend again, let us not forget that there are still challenges on the horizon that pose tremendous risks to the financial system and the public.

Thank you, Madam Chairwoman. I yield back the balance of my time.

Chairwoman CAPITO. Thank you.

I would like to recognize Mr. Westmoreland for 1 minute for the purpose of making an opening statement.

Mr. WESTMORELAND. Thank you, Chairwoman Capito and Chairman Garrett. And I also want to thank Mr. Luetkemeyer for his efforts.

The burden on small banks and credit unions is growing larger every day. The cost of complying with regulation is a thorn in the side of small banks. Small banks need to focus on two things: lending and deposits. Instead, they have to focus half of their time and money on compliance. We need to get rid of some of these wasteful regulations so businesses can get back to work.

Georgia leads the Nation in bank failures, with 73. This bill won't bring back those failed banks, but it will throw a lifeline to those struggling to survive. And I urge all my colleagues to join me and help pass H.R. 1697.

I yield back the balance of my time.

Chairwoman CAPITO. Thank you.

I would like to recognize Mr. Scott for 3 minutes for the purpose of making an opening statement.

Mr. SCOTT. Thank you, Madam Chairwoman. And I certainly want to congratulate you and our ranking member for holding this hearing. It is very important.

Our banking community has just gone through a devastating period. I don't think—not since the Great Depression have we had so many bank failures, and we have had a tremendous problem. And nowhere has that been greater than in my own home State of Georgia, as my colleague, Congressman Westmoreland, has just mentioned. We lead the Nation in bank failures, and a lot of this is due to the housing bubble and the overleveraging of the portfolios into real estate.

But we can learn from this that we must move very quickly to address this area. Our community banks and our credit unions, quite honestly both of these, are at the front lines. They are the ground troops; they are in the pits there. They are the ones that we have to make sure are equipped to do the job of helping to bring our struggling economy around and our community banks around.

This legislation we have under discussion today will provide regulatory relief for community banks, and we need that. The bill would reduce certain reporting and paperwork requirements for many of these smaller institutions, and we definitely need that. In the current economic climate, community banks have struggled. They have struggled to comply with very stringent regulatory and accounting requirements that need to be addressed, and we need to find relief for them.

And as I mentioned, in my home State of Georgia we have just had, just this year alone, our 23rd bank was closed this year. Nationwide, 88 banks have failed this year alone, making it apparent that Georgia's community banks have suffered disproportionately when compared to the national scale.

It is for this reason I work with my colleague. Mr. Westmoreland and I have put forward House Resolution 2056, which this House passed, which instructs the FDIC to study this problem and make recommendations and find ways we can get help down to our community banks. And I take this opportunity to urge the Senate to move forthrightly and get this badly needed piece of legislation promptly passed.

However, the legislation at hand today would provide relief for smaller banks, many of whom resemble the very institutions that have recently been forced to close under tremendous financial strain. I agree that Congress should act to provide targeted relief to small banks that will prevent further failure. And I will be interested today to find out how this measure will benefit the institutions; what effects, if any, that this legislation could have on customers, many of whom are part of the over 10 percent of the population of Georgia who are unemployed and rely on these banks, many businesses who rely on being able to get small loans from this business.

So it is a very important hearing. I look forward to it. And thank you very much, Madam Chairwoman.

Chairwoman CAPITO. Thank you.

I would like to recognize Mr. Luetkemeyer for 2 minutes for the purpose of making an opening statement.

Mr. LUETKEMEYER. Thank you, Chairwoman Capito, and thank you, Chairman Garrett, for holding this hearing and for your very kind remarks leading into the hearing here.

Every day, community banks help Americans realize their dreams. That mission is becoming more and more difficult for our Nation's smaller financial institutions. Regulatory requirements disproportionately burden community banks that do not have the resources necessary to comply.

I introduced the Communities First Act to help community banks and other financial services entities foster economic growth and serve their communities by giving targeted relief to these institutions and their customers. Some are concerned that this legislation is too broad and tries to do too much. The simple truth of the matter is that the legislation must be broader in order to save our community banks.

Across the Nation, community banks are consolidating or closing, not based solely on the weak assets or balance sheets, but because they simply cannot afford to operate in the current regulatory environment. The number of provisions put in this bill is a reflection of the amount of regulation that has been piled on community banks.

Despite the fact that community banks were not part of the financial crisis, they have been dragged in as part of the solution. The regulations that have come out of Congress and this Administration are crushing small businesses, including banks.

I am proud to have more than 50 of my colleagues on both sides of the aisle, 13 of whom sit on this committee, as co-sponsors of H.R. 1697. This legislation is supported by the Independent Community Bankers of America and the National Bankers Association. The bill also has the support of more than 35 State banking groups, including both the Missouri Bankers Association, represented here today by Mr. John Klebba, as well as the Missouri Independent Bankers Association.

Madam Chairwoman, I seek unanimous consent to enter into the record a letter of support from the Missouri Independent Bankers Association.

Chairwoman CAPITO. Without objection, it is so ordered.

Mr. LUETKEMEYER. Thank you, Madam Chairwoman.

It is essential that our community banks continue to have the ability to attract capital, support the credit needs of their customers, and contribute to the local economies. Instead of inhibiting their ability to operate, it is time for Washington to work with community banks.

Thank you, Madam Chairwoman, and I yield back.

Chairwoman CAPITO. Thank you.

I would like to recognize Mr. Royce for 1 minute for the purpose of making an opening statement.

Mr. ROYCE. Thank you, Madam Chairwoman.

Recent projections, as we look forward to 2020, show that we are going to have half the current number of community banks. And I guess we would all expect some consolidation if you are going through a recession, if you are going through an economic downturn. But many of the problems faced by these institutions are, frankly, induced here in Washington, D.C., because it was Washington that gave them the hundreds of new regulations in Dodd-Frank; it was Washington that decided to enact price controls on interchange fees and limit a critical revenue source for these smaller firms; it was Washington that propped up their too-big-to-fail competitors, thus expanding the competitive advantage that those larger firms hold in the market.

And, as a result, smaller institutions are spending more time and more money trying to stay afloat. I recently heard a community banker note that for every 1.2 employees focused on compliance, he has 1 focused on banking. Now, this number is only going to grow as the implementation of Dodd-Frank continues. One step in the right direction is the Communities First Act.

I would also mention, with Mr. Cheney and Mr. Becker here, it is worth noting that H.R. 1418 would help in the effort of shifting the focus from Washington to Main Street. It would free up much needed capital for small businesses by raising the cap on member business loans for those credit unions that meet that set of criteria.

I yield back, Madam Chairwoman.

Chairwoman CAPITO. Thank you.

I would like to recognize the chairman of the full committee, Chairman Bachus, for 1 minute for the purpose of making an opening statement.

Chairman BACHUS. Thank you.

I thank Chairwoman Capito and Chairman Garrett for holding this hearing. And I commend Blaine Luetkemeyer, our colleague from Missouri, for bringing forth what I consider to be a very reasonable approach to reducing regulatory paperwork and tax burdens on small banks and credit unions. This bill has gained the support of nearly 50 co-sponsors to date, and I am proud to be one of them.

So many small financial institutions have shared their concerns with us about the enormous cost of complying with the complicated regulations, especially the hundreds of new rules resulting from Dodd-Frank, which—we are 30 percent through that process, and it fills two Bankers Boxes.

While job creation is at a near standstill, the Bureau of Labor Statistics reports that there will be employment growth from financial examiners and compliance officers due to increased financial regulations. That is not the kind of jobs we are interested in creating.

How can we expect small financial institutions to absorb those increased compliance costs? The reality is they have to pass them on to their customers.

Mr. Luetkemeyer's bill addresses many of the concerns by cutting paperwork and reporting requirements and ensuring that accounting principles are appropriate for small banks. As we hear the testimony today from a number of community lenders, I am eager to learn from them how this bill will help community banks and credit unions to create jobs, foster economic growth, and serve their communities.

Again, I am pleased to support this legislation, and be a co-sponsor, and I commend Mr. Luetkemeyer and my colleagues on both sides of the aisle for tackling these issues.

Thank you.

Chairwoman CAPITO. Thank you.

Mr. Dold is recognized for 2 minutes for the purpose of making an opening statement.

Mr. DOLD. I certainly want to thank Chairwoman Capito and Chairman Garrett for holding this important joint hearing.

And I want to thank our witnesses for your time and testimony today.

This is an important hearing because functional and healthy credit markets are essential for job creation, for business growth, and for economic prosperity. Certainly, our credit markets and financial institutions must be regulated, but those regulations must be sensible and balanced and must account for meaningful differences amongst our broad and diverse array of financial institutions.

Unfortunately, in many respects, our regulatory environment doesn't currently meet these reasonable standards. Instead, our current regulatory environment is actually hurting the functionality and health of our credit markets and, by extension, also hurting job creation, business growth, and economic prosperity.

The regulatory burden is particularly acute for our small financial institutions because they must necessarily devote a far larger percentage of their resources to the enormous costs of reviewing, analyzing, and complying with an avalanche of regulatory burdens. Meanwhile, small financial institutions are essential to financing our small businesses, which are responsible for over two-thirds of net new jobs in our country but which are also struggling in this economy.

Especially with our current economic challenges, all of us in Congress are obligated, in my opinion, to create a legal and regulatory environment that strongly promotes job creation, business growth, and general economic prosperity. And a very important step in creating that kind of improved regulatory environment is helping our small financial institutions get some relief from overly burdensome regulations.

The Communities First Act moves us toward that objective of improving the regulatory environment for small financial institutions. And we can make these positive changes without diminishing safety and soundness and without diminishing depositor and investor protections. For these reasons, I am happy to co-sponsor this legislation, along with many of my Republican and Democratic colleagues. The American people expect and deserve these kinds of smart, bipartisan solutions to our job-creation challenges.

I would like to thank my colleague from Missouri, Mr. Luetkemeyer, for introducing this helpful legislation, and I look forward to continuing to work on this legislation with him and my colleagues on both sides of the aisle after we hear from our witnesses today.

I yield back.

Chairwoman CAPITO. Thank you.

I would like to recognize Ms. Waters for 1 minute for the purpose of making an opening statement.

Ms. WATERS. Thank you very much, Madam Chairwoman, for convening today's hearing. As I have said consistently, community banks are vital to bolstering America's neighborhoods because these banks provide credit in communities throughout the Nation, create jobs, and encourage individual and family savings.

The practices of our community banks had little to do with causing our financial crisis. Therefore, while I believe that we should take a smart approach toward the regulation of small banks in order to spur economic activity and produce jobs, I believe the regulation is necessary to ensure that consumers and banks are protected from harmful practices.

While I am open to looking at the regulatory challenges facing small banks, I do not want to see their compliance challenges used as an excuse to weaken regulation or weaken Dodd-Frank legislation reforms intended for large banks. To this end, I am concerned about provisions that amend the Dodd-Frank Act to restore bank reliance on external credit ratings. We know that reliance on external credit ratings was a key contributor to our current economic troubles.

I know that I have just a few seconds here.

We cannot solve the problems of today with the failed approaches of yesterday. I am also concerned about changes to the Sarbanes-Oxley accounting requirements for community banks. I hope that today's hearing will begin a constructive dialogue that leads us to the approach that is most appropriate for accelerating economic recovery.

To all of the witnesses today, thank you for taking time out of your busy schedules to appear before us. I look forward to hearing your testimony.

Thank you. And I yield back the balance of my time.

Chairwoman CAPITO. Thank you.

And for a final 1-minute opening statement, Mr. Canseco.

Mr. CANSECO. Thank you, Madam Chairwoman, Chairman Garrett, and my colleague, Mr. Luetkemeyer, for bringing this very important Communities First Act to a hearing today.

I represent the 23rd District of Texas, which is home to many small towns which are engaged in farming and ranching. Community banks are sometimes the only source of capital available to these rural areas. In the past year, ranchers and farmers and small businesses and families in my district have had to deal with wildfires and a record drought, and the economic impact has been devastating.

Compounding the problem is the tremendous burden community banks are now facing in serving these affected communities. A great amount of uncertainty and overregulation in the wake of Dodd-Frank has frozen credit in a number of small towns, and the consequences are palpable as you speak with residents and business owners in these areas.

The provisions of the Communities First Act go a long way towards lifting the burden off the shoulders of America's community banks, and I look forward to hearing from our witnesses on this very important topic.

And, again, my thanks to the chairman of this committee, and also Mr. Luetkemeyer for bringing this bill.

Chairwoman CAPITO. Thank you.

I think that concludes our opening statements, so I would like to now introduce our panel of witnesses for the purpose of giving a 5-minute opening statement.

Our first witness is Mr. Salvatore Marranca, president and chief executive officer, Cattaraugus County Bank, on behalf of the Independent Community Bankers of America.

Welcome.

STATEMENT OF SALVATORE MARRANCA, DIRECTOR, PRESIDENT, AND CHIEF EXECUTIVE OFFICER, CATTARAUGUS COUNTY BANK, ON BEHALF OF THE INDEPENDENT COMMUNITY BANKERS OF AMERICA (ICBA)

Mr. MARRANCA. Thank you, Chairwoman Capito, Chairman Garrett, Ranking Member Maloney, Ranking Member Waters, and members of the subcommittees.

I am Sal Marranca, director, president, and CEO of Cattaraugus County Bank, a $180 million community bank in Little Valley, New York. I am pleased to be here today to represent the nearly 5,000 members of the Independent Community Bankers of America.

Thank you for convening this hearing on the Communities First Act, or CFA. This legislation is a top priority for ICBA and community banks nationwide. We are grateful to Congressman Luetkemeyer for introducing CFA and to the more than 50 Members from both parties who have co-sponsored it. Thirty-seven State banking associations have also endorsed the bill.

CFA would provide carefully crafted regulatory and tax relief that would allow community banks to do what we do best: lend locally in our communities and help boost the economy. I would also note that credit unions would benefit from a number of CFA provisions.

Rather than a top-down approach, CFA was crafted from the bottom up, with input from community bankers who know what will work on Main Street. Most community banks are closely held institutions whose viability is directly tied to the economic life of the communities we serve. Our business is built on long-term relationships with customers who are also our neighbors.

My bank, like many community banks, has been in business for over a century and survived the Great Depression. Our longevity is a testament to conservative risk management. Because we are low-risk institutions, our regulations should be distinct from that of large complex banks and Wall Street firms. CFA provides appropriate tiering of regulation and relief for smaller, low-risk institutions so we can better serve our communities.

The steady accretion of regulation over many decades has become a serious and growing threat to community banks. While some of these regulations are sensible and necessary, others are overly prescriptive, redundant, and unduly burdensome. To community banks like mine, regulation is a disproportionate expense, burden, and a real opportunity cost. My compliance staff is half as large as my lending staff. This is out of proportion to our primary business: lending in our communities to support the local economy.

CFA contains 26 provisions. It is broad and diverse because there are some 7,000 community banks of different charter types, ownership, and lending specializations. While no one provision of CFA is a silver bullet, combined they will have a real impact for community banks and their customers. I would like to highlight just a few.

For example, highly capitalized and well-rated community banks would be permitted to file a short-form call report in two quarters a year. This change would allow regulators to focus on high-risk institutions and would reduce the burden on qualified community banks without compromising safety and soundness.

Another provision would exempt certain mortgages held in portfolio by community banks from escrow requirements. Many rural community banks don't have the resources to establish escrow accounts in-house, and outsourcing is a significant expense. Lenders have every incentive to protect the collateral of loans held in portfolio. This provision would help keep community banks in the business of making commonsense mortgages.

Another provision would amend the annual privacy notice requirement. I always want to ensure that my customers are informed of my privacy policies. That said, when no change in policy has occurred, the annual notice provides no useful information to customers and is an unproductive expense for my bank.

To summarize, the increasing burden of regulation will lead to further industry consolidation. The sensible regulatory reforms embodied in the CFA will help preserve the community banking business model and the diverse financial system that supports our Nation's economy.

I encourage you to reach out to the community bankers in your district. Ask them whether the reforms of the CFA would help them to serve your communities. I am confident they will say yes.

Thank you again for the opportunity to testify today and to offer ICBA's perspective on the important reforms of the Communities First Act.

[The prepared statement of Mr. Marranca can be found on page 106 of the appendix.]

Chairwoman CAPITO. Thank you.

Our next witness is Mr. O. William Cheney, president and chief executive officer of the Credit Union National Association.

Welcome.

STATEMENT OF O. WILLIAM CHENEY, PRESIDENT AND CHIEF EXECUTIVE OFFICER, CREDIT UNION NATIONAL ASSOCIATION (CUNA)

Mr. CHENEY. Thank you.

Chairmen Capito and Garrett, Ranking Members Maloney and Waters, thank you very much for the opportunity to testify on behalf of America's 7,400 not-for-profit credit unions, which now serve 94 million Americans.

These credit unions and community banks operate side-by-side to meet the financial services needs of consumers and small businesses. In recent months, there has been a resurgence in consumer interest in local financial institutions. Community banks and credit unions have welcomed the opportunity to serve those frustrated by the ever-increasing fees charged by the largest banks.

One example took place in Santa Cruz, California, where in the lead-up to the recent Bank Transfer Day, credit unions and community banks worked together to make sure consumers in their area knew they had choices other than the largest banks. This represents credit unions and community banks at their best.

Another area where credit unions and community banks should agree and work together is in the pursuit of regulatory relief legislation. Community-based institutions need to be able to spend more time and resources serving their members or customers and less time complying with burdensome regulations brought about by the financial crisis.

We did not cause the crisis, but the regulatory response has imposed disproportionate burdens on smaller institutions. The Communities First Act would provide significant regulatory relief to America's community banks. Several of the provisions of this bill would also apply to credit unions. Our analysis of the provisions relevant to credit unions is included in my written testimony.

While we support several provisions of this bill, I would like to make two points.

First, this legislation would significantly expand the shareholder threshold for Subchapter S banks. We do not oppose this change, but note the irony of the banks' lobbying to expand the Subchapter S tax preference while aggressively lobbying to impose additional taxes on credit unions. They argue that the credit union tax status provides a competitive advantage and that imposing additional taxes on credit unions would level the playing field, but this is not the case. The market share data show that credit unions only have 6 percent of the combined assets and only 5 percent of the small business loans at depository institutions.

If, indeed, the credit union tax status was such an advantage, we would see Subchapter S banks using their tax preference to reduce fees and rates to benefit consumers. This is simply not happening. Our analysis of bank call report data over the last 18 months indicates that, compared to similarly sized C-Corp banks, Subchapter S banks charge higher fees to consumers, have higher return on assets, and pay higher dividends to share their shareholders. In other words, these banks do not use their preferential tax treatment to better compete with credit unions.

Second, we strongly believe that the legislation providing regulatory relief should be balanced. Credit unions and community banks should both see benefits in terms of their ability to serve members or their customers. As part of well-balanced relief legislation, credit unions would expect the inclusion of language, as Representatives Royce and McCarthy have proposed, to raise the statutory member business lending cap for well-capitalized credit unions with ample business lending experience that are operating near the cap.

Additional business lending helps everyone in the community—small businesses, credit unions, and banks. Allowing qualifying credit unions to lend more to small businesses would provide much-needed assistance and relief to the struggling small business sector. It would help create 140,000 jobs in the first year, at no cost to taxpayers.

The combination of these two bills should be embraced by all who serve businesses on Main Street. Unfortunately, we know what the bankers think about credit union regulatory relief. They oppose it every time we propose it. The banks' opposition to credit union legislation has meant that hundreds of thousands of jobs that could have been created through additional credit union business lending have gone uncreated.

Their opposition in Congress and in courts to permitting more credit unions to serve underserved areas has meant that potentially millions of Americans have gone with without access to convenient and affordable financial services. Their opposition to legislation modernizing credit union capital standards has restricted credit unions' ability to grow and better serve their members. When banks oppose credit union legislation, their shareholders may win, but consumers and small businesses lose.

Credit unions support regulatory relief for all financial institutions, but it must be balanced. In its current form, H.R. 1697 is not. To achieve balance, we urge Congress to combine this legislation with H.R. 1418, the Small Business Lending Enhancement Act, and include the other modifications we have urged in our written testimony.

Credit unions across the country firmly believe that this legislation, or the provisions contained therein, must not move through Congress without similarly effective regulatory relief legislation for credit unions. This is a key issue for America's credit unions.

Thank you for the opportunity to testify at today's hearing.

[The prepared statement of Mr. Cheney can be found on page 70 of the appendix.]

Chairwoman CAPITO. Thank you.

Our next witness is Mr. John A. Klebba, president and chief executive officer, Legends Bank, on behalf of the Missouri Bankers Association.

Welcome.

STATEMENT OF JOHN A. KLEBBA, CHAIRMAN, PRESIDENT, AND GENERAL COUNSEL, LEGENDS BANK, ON BEHALF OF THE MISSOURI BANKERS ASSOCIATION (MBA)

Mr. KLEBBA. Thank you.

Chairwoman Capito and Chairman Garrett, Ranking Member Maloney and Ranking Member Waters, and members of the subcommittees, my name is John Klebba, and I am the chairman, president, and general counsel of Legends Bank in Linn, Missouri. I also occasionally sweep the floors and shovel the snow whenever that is necessary.

Thank you for the opportunity to testify today. I would also like to thank my Congressman, Congressman Luetkemeyer, a fellow Missourian, for his work on this bill.

The title of the bill pretty much says it all, the "Communities First Act." Legends Bank is a small community bank by any national standard, with 10 locations and 83 employees, serving rural Missouri. Our headquarters is in a town of 1,450 people, and we have locations in towns as small as 300, which is not much bigger than this room, probably, right now.

We are proud of the fact that we have been in business for almost 100 years. When I was a boy, I listened to my grandfather, one of the bank's co-founders, tell stories of the hardships of taking the bank through the Great Depression. We were, in fact, one of the few banks in our county to survive.

One of the things about Legends Bank that has not changed from the time of his leadership to my dad's leadership to my own is that our bread and butter is our commitment to the communities we serve. To put it simply, if our communities and our customers are not successful, then our bank is not successful. Thus, our fates are inextricably linked.

We know from experience that there is a cost and increased expense to the bank when we have to deal with more regulations. And when there is an increased cost to us, there is an increased cost to our customers. The more expense for the bank, the less that is available to loan to our primary customer base, which is small businesses, farmers, and folks who are just trying to get by in these difficult economic times.

Several provisions of this legislation will provide the kind of regulatory relief my bank and other small banks need to continue to serve our communities. For example, Section 201 deals with escrow accounts for mortgage loans. This section would require the Federal Reserve Board to exempt all banks with assets of $10 billion or less from the escrow account requirement.

In the small towns we serve, many customers don't want escrow accounts, and, in fact, we have served our customers quite well for over 97 years without offering them. Our customers are used to paying their insurance and tax bills directly to the insurance companies and county collectors. Think about how much easier it is to change insurance companies or change coverages without the involvement of a third party, in this case the bank.

Requiring a service our customers don't want doesn't make any sense. It only adds a significant cost to the bank and increases the cost to our customers in the form of higher fees or less attractive interest rates. Many of these loans are small loans. For example, on a mobile home loan, the monthly escrow account payment can be very small, in some cases less than $20 per month.

Another area of the bill I would like to highlight is tax relief for banks, which will allow us to exclude from gross income the interest on loans secured by agricultural real property. This mirrors the exclusion already available to one of our competitors, the Farm Credit Services.

When I was in law school, one of the courses I took dealt with tax policy and whether, in setting tax policy, it was either fair or just for the government in a free-market society to be picking winners and losers. Community banks are having a harder and harder time competing with tax-advantaged entities such as farm credit systems and credit unions. When the government picks winners and losers at the expense of other industries, in this case community banks, our communities suffer the consequences.

Many of the rural areas in this country are struggling. Demographically, their population is getting older, especially with respect to individuals who own and operate family farms. In my experience, one of the main reasons for this is the fact that it is very difficult for younger people to be able to afford the land and equipment necessary to get them started as farmers. Their proposed tax relief for qualified ag lenders would certainly help level the playing field that we operate on and give a boost to our ag borrowers.

I am concerned about the long-term viability of community banking, and unjust tax policy is one of the main reasons.

Thank you for the opportunity to present my views on behalf of the Missouri Bankers Association. And after this is over, I would be happy to answer any questions you might have, especially with respect to Subchapter S status.

[The prepared statement of Mr. Klebba can be found on page 90 of the appendix.]

Chairwoman CAPITO. Thank you.

Our next witness is Mr. Fred Becker, Jr., president and chief executive officer, National Association of Federal Credit Unions.

Welcome.

STATEMENT OF FRED R. BECKER, JR., PRESIDENT AND CHIEF EXECUTIVE OFFICER, NATIONAL ASSOCIATION OF FEDERAL CREDIT UNIONS (NAFCU)

Mr. BECKER. Thank you, Madam Chairwoman.

Good afternoon, Chairmen Capito and Garrett, Ranking Members Maloney and Waters, and members of the subcommittees. My name is Fred Becker. I am testifying today on behalf of NAFCU, where I have served as the president and CEO since January of 2000. I very much appreciate the opportunity to share our views on H.R. 1697 and the need for regulatory relief for all community financial institutions.

While credit unions did not create the financial crisis, credit unions have nevertheless been adversely impacted by the ongoing economic upheaval and ensuing legislation and regulation. Credit union failures have, however, been relatively minimal as compared to other financial depository institutions.

We recognize the leadership and effort of Representative Luetkemeyer to bring relief to community-based financial institutions. Many of the provisions in the Communities First Act provide regulatory and tax relief to community banks.

In particular, we would like to note our support of Section 107, which includes language that will lower the threshold needed for the Financial Stability Oversight Council to override rules issued by the Consumer Financial Protection Bureau. We are pleased that such a provision has already passed the House.

We also believe that Section 201 of the bill, which would amend the Dodd-Frank Act to provide loans held in portfolio by banks under $10 billion in assets, is, in principle, a good idea. Such an exemption should, however, be made for all credit unions. In addition, we are disappointed that the legislation continues to adopt a $10 billion dividing line in many of its provisions.

While the Communities First Act focuses on relief to community banks, credit unions remain among the most heavily regulated of all financial institutions, with a number of outdated statutory limits on their abilities and powers. Passage of new financial reforms in recent years has only increased the regulatory burden on credit unions. Every additional dollar spent on compliance, whether stemming from a new law or an outdated regulation, is a dollar that could have been used to reduce costs or provide additional services to a member.

With that in mind, there are a number of areas where we would like to see relief—relief that would enhance credit unions' service to their 94 million members. These include: raising the arbitrary member business lending cap; allowing credit unions access to supplemental capital; providing the ability for all types of credit unions to add underserved areas; allowing credit unions that convert to community charters to retain their employee groups; permitting voluntary mergers of multiple group credit unions without limitation; and allowing NCUA to establish longer maturities for certain credit union loans.

Combining these provisions with those sought by community banks would strengthen the legislation and provide relief to both, in addition to helping create jobs and aiding in the economic recovery.

Many of these credit union proposals have already received broad bipartisan support. For example, the Small Business Lending Enhancement Act, introduced by Representatives Royce and McCarthy, has over 100 bipartisan co-sponsors. We believe this legislation to raise the member business lending cap would help spur over $13 billion in small business lending and create over 100,000 new jobs in the first year alone. The demand is out there from small business, and credit unions are ready to meet it.

In conclusion, with the recent influx of new laws and regulations, our community financial institutions, and in particular credit unions, are in need of regulatory relief. As our Nation continues to strive to recover from the "Great Recession," we believe it is imperative that every effort be made to strengthen the access and improve the availability of low-cost financial services to all Americans.

In keeping with that spirit and intent, we believe that the Communities First Act can be strengthened by adding the provisions to provide regulatory relief to credit unions, as outlined earlier in my testimony. Such an approach would create a comprehensive reform bill that would create more jobs, help communities, and garner further bipartisan support.

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

[The prepared statement of Mr. Becker can be found on page 54 of the appendix.]

Chairwoman CAPITO. Thank you, Mr. Becker.

Our next witness is Mr. Arthur E. Wilmarth, Jr., professor of law, George Washington University, executive director, Center for Law, Economics, and Finance.

Welcome, Professor.

STATEMENT OF ARTHUR E. WILMARTH, JR., PROFESSOR OF LAW, GEORGE WASHINGTON UNIVERSITY LAW SCHOOL

Mr. WILMARTH. Thank you, and good afternoon. Chairwoman Capito, Chairman Garrett, Ranking Member Maloney, Ranking Member Waters, and members of the subcommittee, thank you for allowing me to participate in this hearing.

Community banks play a crucial role in providing credit and other financial services to consumers and small and medium-sized enterprises, which I will refer to as SMEs. Community banks have long served as a leading source of outside credit for SMEs. By doing so, community banks promote economic growth in the United States. SMEs produce half of the total private sector output, employ a majority of the private sector workforce, and account for two-thirds of net new jobs and more than a third of all private sector innovations.

However, the revival of the community banking sector and its ability to continue serving the needs of consumers and SMEs cannot be taken for granted. Many community banks disappeared in the thousands of bank mergers that occurred between 1990 and 2005. During that time period, the percentage of banking assets held by the 10 largest U.S. banks rose from 25 percent to 55 percent.

This consolidation trend intensified during the financial crisis, as regulators arranged several emergency mergers between very large banks that produced even bigger banks. As a result of those mega-mergers, the 4 largest U.S. banks controlled 56 percent of domestic banking assets at the end of 2009, up from only 35 percent in 2000, and the 10 largest banks controlled 75 percent of such assets.

Community banks suffered disproportionate harm during the current financial crisis, in large part because of the preferential treatment given by the Federal Government to too-big-to-fail mega-banks. The Federal Government provided massive amounts of financial assistance to mega-banks during the financial crisis but gave very limited help to smaller banks.

The 19 largest U.S. banks, each with more than $100 billion of assets, received $220 billion of capital assistance from TARP, and those banks issued $235 billion of FDIC-guaranteed debt. In contrast, smaller banks received only $40 billion of TARP assistance and issued only $10 billion of FDIC-guaranteed debt.

The Federal Reserve provided $1.2 trillion of emergency credit assistance, mostly to large domestic and foreign banks. More than half of this assistance went to the 10 largest U.S. commercial and investment banks.

Most importantly, the Federal Government explicitly guaranteed that none of the 19 largest banks would be allowed to fail. When the stress tests were announced in early 2009, regulators declared that the Treasury Department would provide any additional capital needed to ensure the survival of the top 19 banks. They also said that they would not impose any regulatory sanctions on the top 19 banks under the “prompt corrective action” regime established in 1991. In stark contrast, Federal regulators imposed PCA orders and other public enforcement sanctions on hundreds of community banks and allowed more than 300 of those institutions to fail.

In view of the massive too-big-to-fail bailout that the Federal Government provided to our largest banks, it is not surprising that those banks enjoy a decisive advantage in funding costs over smaller banks. FDIC Chairman Sheila Bair recently pointed out that in the fourth quarter of 2010, the average funding costs for banks with more than $100 billion of assets was about half the average funding costs for community banks with less than $1 billion in assets.

The past 2 decades have also made clear that community banks and mega-banks follow very different business models. Community banks provide high-touch, relationship-based lending and cash management services to SMEs, as well as personalized banking services, including wealth management, to consumers. In contrast, mega-banks provide impersonal, highly automated lending and deposit programs to SMEs and consumers, and mega-banks also focus on complex, higher-risk transactions in the capital markets. Congress should reject a one-size-fits-all regulatory policy and instead, Congress should adopt a tailored policy that gives due attention to the special requirements of community banks.

At the present time, community banks face particularly difficult challenges in raising new capital and dealing with troubled commercial real estate loans. Several provisions of H.R. 1697 have the potential to help community banks in these areas. I would be pleased to answer your questions about those provisions, which are discussed in my written testimony.

Thank you again for allowing me to participate.

[The prepared statement of Professor Wilmarth can be found on page 118 of the appendix.]

Chairwoman CAPITO. Thank you.

Our next witness is Mr. Damon Silvers, director of policy and special counsel for the AFL-CIO.

Welcome, Mr. Silvers.

STATEMENT OF DAMON A. SILVERS, DIRECTOR OF POLICY AND SPECIAL COUNSEL, AMERICAN FEDERATION OF LABOR AND CONGRESS OF INDUSTRIAL ORGANIZATIONS (AFL-CIO)

Mr. SILVERS. Thank you. Good afternoon, Chairwoman Capito and Chairman Garrett, and Ranking Members Maloney and Waters.

In addition to the introduction I just received, I should note that I served as Deputy Chair of the Congressional Oversight Panel for TARP. I am testifying today both on behalf of both the AFL-CIO and the Americans for Financial Reform, a coalition of more than 250 organizations representing more than 50 million Americans.

In listening to the testimony of my fellow witnesses, I am reminded of our experience in the Congressional Oversight Panel holding field hearings with community bankers in Atlanta, in Milwaukee, in Phoenix, and in northeast Colorado, where we focused on agricultural lending, looking at small business lending in particular and at the problems of commercial real estate, particularly in the State of Georgia.

As a result of the things we learned through that experience, the Congressional Oversight Panel warned on multiple occasions that if steps were not taken to both address weaknesses in large banks and to aid smaller banks more aggressively, the United States was in serious danger of repeating the Japanese experience of the 1990s, where a financial system dominated by weak, large banks protected by regulatory and accounting forbearance simply failed to function in the most basic way. In other words, our financial system was in danger of failing to provide credit to operating businesses.

Today, we appear to be living in that world—a world of weak, large banks, constrained credit to small and medium-sized enterprises, overleveraged households, persistent high unemployment, mass foreclosures, and growth so sluggish that there is no sign of job creation on the horizon.

This situation cries out for aggressive policy responses: to end the double standard in bank regulatory policy; to recapitalize weak, large banks; to rebuild business lending; and to restructure home mortgage loans so households are no longer trapped in a downward spiral.

Instead, however, we are at a hearing addressing a bill, H.R. 1697, that has many, many provisions in it, which, as a whole, seek to extend the bad practices of regulatory forbearance from the big banks that Mr. Wilmarth just described to the small banks, rather than asking big banks to live up to the same standards we rightfully ask small banks to live by.

Now, that is not to say that there are not ways in which the bank regulatory system could be intelligently and wisely crafted to address the differences in business models Mr. Wilmarth addressed, which I absolutely concur with. And the testimony that we heard from Mr. Marranca listed a series of provisions embedded within this bill that seem to me to be quite commonsensical.

But that is not all this bill does. This bill allows banks to hide the very real losses that accompany foreclosing on American families, effectively creating a regulatory subsidy for throwing people out of their homes and driving down housing prices.

The bill undoes the fundamental principle that has underpinned our financial accounting system since the 1930s, the principle of the independence of the Financial Accounting Standards Board, by effectively requiring the SEC to only approve financial accounting rules that report good news about small banks rather than having rules that tell the truth about small banks.

The bill exempts banks with assets up to $1 billion from the internal controls requirements of the Sarbanes-Oxley Act, effectively increasing the risk that such banks would pose to the FDIC and overturning the basic proposition that has been in place since the beginning of Federal bank regulation in the 1870s: that banks must have accurate internal controls that are at least adequate to ensure the accuracy of their financial statements.

Most troublingly, H.R. 1697 broadly, for all banks: weakens consumer privacy protections for all banking customers; undermines the integrity of real estate appraisals—and, certainly, we should have learned something about this by now—;seeks to suborn the protection of the American public to the interests of the banks by broadly weakening the authority of the Consumer Financial Protection Bureau; fundamentally undermines the securities laws by allowing public offerings to up to 2,000 people without requiring basic disclosures through registration with the Securities and Exchange Commission; and, most bizarrely puzzling, seeks to make banks more reliant on credit rating agencies.

Over time, I have been impressed with the capacity of some Members of Congress to name bills in ways that are fundamentally dishonest. Now, this grab bag of regulatory subsidies gratuitously appended to the commonsense provisions that my fellow witnesses rightfully seek for their small banks, many of which are, in fact, for the benefit of big banks, no more deserves the name of the "Communities First Act" than did TARP itself.

I have tried to think of a more accurate name for this bill and thought the "Potemkin Village Act" or the "Let's Make Believe Act" sounded pretty good. But as I thought about how much of this Act is really about helping big banks, about helping Wall Street, I concluded that the best title for it, in its current form, would be the "Help the 1 Percent and Hurt the 99 Percent Act of 2011."

Thank you.

[The prepared statement of Mr. Silvers can be found on page 113 of the appendix.]

Chairwoman CAPITO. Thank you.

Our final witness is Mr. Adam J. Levitin—whom we have had before the panel before—associate professor of law, Georgetown University Law Center.

Thank you.

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

Mr. LEVITIN. Good afternoon, Chairmen Capito and Garrett, Ranking Members Maloney and Waters, and members of the subcommittees. My name is Adam Levitin and I am a professor of law at Georgetown University.

As you have heard from the testimony of the other witnesses, there is a palpable sense that the way U.S. financial regulation has proceeded over the past few years is fundamentally unfair. Large financial institutions, many of which behaved irresponsibly during the housing bubble, were bailed out. Small institutions, on the other hand, which were generally much more prudent lenders, were left to sink or swim on their own.

Moreover, increased regulation in the wake of the financial crisis imposes a relatively heavier burden on small institutions because they lack the economies of scale of the large institutions. In short, small banks and credit unions are paying for the problems that large banks created. Small banks and credit unions have really become second-class citizens in the financial world. Unfortunately, the Communities First Act is the wrong solution to this problem.

The bill contains some provisions that are quite reasonable. For example, little is accomplished by Gramm-Leach-Bliley privacy notices in general. They don't tell consumers much of anything. They tell them that you don't have any privacy. But even less is accomplished by requiring their annual reissuance when privacy policies have not changed. Reducing this regulatory burden is quite sensible.

The problem here is that there are several extremely troubling provisions buried in the bill that do much more harm to communities and the economy than they do to help community banks and credit unions. First, Sections 205 and 206 of the bill would change the accounting treatment for loss recognition in foreclosure and of impaired real estate loans. The bill would enable banks to delay loss recognition and carry impaired loans at inflated values. Not only do these provisions encourage voodoo accounting, they encourage foreclosures at the expense of loan modifications.

If there is one point you take away from my testimony, this is it: The Communities First Act will result in families being thrown out of their homes. This bill encourages foreclosures, it affirmatively hurts American families and communities, and it will result in your constituents losing their homes. If you are going to pass this bill, you need to take out Sections 205 and 206.

Second, Section 105 of the bill would require the SEC to conduct a cost-benefit analysis of any changes to accounting rules proposed by the independent Financial Accounting Standards Board. This provision would cover not just small banks but also large ones, and indeed all public companies, banks and nonbanks. The requirement would functionally destroy GAAP accounting by petrifying accounting standards. It will scare away capital from U.S. markets and render American firms less competitive in obtaining financing.

Cost-benefit analysis in general is one of the wishiest-washiest pseudo-scientific things ever. There is no way to scientifically calculate the cost and benefits from the change in accounting treatment of, say, variable interest entities or the treatment of financial leases. These things just aren't quantifiable, and therefore you can't do a cost-benefit analysis. Accounting rules provide their benefits not on a one-off basis, but as a complete information ecosystem, by making information transparent to markets. You can't pick and choose on financial transparency. Destroying GAAP accounting by imposing cost-benefit analysis doesn't reduce the costs of auditing for banks. It just raises their costs of capital. And what does that mean? It means less lending to small and medium-sized businesses and higher rates for those loans that are made.

Finally, Section 107 of the bill would lower the standard needed for the Financial Stability Oversight Council to veto rulemakings by the Consumer Financial Protection Bureau. Let's call this provision for what it is—an attack on the American family. The CFPB was created to be a bulwark to protect American families from unfair, deceptive, and abusive financial practices. We certainly have seen enough of those over the last few years.

The FSOC veto was designed to be a rarely if ever used provision to avoid unintended systemic risk consequences from CFPB action. The standard proposed by the Communities First Act, however, would enable the FSOC to veto CFPB rulemakings whenever they harm the safety and soundness of a subset of banks.

Let's be clear about what safety and soundness means. It is a phrase that means bank profitability. It is axiomatic that a bank that is not profitable is not safe and sound. We need our banks to be profitable, but there is absolutely no public policy interest in the level of bank profitability. But that is what the bill would do. It would elevate bank profitability over the protection of the American family. Community banks and credit unions have become second-class citizens in U.S. financial regulation, and that is wrong.

They are important institutions that provide real value to our financial system, but the Communities First Act is not the solution. It bundles some small-bore, reasonable regulatory changes with some seriously disruptive provisions. It will not fix the problem of small banks being treated as second-class citizens.

I urge the committee that if it wants to fix the problem of two-tiered bank regulation to tackle that problem directly rather than approach it through a misnamed bill like the Communities First Act that puts banks' interests ahead of communities. Thank you.

[The prepared statement of Professor Levitin can be found on page 98 of the appendix.]

Chairwoman CAPITO. Thank you.

That concludes testimony from the panel, and I am going to begin with the questions.

I would like to ask Mr. Marranca and Mr. Klebba on one of the areas of the bill that talks about appraisal values particularly for—I think it is for commercial real estate, and it talks about—we are having a lot of problems with this, certainly this is a problem in Georgia and across the country that has been hardest hit on how do you reasonably appraise properties when nothing has sold in the region, there are no comps. And the suggestion here is that you do an appraisal value over 5 years where you drop out the high, you drop out the low, and then you get an average, which gives you the average—would give you an appraisal value for that piece of property. Do you have any opinion on that, Mr. Marranca?

Mr. MARRANCA. I do. Again, the proposal as stated is a 5-year rolling average, and the purpose of that, of course, is to eliminate the immediate up or the immediate down that troubles so many banks when the regulators come in and then force, if you will, a writedown which does affect your capital and does affect your business plan, it does affect your ability to serve your community.

When an appraisal is written down immediately, it is taken off the books as far as the value on your asset. Those loan losses affect your capital. In other words, that directly affects your ability, again, to lend in your community. I don't see a safety and soundness issue there. Again, this is for regulatory purposes only. This is something that we are willing to work with, willing to discuss. It is an issue with many, many community banks, especially in very specific parts of the country.

Chairwoman CAPITO. Have you had an issue with this in your bank in New York?

Mr. MARRANCA. In rural western New York where my bank operates out of three counties, we have never had any type of real estate boom, we did not have a bust, so appraisals are not at issue.

Chairwoman CAPITO. That is my entire State. Mr. Klebba, do you have an opinion on that?

Mr. KLEBBA. In terms of appraisals, there are some issues, I know, out there. We haven't had a lot in our area because, like Sal, we are luckily in an area where we haven't had booms and busts, but an appraisal is one person's opinion, on one particular day, of what the value of a piece of property is. And I think the overall objective should be that we are coming up with values in terms of long-term values. I think the real issue is when we go through a real estate bubble and a real estate decline like we have now, what is the real value of that property? Is it what it was worth last year, is it what it is worth today, or is it what we project it to be worth a year from now?

So I think it has been in some situations very unfair for banks to be writing down. I know if you look at our securities portfolio, if we have large gains in our portfolio and we have those particular securities on a hold to maturity, we don't write those up. I think there is an argument that the same should be held, should be put forth in terms of real estate. If you are holding these real estate loans to maturity and everything else is looking pretty good on them, is it really fair to the bank to write those down immediately or should you have some sort of standardized or normalized, I should say, real estate values for your particular area?

Chairwoman CAPITO. Thank you.

Mr. Wilmarth, you touched on a subject that I am extremely interested in. You said that the largest banks are now holding 75 percent of assets, and that is up from what?

Mr. WILMARTH. Historically, it was 25 percent in 1990, 55 percent in 2005, and at least by one report, 75 percent in 2009. There may have been a little bit of runoff since 2009 since there have been minor divestitures, but I think it is certainly north of 70 percent.

Chairwoman CAPITO. The reason I want to focus in on this, and I think Mr. Marranca mentioned consolidation, bank consolidation. We have just been through "too-big-to-fail," and our bigger banks are getting bigger. We could argue, and we have argued ostensibly as to whether "too-big-to-fail" has been ended. I personally don't think so, but we will leave that for another day.

My concern here is that we look at regulatory burdens that are being heaped by Dodd-Frank and others without scraping out the old regulations that may not be useful anymore, that are no longer serving their purposes, which is not being done. Even Secretary Geithner testified to that in this committee when I asked him.

Is further consolidation going to occur because of this inability of the smaller institutions to really cope with what they are going to have to cope with in the regulatory environment? I would like to have your opinion on that.

Mr. WILMARTH. I think you have a problem of funding costs and you have a problem of operating costs, and the funding costs I think are driven by the perceived too-big-to-fail subsidy, that people will put more of their money in the largest banks at lower rates if they think that the government absolutely will not let those banks fail. At least in my opinion, if you look at the bailout of Dexia in Europe recently, and you also look at the Federal regulators approving the transfer of derivatives portfolio from Merrill Lynch to Bank of America, those are signals indicating that on both sides of the Atlantic, big banks are going to be supported at all costs, so that drives the funding cost disparity I mentioned where essentially the large banks have about half the funding costs of small banks under $1 billion.

The other side is operating costs. So I think certainly it would be appropriate for Congress to urge regulators to actually start adopting a two-tiered regulatory approach. I understand that Governor Tarullo of the Federal Reserve Board recently mentioned that the Fed was interested in doing that. I think what you are hearing from the witnesses is that it hasn't much happened so far, but that would be certainly a good initiative to start.

Chairwoman CAPITO. Thank you. I overstayed my time there. Mrs. Maloney for 5 minutes.

Mrs. MALONEY. First of all, I want to thank all of you for your excellent testimony. And I was struck when you talked, Mr. Klebba, about how your bank stayed open during the Great Depression when most of them closed, and all the stories I heard for all the banks that were closed. How did your bank survive? Did you have more capital? How did you survive when so many closed during that period—or your father's bank, I guess?

Mr. KLEBBA. They were very, very conservative. No, they were very, very, very, very conservative. Good old German Catholics. They did have a lot of capital, and they were very careful. It was a family-owned bank, and it was their money that they were lending out; it wasn't somebody else's money. And so, I think there was a self-interest in that. I remember him talking about going around on Sundays with his loan list in his pocket and calling on these families and just seeing how they were doing, and so it wasn't just a banking relationship, it was a personal relationship.

I remember him saying how people would come in with basically the deeds to their farm saying, "I can't do this anymore," and he would say, "No, you need to stay on that farm because you can feed your family. And as long as you can eke out enough to pay a little bit of interest, we can stay with you. But once you move off, then what are you going to do?" So it was really compelling stories that he had. He was really an interesting guy. I could go on for hours telling you about his background.

Mrs. MALONEY. Thank you for sharing that.

And, really, when we did Dodd-Frank, one of the things we tried to do was go back to traditional banking, that you have skin in the game, that you are accountable, that you hand out loans and you make sure those people can pay them back, and that you work with them in the traditional way that your father did.

In your statement of trying to help people keep their farms, one of the things we are concerned about is helping people keep their homes. The loan amortization and loan appraisal sections, I want to really ask Mr. Wilmarth, and I think you gave a beautiful description of the role that community banks played during this period. They were really the rock on which most communities turned during this "Great Recession." The stories I hear from across my State, really across the country, are that the only place anyone could get any help or response was from community banks. So one of the criticisms of this section has been that being able to amortize these over a long period of time could incentivize banks to pursue foreclosure rather than modification.

Obviously, there is a social policy to want modification, and I would like to ask you, since you spoke on it and others, do you agree or disagree with that statement? Mr. Silvers, I believe you also spoke on this, as did you, Mr. Levitin, and from the great State of New York, if you could comment on that particular section.

Mr. WILMARTH. Yes, thank you. I suggested that these two provisions, 205 and 206, could be viewed in the context of the forbearance program that was established for agriculture and energy banks in the late 1980s, and that was only extended to well-managed, prudently managed banks. It was carefully overseen by regulators. About four-fifths of the banks that entered that program either survived or emerged without assistance, so it was a successful program.

Certainly, you could build safeguards into 205, you could limit it to well-managed banks, you could certainly give regulators discretion as to whether the appraisal or amortization process was being abused. I think that you could exclude residential real estate if you think that residential real estate is particularly threatened by this.

I certainly think that 206 should probably be limited to smaller banks because I don't think that larger banks have the same need for this, and many of their properties are in larger areas where there are more opportunities for refinancing. I think 205 and 206 should be viewed as provisions that are needed in smaller, frozen markets where there simply is no new credit coming in to refinance properties, and this would give community banks a chance to work with their customers in the way that Mr. Klebba has explained. I think you could build in safeguards to prevent abuses.

Mrs. MALONEY. But others have said that it might mask, really, the difficulty for regulators to see the challenges there and to come in and work with trying to address it. Would anyone else like to comment on this?

Mr. MARRANCA. If I may?

Mrs. MALONEY. Yes.

Mr. MARRANCA. As a community banker for over 30 years, I categorically deny that it would in any way encourage foreclosures. That is not the business we are in. It would, in fact, do the opposite. It allows time for me as a banker, without regulatory pressure, to work with that borrower and find a solution to their financial problem or the economic problem in our area, and this was proven, again, in the agricultural crisis in the 1980s. Again, I need to point out or would respectfully point out that this only affects regulatory capital. This does not affect the books of the bank, it does not affect my investors looking at the bank, it does not affect my call reports and so forth, and it only applies to highly rated banks. So we are in no way justifying or jeopardizing safety and soundness. It helps out the consumer who needs the help at that time, and it helps the bank who needs the help at that time. We are in it for the long run. My bank celebrates its 110th anniversary in January. We need long-term solutions. We don't look for the next quarter or the next two quarters.

Chairwoman CAPITO. The gentlelady's time has expired. Mr. Garrett?

Chairman GARRETT. I thank the Chair. So let's start off at that point. I had some other questions, but let's go back to Sections 205 and 206 and where the testimony was that section is in the bill to allow for, to facilitate for the banks to, as they put it, throw people out of their homes. So in the situation where a bank or credit union has someone who is not paying, is not up to date, what is better for that bank or credit union to do? To try to facilitate a workout with them or is it better to go through the foreclosure process from a bottom-line perspective?

Mr. MARRANCA. Chairman Garrett, the last thing in the world—again, my main office is in a town of 800 people. I live with these people, they are my neighbors. I am not in the business of taking people out of their homes. The last thing in the world I want to do is take somebody's car or take somebody's house, and that is why we have clear, commonsense underwriting standards so that we never get to that point. But if there is an issue, whether it be medical, divorce, or economic, the first thing we do is sit down and talk with that person or family and try to find a solution. In my State of New York, unfortunately, it takes almost 16 to 18 months to foreclose on somebody. A lot of things happen. The last thing I want is somebody's house. We would do anything to stop that.

Chairman GARRETT. And actually, doesn't that cause other community problems when a number of homes in a community are in foreclosure or moving through foreclosure, that period of time for the uncertainty in the marketplace, not only uncertainty for the marketplace but also for the community itself to have that number of homes in foreclosure and not take a final decision?

Mr. MARRANCA. There is no question, nobody wants a home that is abandoned, and that is the case in most cases. When there is a situation and we do end up foreclosing—and I am talking about 2 to 3 loans in the last 2 to 3 years, I am not talking significant numbers—that house is abandoned, it has problems, it is a blight on the community.

Chairman GARRETT. Going to another point. Overall, what we are trying to do with this legislation, I think, is trying to get rid of outdated regulation and try to improve on that. That is the same thing, come to think of it, that Secretary Geithner was talking about, that he said he wanted to do through FSOC and what have you.

Mr. Klebba, maybe through your association, have you engaged there? Do you see this as something, are you optimistic—and maybe it is hard for you to say this—that this is actually going to occur through FSOC and the Secretary as far as getting rid of outdated, unnecessary, unduly burdensome regulations?

Mr. KLEBBA. In terms of through the Consumer Financial Protection Bureau or—

Chairman GARRETT. Through FSOC.

Mr. KLEBBA. Through FSOC?

Chairman GARRETT. Yes.

Mr. KLEBBA. Am I optimistic? No.

Chairman GARRETT. You are not on the record here.

Mr. KLEBBA. I am trying to be realistic about this. Basically, what I found coming out of Washington, at least in the 20 years I have been in the banking business, is more regulation, not less. I would hope that it would happen, but—

Chairman GARRETT. Okay, thank you.

And going to the FASB aspect, this one I may disagree with you all, but let me ask you the question on it. So if FASB was sitting here, they would say we are just creating the rules to have a uniform system of accounting here, and if there is a problem for financial institutions with the interpretation of those rules or if there is a problem for the financial institutions as to how the regulators apply the rules, that is a problem that we should be taking up with the regulators and not having an impediment for FASB, as it does in the bill, to have to go through the SEC, and SEC, hey, don't give us any bad accounting standards under FASB. So isn't the really appropriate response to this not to put a constraint on FASB but to look to how it is interpreted and also how the regulator applies those rules?

Mr. KLEBBA. I think that uniformity for uniformity's sake is a nonplus. That is not where we should be. We should be where you have rules that make sense and are just and actually are reflective of reality, and I think that is where—

Chairman GARRETT. That is what they would argue that they are trying to do here with their regulations, and that the reality for the big is the same as for the small, but that how the regulators—for example, how this may impact upon your capital requirements for your institution may be onerous; but then that is up to the banking, your particular type of banking regulator to step in and say, well, we are going to apply this particular accounting standard to you, and as far as how we are going to maybe change your capital requirements because of that. But as far as an investor is concerned to your institution, they can still open your books and say the standards are the same, but this is how the regulator is going to apply it to your institutions. Does that make sense?

Mr. KLEBBA. Yes, I understand where you are coming from there, and again this is not a reflection on what you are publicly reporting. All banks, even those of us who are privately held, are obviously public reporting on a quarterly basis, but it has to do with how the regulators are dealing with you and dealing with your capital.

Chairman GARRETT. I see my time is up. Thanks.

Chairwoman CAPITO. The gentlewoman from California, Ms. Waters.

Ms. WATERS. Thank you very much. To our presenters here today, I am very pleased that you are here, and I want very badly to cooperate with the opposite side of the aisle to do something for small community banks and credit unions. And I think we may be almost on the right track here.

I hope Mr. Posey will talk a little bit about capital requirements. I am supporting his legislation. But I want to make sure that we are not inadvertently somehow doing something that is going to protect the too-big-to-fail banks, and I want to make sure that we are working strictly on behalf of our credit unions and our community banks. So let me ask just a few questions.

I know that many community banks are having challenges raising capital. Now, the Treasury Department had, was supposed to support lending at financial institutions that have trouble meeting capital requirements. Did any of your members, were you able to use this program before it closed? From the Treasury Department?

Mr. KLEBBA. We did not. We are sitting on about 15 percent capital. We have more capital.

Ms. WATERS. I can't hear you.

Mr. KLEBBA. We are sitting on about 15 percent capital, so we have more capital than we know what to do with right now, so that was not a program that was—

Ms. WATERS. So that is not a problem at this time. I understand that currently, for Mr. Becker, there are restrictions on member business lending for credit unions, and I am very much involved in this issue. How will this—specifically, how will this relax the cap and help to increase loans to businesses?

Mr. BECKER. It will relax the cap by raising the cap under a very well-crafted piece of legislation that doesn't allow credit unions to immediately go wild in member business lending, but slowly increase it. There are requirements such as they have to be doing it for 5 years; there are requirements that they have to be well-capitalized, etc.; there are studies that show that credit unions would be able to increase their member business lending as a result of that cap increase. In addition, there are credit unions that are constrained from or worried about getting into the business because of their size and the existence of the cap.

Ms. WATERS. I understand. I just want to know if the community banks and the credit unions have worked this out and you are together on how this is to happen.

Mr. MARRANCA. We have not worked this out.

Mr. BECKER. No.

Ms. WATERS. No, it is not happening.

Mr. MARRANCA. If I may add, I think we are talking about two different things here. In my opinion, we are talking about apples and oranges.

Ms. WATERS. It would be great if you could mix the apples and oranges and come out with some good fruit so that we could all be behind what you are trying to do. We get caught up in this disagreement between the community banks and the credit unions. We support both of you, but I am not going to say anymore. I just hope that as you work on this, you can work something out.

Quickly, I need you, Mr. Silvers, to elaborate on how exempting banks from the internal controls requirements of the Sarbanes-Oxley Act will increase FDIC risk.

Mr. SILVERS. Section 404 of the Sarbanes-Oxley Act requires that public companies attest that they have adequate internal controls and that independent auditors find that to be a true statement. Adequate internal controls ensure that the financial statements are actually what they purport to be and that everything from line employees walking out the door with depositors' cash, to chief financial officers rewriting the books to make them as they wish them to be.

Ms. WATERS. Okay, I get that. Let me ask the community banks: If you were exempted, how would you ensure that there are internal controls? Who would like to answer that?

Mr. MARRANCA. If I may, we strongly support internal controls for banks. We strongly oppose internal controls attestation for small banks. We are already regulated by the FDIC.

Ms. WATERS. Just tell me how you do it. What is your system?

Mr. MARRANCA. What is my system?

Ms. WATERS. For internal controls. That is the real issue.

Mr. MARRANCA. Let me start at the top with the board of directors who have a fiduciary responsibility. Then it comes down to me, the CEO, who has a fiduciary responsibility for internal controls. We have an internal control auditor, we have an independent CPA third party, unqualified audit, we have a full safety and soundness audit by the FDIC with already—

Ms. WATERS. Okay, I hear you, I hear you. I don't want to cut you off, but that is a problem that needs to be worked out.

Mr. Levitin, you note that Section 205 of this bill, which permits banks to stretch out losses, will lead families to be kicked out of their homes. Can you explain how the bill would hurt homeowners?

Mr. LEVITIN. Sure. If you look at Section 205, Section 205(a)(2) covers loan modifications. It would allow, if a bank chooses to do a principal writedown, that writedown could be amortized over time. That is a good thing. But Section 205(a)(1) refers to OREO, other real estate owned. Those are foreclosure properties and nothing else. So it is allowing losses on foreclosures to be amortized over time. If you take out Section 206 (a)(1), Section 205 is fine, it is actually a good thing. With 205(a)(1) in there, it encourages foreclosures.

Ms. WATERS. You are talking about the REOs?

Mr. LEVITIN. Yes, when loss recognition, when the property becomes REO after a foreclosure sale, that is a loss recognition event. At that point, normal accounting rules say the bank has to recognize the entire loss at that point. What 205(a)(1) would do would let the bank stretch that out over 10 years. That makes the foreclosure less painful.

Ms. WATERS. Thank you very much, Madam Chairwoman, for this hearing. Again, I would like to say to our friends in community banks and credit unions, I think we are onto something here, but I think we need to work out a few things. I hope that we can, because I want to make sure that community banks are able to operate and provide the services, and I am tired of what we have gone through with the too-big-to-fail banks. So please work all of this out. Thank you.

Chairwoman CAPITO. Thank you. Mr. Renacci for 5 minutes for questions.

Mr. RENACCI. Thank you, Madam Chairwoman.

I also believe our community banks and credit unions are really the lifeblood for entrepreneurs and business owners who will create a majority of our jobs, so we need to make sure that they are able to get loans out. And in saying that, I have listened to all the witnesses and all the sections here, it appears that some of you all agree there are some sections. I think there is only one witness who said he pretty much doesn't agree with any of these sections. Otherwise, even—Mr. Levitin, you are shaking your head, but I think you did agree with a couple. I think Mr. Silvers did as well.

Mr. LEVITIN. I very much agree with many of the provisions.

Mr. SILVERS. I agree with several.

Mr. RENACCI. That is good to hear. What I am trying to get at is there are a couple provisions that I am trying to get my hands around, and a couple of my colleagues have already touched on, first Mr. Garrett, when he talked about 104 and 105. When you do have an outside entity who is bringing a standard to the table, why would we want somebody else to interject into that standard? I am confused as to why you would even want that. It confuses. You now have another party. Keeping everything uniform is good to be able to evaluate things.

So I would like to hear from the bank, well, anyone on this side, who can tell me why you would not want uniformity.

Mr. MARRANCA. If I may, regarding Section 104, what comes to my mind is mark-to-market issues, and mark-to-market issues for a small community bank are just a different business model than mark-to-market issues for a trillion-dollar Citibank or whoever it may be. Community banks such as mine and thousands of others hold our securities to maturity for the most part. We hold our mortgages to maturity. It would be very, very difficult to mark-to-market on the asset side of my ledger, my loan portfolio. How do you mark-to-market a one-to-four-family home in rural western New York? How do you mark-to-market—

Mr. RENACCI. Not to interrupt you, because I only have so much time, but isn't that up to an explanation of how you would judge market value versus—you are saying that your bank would be different because you hold your assets for a longer period of time, and there probably isn't a good market comparison, so I am concerned about saying that is something other than uniformity. That is what is confusing here.

Mr. MARRANCA. What I don't want to happen is what is forced on a megabank that is a trillion dollars in size is forced on my bank; that is, it doesn't work the same way.

Mr. CHENEY. If I might offer a perspective?

Mr. RENACCI. Sure.

Mr. CHENEY. Credit unions are fundamentally different than any bank because of their ownership structure. Credit unions are not-for-profit cooperatives, as you know. They are owned by their members; they have no shareholders. For a not-for-profit credit union to follow the same principle, one-size-fits-all across-the-board, actually makes it more difficult for a credit union member to understand the financial condition of the credit union.

For example, for a performing loan to have to be mark-to-market, as has been proposed in the past, it doesn't make it easier. It makes it more difficult. If that loan is performing and it is going to pay to maturity, it makes no sense to write it down partway through the process. Certainly not at a cooperative. And, quite frankly, I do agree that it doesn't make sense to apply the same rules to smaller institutions in all cases as it does to larger institutions.

Mr. RENACCI. But you would agree it does take the consistency out of it when you are comparing from one bank to, one asset to—

Mr. CHENEY. I agree with that. But when they are different types of entities, I think one-size-fits-all creates more difficulties than it solves, in my opinion.

Mr. RENACCI. I want to move on to Section 102, also, because I do have a little bit of a problem with this section, and I want your help to try and help me out with it. I am a big believer in internal controls, I am a CPA, I have audited banks, I understand that internal controls are important no matter what size your bank is.

So the question is, the internal control problem you have today is that the costs are too high. And when the costs are too high in getting these internal control procedures taken care of—that is my assumption; you would like to eliminate those maybe up to the $1 billion mark that is in this piece of legislation. My question would be: If it is the cost that is the issue, maybe we should have a tiering mechanism, because just to pick a random number of $1 billion, you could have internal control problems less than a billion dollars that could be very damaging to the safety and soundness of those—the investors or the owners of the bank. Wouldn't you agree with that?

Mr. KLEBBA. I would agree with that. I think in terms of banking, though, one of the things you need to understand is that no one gets looked at more than we do. I don't think there is any industry—in the sense that we have the FDIC and our State regulator and then, of course, we have our own internal auditors and we have outside auditors, so we have lots and lots of people who are looking.

Mr. RENACCI. I don't mean to interrupt you, and I do understand that. But internal controls are something that as an auditor, I can tell you that many times I would rather see an internal control audit than a full audit, because if I can make sure your internal controls are in place, the audit is not as important to me. So it is really coming from my perspective, but thank you. Thank you all for your testimony.

Chairwoman CAPITO. Thank you. Mr. Hinojosa?

Mr. HINOJOSA. Thank you, Chairwoman Capito. I ask unanimous consent to submit into today's hearing record a letter from the State Community Banks Association expressing their strong support for the Communities First Act.

Chairwoman CAPITO. Without objection, it is so ordered.

Mr. HINOJOSA. Thank you. I want to thank all of you on the panel for your testimony on the Communities First Act. The bill's stated goal is laudable. It is time to enhance the ability of community banks to foster economic growth and serve their communities to boost small businesses and increase individual savings. My understanding is that this legislation is not intended to give community banks an advantage over other financial institutions. It simply increases the ceiling on the asset size for community banks to be exempt from various provisions of existing laws and regulations.

Recently, we held a congressional hearing on legislation to increase commercial lending limit for credit unions. Arguments were made that the current limits are too low, that credit unions are approaching those ceilings quickly and many soon will surpass their levels or those levels. I was not convinced by the testimony I read and the responses received after questioning the interested parties on the legislation. I want all those present to know that I remain committed to requiring credit unions to be subject to Federal taxation if they want to increase their commercial lending limit. Seeking an increase without providing data proving it is merited is not good public policy in my opinion.

I recognize the important role credit unions play in our financial services sector. The credit unions are doing a good job at what they do best, and also helped out considerably during the economic crisis, providing added liquidity to that provided by the community banks, and it was an excellent synergy. However, I am not certain that the performance of credit unions suggests they will be able to manage an increase in commercial loans or even close to surpassing the 12½ percent threshold.

So with that, I want to ask my first question of Mr. Salvatore Marranca. How will this legislation, H.R. 1697, benefit my constituents economically, and will it increase jobs?

Mr. MARRANCA. The answer is "yes" to both. You mentioned about the business lending proposed legislation. That is an expansion of powers legislation. CFA, or Communities First Act, is a regulatory burden relief act. It will allow me and thousands of community banks to do our job better.

We have had a snowflake effect of regulations. I have been in the bank over 30 years. Prior to that, I was a bank examiner for 10 years. The snowflake of regulations has never stopped in 4 decades. It is a cumulative effect, and it is about ready to cave in that roof with the cumulative snowfall.

Over 10 percent of my budget right now is on compliance issues. That could be allocated toward serving my customers better, whether it be a deposit product or whether it be a loan product. I mentioned I have one-half of my staff on compliance that I have on lending, to meet all the current regulations. There is an opportunity cost to this, there is a real cost to this. Let us do our business. We know how to lend in community banks. We know how to lend conservatively, and we know how to lend to our people that we trust and we know.

So it will create jobs. We are there to serve the small businesses; 100 percent of my commercial loan portfolio is to small businesses, meaning mothers, fathers, family, and so forth. Not one loan do I have to a stock-owned operation, publicly owned and so forth. Small business is my bread and butter. Let me do my job, and we will grow jobs.

Mr. CHENEY. Mr. Hinojosa, might I comment as well?

Before I started working at a trade association, I worked for 10 years at a credit union in south Texas, so I am familiar certainly with your district, and I think there is some misunderstanding about how H.R. 1418 can help small businesses, including small businesses in south Texas.

People like to say that somehow credit unions making small business loans is different than our original mission, but the earliest credit unions in this country in the early 1900s made business loans. When the Federal Credit Union Act was passed in the 1930s, credit unions were tasked with promoting thrift and making loans for provident purposes. I can't think of anything more provident than a business loan. The restrictions were not placed on credit unions until 1998, and it is constraining credit union business lending, and it is costing jobs all over this country, including south Texas. So I respect your opinion by all means, but I just ask you to think about how we might be able to help create jobs in south Texas as well. Thank you.

Mr. HINOJOSA. My time has expired, and I yield back.

Chairwoman CAPITO. Thank you. Mr. Schweikert, for 5 minutes.

Mr. SCHWEIKERT. Thank you, Madam Chairwoman.

First, I wanted to ask, and this is for whomever has an expertise on this: My understanding with Dodd-Frank is that when certain things happen, you have to actually set up a budget mortgage, is what we used to call them—I don't know if anyone still calls them that—but set up the impound accounts. Can anyone on the panel educate me on what happens to cause that? Because I think it was actually—

Mr. MARRANCA. I am not familiar with that, sir.

Mr. KLEBBA. I am not sure I understand your question.

Mr. SCHWEIKERT. Current law requires creditors to establish escrow accounts for the collection of taxes and insurance in connection with higher-priced mortgage loans.

Mr. KLEBBA. Correct.

Mr. SCHWEIKERT. That would be a budget mortgage from the old way we understood it where you have collection.

Mr. KLEBBA. Under Dodd-Frank, there is now what is called a higher-priced mortgage, and if you fall into the higher-priced mortgage, then certain requirements come into effect, one of which is that you must escrow for that particular account.

Mr. SCHWEIKERT. What is the mechanic to decide it is a higher-priced mortgage?

Mr. KLEBBA. Basically rate.

Mr. SCHWEIKERT. Creditworthiness?

Mr. MARRANCA. No, sir.

Mr. KLEBBA. It is just rate.

Mr. MARRANCA. I may be wrong on this, but I believe it is 1 to 1½ percent over the current Fannie Mae and Freddie Mac rates, so the "high-priced mortgage" in today's environment would be under 6 percent.

Mr. SCHWEIKERT. Okay. So if I had a 6 percent loan, in that particular case you would not allow me to pay my own insurance, my own taxes?

Mr. KLEBBA. We would not have the option to do that, no; we would have to do it ourselves.

Mr. SCHWEIKERT. And are credit unions and small community banks set up to provide that type of impound service? Are you contracting it out? How do you do that?

Mr. CHENEY. Escrow accounts are a compliance burden, and I think, again, one-size-fits-all does sometimes create unintended consequences. And this is another area where I agree that having flexibility would help smaller institutions and ultimately would allow more resources to be devoted to serving the community versus complying with regulations.

Mr. LEVITIN. Congressman, I think it is important to note that currently Dodd-Frank allows the Federal Reserve to make exemptions to the escrow rule. What is being proposed here would be to require an exemption.

Mr. SCHWEIKERT. Professor, do you know if any of the exemptions have been—

Mr. LEVITIN. I am not aware of the Federal Reserve having even done a rule.

Mr. KLEBBA. I don't think they have issued those rules yet, but under the restrictions it is going to be a minute number of institutions and loans that are going to be subject to that exemption.

Mr. SCHWEIKERT. One of my reasons is that I used to be a large county treasurer, and when you have a million-and-a-half taxpayers, just the clutter of collecting the bills electronically, what if you are on multiple parcels? You would be amazed how often we would have trouble with small lenders where you have a loan, credit lines, other things, but there are multiple parcels, and you are paying all the taxes on, except for one, and a couple of years later, I am as obligated to the county treasurer selling tax liens on it, who ends up carrying the liability? It is that old shifting of responsibility and often has an unintended consequence, and I don't know, does it truly make the loan that much safer and better?

Mr. KLEBBA. I can tell you, as I testified, we went 97 years and never had escrows, never provided escrows even to those few individuals who may have expressed an interest in them, and our foreclosure rates were virtually zero.

Mr. SCHWEIKERT. Okay, I spent twice as much time on that one as I wanted to. Can I throw a quick scenario at you, and you tell me if my friend who is involved in a community bank in Arizona is completely—if this scenario makes sense. He is telling me he has a client that they have had a loan with for a very long time. It is a small strip center that has quite creditworthy tenants, and they are paying—has a terrific cap rate, and they have a very consistent payment history. But a strip center almost across the street went through foreclosure and sold at a fairly dramatic discount, and he apparently has had to do a capital call to the owners of the performing strip center, even though they are creditworthy tenants, have never missed a payment, have a great payment history, but the regulator is saying no, because of our market example across the street. Rational scenario? Is that something you are finding from the regulators?

Mr. MARRANCA. I am hearing this across the country in various scenarios, and I would not—it has never happened to my bank and I would not want it to happen to my bank. If I have a relationship with an individual for many, many years, I understand the property, the cash flow, and it is before me. Why do I need to write that down? That is a forced writedown that does not accomplish anything, either investment-wise or safety- and soundness-wise.

Mr. SCHWEIKERT. In my last 6 seconds, how often were you working with your regulators and they were looking at that mark-to-market, the value of that piece of real estate, they are either looking at the creditworthiness of the tenancy or the cap rate and using a cap rate mechanic to ultimately say, here is the true value of this piece of property the way it is performing?

Mr. KLEBBA. How often is that happening? It depends on how healthy your bank is and how big your bank is as to how often they are in. It can be anywhere from 18 months at the outside to—if you are a troubled bank, they can virtually be living with you. And on these commercial real estate loans, because that is such a huge problem around the country, they are going to look at anything of any size every time they are in.

Mr. SCHWEIKERT. I am over my time. Thank you for your tolerance, Madam Chairwoman.

Chairwoman CAPITO. I am going to go to Mr. Green for 5 minutes.

Mr. GREEN. Thank you, Madam Chairwoman. Mr. Schweikert, if you need an additional moment, I will give you an additional minute.

Mr. SCHWEIKERT. I am fine.

Mr. GREEN. You are fine? Okay.

Thank you, witnesses, for appearing. Mr. Schweikert was engaged in something that I found quite interesting. Let me ask you about these escrow accounts. Do you agree that there are some people who benefit from the escrow accounts and that they genuinely—I hate to use the term "need," but they benefit to the extent that they find themselves in better shape at the end of the year than they would be if they did not have the escrow account? Do you agree that there are some people who benefit?

Mr. KLEBBA. I would agree with that assertion, but the question here is whether we are required to provide escrows. And under the Dodd-Frank Act, now we are. If it is a higher-priced mortgage, we are required to provide that. But, yes, I think that there are some individuals who have a hard time budgeting. Basically, though, if you are in a one-to-four-family house and you are having a hard time budgeting, that becomes an underwriting issue. Are those people qualified to get into a home if they can't even budget enough for their insurance and their taxes? But, no, I think that I do agree with you that there are some people who really do need escrows.

Mr. GREEN. If we adhere to the request and change the rule, would you have available escrow systems or an escrow system for those who would opt to have you do it?

Mr. MARRANCA. Congressman—

Mr. KLEBBA. Go ahead.

Mr. MARRANCA. Congressman, if it was an, I will use the word "option" for a bank, not a requirement, and keeping in mind this is only for the high-priced loans, I think many banks would perhaps evolve to that. It would be a choice. It would be a management choice, a board-driven choice, an internal control choice. But setting up an escrow account is not easy. It is expensive, it is difficult, and you need expertise. I cannot go to a bank tomorrow and say, "I want to set one up." You need the right people, and it is expensive. It has to fit your business model. It should be a decision for the individual bank.

Mr. GREEN. How would you help your client who says, "I really do need the escrow account, and I don't have the system to do it myself?" How would you help the client if you are a bank that has opted not to do this?

Mr. MARRANCA. It is simple, and I have done it before. You simply say, let's put an automatic deduction from "X," from a deposit, an automatic deduction every month into a savings account, into a checking account. That money will be there, then, and we are going to make sure that money is there for when that tax bill comes due. So we can work with the borrower on an individual level and customize that mortgage for that borrower.

Also, if I may, keep in mind that this loan is being held in my portfolio. It is in my best interests, I have skin in the game, I want that loan to work.

Mr. GREEN. Do you find this system of having the automatic deduction less difficult, is that what you are saying, than if you have a system for escrow accounts?

Mr. MARRANCA. Again, it would depend upon the size of the bank. We have community banks in our association that would make two mortgages a month. We have small banks, community banks in very rural parts that just don't have the volume to set up an escrow account. They will work with the individuals, and I am going to use the word again, "customize" it to make sure that we can fulfill the dream of that person to get into their house and not in any way hurt them in the future.

Mr. GREEN. Would you be amenable to something being written into the law that would provide for the person who falls into the circumstance that we have just discussed, something that would encourage the bank to work with the person? I believe you are right, I believe the bank will work with people; but there are times when some people find it difficult to get things done, so if the bank would have some means by which you could have what seems to be an informal escrow account that you are setting up, would that help?

Mr. MARRANCA. I am sure any banker would work with Congress for the right written procedures. I just only hesitate when you say another piece of legislation.

Mr. GREEN. Yes, I would like to not have any legislation at all. Unfortunately, that might lead back to something that we just went through, so legislation is not a bad thing. We are trying to do as best as we can and balance this. And in balancing it, we want to do what is good for the consumer as well as the banks.

I tend to have a lot of consumers who visit with me, and they make a difference, too, you know. So let's try to look at this from both points of view.

Thank you very much, Madam Chairwoman.

Chairwoman CAPITO. Thank you. Mr. Luetkemeyer for 5 minutes.

Mr. LUETKEMEYER. Thank you, Madam Chairwoman, and I thank all of you for your great testimony today. You are doing a good job.

Very quickly, there were some statements made a while ago, or made something to the effect that the legislation jeopardizes the safety and soundness of our banking institutions. Gentlemen, would you like to address that just for a second? Do you feel that it does or does not?

Mr. MARRANCA. Totally disagree, sir.

Mr. LUETKEMEYER. Totally disagree.

6 here Mr. KLEBBA. Totally disagree.

Mr. LUETKEMEYER. Totally disagree. They made some remark to the effect that it jeopardizes our ability to service our customers, and customers are in danger of being foreclosed on more often. Do you believe that is the case with what is going on here?

Mr. MARRANCA. Totally disagree, sir.

Mr. KLEBBA. I think quite to the contrary. I think that it permits us to work with our customers even more so than we have in the past.

Mr. LUETKEMEYER. I think that leads into a couple of the different discussions we have had already with regards to loan amortization as well as loan appraisals. I think sometimes that we are getting some of the context of accounting versus regulatory stuff mixed up here. There is a big, big difference here, and from the standpoint of the regulators, I would certainly like your input on this from the standpoint of when they come in and they analyze your loans and they look at your files, if they only have—the appraisals, for instance, on the 5-year rolling average on Section 206, if that is all they have to look at is the current market, which is in the doldrums here, there are no recent sales, all you have is the foreclosed homes, how does that impact your loan portfolio?

Mr. KLEBBA. First of all, the FDIC fund is fully funded by banks, and so for those of us who are surviving, the last thing we want to do is see a dead bank continue to go on, because the losses just continue to appreciate, and we have to pay that bill. But what we don't want are banks that are viable banks that get closed prematurely, and I think that can happen sometimes when markets temporarily decline if you have to, "mark-to-market" on some of those loans or you have to write down loans to appraised value at that time.

Mr. LUETKEMEYER. At the same time, these appraisals that they look at and they look at the loan and all the other things that are in there, it is a very arbitrary, very subjective way of looking at something. I am sure you don't agree with everything the examiners look at when they analyze your bank, you don't agree with everything they come up with, I am sure.

Mr. KLEBBA. I haven't had an experience yet where I have agreed 100 percent with anything they say.

Mr. LUETKEMEYER. So obviously, if it is arbitrary, then I think the case can be made that for a 5-year rolling average, it gives a more fair assessment of what the risk would really be in that particular line that you are looking at. Would you agree with that statement?

Mr. KLEBBA. Yes. I think we need to get back to normalized values, not the deflated values that we are seeing today, because I believe—

Mr. LUETKEMEYER. If you look at the cyclical nature of real estate, it goes up and down like this, and with a provision like this, it sort of takes the highs and lows off of it, so I think it puts a little more consistency in there. Would you think that would be a good thing to help stabilize things for you and your bank?

Mr. MARRANCA. I think it will, sir.

Mr. KLEBBA. Yes.

Mr. LEVITIN. Congressman, there is an important point that needs to be made about this, which is this provision, Section 206, applies to impaired loans. Impaired loans may not be held to maturity. They may be liquidated within a year, and in a depressed market, using a 5-year average that includes the heights of the bubble in 2006 right now, means that we are going to have banks that are carrying assets at grossly inflated values as a result. It is arbitrary—

Mr. LUETKEMEYER. Reclaiming my time here, with regards to that, I would remind you that this still is an arbitrary figure that is discussed between the banker and the FDIC or the Fed or the Comptroller, or whoever is doing the examination, as to what the true loss is that is involved in this. So I think that there is still some discussion, some arbitrary decisions to be made here. And that is the point I am trying to get at is that this isn't a finite, definite way of looking at things. It is very arbitrary, and I think we need to recognize that fact.

With regards to—I know Mr. Renacci had a couple of questions with regards to the attestation. It is interesting that we are looking here at a billion dollars of assets whenever the Dodd-Frank bill has a capitalization of $75 million for all companies. And, again, we are comparing apples to apples. We are looking at the assets versus the capitalization, which the average bank in this case with 75, it may be a 7½, it may be a billion-dollar bank, capitalized 7½ percent, so I really don't see quite the concern there. Do you guys see something that I am missing in that? No? Good.

I think also—well, I see my time is up, so I will yield back. Thank you, Madam Chairwoman.

Chairwoman CAPITO. Thank you. Mr. Scott?

Mr. SCOTT. Thank you, Madam Chairwoman.

As I mentioned in my opening statements, I represent Georgia. Our primary concern there is how we can help these struggling banks and how we can try to prevent bank failures. Let me just ask, I guess, the banking individuals, do you feel this legislation will be effective in any way in aiding struggling small banks and preventing banks from closing?

Mr. KLEBBA. I think there are a lot of provisions in here, most provisions if not all, that would assist small banks, especially those that are struggling from failure.

Mr. SCOTT. Could you tell me how, please?

Mr. KLEBBA. First of all, you would have less regulatory costs, and the regulatory costs are overwhelming in our industry right now. We have had to hire additional personnel. And worse, I think, than hiring additional personnel on that is the fact that virtually everyone in our bank now is involved to some extent or another in complying with regulations, and so it has taken away from their ability and their resources to both work with our existing customers and also to go out and solicit new customers, helping other people get businesses off the ground. So the compliance burden is huge, and I think that this bill would significantly reduce it.

And then, secondly, as I testified before, the tax burden on us relative to several of our competitors and farm credit services and credit unions is a huge burden for us and makes it very difficult for us to compete, especially with respect to very attractive loans, that we just can't compete on the rate side because our cost structure is different.

Mr. SCOTT. That is very good to have established that it will help and be effective in aiding struggling small banks and preventing them from closure.

The other point is, will it help the banks be able to lend? That is another problem, getting the banks to lend the money to small businesses. Will it help in that area?

Mr. KLEBBA. I can tell you both from our perspective and from the perspective of virtually every bank in Missouri—I am the immediate past chairman of the Missouri Bankers Association, and I had an opportunity in the past 12 months, from last June, to travel throughout the State and talk to many banks. And other than those few who are very troubled and are having capital issues and so need to shrink, every bank has excess liquidity right now that they are trying to lend. And it is not a question of turning down loans. It is a question of getting both consumer and business appetite for taking on new loans.

Mr. SCOTT. So in the two critical areas, then, we can safely say that this legislation will help prevent struggling banks from closing, and it will also help them to be able to lend to small businesses.

Now, let me ask, let's see, the representatives of the credit unions, I believe that is Mr. Becker and Mr. Cheney. How will this legislation affect credit unions?

Mr. BECKER. Primarily, it will not affect credit unions. There are a few small provisions that will affect credit unions, and we think a more balanced approach would be to add other items that we—

Mr. SCOTT. So you basically are a supporter of this legislation; is that correct?

Mr. BECKER. What we would like to do is see an all-encompassing bill that would help not only banks but credit unions as well.

If I might, too, my colleague John here next to me, I would invite him to join the two other banks that converted to credit unions, if he would like to do so. And I would be glad to help him, and I am sure Bill Cheney would be glad to join me in helping them.

Mr. SCOTT. But you are not actively opposing this legislation; is that correct?

Mr. BECKER. Again, Congressman, we would like to see regulatory relief added for credit unions. I believe Congressman Luetkemeyer said the purpose of this, if I might say, is to help all Americans realize their dreams; that they weren't part of the problem, but part of the solution. That sounded like credit unions to me, sir, as well.

Mr. SCOTT. Okay, I will take that for a sort of you are okay with the legislation.

Mr. CHENEY. If I might comment briefly, too, there has been a lot of discussion at this hearing and others about demand, and a lot of talk about that there is not demand. That may be true in some communities, but we have seen demand for credit unions, small business lending, we have seen credit unions make loans that banks either haven't made or aren't able to make.

I am aware of one small community—I was in the Northwest not long ago—where there are four community banks and one credit union in the market. One of the community banks is in the process of being acquired and is not currently making business loans. The other three are under regulatory restrictions and are not able to make business loans. The credit union is approaching its cap.

How do we tell the small businesses in that community that it is good policy not to the raise the cap when they are about to run out of any capital to operate their small businesses from local financial institutions?

There is demand, maybe not in every community. Recessions do limit the demand, but the only way out of the recession is to create jobs. And this is a way to create jobs, H.R. 1418, without costing the taxpayers.

So we would like to see a balanced approach, as Mr. Becker said, to aid community banks and credit unions.

Mr. KLEBBA. I don't know if you have time, but—

Chairwoman CAPITO. Thank you.

Mr. KLEBBA. —do I have time to respond to any of that?

Chairwoman CAPITO. I think we need to go to the next questioner, because we are pushing up against votes here.

Mr. Canseco?

Mr. CANSECO. Thank you, Madam Chairwoman.

Mr. Marranca, you mentioned something in your testimony that caught my eye. You state that "rural borrowers, in particular, would be hurt by industry consolidation because large banks don't comprehensively serve rural areas."

Now, I represent a large portion of west Texas, and, as I said in my opening statement, a lot of small towns in my district depend heavily on local community banks.

Could you provide us a little more color on the effect of consolidation on rural communities, given the conversations you have had with some of these bankers?

Mr. MARRANCA. Yes, sir. Both personally and in my role as chairman of the ICBA this year, I have said over and over and over again, when you are gone, you are gone. Whether it is regulatory effect, the cumulative effect of the regulations, the accounting effect, or the economy, when you are gone, you are gone.

My 110-year-old bank serves three counties, including a large Amish population. I actually have a branch on a Seneca Indian reservation. This is not a—the population density of my county is 67 people per square mile. This is not an area that Bank of America is interested in.

If I ever had to sell or merge or consolidate my bank, my customers lose, because of the personal service, the relationships, and the ability that we have had, for 110 years, to meet the credit needs of our community.

It is very important across Main Street and across America that Main Street community banks continue to do what they have done for generations. We are the only country in the world that has a foundation of 7,000 community banks. There is no other country in the world that has that. And we can't lose that, sir.

Mr. CANSECO. Thank you, sir.

Mr. Klebba?

Mr. WILMARTH. Congressman, may I add something to that?

On page 2 of my written testimony, I point out how different Canada and the United Kingdom are from the United States in terms of their banking systems. And there is abundant evidence that in those countries, which are dominated by very large banks and have very few community banks, consumers and SMEs are not well served.

The Vickers report that just came out from the Independent Commission on Banking in England in September advocated a more aggressive breakup of the big banks because they concluded that the big banks are not providing adequate services for local communities, consumers, and small businesses in England.

Mr. CANSECO. Thank you.

Mr. Klebba, if you were to prioritize some of the provisions of the Communities First Act, which ones do you feel are the most important to community banks and should take precedence?

Mr. KLEBBA. I can't choose one. I would choose two, and I—

Mr. CANSECO. Go ahead, give us the two.

Mr. KLEBBA. The first is, I think, the tax provisions to try and put us back on a level playing field with respect to—or a more level playing field; it doesn't get us anywhere near to being all the way there—but with respect to both Farm Credit Services and having the same exemptions from income from taxability on farm loans, certain farm loans, and residential loans in very small communities, I think, is very, very important to us. It also allows us to get a little bit closer to credit unions, in terms of taxability.

A family of four, an average family of four in this country pays more in Federal taxes than a credit union does. So, their tax burden in that respect is zero. Ours is significant. We paid close to a million dollars in total taxes last year. So it is a significant cost differential for us.

And the second is the regulatory burden and the fact that this would recognize that for smaller banks like ours who are in smaller communities, the fact that we live with our customers, we go to church with our customers, we see those people on a day-to-day basis. And I don't think there is near the regulatory concern, or should not be, for our size banks as there are for other banks. And it is just getting to be a tremendous and overwhelming cost for us.

Mr. CANSECO. Mr. Marranca, do you want to add anything to that?

Mr. MARRANCA. Congressman, I think if you asked a thousand bankers, you would probably get a thousand different answers of priority. But the overregulation, yes. The tax provisions make a real difference to my bottom line. In the last, I believe it is 9 years, I have paid over $2 million in Federal and State taxes, and I could have put that money to capital and to lending. So the tax provision is important.

The small business, I am going to call it, potential new regulation, the small business reporting is a concern of mine for another regulation that would burden my bank and my people.

And then you get into things that are just, in fact, a waste of energy and time: the privacy notice; the four-times-a-year call report.

So, if I may, sir, I want them all.

Mr. CANSECO. Let me just add this, because I have 15 seconds left. I hear the same, same priorities from every single one of my community banks. And I represent a huge district of Texas, from San Antonio to El Paso, and you are voicing from Missouri to—New York?

Mr. MARRANCA. New York, sir.

Mr. CANSECO. New York. You are voicing the same thing that I hear in my district. I thank you very much and I yield back.

Chairwoman CAPITO. Thank you.

Mr. Perlmutter?

Mr. PERLMUTTER. Thanks, Madam Chairwoman.

I appreciate everybody's testimony today.

And I will state that I have a bias in this. We passed a bill out of the House into the Senate last year which allowed for amortizing losses so that you didn't have to have an immediate capital infusion, which some banks couldn't come up with, which then led to their closure. And in Colorado, we have had a number of banks close.

And so I have to look at some basic principles: more competition, not less, that is what I want to see; help the innocent or the less guilty, less culpable; I guess I am more for workouts, not liquidations or foreclosures if they can be avoided; and hold for the long term, not just the short term. So, based on those principles, there is a lot I like in the sponsor's bill. There are some things that are problematic, from my point of view.

So, having said that, Mr. Levitin, I would—and you and Mr. Silvers were sort of the most aggressive against the bill. Mr. Wilmarth, I will have some questions for you, too.

But let's take that shopette that Mr. Schweikert was talking about. So one shopette is paying as agreed. The other shopette across the street is in foreclosure. They had lousy management, who knows what it was. Now we have an accounting issue. Do you mark that down to the foreclosure price across the street, or do you allow the income to establish what the market price is?

Mr. Luetkemeyer's bill has an accounting component to it. And, Mr. Silvers, you were—sort of, the mark-to-market piece of this—you were concerned about that. That is number one. Okay, maybe I am misspeaking.

The other piece is, let's say I write that shopette down. My feeling is that the small banks, the credit unions didn't cause the mess that we are facing today. Okay? So I want to give them a chance to work their way out of this thing, along with their customers. My people in Colorado say, nobody's lending, not enough anyway.

So, if you have a reaction, first Professor Levitin and then Professor Wilmarth and then Mr. Silvers?

Mr. LEVITIN. Currently as drafted, Section 206 applies to all real estate. It is not just a commercial-real-estate provision. If you narrowed it to commercial real estate, I think it is much less problematic. And if you narrowed it to commercial real estate, it really kind of brings some focus to what the CRE problem is.

Commercial real estate and the CRE values aren't going to come back until consumer spending comes back. There is really no way to fix the commercial real estate problem and asset prices there without fixing consumer spending. And that brings you, then, to consumer mortgages.

Mr. PERLMUTTER. The need for jobs. We need to have jobs.

Mr. LEVITIN. It is jobs, but it is also de-leveraging consumers.

Mr. PERLMUTTER. Okay.

Mr. LEVITIN. You need to get rid of the $700 billion in negative equity that roughly 11 million consumers have.

Mr. PERLMUTTER. Okay.

Professor Wilmarth?

Mr. WILMARTH. I agree. As I mentioned in my written testimony, Section 206 is most applicable to commercial real estate. I think you could also limit it to smaller banks, not the huge ones. And I think you could include some regulatory safeguards in Section 206, for example, by limiting that section to well-managed banks. I think you could look back at the 1980s forbearance program for agricultural banks and get some pointers from that experience.

I agree that the goal should be what you have identified, that where markets are frozen and there really is no reliable market value available but the properties are still performing, can support the loans, it doesn't make sense to force a drastic write-down in those situations.

Mr. PERLMUTTER. Or, if you do, to at least give the bank a chance, or a credit union. I think these things apply across the financial strata there. It doesn't have to be the big banks. We already infused capital. We did it the other way. We didn't let them have time to work it out; we gave them the money. Work it out. They did, thank goodness. They obviously have a major role to play here. But now, what about the little guys? And I want that competition.

Mr. Silvers, what is your reaction?

Mr. SILVERS. An observation about mark-to-market—generally, historically, we have asked firms and all kinds of institutions to mark assets to market when they are readily tradeable, there is a price you can get, and there is some possibility that they might be sold, right?

Mr. PERLMUTTER. Right.

Mr. SILVERS. And this has been important in relation to banking because banks, big or small, have demand deposits so that there is a possibility that people could want their money back, right?

Mr. PERLMUTTER. Right.

Mr. SILVERS. And so, there has been something of a bias around banking toward marking to market.

Now, it is interesting, the extent of folks' unhappiness with that regime in banking, because pension funds, who don't have demand deposits, with fixed obligations, very long-term fixed obligations, have been asked to mark everything to market now, and particularly have been asked by some of your colleagues on the other side of the aisle to mark everything to market.

Mr. PERLMUTTER. Okay, but I am going to stop you then. I know my time has expired.

Mr. SILVERS. Sir, can I just—in response to your question—

Mr. CARNEY. I will yield—

Chairwoman CAPITO. Hold on just a minute.

Mr. SILVERS. Sorry.

Chairwoman CAPITO. Mr. Carney has generously offered to yield you time, Mr. Perlmutter.

Mr. CARNEY. I will yield the gentleman time, whatever time he needs.

Chairwoman CAPITO. All right. Go ahead.

Mr. SILVERS. In response to your question, what troubles me particularly about the provisions in this bill in relation to mark-to-market is not realizing the loss that occurs in a foreclosure when the loan has turned into a bad asset, not just a bad loan but a piece of property.

Mr. PERLMUTTER. Thanks, Madam Chairwoman.

Chairwoman CAPITO. Sure.

Mr. Stivers?

Mr. STIVERS. Thank you, Madam Chairwoman.

I appreciate all the witnesses' testimony. And I certainly sympathize with the plight of our community banks and credit unions who are trying to comply with laws that were intended to fix the crisis that you guys had nothing to do with. And I know it is increasing your costs.

There have been a couple of bogus claims I want to address and ask some questions about, and then I do have a couple of concerns I would like to dig into a little bit.

My first question is for Mr. Marranca and Mr. Cheney and Mr. Klebba. Is there any way for a bank or a credit union to profit from foreclosures? Just a "yes" or "no."

Mr. MARRANCA. I would love to find a way, sir. No. No. It hurts the community, it hurts the banker, both—

Mr. STIVERS. I am just talking—don't talk about the community. I am asking, this is a "yes or no" question.

Mr. MARRANCA. No.

Mr. STIVERS. Thank you.

Mr. CHENEY. No. We agree.

Mr. STIVERS. Thank you.

And can you tell me, on average, about how much, each of you again, foreclosures cost you for each foreclosure? I know it is a range, but on your average mortgage.

Mr. MARRANCA. Average size of my mortgage—and, again, I am in a very rural, poor market—average size mortgage in my market is approximately $75,000. When it gets down to foreclosure, we probably write down at least two-thirds of that, so let's bring it down to approximately a $25,000 loss. We have had approximately 6 foreclosures in the last 2 years—relatively small.

Mr. STIVERS. Okay.

Mr. CHENEY. I don't have the numbers with me for credit unions, but we can certainly get that for you.

Mr. STIVERS. No, that is fine.

Mr. KLEBBA. I would have to answer two ways. One, for commercial foreclosures, it is all over the place, depending on how—

Mr. STIVERS. Let's talk about residences. The claim was that people were going to be thrown out of their homes into the streets, so let's talk about residences.

Mr. KLEBBA. I think we have had two or three residential foreclosures in the last couple of years.

Mr. STIVERS. And they have cost about how much, in round numbers?

Mr. KLEBBA. Probably $5,000 to $10,000 apiece.

Mr. STIVERS. Great. Okay. So if these small banks that we are talking about, and credit unions, can amortize that loss over 5 years, won't it really result in those banks having more money to lend, and won't it also result in keeping them, as Mr. Perlmutter said, from having to raise capital at exactly the worst time?

Mr. MARRANCA. Yes, sir.

Mr. CHENEY. I agree.

Mr. STIVERS. Great. Thank you.

And I do want to get to appraisals, but before I do—because I did have a question for Mr. Levitin because he talked about the cost-benefit analysis.

Mr. Levitin, do you have a Ph.D. in economics?

Mr. LEVITIN. I am not.

Mr. STIVERS. Do you have an accounting Ph.D., maybe, or statistics or mathematics?

Mr. LEVITIN. I do not, but I do—

Mr. STIVERS. Do you have a background—

Mr. LEVITIN. I do, however—

Mr. STIVERS. Do you have a background as a business analyst?

Mr. LEVITIN. I do not.

Mr. STIVERS. So I understand why you can't do the cost-benefit analysis, but I guess—so have you consulted with economists, accountants, statisticians, mathematicians, or business analysts about whether they can do these cost-benefit analyses?

Mr. LEVITIN. In fact, I have. And I can speak to you, actually, about specifically what the people at the SEC, who have J.D.s and Ph.D.s in economics think about the difficulties in doing cost-benefit analyses, and I am happy to have that conversation with you.

I do want to point out there is something about foreclosures which I think you have misunderstood. The issue is not whether banks lose money on foreclosures. Of course they do. The problem is that banks have a choice. They make a choice between trying to restructure the loan and foreclosure. And it is which choice is more attractive to them, where are they going to lose less money. It is not where they profit; it is where they lose less.

By allowing the loss amortization over 10 years, you are making foreclosure the relatively more attractive option. I don't need an economics Ph.D. to understand that.

Mr. STIVERS. Yes, but do you feel like these community banks just make every decision on the bottom-line dollar and they don't ever look at the community, the lender, the relationship with the borrower? Is that what you are saying?

Mr. LEVITIN. The relationship is part of the bottom line. However, they do owe a duty to their shareholders to try and maximize the value. And if that means kicking someone out of their house, that is what they should do for their shareholders.

Mr. MARRANCA. Sir, that is not true.

Mr. STIVERS. So, Mr. Levitin, do you understand that Dodd-Frank already requires cost-benefit analysis?

Mr. LEVITIN. I am sorry, for?

Mr. STIVERS. A lot of things, including dealing with any rulemaking.

Mr. LEVITIN. I understand that—and it is not just Dodd-Frank. Cost-benefit analysis—

Mr. STIVERS. Great. I need to move on to another subject.

Mr. LEVITIN. —is a general problem. This is not just banking; this is—

Mr. STIVERS. Thank you. I am reclaiming my time. Thank you so much.

I do want to quickly deal with appraisals. Have any of your—I know that that subject has come up already, but I have heard from a lot of Ohio banks that they have been forced to not just make a capital call but actually write down their loans based on appraisals of performing loans, and that results in them having less money to lend.

Have any of the bankers heard of that? And I am out of time.

Mr. MARRANCA. I have heard of that consistently across the country, yes.

Mr. KLEBBA. And I have heard a number of stories to the same effect.

Chairwoman CAPITO. Thank you.

We have a vote coming at about 4:15. I want to ask Mr. Carney, do you want your other 4 minutes, your remaining 4 minutes, for questions?

Mr. CARNEY. Sure.

Chairwoman CAPITO. Mr. Carney, for 4 minutes.

Mr. CARNEY. Thank you very much, Chairwoman Capito. I appreciate very much you having this hearing today.

Like others on the panel today, I am sympathetic about some of your concerns with respect to the cumulative effect of regulations. We have heard that often—outdated regulations. So this represents a compilation of those regulations that are troublesome for community bankers, is that fair to say?

Mr. MARRANCA. It is a start, sir.

Mr. CARNEY. It is a start. Are there others?

Mr. MARRANCA. Given time, I am sure there are many, many, many others.

Mr. CARNEY. The reason I ask is because I ask this question of small business people, mostly in my State of Delaware, all the time, not as much of banks, because it is something I hear all the time, complaints about regulations that get in the way, whether environmental or otherwise. And often, they are caught not being able to respond directly, and they will say, "Let me get back to you on this."

The reason I ask is because this is the forum for doing that. And so, I appreciate you bringing this forward. We have heard—do the credit union organizations have a similar list that we ought to be considering, as well?

Mr. BECKER. It is in my written statement, sir.

Mr. CARNEY. Okay. I will take a look at that.

We have heard a lot of differences of opinion—I want to go to that—on the amortization question, Sections 205 and 206, and I think Section 102, as well, with respect to accounting standards. Like my good friend from Ohio, Mr. Renacci, I am a stickler for standards, as well. And I guess I need to understand how a change there is really important to the business that you do.

So, the three folks at the end here who come with a little bit more objective, I guess, point of view here, could you explain to me your objection to Sections 205 and 206, expand on the conversations that we have had with Mr. Perlmutter and Mr. Stivers and others?

Mr. LEVITIN. If I may, Congressman—

Mr. CARNEY. Yours, I think, is more with respect to residential.

Mr. LEVITIN. In particular. I think that is where it is the most problematic. There are two problems with it.

One is simply a general accounting principles problem. Congress should not be encouraging voodoo accounting.

Mr. CARNEY. Right. I agree with that.

Mr. LEVITIN. And that is what this is doing. It is trying to have exceptions to accounting rules—

Mr. CARNEY. Is it really voodoo accounting or is it really trying to find a way to address a particular kind of business model here on the banking side?

Does anybody have—Mr. Wilmarth is shaking his head. Do you have a different view of that?

Mr. WILMARTH. That is why I suggested that this approach could be tailored to the kind of commercial real estate situations we have been hearing about.

Mr. CARNEY. So I guess that is the question: Is it tailored enough?

Mr. WILMARTH. I would have—

Mr. CARNEY. Mr. Silvers is shaking his head "no."

Mr. Silvers, could you explain why you don't think it is tailored enough?

Mr. SILVERS. I think you have—let me just again reiterate Professor Levitin's comments. This is really focused on residential real—

Mr. CARNEY. Right.

Mr. SILVERS. This isn't meant for residential real estate. There are some—

Mr. CARNEY. So you don't have similar concerns, serious concerns with the commercial application, is that accurate?

Mr. SILVERS. I have less serious concerns. And I think there are still problems that relate to, sort of, the basic integrity of the accounting system.

Mr. CARNEY. Gotcha.

Mr. SILVERS. But when it comes down to what kind of behavior we are going to be incentivizing and what the implications of that for our economy are going to be, it is more in the residential area that the concerns lie.

Now, how might one tailor it? As Professor Levitin has pointed out, if you confined the loan amortization provisions to an impaired loan and to losses that might result from that, it creates less of an incentive issue. It also does less violence to the accounting regime, because an impaired loan is not a realization event in the way that a foreclosure is. Those types of considerations could get you to something more reasonable.

There is something else, also—

Mr. CARNEY. I only have 5 seconds left, so let me ask one more question.

Do you three agree with the other provisions of the bill? Do you think that they are reasonable changes?

Mr. SILVERS. If I might just quickly say that there are a number of provisions in the bill. The three that were listed in the oral testimony of Mr. Marranca are reasonable provisions. But the bill is laced with extremely dangerous things. And an effort could be made to separate—

Mr. CARNEY. Is that in your statement? Because my time is up.

Chairwoman CAPITO. Yes, I am going to have to call it, because we have been called for votes and I have a few more folks.

Mr. Posey?

Mr. POSEY. Thank you very much, Madam Chairwoman.

Mr. Silvers, do you think there is any such thing as overregulation?

Mr. SILVERS. Oh, sure, there is. As I just said in response to Mr. Carney's question, I think the three items that Mr. Marranca emphasized in his opening testimony are items which, on the surface, would appear to be reasonable changes that Congress should take a look at—

Mr. POSEY. But do you think there is such a thing as overregulation? Just kind of a "yes or no" would save us both a lot of time, and I am running out of time.

Mr. SILVERS. I think I just said "yes."

Mr. POSEY. Well, "yes" sounds a whole lot better than, "I think I just said 'yes'," but thank you very much.

Mr. Levitin, do you think there is such a thing as overregulation?

Mr. LEVITIN. Yes, but I think the critical thing is not the amount of regulation; it is whether they are good regulations or bad regulations.

Mr. POSEY. Give me an example of bad overregulation.

Mr. LEVITIN. It is not bad overregulation, it is bad regulation. The question is not the number of regulations, it is whether they are smart regulations.

Mr. POSEY. So you don't think there is such a thing as bad overregulation?

Mr. LEVITIN. There is bad regulation, and if you have too much of that, that is bad overregulation.

Mr. POSEY. So that is a "yes."

Mr. LEVITIN. If I understand the—for what I think you are asking me—I am not trying to play with semantics here. I am really trying to actually make a point that the problem is whether these are good regulations or not, not the sheer number of regulations—

Mr. POSEY. Reclaiming my time, I just want to qualify your comments. We have had people come in here to talk about overregulation and never acknowledged in their written or oral testimony that there was such a thing as overregulation. They always just talked about what happens if there is underregulation. But I think every member of this committee has been convinced over the past couple of years of testimony that there is significant overregulation.

And I can assure you, despite your inference to the contrary, there is not a single Member on either side of this aisle in this committee, ever, who wants to harm American families. I think every Member here wants the same thing. They want the American dream to be available for everybody in this country. We do have differences over how to get there occasionally, but nobody is trying to harm the American family, I can assure you.

As to handling—

Mr. LEVITIN. I am glad to hear that, but—

Mr. POSEY. It is my time.

Mr. LEVITIN. —that is what this bill will do.

Mr. POSEY. Excuse me. Excuse me. You are out of order.

As to the handling of loans, my local community banker, where I bank, had to fail to renew a loan for a businessman because regulators said, if you renew this loan, modify this loan, it automatically goes on non-accrual. So he couldn't do that, which would cause his bank significant losses. So of course, the guy became delinquent in his home loan, and just came in and put the keys on the bank president's desk and said, "It is yours. I can't do it." And the bank president said, "No, no, no. No, you don't. No." They didn't want a house back that is empty. They didn't want to ruin the neighborhood values. He hung in there with the guy until he got a REALTOR® to sell it for him and did the best possible thing in that instance.

And I beg to differ with some of the other opinions expressed that big banks have a greater ability to do this. They are less willing to do it. The community banks, obviously, are much more inclined to give that personal attention to individual homeowners or individual businesspeople.

With the exception of the Veterans Administration, which has a loss ratio of about 2½ percent, enviable for any lender anywhere—and I understand that is attributable to the fact that they qualify their people. And when there are problems—and people are inevitably going to have some problems—they spend the time to work it out with them. They are not handicapped by a bunch of monolithic bureaucrats or bureaucratic written regulations, and that gives the VA the ability to have such a low loss ratio.

So, I see my time is running out. I would ask any of the other members, the other four that I haven't asked questions to you yet, you have 36 seconds if any of you want to weigh in or comment on that.

Mr. MARRANCA. Congressman, I would invite the academics at the other end of the table to come to my bank, and I will show them overregulation.

Chairwoman CAPITO. If we could, I am going to go to to Mr. Sherman for 3 minutes, and then Mr. Westmoreland for 3 minutes, and then, I think that will conclude the hearing.

I am going to go vote. Thank you all very much.

Mr. SHERMAN. I will stipulate for the gentleman that there is such a thing as overregulation. There is also underregulation. There is smart regulation. There is dumb regulation. And, hopefully, government will get it right someday.

When I talk to everybody in my district, they want jobs, small businesses want capital. If any of you have some extra loans to make to small businesses in the San Fernando Valley, see me. I will miss votes to talk to you.

Now, I want to support this bill so that small banks and community banks in my district will have the capital to make loans. And, at the same time, there are credit unions that aren't able to make loans because we prohibit them, in effect, or limit what they do.

Mr. Klebba, the credit union witnesses have suggested that we go with this bill but also allow member business lending from credit unions.

Is there a reason why I should tell people in my district, "Well, try to get a loan from a community bank, and if they say no, don't go to a credit union because Congress is going to prevent them from making the loan?" Or should we be trying to help both kinds of institutions make small business loans?

Mr. KLEBBA. A couple of facts—99.5 percent of the credit unions in this country are nowhere near their business lending cap. So—

Mr. SHERMAN. Many of them haven't gone into business lending because they can't gear up to do it. Their small business lending cap might be a million dollars, and so they go with zero because they can't hire a loan officer to make a million dollars' worth of small business loans.

We want to have all credit unions making small business loans in the San Fernando Valley. But is there some reason why we should just help you and not help them?

Mr. KLEBBA. What I am saying, I guess, is that there is a relatively easy way for them to make as many business loans as they want: Convert to a bank. It is not that hard. And then, they become a tax-paying entity.

Mr. SHERMAN. I am waiting for my Republican colleagues to convert to Democrats. It is not that hard.

And, Mr. Marranca, small banks would like to be able to be Subchapter S and have preferred stock. I see your need for new kinds of capital. Would you oppose having alternative capital for credit unions along with that?

Mr. MARRANCA. Sir, first, the issue of Subchapter S, I just have to clarify that a little bit. Subchapter S banks, their stockholders pay taxes. They pay it at a 35 percent level. So it is a piece of misinformation that Subchapter S do not pay taxes.

Mr. SHERMAN. I didn't say anything about that. I understand Subchapter S rather well.

Mr. MARRANCA. Okay. I would be open to discuss—

Mr. SHERMAN. You want to be able to have more flexibility for your members to raise capital. The guy next to you wants more flexibility for his members to raise capital. Can you join hands, the way I joined hands with my Republican colleagues?

Mr. MARRANCA. Capital is important for both credit unions and small banks, and we certainly are not opposed to any ways to find more capital to go into those banks.

Mr. SHERMAN. That is a great answer. Thank you.

Chairman GARRETT [presiding]. If the gentleman yields back?

Mr. SHERMAN. Yes.

Chairman GARRETT. Mr. Westmoreland is recognized for 3 minutes.

Mr. WESTMORELAND. Thank you, sir.

Mr. Silvers, quick question. This is a math question. You say you represent 250 organizations representing more than 50 million people.

Mr. SILVERS. Yes.

Mr. WESTMORELAND. That is one-sixth of the American population. That is an average of 200,000 people per organization. Are those numbers correct?

Mr. SILVERS. I think they are mathematically correct, but they are not very—they don't really explain the—it is not 250 organizations each with a couple hundred thousand members. Some have small numbers; some have big numbers. Organizations like the AARP have lots of members.

Mr. WESTMORELAND. Okay. But you represent—one-sixth of the American people are represented by you. That is a pretty big job.

Mr. Levitin, in your statement, you said, "The Communities First Act will actually destroy communities by encouraging mortgage foreclosures that hurt families, neighboring property owners, and local government."

You were part—or served as Special Counsel to the TARP program; is that correct?

Mr. LEVITIN. To the Congressional Oversight Panel supervising the TARP.

Mr. WESTMORELAND. Okay. Now, let me explain to you what TARP did. It destroyed communities, it cut neighboring property owners, and it really hurt local governments.

So let me tell you how it did it. When you gave the money to the big banks, or whoever did—or you were the oversight—let me tell you what happened. They started holding companies, and then they straightened out the books of these big banks, and then they came into our communities and they had absolute auctions on these houses—absolute auctions. Somebody may have bought a house a month before, 2 months before, 3 months before, and then you had a builder building next-door, and all of a sudden he can't sell his stuff for 40 cents on the dollar because the government didn't give him any money.

Now, because of these goofy mark-to-market accounting principles that you try to uphold, these community banks had to write down some of these loans, even some loans that were performing, because of these fire sales that TARP enabled people to do. So now, you have this first round of banks that have to close, not really because they don't have the money, but for paper losses.

Next, they go in, these loss-share-agreement acquiring banks come in, destroying neighborhoods, lowering the value, because you know what? They don't have any incentive to work out these loans, because when they do, they come out from under the loss-share agreement. So there is no incentive.

So what do they do? They foreclose, they fire-sale the property. And then what happens? More community banks close because of the mark-to-market. They have plenty of liquidity, but they can't raise capital and they can't get rid of 20 percent of their real estate portfolio in the market it is.

And so, if you want to talk about destroying neighborhoods and you want to talk about something that sucks the wealth out of a community, you let a community bank close.

And these community banks are being closed, and they have no legal recourse against the FDIC to try to find out why they were closed when they were paper losses and they had liquidity. Now, to me, that is just not right.

And so I guess, that is more than a question, I have a statement. And my statement is that some of this stuff in here, if you were associated with TARP, you took part in destroying some of these communities. As a result, probably unintended consequences—I am sure you didn't mean to do it—

Mr. LEVITIN. I need to interrupt because I think it is actually critical that you understand. The Congressional Oversight Panel did not create TARP, it did not administer TARP, it was incredibly critical of TARP from the get-go—

Mr. WESTMORELAND. Okay. That is great.

Mr. LEVITIN. —and that I am in no way responsible for TARP and—

Mr. WESTMORELAND. Okay. That is what TARP did. And, as a result of the mark-to-market—you did defend the accounting.

Mr. LEVITIN. Mark-to-market accounting should be defended. That is a different issue than TARP.

Mr. WESTMORELAND. I understand, but—

Mr. LEVITIN. That is market transparency.

Mr. WESTMORELAND. But, as a result, that accounting practice put a lot of these businesses out.

And, Mr. Cheney, you said that some of the communities—that credit unions go into underserved communities.

Mr. CHENEY. Yes.

Mr. WESTMORELAND. What is your definition of an underserved community? One that doesn't have a bank?

Mr. CHENEY. I don't have a statutory definition with me. There is, within statute, rules—

Mr. WESTMORELAND. Could you get that to me?

Mr. CHENEY. —for underserved communities. But, yes, sir, I will.

Mr. WESTMORELAND. All right.

And then, Mr. Becker, you said that 13 million people, I think, are needing to get commercial loans. Why can't the banks loan them money?

Mr. BECKER. I think the demand fluctuates back and forth. And at various times in various regions of the—

Mr. WESTMORELAND. But why can't a bank make those people loans?

Mr. BECKER. I think they won't. In fact, there is a report—

Mr. WESTMORELAND. Won't or can't?

Mr. BECKER. I would say "c: all of the above" is the answer to that question, depending on the particular circumstances. There is a report by the SBA that I would be willing to share with you that goes into this in quite some detail.

Mr. WESTMORELAND. I would like to see it, because underserved credit unions—and, look, I used to be a member of a credit union, some of my family are members of a credit union. But when you go to a corner, and you have four corners and you have a bank on three of them and a credit union on the fourth one, that is not really underserved. Is that not true?

Mr. BECKER. There is a statutory definition we will get you—

Mr. WESTMORELAND. Okay. And I would love to see that.

And, with that, Mr. Chairman, I will yield back, and thank you for the extra time.

Chairman GARRETT. The gentleman yields back. Thank you for yielding back.

And, with that, I thank the panel.

The Chair notes that some Members may have additional questions for these witnesses—despite all the questions they have already had—which they may wish to submit in writing. Without objection, the hearing record will remain open for 30 days for Members to submit written questions to these witnesses and to place their responses in the record.

With that, I again thank the panel. This hearing is adjourned.

[Whereupon, at 4:35 p.m., the hearing was adjourned.]

A P P E N D I X

November 16, 2011

NAFCU

Testimony of

Fred R. Becker, Jr.

President/CEO of the National Association of Federal Credit Unions

regarding

"H.R. 1697: the Communities First Act"

Before a joint hearing of the

House Financial Services Committee

Subcommittee on Financial Institutions and Consumer Credit and

Subcommittee on Capital Markets and Government Sponsored Enterprises

November 16, 2011

Introduction

Good afternoon, Chairman Shelley Moore Capito, Chairman Scott Garrett, Ranking Members Carolyn Maloney and Maxine Waters and members of the Subcommittees. My name is Fred Becker. I am testifying today on behalf of the National Association of Federal Credit Unions (NAFCU), where I have served as the President and CEO since 2000. I appreciate the opportunity to share our views on H.R. 1697 and the need for regulatory relief for all community based financial institutions.

NAFCU is the only national organization that exclusively represents the interests of the nation's federally chartered credit unions. NAFCU is comprised of over 800 member-owned and operated federal credit unions. NAFCU member credit unions collectively account for approximately 62 percent of the assets of all federally chartered credit unions. NAFCU and the entire credit union community appreciate the opportunity to participate in this discussion on how relieving regulatory burden on our nation's financial depository institutions can help them better serve their communities and, most importantly, help grow our economy as it continues to strive to recover from the Great Recession.

Background on Credit Unions

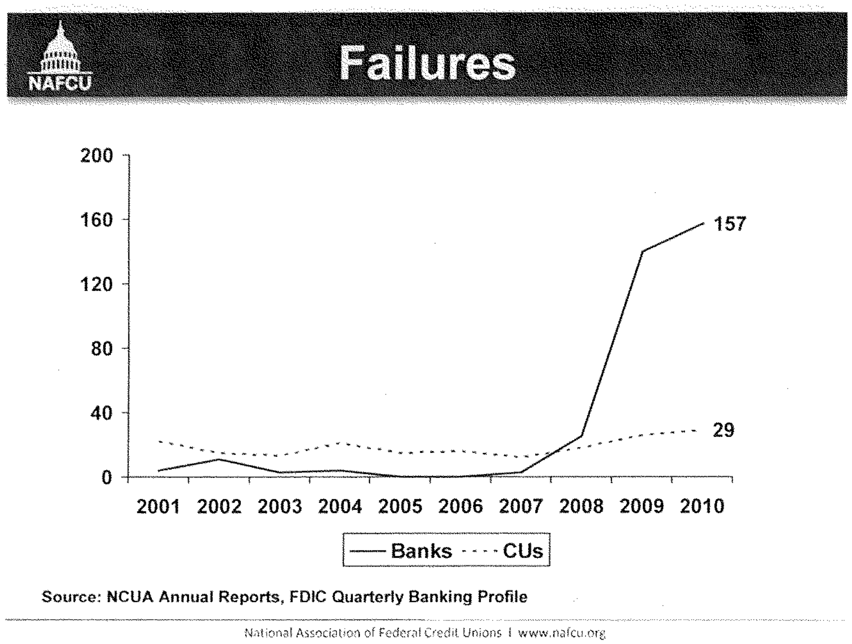
Historically, credit unions have served a unique function in the delivery of necessary financial services to Americans, including making business loans. Established by an Act of Congress in 1934, the federal credit union system was created—and has been widely recognized—as a way to promote thrift and to make financial services available to all Americans, including small businesses, who would otherwise have limited access to financial services. Congress established credit unions as an alternative to banks and to fill a precise public need—a niche that credit unions fill today for nearly 93 million Americans.

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

- Credit unions remain singularly committed to providing their members with efficient, low cost, personal service; and,
- Credit unions continue to emphasize traditional cooperative values such as democracy and volunteerism.

The nation's approximately 7,200 federally insured credit unions serve a different purpose and have a fundamentally different structure than banks. Credit unions exist solely for the purpose of providing financial services to their members—while banks strive to make a profit for their shareholders while also serving their customers. As owners of cooperative financial institutions united by a common bond, all credit union members have an equal say in the operation of their credit union—"one member, one vote"—regardless of the dollar amount they have on account. These singular rights extend all the way from making basic operating decisions to electing the board of directors. Federal credit union directors also generally serve without remuneration—a fact epitomizing the true "volunteer spirit" permeating the credit union community.

While credit unions did not create the financial crisis, credit unions have nevertheless been adversely impacted by the ongoing economic upheaval and ensuing legislation and regulation. However, as indicated in the chart below, credit union failures have been relatively minimal as compared to other financial depository institutions.



Today, credit unions continue to play a very important role in the lives of millions of Americans from all walks of life. As consolidation among financial depository institutions has progressed with the resulting de-personalization in the delivery of financial services by some large banks, the emphasis in consumers' minds has begun to shift not only to services provided but also—and in many cases more importantly—to quality and cost. While many large banks have increased their fees and curtailed customer service as of late, credit unions have continued to provide their members with high quality personal service at the lowest possible cost. This has been evidenced most recently as thousands of Americans turned to local credit unions after several large national banks proposed new fee increases.

Credit Unions Need Regulatory Relief in a Number of Areas

NAFCU recognizes the leadership and effort of Representative Blaine Luetkemeyer to bring relief to community based institutions. Credit unions are among the most heavily regulated of all financial institutions, with a number of statutory limits on their ability and powers that have been in place since the last century. Passage of new financial reforms in recent years has only increased the regulatory and compliance burdens on credit unions. Unfortunately, every additional dollar spent on compliance, whether stemming from a new law or outdated regulation, is a dollar that could have been used to reduce cost or provide additional services to a member. With that in mind, there are a number of areas where NAFCU would like to see relief—relief that would help credit unions enhance their service to their 93 million members. I have outlined some of these areas below.

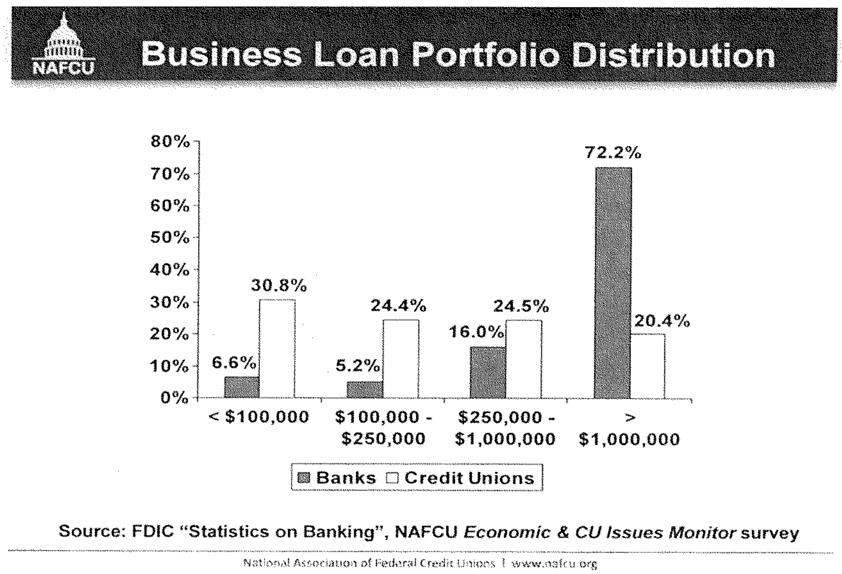
Arbitrary Member Business Lending Restrictions

When Congress passed the *Credit Union Membership Access Act* (CUMAA) (P.L.105-219) in 1998, it placed restrictions on credit union member business lending. Credit unions had existed for nearly 90 years and operated in a safe and sound manner without such statutory restrictions. First, Congress codified the definition of a member business loan and limited a credit union's member business lending to the lesser of either 1.75 times the net worth of a well-capitalized credit union or 12.25 percent of total assets.

Second, Congress established, by definition, that a business loan of $50,000 and above is a member business loan that counts toward the statutory limitation. This number was not indexed and has not been adjusted for inflation in the more than 13 years since enactment, eroding the *de minimis* level. While many vehicle loans or small lines of credit were initially exempt from the cap in 1998, many of those that meet the needs of small businesses today are now included in the statutory limitation. To put this in perspective, what cost $50,000 in 1998 costs $69,500 today, based on the August 2011 consumer price index data.

Pursuant to section 203 of CUMAA, Congress mandated that the Treasury Department study the issue of credit unions and member business lending. In January 2001, the Treasury Department released the study, "Credit Union Member Business Lending" finding that: "credit union's business lending … (had) no effect on the viability and profitability of other insured depository institutions." (p. 41). Additionally, when examining the issue of whether modifying the arbitrary cap would help increase loans to businesses, the study found that "relaxation of membership restrictions in the Act should serve to further increase member business lending…" (p. 41).

As the chart on the next page demonstrates, while the majority of bank business lending focuses on making larger ($1+ million) business loans, the vast majority of credit union loans are smaller loans.



While the 2001 Treasury study found that credit unions do not pose a threat to the viability and profitability of banks, it did note that in certain cases, credit union business lending could be an important source of competition for banks. Nevertheless, today credit unions market share is approximately 5% of all small business loans. As of December 31, 2010, credit unions had approximately 165,800 outstanding member business loans, totaling just over $33 billion.

A more recent 2011 study, commissioned by the Small Business Administration's Office of Advocacy found that bank business lending continues to be largely unaffected by changes in credit unions' business lending and that credit unions' business lending can actually help offset declines in bank business lending and satisfy lending demand during a recession. (James A.

Wilcox, *The Increasing Importance of Credit Unions in Small Business Lending*, Small Business Research Summary, SBA Office of Advocacy, No. 387 (Sept. 2011)). The SBA's findings in this regard are reflected by the fact that lending by banks as a percentage of their assets contracted during the 2007 – 2010 financial crisis, while credit union lending, as a percentage of their assets, increased. The SBA's finding, therefore, demonstrates the necessity to lift the MBL cap to meet credit union members' demand, as well as demonstrates credit unions' continued efforts to meet the capital needs of their members during the most difficult financial environment since the Great Depression.

In April of 2011, Representatives Ed Royce and Carolyn McCarthy introduced the *Small Business Lending Enhancement Act* (H.R. 1418), which would raise the arbitrary credit union member business lending cap to 27.5 % of total assets, up from 12.25%, and help stimulate the nation's struggling economy by increasing access to credit for small business owners. This important legislation has over 100 bipartisan co-sponsors. Identical bipartisan legislation (S. 509) has been introduced in the Senate.

Industry estimates indicate that enacting the *Small Business Lending Enhancement Act* would help spur over $13 billion in business lending and help small businesses create over 140,000 new jobs in the first year alone. This is a well thought out solution, supported by the Obama Administration and the National Credit Union Administration (NCUA), that includes important provisions to ensure that safety and soundness concerns are addressed. Enacting this legislation will not only aid credit unions, but also the small businesses that they serve.

Limitations on Ability to Access Capital

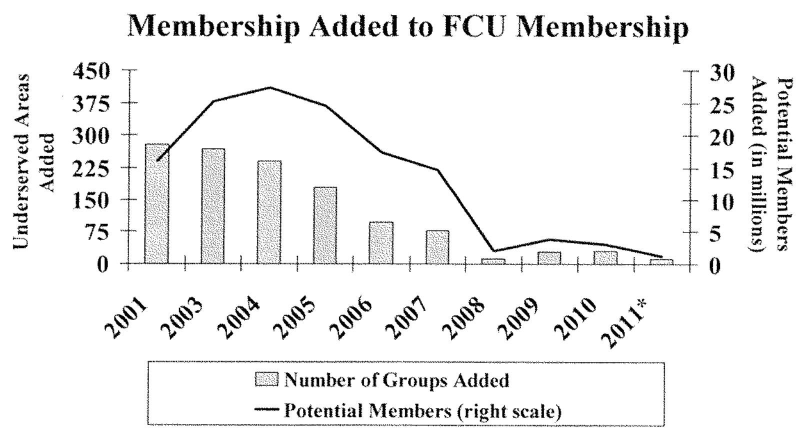
Credit unions are restricted in their ability to raise capital and are subject to capital benchmarks under a regulatory prompt corrective action (PCA) regime. Furthermore, credit union capital under PCA does not fully account for risk. Congress should modernize capital requirements for credit unions, including allowing access to supplemental capital. To preserve mutuality, NAFCU recommends that supplemental capital for federally insured credit unions come from members, to include sponsor organizations and select employee groups. This supplemental capital should not be federally insured, and it must be subordinate to other claims against an insured credit union and the National Credit Union Share Insurance Fund.

Furthermore, very few new credit unions are being started today. One reason is that a new credit union with more than $10 million in capital when it is chartered must comply with PCA requirements. A suggested fix would be to modify Section 216(o)(4) of the *Federal Credit Union Act* to give new credit unions some relief from PCA. We suggest that a "new credit union" be defined as one that: "(A) has been in operation for less than 10 years; ***or*** (B) has not more than $10,000,000 in total assets."

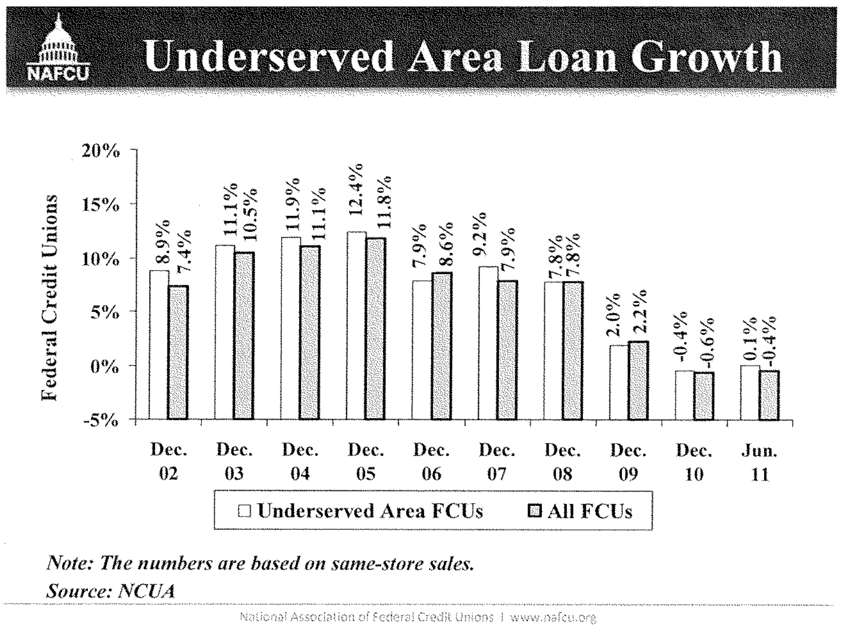
Underserved Areas

Credit unions play an important role in helping those that other financial institutions have turned their backs on and left behind. NAFCU supports making a necessary clarification to the 1998 *Credit Union Membership Access Act* (CUMAA) that all credit unions are able to add underserved areas to their fields of membership, regardless of charter type. In 2005, the American Bankers Association brought litigation against NCUA arguing that under the CUMAA (American Bankers Association et al. v. NCUA, No. 2:05-cv-000904 (D. Utah, filed Nov. 1, 2006)), in the case of federally chartered federal credit unions, only multiple-common-bond credit unions could add underserved areas to their fields of membership (FOM). In response to that lawsuit, NCUA limited expansion of underserved areas to multiple-group FOM federal credit unions in June 2006, substantially curtailing expansion into underserved areas (see chart below). As a result, in 2011, NAFCU is projecting that credit unions will add 12 underserved areas, representing 1.2 million people. By contrast, during 2001, credit unions added 279 underserved areas with 16 million potential members. As is, therefore, readily apparent, the 2006 limitation of underserved area expansions to multiple common bond credit unions has also had a significant impact on FCU loan growth in underserved areas (see chart on next page).

Underserved Areas Added



**Projected Figure*
Source: NCUA



Community Charter Conversions Involving Employee Group Credit Unions

Under current law, federally chartered federal credit unions that convert to a community FOM from a multiple group FOM may no longer add individuals from their select employee groups (SEGs) to their membership where the member does not work or reside within the community. This results in disparaging outcomes. For example, in 2011, Finance Center Federal Credit Union in Indianapolis, Indiana, converted to a community credit union. At that time, Finance Center Federal Credit Union served, as a select employee group (SEG), a military base in Europe. As a result of the conversion to a community charter, Finance Center Federal Credit Union was no longer able add to its membership those members of the military stationed at the base who wished to join the credit union – a result that neither the credit union nor the base desired.

NAFCU strongly supports giving the NCUA the authority to allow credit unions to continue to add members from their SEGs after a credit union converts to a community charter. This change would ensure that groups within the credit union's existing membership at the time of conversion are not discriminated against and are able to join the credit union if they wish, even though they reside or work outside the new community charter's geographic boundaries. This continuity of services is especially important for credit union members as the country struggles to regain sound economic footing.

Authority of NCUA to Establish Longer Maturities for Certain Credit Union Loans

NAFCU supports providing NCUA with the flexibility to provide for loan terms exceeding 15 years, for certain types of loans. As part of regulatory relief efforts in the 109th Congress, the NCUA was allowed to increase the 12-year limit on non-real-estate-secured loans to 15 years. NAFCU, however, believes that greater flexibility is warranted for certain products, such as student loans.

Credit Union Governance

The FCUA contains many antiquated "governance" provisions that, while perhaps appropriate in 1934, are outdated, unnecessary and inappropriate restrictions on the day-to-day operations and policies of a federal credit union. For example, federal credit unions are not allowed to expel disruptive or threatening members without a two-thirds vote of the membership. NAFCU supports giving federal credit union boards this necessary flexibility.

Providing NCUA with Greater Flexibility to Respond to Market Conditions

NAFCU supports giving the NCUA greater flexibility to adjust interest rates relative to market conditions. Under current law, federal credit unions are the only type of insured institutions subject to federal usury limits on consumer loans. We believe that the NCUA should have greater flexibility regarding the tests that must be met to modify those limits under certain market conditions.

Voluntary Mergers Involving Multiple Common Bond Credit Unions

Current law imposes a numerical limitation of 3,000 on the size of a group that can go forward with a federal credit union merger before considering spinning off the group and requiring it to form a separate credit union. There is no sound reason for this restriction; NAFCU believes the 3,000 limit is arbitrary and should be removed.

Interest on Lawyers Trust Accounts (IOLTAs)

Last year Congress passed legislation to clarify and expand FDIC coverage for lawyer's trust accounts held at banks. Similar action should be taken for such accounts held at federally-insured credit unions.

Member Business Loan Exclusion for Loans in Underserved Areas

NAFCU supports excluding member business loans made in underserved areas from the credit union member business lending cap. We feel that this proposal reflects an understanding that the credit union member business lending cap is often restrictive, hindering credit unions from promoting economic growth in underserved areas. While NAFCU also supports an overall modification in the member business lending cap to better facilitate economic growth in all the communities that credit unions serve, we also recognize that there continues to be an urgent need to address this matter with regard to underserved areas.

H.R. 1697, the *Communities First Act*

While many of the provisions in the *Communities First Act* provide regulatory and tax relief to community banks, we would like to make special note of Section 107 which includes language supported by NAFCU, and many in the financial services community, that would improve the unrealistic veto threshold needed for the Financial Stability Oversight Council to review new rules issued by the Consumer Financial Protection Bureau. We are pleased that such a provision has already passed the House in the form of H.R. 1315, the *Consumer Financial Protection Safety and Soundness Improvement Act of 2011*.

We would also note Section 201 of the bill which would amend the Dodd-Frank Act to provide that loans held in portfolio by banks under $10 billion in assets are excluded from escrow requirements. NAFCU believes this is a good idea in principle; however, we believe such an exemption should be made for all credit unions. We are disappointed that the legislation, in this section and others, continues to advance the arbitrary $10 billion dividing line threshold for many provisions. We see that as a major flaw in the legislation. It should be noted, in the only vote in the 111th Congress that the full Committee took where it had a choice to replace the arbitrary $10 billion number found throughout the Dodd-Frank Act, the Committee choose $50 billion by an overwhelming bipartisan margin of 52-17 (Full Committee Record Vote FC-99).

As our great nation continues to strive to recover from the Great Recession, NAFCU believes that is it imperative that every effort be made to strengthen the access and improve the availability of low cost financial services to all Americans. In keeping with that spirit and intent, we believe that the *Communities First Act* can be strengthened by adding the provisions to provide relief to credit unions as outlined earlier in my testimony. Such an approach would create a comprehensive reform bill that could create more jobs, help communities and garner bipartisan support and help the economy further its recovery.

While the banking industry consistently argues that credit unions should not have increased powers and authorities to better serve their members, NAFCU has never previously opposed enhanced authorities for banks to better serve their customers. In particular, we would note that H.R. 1697 includes provisions to strengthen the Subchapter S tax option and other tax breaks for banks. A large number of banks do not pay corporate federal income tax because of their Subchapter S status. In fact, there are approximately 2,358 Subchapter S banks that avoid federal corporate income taxes today. One estimated value of the Subchapter S federal tax break for banks is $2.05 billion for 2010, *which is **significantly greater*** than the estimated value of the entire credit union tax expenditure ($1.27 billion) for FY 2010 as included in the President's FY 2012 budget. Enacting H.R. 1697 will likely increase the total value of the Subchapter S tax break.

Conclusion

Financial depository institutions and, in particular, credit unions are in need of regulatory relief. H.R. 1697, the *Communities First Act*, would be greatly strengthened by adding credit union relief provisions and moving the larger package, creating a win-win for community banks and credit unions and, most importantly, the American economy.

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

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Testimony
of

O. William Cheney
President and Chief Executive Officer
Credit Union National Association

Before the
United States House of Representatives
Committee on Financial Services
Subcommittee on Financial Institutions and Consumer Credit
and the
Subcommittee on Capital Markets and Government Sponsored Enterprises

Hearing on
H.R. 1697 – The Communities First Act

November 16, 2011

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Chairman Capito, Chairman Garrett, Ranking Member Maloney, and Ranking Member Waters, thank you very much for the opportunity to testify at today's hearing. I am very pleased to present the views of the Credit Union National Association (CUNA) regarding H.R. 1697, the *Communities First Act*.

Credit unions and community banks are different in many ways, and our view of regulatory relief legislation for community banks is just another example of our differences. Unlike the banks' view of credit union legislation, we do not reflexively oppose their regulatory relief bill. In fact, while there are several provisions with which we have significant concern, we are supportive of several of the provisions which would also provide regulatory relief to credit unions.

We encourage Congress to thoroughly examine each provision of H.R. 1697 to ensure that the changes are consistent with the best interest of public policy. We also call on Congress to enact a well-balanced bill that provides meaningful regulatory relief for credit unions and community banks, including provisions from this bill as well as H.R. 1418, which would allow well-capitalized credit unions with business lending experience, which are at or close to the credit union member business lending cap, to lend in excess of the cap. The combination of the proposals of both of these bills should be embraced by all who serve businesses on Main Street.

In communities across the country, credit unions and community banks operate side-by-side to meet the financial services needs of consumers and small businesses. In most cases, they peacefully coexist. In fact, we hear regularly of community banks that have referred borrowers to credit unions, and credit unions which have referred members to community banks, in an effort to meet the needs of the community. We can get along and we know Congress wants us to get along.

Few issues have brought credit unions and community banks together like the recent battle over the regulation of debit interchange fees. While we strongly opposed this provision of the Dodd-Frank Act, we continue to work with the payment card networks to ensure that the exemption for small issuers that Congress provided proves meaningful.

Although we expect the debit interchange regulation to negatively impact credit union bottom lines over time, one of the immediate positive impacts of this regulation – for community banks and credit unions, alike – has been resurgence in consumer affinity to local financial institutions. Community banks and credit unions have welcomed the opportunity to serve those frustrated by the ever-increasing fees charged by the largest banks.

In the lead-up to the recent "Bank Transfer Day," credit unions and community banks in Santa Cruz, California worked together to make sure consumers in their area knew they had choices other than the largest banks. As a part of my written testimony, I have attached an advertisement that Bay Federal Credit Union, Lighthouse Bank, Santa Cruz County Bank, and Santa Cruz County Community Credit Union placed in a local paper encouraging consumers to keep their money local. (See Attachment A).

This represents credit unions and community banks at their best.

Another area where credit unions and community banks should agree and work together is in the pursuit of regulatory relief legislation. Unfortunately, whenever credit unions propose legislation intended to reduce our regulatory burden, it is almost always reflexively opposed by the community banks. They mislead Congress with misinformation regarding the credit union charter and mission. They try to leverage the credit union tax status to prevent new credit union powers, ignoring the fact that Congress has provided and reaffirmed this tax status based on the ownership structure and not-for-profit nature of credit unions. They denigrate credit unions' ability to provide financial services to credit union members on a safe and sound basis when in fact the credit union safety and soundness record compares very favorably with that of banks.

The banks' opposition to credit union legislation has meant that hundreds of thousands of jobs that could have been created through additional credit union business lending have gone uncreated. Their opposition to legislation allowing more credit unions to serve underserved areas has meant that many Americans have gone without convenient and affordable financial services. Their opposition to legislation providing credit unions access to alternative forms of capital has constricted credit unions' ability to grow and better serve their members. When banks oppose credit union legislation, their shareholders may win, but consumers and small businesses lose.

Frankly, community-based institutions need to be able to spend more time and resources serving their members or customers and less time complying with burdensome regulations that have been the result of negligence and misdeeds perpetrated by the largest banks or unregulated financial services providers. We did not cause the problem, but the solution to the problem all too often includes our institutions and imposes disproportionate burdens.

H.R. 1697, the *Communities First Act*, would provide significant regulatory relief to America's community banks, and expand the ability of certain banks to incorporate under Subchapter S of the Internal Revenue Code. Our analysis of the legislation is divided into three categories: provisions that CUNA supports; provisions that Congress should amend to provide parity for credit unions; and provisions that expand the tax advantages for banks organized under Subchapter S of the Internal Revenue Code.

CUNA supports the following provisions of H.R. 1697:

- Section 107. FSOC review of Bureau Regulations. This provision would authorize the Financial Stability Oversight Council (FSOC) to set aside a final regulation prescribed by the Bureau of Consumer Financial Protection (CFPB) if the FSOC decides that it would be inconsistent with the safe and sound operation of U.S. financial institutions, or could adversely impact disproportionately a subset of the banking industry. CUNA has supported a similar provision in

H.R. 1315, the Consumer Financial Protection Safety and Soundness Act. At a hearing on H.R. 1315 earlier this year, CUNA suggested that the FSOC be authorized to set aside a CFPB rule if it determined the rule was "inconsistent with the safe and sound operation of United States financial institutions."[1]

- Section 201. Escrow Requirements. This provision would amend the *Truth in Lending Act* (TILA) to instruct the Federal Reserve Board to exempt from escrow or impound account requirements any covered loan secured by a first lien on a consumer's principal dwelling, if the loan is held by a creditor with assets of $10 billion or less. CUNA supports this provision, which would apply to credit unions and community banks.

- Section 202. Exception to annual privacy notice requirement under the *Gramm-Leach-Bliley Act*. This provision would amend the *Gramm-Leach-Bliley Act* to exempt certain financial institutions from furnishing a mandatory annual privacy notice. CUNA supports this provision, which would apply to credit unions and community banks.

- Section 203. Fees for agricultural loans. This provision would amend the *Consolidated Farm and Rural Development Act* to authorize the Secretary of Agriculture to: (1) assess, for agriculture loans under $5 million, a one-time fee of 1% or less of the loan's guaranteed principal; and (2) establish a preferred certified lender's program for specified lenders. CUNA supports this provision, which would lower guarantee fees on farm loans; it would benefit credit union members as well as bank customers, and could encourage additional farm lending.

- Section 204. Reimbursement for production of mandated records. This provision would amend the *Right to Financial Privacy Act of 1978* to provide that small financial institutions be reimbursed when they are required by federal law enforcement authorities to furnish records or data for investigative purposes. CUNA supports this provision, which will reduce the cost of compliance with data requests from federal law enforcement officials.

[1] Testimony of Rod Staatz on behalf of Credit Union National Association. House Committee on Financial Services. Subcommittee on Financial Institutions and Consumer Credit. Hearing on "Legislative Proposals to Improve the Consumer Financial Protection Bureau." April 6, 2011. 6.

- Section 207. Credit ratings. This provision would amend the *Dodd-Frank Wall Street Reform and Consumer Protection Act* regarding federal regulatory agencies' review of their reliance on credit ratings to direct them to require, in specified circumstances, that ratings-based determinations be confirmed by an analysis of the probability of a loss from holding an asset. CUNA supports this provision, which would allow financial institutions to continue to rely on external credit ratings and supplement them with information regarding the "analysis of the probability of loss" only if external credit ratings are not complete or there are heightened risks.

- Section 208. Small business data collection exclusion. This provision would amend the *Equal Credit Opportunity Act* to exempt certain small-sized businesses from a mandatory collection of business data. CUNA supports this provision which would exempt credit unions and community banks under $1 billion from the mandatory collection of business data under the Dodd-Frank Act.

- Section 301, related to reduced rate and deferral of income recognition on long-term certificates of deposit, and Section 305, related to young savers' accounts, are provisions that would not directly impact credit unions' provision of financial services to their members, but would benefit members that use these services. We are supportive of both provisions.

CUNA suggests that the following provision be amended to provide credit unions with parity under the law.

- Section 101. Short form reports of condition for certain community banks. This provision would permit qualifying community banks under $10 billion to submit a short-form of their quarterly disclosure to their regulator. This form is expected to be significantly and materially less burdensome than the current quarterly form, while at the same time providing sufficient material information for the regulator to assure the safety and soundness of the bank. If Congress determines that it is in the best interest of public policy for the vast majority of community banks to file quarterly reports with their regulator that are significantly less burdensome than they do under current law, we would encourage Congress to likewise direct the

National Credit Union Administration to develop a similar short form for similarly qualifying credit unions.

H.R. 1697 also includes several provisions designed to enhance the tax status for banks organized under Subchapter S of the Internal Revenue Code.

One provision (Section 501) would double the maximum number of shareholders permitted under Subchapter S.

We do not oppose this change but point out that the hypocrisy of the bank lobby appears to have no end. While aggressively lobbying to increase the tax advantages of Subchapter S for banks, the banking industry also continues to actively lobby to impose additional taxes on credit unions, arguing that credit unions' federal income tax status provides a competitive advantage and that imposing additional taxes would "level the playing field."

Before making any change to "level the playing field," Congress should consider what that would mean and who that would benefit. The banks would have Congress believe that expanding the Subchapter S tax preference would reduce operating costs for these banks and make them better able to compete with credit unions. Where is their evidence that additional tax advantages to banks would result in lower fees, lower rates or better service for consumers?

Our examination of Subchapter S bank financial results for 2010 and for the first half of 2011 shows that these banks recorded depositor fees as a percent of average assets that were nearly two-thirds higher than the fees at other similar-sized non-Subchapter S banks. At the same time, Subchapter S banks recorded earnings (ROA) that were roughly three times higher than similarly-sized C corporation commercial banks. For example, the Subchapter S bank average ROA (annualized) was 1.22% in the first half of 2011 while non-Subchapter S banks with less than $1 billion in assets earned 0.40%. Subchapter S bank cash dividends as a percent of assets averaged approximately four times higher than those at peer banks.

Subchapter S banks charge higher fees for consumers, have higher return on assets, and pay higher dividends to their shareholders than C-corp banks. In other words, these banks do not use their preferential tax treatment to better compete with credit unions. If indeed the credit union tax exemption created undue competition for banks, these Subchapter S banks would use their tax preference to lower rates and fees to their customers. The proposal before Congress would expand eligibility to this class.

When considering whether expanded Subchapter S authority is in the best public policy interest, Congress should consider who would benefit: consumers or bank shareholders? We strongly believe any savings should be passed along to consumers. Unfortunately, past performance of Subchapter S banks and their for-profit structure suggests that the most likely beneficiaries will be the banks' shareholders.

Another provision (Section 502) would permit Subchapter S banks to issue preferred stock. Current law only allows Subchapter S banks to have one class of stock outstanding. In previous testimony before Congress, the Independent Community Bankers of America (ICBA) has indicated that the driving factors behind its support for this provision are the constraints on growth that the current capital structure presents and the minimum capital ratios necessary to be well-capitalized for regulatory purposes.[2]

These concerns are familiar to credit unions, which face even more stringent capital restrictions and requirements than Subchapter S banks. The *Federal Credit Union Act* contains a statutory requirement that credit unions must maintain a net worth ratio of 7% in order to be considered well-capitalized; in addition, credit unions must meet certain risk-based capital requirements set by the National Credit Union Administration. Only the retained earnings of the credit union are considered capital for this purpose.

The ICBA says that the Subchapter S capital restrictions "prevent small community banks from having access to an important source of capital vital to the economic health and stability of the bank and the

[2] Testimony of Cynthia Blankenship on behalf of the Independent Community Bankers of America. House Committee on Small Business. Subcommittee on Finance and Tax. Hearing on "S-Corps: Recommended Reforms That Promote Parity, Growth and Development for Small Businesses." June 18, 2008. 4.

community it serves."[3] A similar statement could be made regarding the capital restrictions contained in the *Federal Credit Union Act*.

If there is one lesson from the financial crisis, it is that capital is king. Financial institutions should be encouraged to have appropriate levels of capital and should have enhanced access to supplemental forms of capital. As the ICBA argument demonstrates, the tax treatment of a group of financial institutions should not hinder the ability of those institutions to acquire sufficient capital. Should this legislation move forward, we encourage Congress to consider provisions that would permit credit unions additional access to capital, and we would be happy to work with you toward this end.

Congress Should Consider Other Regulatory Burden Proposals

- ATM Fee Disclosure – The *Electronic Fund Transfer Act* requires financial institutions to display a physical **and** electronic disclosure of fees on automatic teller machines. The physical disclosure requirement is antiquated, dating back to a time before all ATM machines were able to provide electronic disclosures of fees. We have heard from several credit unions victimized by vandals or other individuals who remove the physical disclosure from the ATM, take a picture of the ATM, and then sue the credit union for noncompliance with the EFTA. We certainly appreciate Chairman Bachus' recent letter to the Consumer Financial Protection Bureau regarding this issue. We also support a legislative remedy. We encourage the Committee to investigate this issue and would like to work with you to secure a remedy that provides consumers with the important disclosure, but protects credit unions and community banks from outrageous and contrived lawsuits.

- Office of Regulatory Burden Monitoring – CUNA has encouraged the Consumer Financial Protection Bureau to create an Office of Regulatory Burden Monitoring to work with credit unions and community banks to assess the impact of regulatory burdens being imposed on these institutions and to coordinate with their prudential regulators. If the Bureau does not create such an office, we encourage Congress to consider directing the Bureau to do so.

[3] Ibid.

Regulatory Relief for Community-Based Financial Institutions Should Be Balanced

Make no mistake: credit unions support regulatory relief for all financial institutions -- community banks and credit unions alike. However, we strongly believe that legislation providing regulatory relief should be balanced so that credit unions and community banks both see benefit in terms of their ability to serve their members or their customers.

As part of well-balanced regulatory relief legislation, credit unions would expect the inclusion of language to permit well-capitalized credit unions, with business lending experience, that are operating near the statutory cap on credit union business lending to perform additional lending. This would allow qualifying credit unions to serve their local communities and small business owning members even better.

Representatives Ed Royce and Carolyn McCarthy have introduced a bill to this effect in the House of Representatives (H.R. 1418), and it has over 100 bi-partisan cosponsors. In October, the Subcommittee on Financial Institutions and Consumer Credit held a hearing on this legislation. Several members of the Subcommittee asked questions focusing on the demand for small business lending and the need for legislation to increase the credit union member business lending cap. While these topics were covered in depth at the hearing, we sent Chairman Capito a letter following the hearing that goes into greater detail with respect to the demand that exists in the market and the need for this legislation from the credit union perspective. I have attached a copy of this letter to this testimony (See Attachment B).

As we point out in the letter, the legislation that Representatives Royce and McCarthy have introduced would not harm community banks or the banking sector as a whole. It is not a zero-sum game, as one witness at the October 12 hearing incorrectly suggested.

Even if credit unions doubled the amount of business lending they do, banks would still have 90% or more of the commercial lending market in the country. The Royce-McCarthy legislation includes safeguards to ensure that the additional business lending would not jeopardize the credit union system. Additional business lending in a community helps everyone – banks, small businesses and credit unions.

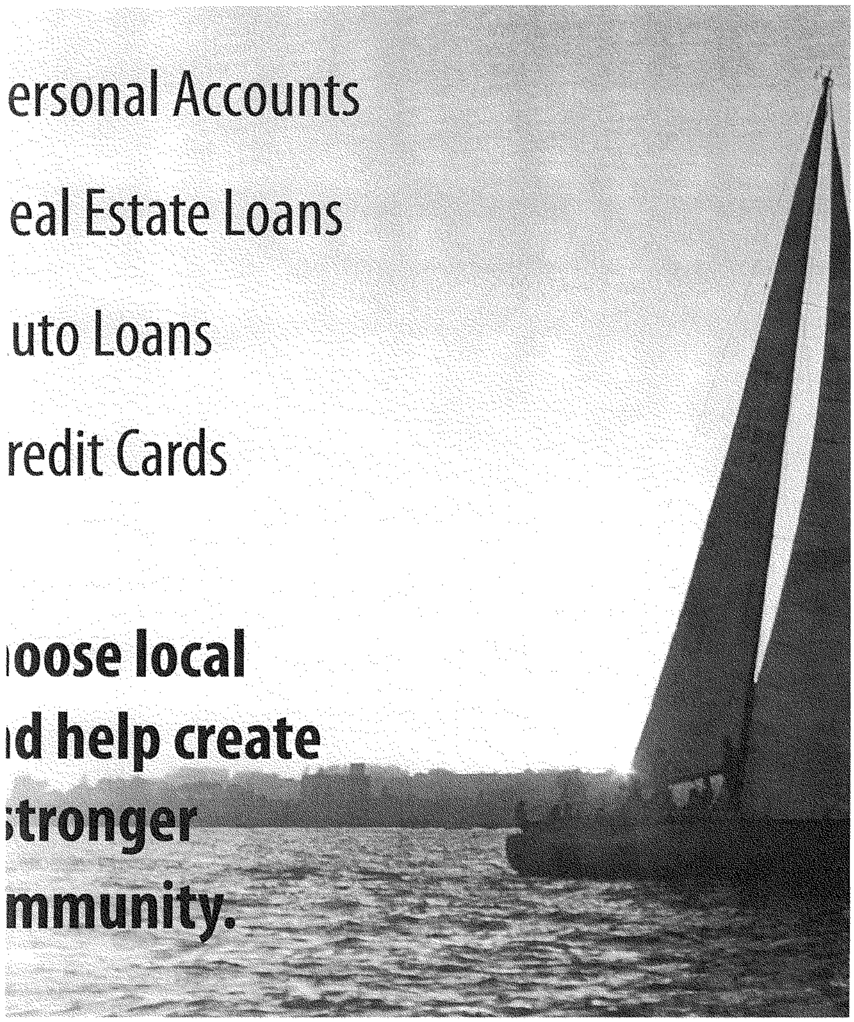
This legislation would provide much-needed assistance and relief to the small business sector that is struggling. It would help create 140,000 jobs in the first year at no cost to taxpayers.

Conclusion

Credit unions and community banks both play an important role in their communities. Both served their constituencies well during the financial crisis. Both face a crisis of creeping complexity related to regulatory burden. Both deserve meaningful and balanced regulatory relief. However, we do not believe that H.R. 1697, in its current form, provides balanced regulatory relief to credit unions and community banks; therefore, we cannot support it at this time.

Further, credit unions across the country firmly believe that this legislation, or the provisions contained therein, must not move through Congress without similarly effective regulatory relief legislation for credit unions. We urge Congress to combine this legislation with H.R. 1418, the Small Business Lending Enhancement Act, and consider the other modifications we have suggested in this testimony. At such time as there is meaningful legislation before Congress providing meaningful and balanced regulatory relief for both credit unions and community banks, we will gladly support that measure. This is a key issue for America's credit unions.

On behalf of America's credit unions and their 93 million members, thank you for the opportunity to testify at today's hearing. I am pleased to answer any questions the Members of the Subcommittees may have.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BILL CHENEY
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October 26, 2011

The Honorable Shelley Moore Capito
Chairman
Subcommittee on Financial Institutions and Consumer Credit
Committee on Financial Services
United States House of Representatives
Washington, DC 20515

Dear Chairman Capito:

On behalf of the Credit Union National Association (CUNA), I wanted to thank you for holding the hearing earlier this month on H.R. 1418, the Small Business Lending Enhancement Act. This legislation is critical job creation legislation which would permit credit unions to lend an additional $13 billion to small businesses in the first year, helping them create over 140,000 new jobs. We appreciated the opportunity to present testimony in support of this legislation and look forward to working with you to move the bill through the legislative process.

At the hearing, several Members, including you, raised questions related to the demand for this legislation. These questions focused both on whether there was enough available small business credit as well as whether there was a need to increase the credit union business lending cap in order to make additional credit available. Some also expressed concern that increasing the member business lending cap would lead to a reduction of bank business lending. I wanted to take the opportunity to address these questions.

Demand for and Availability of Small Business Credit

There is no doubt that there has been a reduction in the demand for business credit as a result of the recession. However, unlike the consumer sector, there is no indication that the small business sector is (or has been) engaged in a process of systemic deleveraging. On the contrary, there is a large body of evidence that confirms a healthy demand for loans as discussed in more detail below.

At the same time, there also is considerable evidence that a significant contraction in the supply of bank business credit has contributed to a reduction in business credit outstanding. Small businesses want credit but far too many cannot obtain the capital they need from the nation's banks. The record is clear: a lack of more robust small business borrowing, business expansion and job growth can be traced in large part to ongoing reductions in lending activity among the nation's commercial banks.

Since mid-2009, no fewer than 25 Congressional hearings have been held to discuss issues related to small business access to credit. Further, credit availability was a major driver behind the enactment of the Small Business Jobs Act of 2010, which created the Small Business Lending Fund (SBLF), a $30 billion taxpayer funded incentive to community banks to lend to small businesses.[1]

The importance of access to credit for small businesses was clearly articulated by a witness advocating for the enactment of the SBLF in 2010.

> "The Wall Street meltdown of fall 2008 and the ensuing credit crisis and recession hit small businesses harder than medium and large-size businesses because they have faced greater challenges in obtaining credit. Boosting the flow of credit will help the small business sector to lead the recovery of economic growth and employment... small businesses responded to the recession by laying off more workers than medium and large size businesses. The difference lies in access to credit. Small businesses are more dependent on bank credit than medium and large businesses. Medium and large businesses regained access to credit through the corporate bond market, while small businesses continue to suffer from lack of credit... The greatest potential for job creation is among small business with restored access to credit."[2]

There is considerable evidence suggesting not only that there is unmet demand for small business lending, but also that small businesses that would otherwise be interested in pursuing credit are not doing so because of the perception that credit is difficult to get in this economic environment.

In testimony before the House Small Business Committee earlier this year, the International Franchise Association, whose membership, according to their website, employs 6% of Americans, stated:

> "While we estimate that franchise businesses will be able to access $8.4 billion in lending this year, this analysis also shows that we will face a $2 billion shortfall in available loans. This shortfall will result in the loss of nearly 8,000 franchise unit transactions, both new business development and transfers, and a loss of more than 82,000 jobs and $10.7 billion in annual economic output."[3]

The National Association of the Self-Employed testified before the Senate Small Business Committee in May that, "Access to capital also continues to be a large

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[1] Credit unions did not need and did not seek access to this fund because the chief impediment to credit union small business lending is neither liquidity nor capital. It is the statutory cap on business lending.
[2] Testimony of James D. MacPhee on behalf of the Independent Community Bankers of America before the House Committee on Financial Services Hearing on "Initiatives to Promote Small Business Lending, Jobs and Economic Growth." May 18, 2010. 2.
[3] Testimony of William G. Hall on behalf of the International Franchise Association before the House Committee on Small Business Hearing on "Access to Capital: Can Small Businesses Access the Credit Necessary to Grow and Create Jobs?" June 1, 2011. 4.

problem for the self-employed and microbusinesses, despite efforts by the federal government to spur lending to small businesses."[4]

As noted in our written testimony, the Pepperdine Capital Markets Project conducts on ongoing, twice-yearly survey of U.S. small businesses in conjunction with Dunn and Bradstreet. While the second 2011 full report has not yet been published data collected during the week of August 29, 2011 (from a sample of over 5,500 U.S. small business owners) finds that nearly one-quarter of small businesses sought a bank loan in the preceding 12 month period. Among those that sought bank financing fully 57% indicated that they were not successful in obtaining financing. This is a clear indication that a substantial number of small businesses continue to need more access to capital.[5]

The most-recently published full report from the Pepperdine Project (Survey Report V – Summer 2011) is attached.[6] The Report – summarizes views of 1,221 privately-held businesses that responded to the survey. Among these, 24% had businesses that involved manufacturing and 11% were in the engineering and construction industry. Approximately 59% of respondents have between 11 and 100 employees.

One of the report's key findings was: **"Business owners enthusiastic about growing, but lack resources.** Nearly 95% of privately-held businesses owners report having the enthusiasm to execute growth strategies, yet just 53% report having the necessary financial resources to successfully execute growth strategies."[7]

Given this reported enthusiasm for growing it is not surprising that the report also finds substantial demand for financing on the part of small businesses: Overall, 38% of businesses indicated that they are "currently" seeking financing, with about one-half (48%) of these seeking bank loans.[8] In fact, bankers tell the Pepperdine researchers the same story being told by small business- and one that is disturbingly at odds with what banks been telling policy makers: Overall, 65% of banks responding to the Capital Markets Project Survey tell researchers that they have seen an increase in demand for small business loans compared to six months ago.[9]

On the supply side of the equation, the bank lobby has been telling policymakers that there is an ample supply of business credit. But they provide a starkly contrasting view in the Pepperdine Survey. Indeed the Report states: "Currently, lenders see economic uncertainty (48.6%) and access to capital (25.7%) as the top issues facing privately-held businesses".[10] Yet, despite their public claims to the contrary, bankers reveal to the Pepperdine researchers that they are restricting the supply of credit.

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[4] Testimony of Kristie Arslan on behalf of the National Association for Self-Employed before the Senate Committee on Small Business and Entrepreneurship Hearing on "Small Business Recovery: Progress Report on Small Business Jobs Act of 2010 Implementation." May 19, 2011. 5.
[5] See: http://bschool.pepperdine.edu/appliedresearch/research/pcmsurvey. Survey of firms with less than $5 million in annual revenues.
[6] Pepperdine Private Capital Markets Project Survey Report V. Summer 2011.
[7] Ibid. p.8
[8] Ibid. p.19.
[9] Ibid. p. 119.
[10] Ibid. p.111.

Overall, bank survey respondents indicate they are declining 60% of small business loan applications.[11]

Importantly, bank credit restriction in the face of healthy demand has been an ongoing problem. A 2010 Business Week article, *Why Small Business Can't Get Financing*, contains an extensive interview with John Paglia, senior researcher for the Pepperdine Private Capital Markets Survey. In the course of the interview Paglia states: "The No. 1 concern for private companies is access to capital. Nearly 31 percent cited that..." and "The companies also reported, by 71 percent, that if they had additional growth capital they believed they would see an increase in revenue growth." [12]

During the course of the interview, Business Week reporter Karen Klein states "Many bankers say they aren't lending, at least in part, because demand for loans is down. But your survey seems to contradict that assertion." Paglia's response is noteworthy: "Generally speaking, we found more demand for loans among business owners. And among the banks that responded to our survey, 72 percent indicated that the number of loan applications they received had increased during the last six months. So there's demand for capital. Something's not quite sitting right when we hear from the banks that there's no demand." [13]

The National Small Business Association's 2011 Mid-Year Economic Report found that lack of available capital was a concern for 22% of those responding to their survey of small business owners.[14]

According to the National Association of Realtors®, 87% of Realtors® said that lack of financing impacted their clients decisions in 2011; nearly 60% said that they failed to complete a transaction due to financing; and lack of available financing was the most frequent response of Realtors® when asked what were the major obstacles to commercial real estate this year. Sixty-five percent report significantly or somewhat significantly tightening of lending conditions; none reported a significant easement of lending conditions. The Realtors® report further states, "While large corporations do not have difficulties securing capital, small businesses have been struggling to find access to financing."[15]

Some small business owners may have simply given up on the credit market. Multifunding.com, a small business finance consulting organization, conducted a survey of 1200 small businesses in July 2011 and found that 73% of small business owners who say they are in need of a loan have not applied for a loan. Twenty-one

[11] Ibid. p.118.
[12] Klein, Karen E., "Why Business Can't Get Financing." Business Week. August 31, 2010.
[13] Ibid.
[14] National Small Business Association. "2011 Mid-Year Economic Report". Page 8. August 3, 2011. See: http://nsba.biz/surveys.shtml.)
[15] National Association of Realtors® Research. August 2011. 1.

percent said they were afraid of application rejection; 18% said they were not willing to pay high interest rates.[16]

According to Gallup, 30% of small business owners say it is difficult for them to obtain credit – two to three times more difficult than it was in 2006 and 2007; 21% say credit is easy to get, which is about half the number from 2006 and 2007.[17]

The demand for small business loans is present in the market and the data suggest that banks continue to constrict credit availability while credit unions are expanding their business loan portfolios. Since the beginning of the recession three and a half years ago, total bank business loan portfolios have declined by almost 14%, while credit union business loan portfolios grew at a healthy rate of over 40% – a very stark difference. If indeed the contraction in business credit outstanding was due solely to reduced demand, credit union business lending would have declined as it has at banks. That is obviously not the case.

Why Increasing the Credit Union Member Business Lending Cap Is Necessary

Another question that you and other members of the subcommittee raised at the hearing was whether it is necessary for Congress to permit qualifying credit unions to lend to business owning members in excess of the statutory cap in order for credit unions to continue to meet the business lending needs of their members. We believe that it is.

The recently strong growth of credit union business lending is slowing as an increasing number of credit unions approach the cap, and the support credit unions have provided to America's small businesses cannot continue into the future unless Congress raises the credit union business lending cap.

The bank lobby claims that only a "handful" of credit unions are actually capped, but a total of more than 500 credit unions will be bumping up against the cap in the next three years. Contrary to the bank lobby claims that the credit unions constrained by the cap are a "new breed" of large credit unions, it is worth noting that a credit union seeking to offer business services to its members is not engaging in activity that is "new" to credit unions – credit unions have been offering business services to their members since they were founded in the United States over 100 years ago. In addition, roughly 75% of the over 500 credit unions that are constrained by or at the cap have total assets of $500 million or less, rendering the bank lobby's assertion that these are only large credit unions false.

Most of these credit unions are already looking for ways to moderate their business loan growth.

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[16] Multifunding.com. August 11, 2011. (see: http://www.multifunding.com/uncategorized/multifunding%e2%80%99s-second-quarterly-small-small-businesses-arent-applying-for-loans/ .)

[17] Testimony of Dennis Jacobe before the House Committee on Small Business Hearing on "Access to Capital: Can Small Businesses Access the Credit Necessary to Grow and Create Jobs." June 1, 2011. 3.

- A total of 227 credit unions hold business loans between 5% and 7.5% of assets. These credit unions will be capped within 2.7 years at recent growth rates. They held $6.5 billion in business loans at mid-year 2011 and their business loans grew by $3.9 billion over the preceding three years. Their business lending will have to slow dramatically in the coming few years without an increase in the cap.

- Another 149 credit unions hold business loans between 7.5% and 10% of assets. These credit unions will be capped within 2.5 years at recent growth rates. They held $7.0 billion in business loans at mid-year 2011, and their business loans grew by $2.1 billion over the preceding three years. Their business lending will have to slow dramatically in the coming few years without an increase in the cap.

- 148 credit unions, with $7.1 billion in business loans outstanding, had business loans of more than 10% of assets. These credit unions are essentially capped or will reach the cap in the next twelve months. In the three years ending June 2011, business loans outstanding at these credit unions rose by only $137 million. They will be able to contribute very little to future business loan growth without an increase in the cap.

Taken together these 524 credit unions now account for 75% of all business loans subject to the 12.25% cap. These credit unions have been the major contributors to credit union business loan growth over the past few years – accounting for 83% of total growth in non-grandfathered credit unions.

When the business lending growth in these credit unions is contrasted, the cap limitations are clearly reflected in slower growth rates among credit unions that are closer to the cap. In fact, the aggregate data shows:

- Credit unions with 5% to 7.5% MBL/Asset ratios saw portfolios increase by 36% in the year ending June 2011;
- Credit unions with 7.5% to 10% MBL/Asset ratios experienced an increase of 23%;
- Credit unions with more than 10% MBL/Asset ratios actually saw their loan portfolios decline. These credit unions will be able to contribute very little to future business loan growth without an increase in the cap.

As the economy hopefully recovers over the next few years, the business loan growth of this group of credit unions will disappear without an increase in the cap. In an environment where banks have constricted their lending, the credit constriction resulting from the statutory credit union business lending cap will mean that some members with existing business relationships may find it increasingly difficult to secure business credit from their credit union, and the credit unions which have contributed to business lending growth during the recession will be increasingly unable to serve new member business borrowers. All of this makes it critical that legislation to increase the business lending cap is enacted.

Increased Credit Union Business Lending is Not a Zero Sum Game for Banks

One of the more perplexing arguments made by the bank lobby is that Congress should not increase the cap because there is no excess demand for small business lending but that raising the cap would harm banks by allowing credit unions to take loans from them.

The bank lobby grossly misrepresents the impact of raising the credit union business lending cap on their own lending volumes. Research suggests that additional credit union business lending would not crowd out bank business lending. And certainly, with the banks controlling 95% of the commercial lending market, even a doubling of credit union market share would not significantly alter their dominance of this market.

During the hearing, one of the bank witnesses specifically claimed that that business lending is a "zero-sum game" – which, if true, would mean that every loan originated by a credit union is a loan that is not originated by a bank. This is simply not true.

Economic theory is revealing on the extent to which credit union lending may or may not "crowd out" bank business lending. Raising the credit union business lending cap is equivalent to an increase in the supply of business credit. Unless the demand for business loans were totally price inelastic, that increase in supply would lead to some increase in loans (i.e., the demand curve is not vertical.). Recently, researchers at the Federal Reserve Board estimated a semi-elasticity of demand for unsecured business loans to be -1.4, implying that a 100 basis point reduction in loan rate would be associated with a 1.4% increase in the amount of loans demanded.[18]

This suggests that an increase in credit union lending would not substantially come from reduced bank loans. Using their estimate, and considering that credit unions currently hold on average only about 5% of the small business loans held by depository institutions, and that H.R. 1418 would limit annual business loan growth above the old cap to 30%, if credit unions entered the market lowering interest rates by roughly 100 bp, the vast majority of that new lending could be accomplished without any reduction in bank loans.

In a recently published report for the Small Business Administration, Professor James A.Wilcox also dispels the zero-sum-game myth. While estimates in the Wilcox paper indicate that developments that boost small business loans at credit unions tended to reduce business loans at banks – the effect was very small. The evidence suggests that the offset was about $0.20 per dollar of additional small business loans at credit unions. In other words, a reduction in business loans at banks implies that a $1 increase in the supply of small business loans by credit unions would lead to a net increase in business loans of $0.80.[19] Put simply, on average, 80% of the increase in credit union lending is new capital that would otherwise not be available in the

[18] Basset, William F., Chosak, Mary Beth, Driscoll, John C., and Egon Zakrajsek (All of the Division of Monetary Affairs, Federal Reserve Board.) "Identifying the Macroeconomic Effects of Bank Lending Supply Shocks." December 2010. Page 18. Available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1758832.

[19] James A. Wilcox. *The Increasing Importance of Credit Unions in Small Business Lending.* SBA Office of Advocacy. Release Date: September 2011.

marketplace. Thus, the vast majority of new credit union lending is not "siphoned" from banks that would otherwise make these loans.

Conclusion

Throughout our history, credit unions have existed to serve the credit needs of their members. From the very first days, this has included the business credit needs of members. During the recession, credit unions remained engaged in member service, and increased lending to small businesses when other lenders fled the market. The credit unions that contributed the most to this growth are or soon will be approaching the cap. In order for these credit unions to continue to serve their small business owning members, Congress must raise the statutory cap. Representatives Royce and McCarthy have put forward a thoughtful bill to achieve this that includes provisions designed to enhance safety and soundness. We urge you to strongly support this legislation, which would allow credit unions to lend an additional $13 billion in the first year, helping small businesses create 140,000 new jobs.

Again, we appreciate your holding the hearing on H.R. 1418, the Small Business Lending Enhancement Act. We look forward to working with you and your staff as this legislation moves forward.

Best regards,

Bill Cheney
President & CEO

Attachment

Testimony of

John A. Klebba

On behalf of the

Missouri Bankers Association

before the

Financial Institutions and Consumer Credit Subcommittee

and

Capital Markets and Government Sponsored Enterprises Subcommittee

of the

Committee on Financial Services

United States House of Representatives

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November 16, 2011

Chairman Capito, Chairman Garrett, Ranking Member Maloney, Ranking Member Waters and members of the Subcommittees, my name is John A. Klebba, President and Chief Executive Officer, Legends Bank, Linn, Missouri.

What today is Legends Bank was established in 1913 in the community of Rich Fountain, Missouri, as the Rich Fountain Bank and is a $253 million institution with ten offices and 83 employees. We serve six rural counties in central and east central Missouri. Our bank was one of the few banks in Osage County to survive the Great Depression. In fact, its move to Linn in 1936 was the result of the failure of all of the banks which had been operating in Linn, and the Missouri bank commissioner's subsequent request to the Board of the Rich Fountain Bank to move the bank so that the county seat of Osage County would have a financial institution. Operations being a little simpler then than they are now, it is said that the move was accomplished by loading everything that was needed in the trunk of a car, with the bank reopening the next business day in its new town and under a new name.

I appreciate the opportunity to present the views of the Missouri Bankers Association on the Communities First Act. The MBA represents Missouri's commercial banks and savings and loan associations, and is the voice of over 30,000 bank employees in the state.

At my bank, as is true of my banker colleagues around the country, we are intensely focused on building and maintaining long-term relationships with our customers. It is because of these relationships that Legends Bank will soon be celebrating a century of service to our customers and community. We cannot be successful without such a long-term philosophy and without treating our customers fairly.

The success of Legends Bank is inextricably linked to the success of the communities we serve, and we are very proud of our relationships with them. They are, after all, our friends and neighbors.

Let me give you just a glimpse of Legend Bank's close ties with our communities. We have just under $170 million in loans on our books. Included in that number are approximately 609 loans, totaling $25.8 million to local farmers for agricultural operations, 268 loans, totaling $8.9 million to our local businesses for their commercial and business needs, 68 loans, totaling $8.1 million to developers for commercial construction projects and farmers for purchase of farm land, and 1084 loans, totaling $65.55 million for the construction and financing of 1 to 4 family homes. In addition, we have $6.1 million in loans to our local government entities that help them fund improvements to the services that they provide to our local citizens.

Not only do we provide the funding to meet the credit needs for our communities, our people are truly a part of these communities. For example, each year our bank participates in the ABA's National Teach Children to Save Day. In 2010, we had 9 employees volunteer their time in eleven area schools. We had another 15 employees involved in community organizations, such as The Chamber of Commerce, Lions Club, Rotary Club, and numerous other Civic Clubs. Moreover, in the last two years, our bank has donated over $180,000 for scholarships, community events, and other local projects.

When a bank sets down roots, communities thrive. A bank's presence is a symbol of hope, a vote of confidence in a town's future. The health of the banking industry and the economic strength of the nation's communities are closely interwoven. We strongly believe that our communities cannot reach their full potential without the local presence of a bank – a bank that understands the financial and credit needs of its citizens, businesses, and government. I am deeply concerned that this model will collapse under the massive weight of new rules and regulations. The vast majority of banks have never made an exotic mortgage loan or taken on excessive risks. They had nothing to do with the events that led to the financial crisis and are as much victims of the devastation as the rest of the economy. We are the survivors of the problems, yet we are the ones that pay the price for the mess that others created.

Managing this mountain of regulation will be a significant challenge for a bank of any size. The median-sized bank has only 37 employees – for them and for banks like mine, this burden is already overwhelming and getting worse with every new regulation coming out of Washington. It is important to note that historically, the cost of regulatory compliance as a share of operating expenses is two and a half times greater for small banks than for large banks. Moreover, each new regulation creates more pressure to hire additional compliance staff. More regulation means more money spent on outside lawyers to manage the risk of compliance errors and greater risk of litigation. It means more money to hire consulting firms to assist with the implementation of all of the changes, and more money hiring outside auditors to make sure there are no compliance errors. It means more risk of regulatory scrutiny, which can include penalties and fines. All of these expenditures take away precious resources that could be better used serving the bank's community.

The consequences are real. Costs are rising, access to capital is limited, and revenue sources have been severely cut. It means that fewer loans get made. It means a weaker economy. It means slower job growth. With the regulatory over-reaction, piles of new laws, and uncertainty about government's role in the day-to-day business of banking, our goal of meeting the needs of our local communities becomes more difficult and more expensive.

Without quick and bold action to relieve regulatory burden we will witness an appalling contraction of the banking industry, with a thousand banks or more disappearing from communities all across the nation over the next few years. These are good banks that for decades have been contributing to the economic growth and vitality of their towns, cities, and counties but whose financial condition is being undermined by excessive regulation and government micro-management. Each bank that disappears from the community makes that community poorer.

In my testimony today, I'd like to focus on two key themes:

- ***Regulatory relief for community banks and their customers***

Banks are working every day to make credit and financial services available. Those efforts, however, are made more difficult by increasing regulatory costs that are slowly but surely strangling traditional community banks, handicapping our ability to meet the credit needs of our communities.

- ***Tax Relief for Rural Banks***

Tax relief for banks would be one way to help create jobs and get the economy going. Any tax relief granted to banks would be reinvested in loans to small businesses, farmers and individuals. In turn, the investments would allow for expansion and job creation. It would also help level the playing field as community banks try to compete with tax advantaged credit unions and the tax advantaged Farm Credit Services.

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

I. Dodd-Frank Rules on High Priced Mortgages, Including Required Escrow Accounts, Increase Costs of Doing Business

Increasingly, the government has inserted itself in the day-to-day business of banking. Micro-managing private industry should not be the role of government. Inevitably it leads to negative unintended consequences.

H.R. 1697 addresses one of these issues by allowing the Federal Reserve Board, at its discretion, to exempt banks from DFA provisions that mandate the establishment of escrow accounts. Sec. 201 would require the Board to exempt all banks with assets of $10 billion or less. The proposed language would be of benefit to many banks, including mine. In the small towns we serve, many of our customers don't want escrow accounts. They are used to paying their insurance and tax bills directly to the insurance companies and county collector. Think about how much easier it is to change insurance companies or change coverages without the involvement of a third party, in this case the bank. Requiring a service our customers don't want doesn't make any sense. It only adds a significant cost to the bank and increases the cost to our customers in the form of higher fees or less attractive interest rates. Many of these loans are small loans. For example, on a mobile home loan the monthly escrow account payment can be very small, sometimes less than $20 per month. Someone doing a cost-benefit analysis would certainly determine that the costs of maintaining such escrows clearly outweigh the benefits.

II. Privacy

Section 208 exempts banks with $1 billion or less in assets from the DFA's Small Business Data Collection requirements. Data collection and reporting for the government is a major burden for community banks and making that information public could violate customers' privacy. Every small business loan has unique characteristics. We question the usefulness of this data for regulatory purposes. Once again this would require that more time be dedicated by bank employees to compliance, when bank resources could instead be dedicated to working with businesses to help those businesses expand and create jobs.

III. Enhanced Rural Lending

Section 302 would permit qualified agricultural lenders insured under the Federal Deposit Insurance Act to exclude from gross income the interest on loans secured by agricultural real property. We strongly support this. This section would help level the playing field between banks like mine and the government sponsored, tax-advantaged Farm Credit System, in that such an exclusion would mirror the exclusion currently available to the FCS. Lets face it, community banks are having a harder and harder time competing with tax advantaged entities, such as the Farm Credit System and credit unions. When the government picks winners and losers at the expense of other industries, in this case, community banks, our communities suffer the consequences.

Many of the rural areas in this country are struggling. Demographically, their population is getting older, especially with respect to individuals who own and operate family farms. In my experience one of the main reasons for this is that it is very difficult for younger people to be able to afford the land and equipment necessary to get them started as farmers. The proposed tax relief for qualified ag lenders would certainly help level the playing field and give a boost to our ag borrowers.

I am concerned about the long term viability of community banking. Tax policy is one of the main reasons.

IV. Tax Relief for Community Banks and Holding Companies

This provision would help community banks redirect their capital back into their communities. Section 403 would extend the net operating loss (NOL) carryback period for banks with less than $15 billion in total assets from two to five years for losses incurred in 2010 and 2011.

Conclusion

The economic recovery is critical to the well-being of families, businesses and all levels of government. Bankers are in a position to be the engine of job creation and to assist in the acceleration of growth in the country. The more that can be done to assist community banks in helping our communities, the sooner this resilient US economy will prosper.

It is for these and other reasons that we strongly support H.R. 1697. We urge quick action to enact this important piece of legislation.

GEORGETOWN UNIVERSITY LAW CENTER

Adam J. Levitin
Professor of Law

Written Testimony of

Adam J. Levitin
Professor of Law
Georgetown University Law Center

Before the
House Financial Services Committee
Subcommittee on Financial Institutions and Consumer Credit
&
Subcommittee on Capital Markets and Government Sponsored Enterprises

Joint Hearing on "H.R. 1697: The Communities First Act"

November 16, 2011
2:00 pm

Ms. Chairman Capito, Mr. Chairman Garret, Ranking Member Maloney, Ranking Member Waters, Members of the Subcommittees:

Good afternoon. My name is Adam Levitin. I am a Professor of Law at the Georgetown University Law Center in Washington, D.C., where I teach courses in bankruptcy, commercial law, contracts, and structured finance. I have previously served as Special Counsel to the Congressional Oversight Panel supervising the Troubled Asset Relief Program (TARP).

I am here today to testify against H.R. 1697, the so-called "Communities First Act." I oppose the bill for several reasons:

- The Communities First Act will actually destroy communities by encouraging mortgage foreclosures that hurt families, neighboring property owners, and local government.
- The Communities First Act encourages spurious accounting practices that debase the informational currency on which American capital market investors depend.
- The Communities First Act would make it impossible for accounting rules to be updated unless they met a pseudo-scientific cost-benefit analysis standard.
- The Communities First Act would enable banks to game the regulatory system by picking their regulator.
- The Communities First Act would gut the Consumer Financial Protection Bureau.

Fundamentally, the Communities First Act is a regulatory subsidy for big and small banks, with some extra morsels tossed in for the small banks. It does nothing for communities. I urge the Subcommittees to reject the bill for the narrow, special interest pleading that it is.

1. The Communities First Act Puts Communities Last and Banks First

The Communities First Act will result in families being thrown out of their homes. Section 205 of the bill permits banks with less than $10 billion in net assets to stretch out loss recognition from foreclosures over 10 years for regulatory capital accounting purposes, rather than recognizing all of the losses when they actually occur, which is immediately. This extended amortization is not only bad accounting; it creates an incentive for banks to foreclose troubled mortgages, rather than modify them and work with borrowers. Favorable and unrealistic accounting treatment of foreclosures will result in more foreclosures and less loan modifications. The Communities First Act will affirmatively hurt American families and communities. It is bad accounting and it is bad policy.

The supporters of the Communities First Act note that Congress extended this sort of favorable loss recognition treatment to banks in the 1980s for troubled farm loans.[1] There is more to the historical story, however. First, Congress extended less favorable treatment loss recognition for agricultural loans than the Communities First Act proposes for residential mortgage loans. The Competitive Equality Banking Act of 1987 capped the loss amortization for agricultural loans at seven years, rather than the ten years proposed by the Communities First

[1] Competitive Equality Banking Act of 1987, Title VIII, § 801, 101 Stat. 656, P.L. 100-86, Aug. 10, 1987, codified at 12 U.S.C. § 1823 (permitting loss recognition on agricultural loans to be amortized over seven years); 52 F.R. 42090, Nov. 3, 1987, codified at 12 C.F.R. § 208.23 (formerly § 208.15) (same).

Act for residential mortgage loans. Second, and critically, Congress extended favorable loss recognition treatment only after having authorized family farmers and fishermen to file for bankruptcy more easily through the creation of Chapter 12 of the Bankruptcy Code in 1986, ten months before the loss amortization statute was passed.[2] Notably, Chapter 12 permits the cramdown of underwater farm loans.[3]

This House passed cramdown legislation in 2008.[4] Unfortunately, the legislation[5] failed to gain cloture in the Senate. That was the last best opportunity to deal with the $700 billion negative equity problem in this country that is weighing down the entire economy. Now the community banks want the regulatory accounting benefit without the burden. That's is a regulatory bailout of the community banks, plain and simple.

2. The Communities First Act Authorizes Voodoo Accounting

Section 206 of the Communities First Act would further exacerbate the incentive to foreclose. It would also institutionalize voodoo accounting. Currently, under Generally Accepted Accounting Principles (GAAP), as mortgage loans are held-to-maturity assets and tare therefore carried on banks' books at face value as long as they are performing. When a mortgage loan is impaired, however, the bank is required to carry it at the fair value of the collateral, under Statement of Financial Accounting Standards 114.

Section 206 would have Congress create a statutory exception to accounting principles for all banks. It would permit them to value the collateral of impaired loans based on the 5-year average price of the collateral property, rather than on current market valuation. This is voodoo accounting. It would allow a bank in 2011-2012 to benefit from the ridiculously inflated property values of 2006-2007 on an asset that might be in foreclosure in a month. Section 206 thus lessens the regulatory accounting blow to a bank from foreclosure and thereby incentivizes foreclosures over loan restructurings.

Section 206's voodoo accounting would allow for "zombie banks" to avoid prompt corrective action notices by artificially inflating their capital. A critical lesson from the S&L crisis was that we should never permit zombie banks to operate—once a bank is insolvent, it should be shut down lest it "gamble on resurrection" by investing in riskier assets in the hopes of a payoff that will return it to solvency. The gamble on resurrection is a gamble with the taxpayer's money and is contrary to fundamental principles of safe-and-sound bank regulation.[6] If a bank isn't solvent based on GAAP accounting, it shouldn't be operating. There is no reason to make exceptions to this common sense principle.

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[2] P.L. 99-554, 100 Stat. 3105-3114, Oct. 27, 1986, codified at 11 U.S.C. §§ 1201 *et seq.*

[3] P.L. 99-554, 100 Stat. 3105, 3109, Oct. 27, 1986, codified at 11 U.S.C. § 1222(b)(2).

[4] H.R. 1106, The Helping Families Save Their Homes Act of 2009 (111th Congress) (passed House on Mar. 5, 2009).

[5] S. 896, The Helping Families Save Their Homes Act of 2009 (111th Congress) (failed to achieve cloture while cramdown provision was included. Bill subsequently passed without cramdown provision).

[6] Section 206 would also appear to encourage banks to let foreclosed properties sit in their portfolios as REO, rather than return the properties to the market, because it would override the GAAP treatment of REO, which requires that foreclosed assets be carried at fair market value less the cost of resale. *See* Accounting Standards Codification 310-40-40-3.

Ultimately, accounting shenanigans are bad for business. The importance of good accounting for the financial system cannot be overstated. As former Treasury Secretary Lawrence Summers once observed, "[T]he single most important innovation shaping [the American capital] market was the idea of generally accepted accounting principles. The transparency implicit in the generally accepted accounting principles (GAAP) promotes efficient market responses to change, and it supports stability."[7] Information transparency is essential for markets to work correctly. This means recognizing losses and gains in the correct time period.

Voodoo accounting is a recipe for capital flight from community banks. If investors don't trust the accounting of community banks, they won't invest or will demand a premium. The regulatory accounting gain from voodoo accounting will come at a cost of capital loss for community banks and is deeply shortsighted.

3. The Communities First Act Would Impose a Pseudo-Scientific Cost-Benefit Analysis

Section 105 of the Communities First Act would require that the Securities and Exchange Commission conduct a cost-benefit analysis before approving any change to accounting standards proposed by the Financial Accounting Standards Board. No change could be approved unless the benefits "significantly" outweigh the costs *and* there is no undue economic impact on banks with less than $10 billion in assets. Thus, even if there were no undue economic impact on small banks, the SEC would still have to find that benefits of an accounting rule *significantly* outweigh the costs.

At first blush, cost-benefit analysis seems like an eminently reasonable, sensible idea. We should want regulation where the benefits outweigh the costs, no?

The problem with cost-benefit analysis, however, is that it is one of the wishiest-washiest, pseudo-scientific things ever. No one who has ever conducted a regulatory cost-benefit analysis would ever think to write legislation requiring such an analysis.

Once you have had a tour of the regulatory cost-benefit sausage factory, the idea that there is anything remotely scientific or even intellectually honest about the process rapidly dissipates. Instead, one quickly realizes that regulatory cost-benefit analysis means that there is a roadblock to regulation, plain and simple, and that ideologically-motivated judges may strike down any regulation they do not like by finding fault with an inherently subjective, faulty cost-benefit analysis process. Put differently, section 105 enables activist judges to strike down regulation on the basis of inherently unscientific cost-benefit analysis being unscientific.

Consider the absurdity of applying cost-benefit analysis to accounting standards. How is the SEC possibly to quantify the benefit to the market from having somewhat different accounting treatment of qualified special purposes entities or variable interest entities? How is the SEC to quantify the benefits of permitting lease liabilities to remain off-balance sheet? These are simply not quantifiable benefits. One cannot put a value on them the way one might value a human life or a human hand. Indeed, one might argue that clear accounting rules help prevent systemic risk. The chance of systemic risk is slight, but the loss severities are nearly infinite. Does that mean that if the SEC finds that an accounting rule helps increase financial

[7] Lawrence H. Summers, "International Financial Crises: Causes, Prevention, and Cures," in ECONOMIC GLOBALIZATION IN ASIA (MANAS CHATTERJI & PARTHA GANGOPADHYAY, EDS.) 47, 56 (2005).

transparency and thus avoid systemic risk that the benefits outweigh almost any cost? Any attempt to quantify the benefits is inherently speculative and that speculation can be as broad or narrow as the SEC wishes.

As for costs, what are the costs to be considered? The marginal increase in auditors' fees? Surely they are so small that they are outweighed by nearly any cost-of-capital benefit from clearer accounting. The regulatory capital charges to the extent regulatory accounting principles follow GAAP?

Add to this the novel inclusion of the "significantly" outweigh requirement, not typically included in cost-benefit analysis. How much of a difference qualifies as "significant"? Again, this fuzzy standard merely opens the door to judicial activism.

The point here is that cost-benefit analysis as a mode of regulatory review is fundamentally ridiculous. Cost-benefit analysis may sound sensible at first, but those who have dealt with it know that in practice it is one of the worst ideas to come out of Congress and is really just a shadow form of deregulation.

The effect of requiring cost-benefit analysis for accounting standards would be to petrify the accounting standards as they stand today. That would prevents accounting standards from being modernized to keep up with transactions and means firms would have insufficient guidance regarding their accounting, opening them up to securities fraud litigation claims. Ultimately section 105 damages American capital markets because investors will come to question whether firms' financial statements actually give a true picture of the firms' finances.

4. The Communities First Act Would Permit Small Banks to Game the Regulatory System for Examinations

Section 108 of the Communities First Act would prohibit the Board of Governors of the Federal Reserve from transferring examination authority for federal consumer laws for insured depositories with less than $10 billion in assets to the Consumer Financial Protection Bureau (CFPB), as currently authorized under section 1012 of the Dodd-Frank Act.

The issue here is not whether there will be examinations of small banks for compliance with federal consumer laws. The only question is who will do the examinations. The only reason that small banks should care who does the examinations is if they think one examiner will be more favorable to them than another, and that is exactly why section 108 of the Communities First Act is terrible idea. Regulated entities should not be permitted to pick their regulator. Such permission allows them to engage in regulatory arbitrage, where they will always seek out the weaker, more permissive regulator. Section 108 of the Communities First Act, then, is a license to let small banks game the regulatory system.

5. The Communities First Act Is a Backdoor Attempt to Gut the Consumer Financial Protection Bureau

Section 107 of the Communities First Act would lower the standard needed for the Financial Stability Oversight Council (FSOC) to veto rule-makings by the Consumer Financial Protection Bureau (CFPB). The current standard requires the FSOC to find that the CFPB's rule-making poses a systemic risk to the United State's financial system, namely that it would "put the safety and soundness of the United States banking system or the stability of the financial system of the United States at risk."[8] The proposed standard in section 107 would require a lesser finding, namely that the rulemaking would be either "inconsistent with the safe and sound operation of United States financial institutions" or that it "could adversely impact a subset of the banking industry disproportionately." Note the use of "could" rather than "would" in the second phrase, implying that there need be only a possibility, not a likelihood or certainty of the result.

A. "Inconsistent with Safe and Sound Operation of United States Financial Institutions"

In the bank regulation context, safety and soundness means, first and foremost, profitability. It is axiomatic that a financial institution that is not profitable cannot be safe and sound. Consumer financial protection, however, is often inconsistent with bank profitability. Financial institutions only engage in unfair, deceptive and abusive acts and practices because they are profitable; they are not done for spite or Sadism. Predatory mortgage lending, for example, exists only because it is profitable.[9]

To the extent that a proposed CFPB regulation would reduce the profitability of a financial institution, it would reduce that institution's safety and soundness. Thus, any CFPB regulation, even if it merely increased compliance costs, would be "inconsistent with the safe and sound operations" of a financial institution.

While bank regulators have argued that consumer protection goes hand in hand with safety and soundness because it is unsafe for a bank to systematically exploit its customers or engage in unfair and deceptive practices, the run up to the financial crisis provides clear evidence that federal bank regulators were unwilling to put the brakes on unfair and deceptive mortgage lending. Similarly, the run up to the Credit CARD Act of 2009 shows that federal regulators were unwilling to act on unfair and deceptive credit card acts and practices until Congress itself started to move. Only then did the Federal Reserve, OTS, and NCUA hustle to amend their unfair and deceptive acts and practices (UDAP) regulations.

To understand just how overbroad the Communities First Act's proposed veto standard is, consider, for example, consider if there had been a CFPB in 2005, and it had proposed a rule that would have severely restricted the underwriting of payment-option adjustable-rate mortgages (so-called pick-a-pay mortgages) to borrowers who have demonstrated an ability to repay. Such a rulemaking would have put an end to the "Countrywide special," that was the hallmark of Angelo Mozillo and Countrywide, the nation's largest mortgage lender.

Such a restriction would have significantly curtailed Countrywide's mortgage lending business, and would surely have resulted in the OCC or OTS demanding an FSOC veto. Yet such a move could hardly be called radical. Congress itself passed just such a requirement in section 1411 of the Dodd-Frank Act,[10] and a parallel requirement for credit cards in section 109 of the Credit C.A.R.D. Act of 2009.[11]

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[8] 12 U.S.C. § 5513(a).

[9] There is no public policy justification for caring about the particular profit level of U.S. banks, as long as those banks are profitable. Safety-and-soundness concerns mandate that banks be profitable, but not a level of profitability.

[10] P.L. 111-203, § 1411, 124 Stat. 1376, 2142, July 21, 2010, *codified at* 15 U.S.C. § 1693c ("no creditor may make a residential mortgage loan unless the creditor makes a reasonable and good faith determination based on verified and documented information that, at the time the loan is consummated, the consumer has a reasonable

Indeed, we actually have an example from 2008 of a bank regulator challenging a proposed consumer financial protection regulation on safety-and-soundness grounds. In August 2008, Comptroller of the Currency John C. Dugan wrote to the Federal Reserve Board to urge it to insert two significant exceptions to the proposed Regulation AA (governing unfair and deceptive acts and practices) rule on credit cards that would limit the ability of card issuers to reprice (or, colloquially, "rate jack") cardholders.[12] Duggan wrote that the restrictions "raise safety and soundness concerns" because they limited the ability of issuers to re-price their loans if issuers determined that the risk profile of the customer had worsened.[13] If the CFPB had proposed such a rule, the OCC would surely have challenged it before the FSOC as "inconsistent with the safe and sound operations of United States financial institutions." Yet, Congress itself passed an even tougher restriction on credit card repricing less than a year later.[14]

Under the Communities First Act's veto standard, several laws passed by Congress in recent years, such as the Credit C.A.R.D. Act and the Mortgage Reform and Anti-Predatory Lending Act would themselves be unenforceable by regulation because the laws themselves might reduce bank safety-and-soundness (i.e., profitability), so any faithful rule-making would have to as well. The effect of the Communities First Act would be to eviscerate several recent, popular, consumer financial protection statutes. The proposed expansion of the FSOC veto would place bank profits ahead of the well-being of American families, and would put us on a return course to the financial crisis of 2008.[15]

B. "Could Adversely Impact a Subset of the Banking Industry Disproportionately"

For all the problems with the safety-and-soundness veto standard proposed by the Communities First Act, the alternative standard it proposes, namely that a CFPB rulemaking "could adversely impact a subset of the banking industry disproportionately" is just as troublesome. This lower standard would prevent the CFPB from regulating really bad, predatory products as long as they were only provided by some banks because the regulation would affect a subset of the industry disproportionately. Unless a problematic product or practice is industry-

ability to repay the loan, according to its terms, and all applicable taxes, insurance (including mortgage guarantee insurance), and assessments.").

[11] P.L. 111-24, 123 Stat. 1743, § 109, May 22, 2009, *codified at* 15 U.S.C. § 1665e ("A card issuer may not open any credit card account for any consumer under an open end consumer credit plan, or increase any credit limit applicable to such account, unless the card issuer considers the ability of the consumer to make the required payments under the terms of such account.").

[12] Letter from Comptroller of the Currency John C. Dugan to Jennifer Johnson, Secretary, Board of Governors of the Federal Reserve System, Re: Docket Number R-1314, August 18, 2008.

[13] *Id.*

[14] P.L. 111-24, § 101, 123 Stat. 1736-37, May 22, 2009, *codified at* 15 U.S.C. § 1666i-1.

[15] I would also note that the FSOC veto under section 1023 of the Dodd-Frank Act, codified at 12 U.S.C. § 5513(a), is already of dubious constitutionality. On June 28, 2010, a fortnight before the enactment of the Dodd-Frank Act, the Supreme Court handed down its judgment in a case captioned *Free Enterprise Fund v. Public Company Accounting Oversight Board*, 130 S. Ct. 3138 (2010). In this case, the Supreme Court held that it was an unconstitutional violation of the separation of powers to restrict the President in his ability to "remove a [principal] officer of the United States, who is in turn restricted in his ability to remove an inferior officer, even though that inferior officer determines the policy and enforces the laws of the United States". *Id.* at 3147. This ruling raises the question of whether by giving the FSOC veto power over CFPB rulemaking, Congress has impermissibly restricted the power of the President to "take Care that the Laws be faithfully executed" through his appointee as Director of the Bureau of Consumer Financial Protection. It also raises the concern that the CFPB is not truly an independent agency as it would be subject to a veto exercised in part by cabinet agencies.

wide, regulation of that product not just could, but would adversely impact a subset of the banking industry disproportionately.

Imagine for a minute that a subset of the financial industry were selling financial poison, the financial equivalent of crystal meth. If the CFPB declare such a product to be unfair, deceptive, or abusive and prohibited it, the CFPB's action would undoubtedly hurt a subset of the financial industry, namely the "financial meth" pushers. That could trigger an FSOC veto. The threat of the veto in turn might chill the CFPB's actions, so that the financial meth would remain on the street. This isn't how things should work.

To apply this in very real terms, in 2009, Congress passed the CARD Act which restricted so-called "fee harvester" credit cards—cards with extremely low ($300 or less) credit limits and fees that often took up half of the credit limit.[16] There are a limited number of banks that issued fee harvester cards. They were surely adversely impacted by the CARD Act and disproportionately so. The regulation of fee harvester cards is exactly what we should want the CFPB to do, but the Communities First Act would always cast the threat of a FSOC veto over such a CFPB action.

C. The Purpose of the FSOC Veto: Systemic Risk, Not Maximization of Bank Profits

It is important to remember why there is an FSOC veto over the CFPB and why it is a systemic risk standard. The FSOC is a Justice League of bank regulators tasked with preventing *systemic* risk, not with ensuring optimal prudential regulation of banks and not protecting bank profits. The purpose of the FSOC veto is to ensure that the CFPB does not inadvertently create harm to the entire financial system. Community banks just aren't systemically important enough for the FSOC to consider.

And that points to what the proposed expansion of the FSOC veto is really about: it is a backdoor attempt to gut the CFPB. Banks don't like regulation in general, but the FSOC veto was never meant to prevent the CFPB from making rules that banks don't like. If that's the policy result that's desired, why not be frank about it and propose a bill that states, "Banks may choose to disregard any regulation they do not like"? It's an obviously preposterous idea, but that is what the proposed FSOC veto expansion is trying to do—give banks carte blanche in how they treat consumers.

Conclusion

The Communities First Act would affirmatively harm communities by encouraging foreclosures. It would harm capital markets by authorizing voodoo accounting and hamstringing GAAP, "the single most important innovation shaping [the American capital] market." It would enable banks to game the regulatory structure by awarding them a more lenient regulator. And the bill would gut the new Consumer Financial Protection Bureau before it has a chance to even implement a rule-making. The Communities First Act is another Orwellian title that belies what the bill is really about. A more accurate name for this legislation would be the Banks First Act of 2011. Congress needs to put the public's interest first, not the banks'.

[16] P.L. 111-24, 123 Stat. 1741-42, § 105, May 22, 2009, *codified at* 15 U.S.C. § 1637(n) (capping the fees that can be put against the credit limit of a credit card account in the first year during which the account is open at 25 percent in aggregate of the credit limit).

Testimony of

Salvatore Marranca
Director, President, and CEO
Cattaraugus County Bank

On behalf of the

Independent Community Bankers of America

Before the

United States House of Representatives
Subcommittee on Capital Markets and Government Sponsored Enterprises
Subcommittee on Financial Institutions and Consumer Credit

Joint Hearing on

"H.R. 1697, The Communities First Act"

November 16, 2011
Washington, D.C.

Opening

Chairman Capito, Chairman Garrett, Ranking Member Maloney, Ranking Member Waters and members of the subcommittees, I am Sal Marranca, Director, President, and CEO of Cattaraugus County Bank, a $180 million asset bank in Little Valley, New York. I am pleased to be here today to represent the nearly 5,000 members of the Independent Community Bankers of America. Thank you for convening this hearing on the Communities First Act (H.R. 1697). This legislation is a top priority for ICBA and community banks nationwide. We are grateful to Rep. Luetkemeyer for introducing this legislation and to the more than 50 Members from both parties who have cosponsored it.

ICBA strongly supports the Communities First Act because, put simply, it will help community banks better serve their communities by providing carefully crafted regulatory relief without jeopardizing consumer protection or safety and soundness. It will also provide needed tax reforms and encourage individual savings. Rather than a top-down program crafted by academics, the CFA was crafted from the bottom up with input from community bankers who know what will work on Main Street.

Community Banks and Local Economies

Community banks will play an integral role in any broad-based economic recovery. We serve the small towns and rural areas not served by the larger institutions, and we are responsible for 60 percent of all small business loans under $1 million. As the economy recovers, small businesses will lead the way in job creation with the help of community bank credit.

Most community banks are closely-held institutions whose viability is directly tied to the economic life of the communities they serve. My bank has nine offices serving the small communities of rural Western New York. Community bank deposits are reinvested in the community to support local businesses and residents, not transferred out of state. Community banks focus on traditional banking products and have a distinct business model from larger banks and Wall St. firms. Our businesses are built on long term relationships with customers who are also neighbors, parents of our children's friends, and people we see in the community every day. We often deliver customized products that large banks with their mass marketing and volume-based business models cannot or will not offer. We make loans passed over by the mega-banks because we have first-hand knowledge of local conditions and of the character of the borrower that cannot be captured by statistical modeling done in another region of the country. We thrive when the community thrives.

Community Banks are Low Risk Institutions

Early in my career, I was a Senior Bank Examiner with the FDIC for over a decade, and the commitment I made then to safety and soundness I still carry with me today as President of my bank and as Chairman of ICBA. The longevity of my bank – like many community banks we've been in business for over a century and survived the Great Depression and many intervening recessions – is a testament to our conservative risk management. Our commitment to treating customers fairly is equally strong because our business will thrive or fail based on our reputation in the small communities we serve. These twin commitments to safety and soundness and fair treatment of customers are broadly shared by community banks. Because we are low risk institutions, the manner in which we are regulated should be distinct from that of large banks and Wall Street firms. Regulation calibrated to large bank risks and business models can suffocate smaller banks. This is why the Communities First Act is needed to provide appropriate tiering of regulation and relief for smaller, low risk institutions so that they can better serve their communities.

Growing Regulatory Burden

The steady accretion of regulation over many decades – always added but too seldom modernized or removed – has become a growing threat to community banks. Some of these regulations are sensible and necessary. But, as President Obama recognized in his January Executive Order requiring a government-wide review of existing regulations, others are outmoded, conflicting, overly prescriptive, redundant and overly burdensome. To community banks like mine, regulation is a disproportionate expense, burden, and distraction. We simply don't have the scale of larger banks to amortize the expense of compliance. Cattaraugus County Bank has 65 employees. A compliance staff of five to six employees manages the multiplicity of rules covering every aspect of our business. This is out of proportion to our primary business of lending and deposit taking. My compliance staff is half as large as my lending staff, the 11 loan officers who serve customers directly. Every new regulation is a strain on my staff and the thin margins on which we operate. Every new regulation brings new liability exposure in case we fail to interpret it properly, despite our best efforts. Every hour that I spend on compliance is one hour less to spend with customers or prospective customers who can help our local economy grow.

Regulations are particularly burdensome when they are insufficiently flexible to fit the community bank business model. As I've stated, our competitive advantage with regard to the large banks is offering customized products and services to meet our local customers' needs. Regulations that privilege plain vanilla products, for example, or prohibit certain product features would put our customers at a disadvantage.

Of course, many regulations serve a legitimate purpose. But what's most troubling is the cumulative effect. One of my ICBA colleagues describes it this way: It's like snowflakes falling on a roof. Falling steadily over the course of hours – without any sweeping away – they accumulate enough weight to strain even a well-constructed roof, but you can't identify the one snowflake that was responsible. The problem is the cumulative impact, and a cumulative problem warrants a broad response. That's why the Communities First Act contains 26 provisions. No one of them is a silver bullet. Some of the provisions, while important, are narrow and technical. Others will have a broader impact. All of them are carefully chosen, balanced and fully consistent with the President's Executive

Order. Cumulatively, they will have a real impact for community banks and their customers.

Provisions of the Communities First Act

Of the 26 provisions of the CFA, 18 are within the jurisdiction of this committee. I would like to highlight some of the more important provisions.

Short Form Call Report for Qualifying Banks

The report of condition, or "call report," is an essential tool for bank regulators, providing important information. Insured depository institutions are required to file call reports on a quarterly basis. The call report runs to over 70 pages with schedules covering every aspect of our business. This is useful information, but when a bank has assets of less than $10 billion and is highly-rated and well-capitalized, we believe that it would make sense for regulators to focus their limited resources on undercapitalized institutions. H.R. 1697 would not dispense with the call report for qualified banks. Rather, it would require bank regulators to develop a short form call report that is "significantly and materially less burdensome" to prepare and "provides sufficient material information for the appropriate Federal bank agency to assure the maintenance of the safe and sound condition of the depository institution and safe and sound practices." A qualifying bank would be allowed to file the short form call report in two non-consecutive quarters each year. This change would reduce the burden on qualified community banks without compromising safety and soundness.

Exemption from Escrow Requirement for Mortgages Held in Portfolio

Current law requires creditors to establish escrow accounts for the collection of taxes and insurance in connection with higher-priced mortgage loans. The Dodd-Frank Act lengthened the period during which such accounts must be maintained. While escrow accounts make good sense in many cases in order to protect collateral value, they are simply impractical for many low volume lenders who don't have resources to perform this function in house and for whom outsourcing would be prohibitively expensive. Community banks often lend to uniquely situated borrowers with properties that are atypical due to the location or the acreage. Because the collateral is atypical, the loans are frequently "high priced," as defined by Federal Reserve Regulation Z. This is especially true in the current interest rate environment in which a loan with an annual percentage rate below 6.5 could be considered high priced and therefore subject to the escrow requirement. Given the low profit margins of mortgage lending, an escrow requirement could tip a community bank's decision against remaining in this line of business and lead to further consolidation in the mortgage industry. Rural borrowers in particular would be harmed by industry consolidation because large banks don't comprehensively serve rural areas. When a community bank holds a mortgage in portfolio, they have more than enough "skin in the game" and every incentive to protect their collateral. CFA would exempt lenders with less than $10 billion in assets who hold loans in portfolio from the escrow requirement. This provision would help keep community banks in the mortgage lending business at a time when it is becoming increasingly hard to compete with large lenders.

Eliminate Annual Privacy Notices When No Change in Policy Has Occurred

Under the Gramm-Leach-Bliley Act, financial institutions are required to provide annual privacy notices to customers even when their policies have not changed. The Communities First Act would eliminate the annual privacy notice when no change in policy has occurred and require annual notices only when a change in policy has occurred or to give a customer the opportunity to opt-out of information sharing, except as provided under an established exception. Annual notices when no change in policy has occurred do not provide useful information to customers and represent an unproductive expense for financial institutions.

Reimbursement for Mandatory Production of Records

A number of Federal agencies have authority to require banks to produce records for investigative and law enforcement purposes under the Right to Financial Privacy Act. However, banks may only claim reimbursement for the expense of producing records when they have been requested by a Federal banking agency. They may not do so when the request comes from the SEC, IRS, or other agencies.

CFA would amend the Right to Financial Privacy Act to require any Federal government agency to reimburse any financial institution with assets of $10 billion or less for the cost of producing records for any Federal law enforcement or investigative purpose. In one case, an ICBA member bank incurred significant expenses in complying with a records request from the SEC. Such cases are not frequent, but the underlying principle is important. Reimbursement of reasonable expenses is only fair and would relieve some community banks of a significant cost burden.

Additional Provisions

There are several additional provisions of CFA that warrant mention. One would raise the exemption for qualifying small bank holding companies from the Federal Reserve's capital adequacy guidelines. This exemption is known as the Federal Reserve Small Bank Holding Company Policy Statement. Another CFA provision would exempt banks with assets of less than $1 billion from the internal control attestation requirement of Sarbanes-Oxley Section 404(b). This exemption threshold is warranted because community bank internal control systems are closely and continuously monitored by bank examiners. Two provisions of CFA address accounting principles. The first would require the SEC to ensure that the reports and other disclosures it requires take into account the business model of the preparer. Specifically, the SEC should differentiate between traders in assets and liabilities and community banks that hold assets and liabilities for the long term and should not be required to revalue them frequently. The other accounting provision would require the SEC to conduct a cost-benefit analysis of GAAP standards. Another provision of CFA, championed by Mr. Perlmutter, would allow banks with less than $10 billion in assets to amortize losses on commercial real estate loans over 10 years, but only for regulatory capital purposes. This provision, which would be temporary, would encourage workouts and reduce foreclosures. It is modeled on temporary extended amortization approved by Congress in the 1980s to help agricultural lenders. A related provision would address the impact of sudden and temporary drops in real estate values by measuring losses using a rolling five-year average appraisal value instead of a single appraisal. This change, which would apply only for regulatory capital purposes, would provide more useful real estate values by smoothing out potentially wide fluctuations.

Additional provisions which lie outside of the jurisdiction of this committee would reform Subchapter S of the tax code to facilitate capital formation among Subchapter S firms. Some 2,300 community banks are organized under Subchapter S. Bank examiners are constantly telling community banks to raise additional capital. Without access to the broader capital markets, these banks turn to their communities for additional capital. Amending the Subchapter S rules will help them to raise capital in their communities and meet the demands of their examiners. Other provisions would encourage individual savings, extend the 5-year carry back period for net operating losses to 2010 and 2011, create a limited tax credit for community banks to offset the competitive advantage enjoyed by tax-exempt credit unions, and support rural lending.

Finally, I'd like to thank the committee for passing H.R. 1965 which raises the threshold number of bank shareholders that triggers SEC registration from 500 to 2,000. Registration is a significant expanse and an update to the threshold trigger is long overdue. We're grateful to representatives Himes and Womack for introducing this legislation, and we were very pleased to see it pass this committee and the House with nearly-unanimous support. A similar provision is included in CFA, and similar ICBA-backed legislation is now advancing in the Senate.

Closing

This is not a comprehensive description of the Communities First Act, which is beyond the scope of this testimony, but it does fairly represent the range of provisions and the overarching intent and potential impact of the bill. Each provision is carefully selected with input from community bankers nationwide and crafted to preserve and strengthen consumer protections and safety and soundness. There are some 7,000 community banks in this country with different charter types, ownership, tax statuses, and lending specializations, from agriculture to small business to residential mortgage. The Communities First Act is a broad and diverse solution to the regulatory challenges facing a diverse industry. I would also note that credit unions, which are represented at today's hearing and play a significant role in our diverse financial system, would benefit from several provisions of the CFA, including reforms to the Financial Stability Oversight Council review of CFPB rules, reimbursement for mandatory production of records, and the limited restoration of credit ratings for small institutions that do not have internal resources to perform credit analysis.

Left unaddressed, the increasing burden of regulation will discourage the chartering of new community banks and lead to further industry consolidation. Consolidation will lead to higher interest rates for borrowers, lower rates paid on deposits, and fewer product choices – especially in the rural areas and small towns currently served by community banks. A more concentrated industry, dominated by a small number of too-big-to-fail banks, will jeopardize the safety and soundness of the financial system and expose taxpayers to the risk of additional costly bailouts. That's why it's so important to enact the sensible regulatory reforms embodied in the Communities First Act. These reforms will help preserve the community banking model and the rich, diverse financial system that supports our nation's diverse economy.

We encourage you to reach out to the community bankers in your district. Ask them about the current regulatory environment and whether the reforms of the CFA would help them to better serve their customers and the communities of your district. We're confident that they will agree with us. Please consider becoming a cosponsor of CFA. And to the leaders of these subcommittees, we encourage you to act on the CFA soon in response to the struggling economy.

Thank you again for the opportunity to testify today and offer ICBA's perspective on the important reforms of the Communities First Act.

Testimony of Damon A. Silvers

Policy Director and Special Counsel

American Federation of Labor and Congress of Industrial Organizations

Joint Hearing on H.R. 1697: The Communities First Act

House Subcommittee on Financial Institutions and Consumer Credit and House Subcommittee on Capital Markets and Government Sponsored Enterprises

November 16, 2011

Good afternoon Chairman Capito and Chairman Garrett, and Ranking Members Maloney and Waters. My name is Damon Silvers, I am the Policy Director and Special Counsel for the American Federation of Labor and Congress of Industrial Organizations. I served as Deputy Chair of the Congressional Oversight Panel for TARP for the entirety of that body's statutorily mandated existence. I am testifying today on behalf of both the AFL-CIO and Americans for Financial Reform, a coalition of more than 250 organizations representing more than 50 million Americans. The AFL-CIO and AFR very much appreciate the opportunity to be heard before the subcommittees on these important issues relating to small banks.

Let me begin by stating that the double standard in the treatment of small banks by both the Bush and the Obama Administration during the financial crisis should be a source of lasting embarrassment to all involved. As near as the Congressional Oversight Panel could determine, small banks were uniformly required to rigorously demonstrate their health before they could access TARP funds, and have been required to repay those funds with equity capital, which in many cases has proved difficult to raise. By contrast, large institutions on the brink of failure—Citigroup and Bank of America were given ad hoc access to TARP funds, and arguably several others were as well, in each case without having to demonstrate that they were healthy.

Furthermore, on at least one occasion a large institution, Bank of America, was allowed to repay TARP funds with borrowed money despite having been found to have been in need of capital in the stress tests, while numerous small institutions continue to hold TARP funds because they have no realistic ability to raise equity to repay those funds and are not being allowed to do so with debt. Currently, 375 smaller financial institutions continue to have outstanding Capital Purchase Program preferred stock. However, since the statutory sunset of the Congressional Oversight Panel, 278 smaller banks have repaid their TARP funds.

Smaller banks face fundamental problems in this economic environment raising new capital. Those problems relate to the broader weakness of our economy, the weakness of commercial real estate markets, and the competitive challenges associated with operating in markets where larger institutions have implicit government guarantees. These challenges will not be addressed by weakening our securities laws. All that will do is endanger the investing public.

The Financial Services Committee should consider looking closely at the circumstances that have led to the 278 banks that have repaid TARP funds over the last eight months being able to do so and the circumstances that have led the remainder not to be able to do so. Both small banks and the American public would be benefited by creative solutions that helped smaller banks repay the American public and obtain cheaper long term capital as the cost of TARP capital escalates.

At the same time, while there are disagreements about the causes, there is clearly a continuing crisis of commercial credit for small and medium sized enterprises in the United States. More than two years after the official end of the 2007-2009 recession, commercial lending levels remain just off recession era lows when looked at in aggregate.

The Congressional Oversight Panel warned on multiple occasions that if steps were not taken to both address weaknesses in large banks and to aid smaller banks more aggressively, the United States was in danger of repeating the Japanese experience of the 1990's—where a financial system dominated by weak large banks protected by regulatory and accounting forbearance simply failed to function in the most basic way—i.e. failed to provide credit to operating businesses. Today, we appear to be living in that world—a world of weak banks, constrained credit to small and medium sized enterprises, overleveraged households, persistent high unemployment and growth so sluggish there is no sign of job creation on the horizon.

This situation cries out for aggressive policy responses—to end the double standard in bank regulatory policy, to recapitalize weak large banks, to rebuild business lending and restructure home mortgage loans so households are no longer trapped in a downward spiral. Instead, however, this joint hearing addresses a bill, H.R. 1697, that seeks to extend the bad practices of regulatory forbearance from the big banks to the small banks, rather than asking big banks to live up to the same standards we ask small banks to live by.

This bill seeks to allow banks to hide the very real losses that accompany foreclosing on American families—effectively creating a regulatory subsidy for throwing people out of their homes and driving down housing prices.

It undoes the fundamental principle that has underpinned our financial accounting system since the 1930's—the principle of the independence of the Financial Accounting Standards Board—by effectively requiring the Securities and Exchange Commission to only approve financial accounting rules that report good news about small banks, rather than having rules that tell the truth about small banks.

The bill seeks once again to weaken the Consumer Financial Protection Bureau by depriving the Bureau of jurisdiction over banks with assets of less than --, effectively recreating the fragmented system of consumer protections that brought us the mortgage crisis that we continue to suffer through.

H.R. 1697 exempts banks assets up to $1 billion from the internal controls requirements of the Sarbanes-Oxley Act, effectively increasing the risks that such banks would pose to the Federal Deposit Insurance Corporation, and overturning the basic proposition that has been in place since the beginning of federal bank regulation in the 1870's that banks must have internal controls that are at least adequate to ensure the accuracy of their financial statements.

H.R. 1697 weakens capital requirements for banks with assets from $500 million to $1 billion, again increasing the risk borne by the FDIC.

More broadly, H.R. 1697 weakens consumer privacy protections for all banking customers, undermines the integrity of real estate appraisals, allowing lookbacks to the bubble period for determining the value of real estate that backs demand deposits, seeks to suborn the protection of the American public to the interests of the banks by broadly weakening the authority of the Consumer Financial Protection Bureau, fundamentally undermines the securities laws by allowing public offerings to up to 2,000 people without requiring registration with the Securities and Exchange Commission, and seeks to make banks more reliant on credit rating agencies.

Over time, I have been impressed with the capacity of members of Congress to name bills in ways that are fundamentally dishonest. This grab bag of regulatory subsidies, many of which are in fact for the benefit of big banks, no more deserves the name of The Communities First Act than did TARP itself. I have tried to think of a more accurate name for this bill, and thought the

Potemkin Village Act or the Let's Make Believe Act of 2011 sounded pretty good. But as I thought about how much of this Act is really about helping big banks, about helping Wall Street, I concluded that the best title for it would be the Help the 1% and Hurt the 99% Act of 2011.

Thank you for the opportunity to testify today. I look forward to your questions.

JOINT HEARING ON "H.R. 1697, THE COMMUNITIES FIRST ACT," ON NOVEMBER 16, 2011, BEFORE THE SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT, AND THE SUBCOMMITTEE ON CAPITAL MARKETS AND GOVERNMENT SPONSORED ENTERPRISES, OF THE COMMITTEE ON FINANCIAL SERVICES, U.S. HOUSE OF REPRESENTATIVES

WRITTEN TESTIMONY OF ARTHUR E. WILMARTH, JR.
Professor of Law, George Washington University Law School
Washington, D.C.

Thank you very much for inviting me to participate in this important hearing. My testimony will address the following topics related to the community banking industry: (1) the unique role of community banks as the most important source of external credit for small and medium-sized enterprises ("SMEs"), and the negative impact of consolidation in the banking industry on community banks and SMEs; (2) the differential treatment provided to "too big to fail" ("TBTF") megabanks and community banks during the financial crisis, and the adverse effects of continuing losses in the commercial real estate ("CRE") market on community banks; and (3) provisions of H.R. 1697 that could assist community banks in dealing with their current challenges and thereby strengthen the ability of community banks to serve as continuing sources of credit to SMEs.

1. Community Banks Play a Vital Role in Our Economy as Primary Providers of Outside Credit to SMEs But Are Threatened by Industry Consolidation

The dual banking system in the United States is a decentralized, diverse system comprising more than 7,000 banks, including thousands of community banks, scores of midsized regional banks, and a small group of large, multistate banking organizations. Community banks play a crucial role in providing credit and other financial services to consumers and SMEs.[1] In contrast to the United States, Canada and the United Kingdom each have fewer than 100 banks. The highly concentrated banking systems of both nations are dominated by a handful of big banks. Very few community banks exist in Canada and the U.K.[2] Due in large part to the significant role played by community banks, the U.S. banking system has performed much better than the Canadian and U.K. systems in serving the needs of SMEs.[3]

Community banks have long served as the leading source of outside (as contrasted with inside) credit for SMEs. In 2010, community banks with assets of less than $10 billion held only 23% of the banking industry's assets but accounted for 56% of

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[1] Arthur E. Wilmarth, Jr., "The OCC's Preemption Rules Exceed the Agency's Authority and Present a Serious Threat to the Dual Banking System and Consumer Protection," 23 *Annual Review of Banking and Financial Law* 225, 263-65 (2004) (available at http://ssrn.com/abstract=577863) [hereinafter Wilmarth, "Dual Banking System"); *see also* Arthur E. Wilmarth, Jr., "The Transformation of the U.S. Financial Services Industry, 1975-2000; Competition, Consolidation, and Increased Risks," 2002 *University of Illinois Law Review* 215 (2002) (available at http://ssrn.com/abstract=315345) [hereinafter Wilmarth, "Transformation"], at 254-72.

[2] Canada has only about 70 banks, and the six largest banks dominate Canada's domestic banking markets. C.J. Shaw, "Big Bank Merger Review in Canada," 21 *Journal of International Banking Law and Regulation* 474, 475 (2006); Arthur E. Wilmarth, Jr., "Too Big to Fail, Too Few to Serve? The Potential Risks of Nationwide Banks," 77 *Iowa Law Review* 957 (1992) hereinafter Wilmarth, "Too Big to Fail"), at 1052. Similarly, the U.K. has fewer than 100 banks, and the four largest banks dominate the U.K.'s domestic banking markets. Shelagh Heffernan, "UK bank services for small business: How competitive is the market?", 30 *Journal of Banking and Finance* 3087, 3089 (2006); Wilmarth, "Too Big to Fail," supra, at 1052

[3] Wilmarth, "Dual Banking System," *supra* note 1, at 263-65; Wilmarth, "Too Big to Fail," *supra* note 2, at 1038-40, 1052-55 (stating that "[t]he highly concentrated banking systems in both countries have long been characterized by oligopolistic behavior," *id.* at 1052); *see also* Shaw, *supra* note 2, at 476 (noting that "[l]ike public utilities, the large [Canadian] banks are perceived to co-exist in a business environment which is (or very close to) oligopoly"). The largest Canadian banks have received widespread public criticism for their high profits, excessive fees and poor service to consumers and SMEs. *See* Gaétan Breton & Louise Côté, "Profit and the legitimacy of the Canadian banking industry," 19 *Accounting, Auditing & Accountability Journal* 512, 521-31 (2006). Analysts have concluded that the "big four" U.K. banks display oligopolistic conduct in charging excessive prices for services to consumers and SMEs. *See* Heffernan, *supra* note 2; Shelagh A. Heffernan, "How do UK financial institutions really price their banking products?", 26 *Journal of Banking and Finance* 1997 (2002). For additional reports criticizing major Canadian and U.K. banks, *see* sources cited in Wilmarth, "Dual Banking System," *supra* note 1, at 264 n.146

outstanding bank loans to SMEs.[4] By serving as the most important source of external credit for SMEs, community banks promote economic growth in the United States. SMEs account about half of the total private sector output, employ a majority of the private sector workforce, and account for (i) about two- thirds of net new jobs and (ii) more than a third of all private sector innovations.[5]

A 2004 study confirmed the link between community banks, the success of SMEs and economic growth. Based on a review of banking systems in 49 countries, that study found that countries recorded faster growth rates in their gross domestic profit ("GDP") if community banks accounted for a larger share of their banking system. The study concluded that the superior ability of community banks to provide relationship loans to SMEs was the most likely explanation for the observed correlation between community bank strength and faster GDP growth.[6]

However, the survival of the community banking sector and its ability to serve the needs of consumers and SMEs cannot be taken for granted. Many community banks have disappeared during the consolidation trend of the past two decades. More than 5,400 bank mergers occurred in the United States between 1990 and 2005, involving more than $5.0 trillion in banking assets. During the same period, the percentage of banking assets

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[4] Tanya D. Marsh, "Too Big to Fail vs. Too Small to Notice: Addressing the Commercial Real Estate Debt Crisis" (Mar. 3, 2011), at 50, available at http://ssrn.com/abstract=1775984; *see also* Stephen Happel & Bill Lynch, "Viewpoint: Leverage Limits Hurt Credit for Small Biz," *American Banker*, Jan. 19, 2011, at 8 (stating that, in 2009, community banks held 11% of total industry assets but made 38% of small business and farm loans).
[5] Wilmarth, "Transformation," supra note 1, at 257-58; Major L. Clark, III and Radwan N. Saade, "The Role of Small Business in Economic Development of the United States: From the End of the Korean War (1953) to the Present" (Sept. 2010), U.S. Small Business Admin., Office of Advocacy, at 6.
[6] Allen N. Berger et al., "Further Evidence on the Link between Finance and Growth: An International Analysis of Community Banking and Economic Performance," 25 *Journal of Financial Services Research* 169 (2004).

held by the ten largest U.S. banks rose from 25% to 55%.[7] Extensive consolidation also occurred in many local, statewide and regional markets.[8] Many of the mergers during that period resulted in the disappearance of community banks.[9]

The consolidation trend intensified during the financial crisis, as regulators arranged several emergency mergers between large banks that produced even larger banks.[10] As a result of those mega-mergers, the four largest U.S. banks controlled 56% of domestic banking assets at the end of 2009 (up from only 35% in 2000), while the ten largest banks controlled 75% of such assets.[11]

The consolidation trend has called into question the long-term viability of the community banking sector. As described below, community banks have also suffered disproportionate harm from the current financial crisis, in large part because of the preferential treatment given by the federal government to TBTF megabanks. If the community bank sector continues to struggle, the availability of small business credit is likely to decline further. Even before the financial crisis began, highly concentrated local

[7] Kenneth D. Jones & Robert Oshinsky, "The effect of industry consolidation and deposit insurance reform on the resiliency of the U.S. bank insurance fund," 5 *Journal of Financial Stability* 57, 58 (2009).
[8] Wilmarth, "Transformation," *supra* note 1, at 252-53, 293-96; *see also* Gerald A. Hanweck & Bernard Shull, "The bank merger movement: efficiency, stability and competitive policy concerns," 44 *Antitrust Bulletin* 251, 252-57 (1999).
[9] More than 3,500 bank mergers occurred between 1994 and 2003. More than 3,200 of the target institutions acquired in those transactions were community banks with assets of less than $1 billion. The average size of the acquiring banks in those mergers was $11 billion. Steven J. Pilloff, "Bank Merger Activity in the United States, 1994-2003," Federal Reserve Board Staff Study 176 (May 2004), at 4-5.
[10] Arthur E. Wilmarth, Jr., "The Dodd-Frank Act: A Flawed and Inadequate Response to the Too-Big-to-Fail Problem," 89 *Oregon Law Review* 951, 958, 958 n.15 (2011) [hereinafter Wilmarth, "Dodd-Frank"] (discussing acquisitions of Wachovia by Wells Fargo, of National City by PNC, of Washington Mutual by JP Morgan Chase, and of Countrywide by Bank of America), available at http://ssrn.com/abstract-1719126. .
[11] *Id.* at 985.

banking markets that were dominated by large banks produced less credit for SMEs.[12] Moreover, after the financial crisis broke out, big banks made significantly larger cuts in their small business loan portfolios compared to smaller banks.[13]

2. Community Banks Received Limited Government Assistance and Suffered Disproportionate Harm during the Financial Crisis

The federal government provided massive amounts of financial assistance to TBTF megabanks during the financial crisis but gave very limited assistance to smaller banks. The 19 largest U.S. banks (each with more than $100 billion of assets) received $220 billion of capital assistance from the Troubled Asset Relief Program ("TARP"), and those banks issued $235 billion of FDIC-guaranteed, low-interest debt. In contrast, banks with assets under $100 billion received only $41 billion of TARP capital assistance and issued only $11 billion of FDIC-guaranteed debt.[14]

Moreover, the Federal Reserve System ("Fed") provided $1.2 trillion of emergency credit assistance to financial institutions through various programs. The Fed extended the vast majority of that credit assistance to large U.S. and foreign banks and provided very little help to smaller institutions. Indeed, the Fed extended $669 billion of emergency

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[12] Steven G. Craig & Pauline Hardee, "The impact of bank consolidation on small business credit availability," 31 *Journal of Banking and Finance* 1237 (2007).
[13] *See, e.g.*, Harry Terris, "Second-Quarter Lending Trends Remain Poor," *American Banker*, July 2, 2010, at 5 (reporting that outstanding commercial loans fell 8.4% at the 25 largest banks during the second quarter of 2010, compared to a decline of only 3% at smaller banks); Damian Paletta, "U.S. News: Lending Declines as Bank Jitters Persist," *Wall Street Journal*, Nov. 25, 2009, at A10 (reporting on a press conference at which FDIC Chairman Sheila Bair stated that "large banks – which account for 56% of industry assets and received a large share of the government's bailout funds – accounted for 75% of the decline" in small business lending in the third quarter of 2009).
[14] Arthur E. Wilmarth, Jr., "Reforming Financial Regulation to Address the Too-Big-to-Fail Problem," 35 *Brooklyn Journal of International Law* 707, 737-38 (2010) [hereinafter Wilmarth, "Reforming Financial Regulation"], available at http://ssrn.com/abstract=1645921.

credit assistance (more than half of the total amount) to the ten largest U.S. commercial and investment banks.[15]

Most importantly, the federal government guaranteed that none of the 19 largest banks would be allowed to fail. When federal regulators announced their "stress tests" in early 2009, they declared that the Treasury Department would provide any additional capital that was needed to ensure the survival of all 19 banks. They also stated that they would not impose regulatory sanctions on the top 19 banks under the "prompt corrective action" ("PCA") regime established by Congress in 1991, despite the non-discretionary nature of those sanctions. Instead of issuing public enforcement orders, federal regulators entered into private and confidential "memoranda of understanding" with Bank of America and Citigroup despite the gravely weakened conditions of both banks. Thus, federal regulators gave white-glove treatment to the 19 largest banks and unequivocally promised that they would survive.[16]

In stark contrast, federal regulators imposed PCA orders and other public enforcement sanctions on hundreds of community banks and allowed many of those institutions to fail.[17] Almost 350 FDIC-insured depository institutions failed between January 1, 2008 and March 31, 2011.[18] Only one of those institutions – Washington Mutual, a large thrift institution – had more than $50 billion of assets.[19] In view of the massive TBTF protections that the federal government provided to our largest banks, it is

[15] Bradley Keoun & Phil Kuntz, "Wall Street Aristocracy Got $1.2 Trillion in Secret Fed Loans," *Bloomberg.com*, Aug. 22, 2011.
[16] Wilmarth, "Dodd-Frank," *supra* note 10, at 958-59, 983; Wilmarth, "Reforming Financial Regulation," *supra* note 14, at 712-13, 743-44.
[17] Wilmarth, "Reforming Financial Regulation," *supra* note 14, at 744, 744 n.145.
[18] 5 *FDIC Quarterly* No. 2 (2011), at 16 (Table II-B).
[19] 2 *FDIC Quarterly* No. 4 (2008), at 14 (referring to the failure of Washington Mutual Bank, with $307 billion of assets, on Sept. 25, 2008).

small wonder that those banks enjoy a decisive advantage in funding costs over smaller banks. As former FDIC Chairman Sheila Bair pointed out in a speech on May 5, 2011, "In the fourth quarter of [2010], the average interest cost of funding earning assets for banks with more than $100 billion in assets was about half the average for community banks with less than $1 billion in assets."[20]

When the federal government finally promised to help community banks, it failed to deliver. On February 2, 2010, President Obama announced a new program that would use $30 billion of TARP funds to assist community banks in making small business loans.[21] However, in September 2011, the Treasury Department program shut down the Small Business Lending Fund after providing only $4.2 billion – just 14% of the promised amount – to community banks. Members of Congress strongly criticized the Treasury Department for long delays in approving applications by community banks and for imposing onerous conditions on applicants.[22]

Supporters of community banks also maintain that federal regulators have applied a double standard in enforcing capital standards and other safety-and-soundness requirements against community banks. Regulators have imposed significantly higher

[20] Sheila C. Bair, "We Must Resolve to End Too Big to Fail," 5 *FDIC Quarterly* No. 2 (2011), at 25, 26 (reprinting speech delivered on May 5, 2011); *see also* David Cho, "Banks 'Too Big to Fail' Have Grown Even Bigger: Behemoths Born of the Bailout Reduce Consumer Choice, Tempt Corporate Moral Hazard," *Washington Post*, Aug. 28, 2009 (reporting that "[l]arge banks with more than $100 billion in assets are borrowing at interest rates 0.34 percentage points lower than the rest of the industry," compared to a borrowing advantage of 0.08% in 2007 before the financial crisis began).
[21] Cheryl Bolen, "Troubled Asset Relief Program: White House Explains $30 Billion Plan To Expand Bank Loans to Small Businesses," 94 *BNA's Banking Report* 262 (Feb. 9, 2010).
[22] Kevin Wack, "Lending Fund Puts Geithner on the Defensive," *American Banker*, Oct. 19, 2011.

leverage capital requirements for community banks compared to larger banks, and regulators have also demanded severe write-downs for problem loans.[23]

Community banks currently face their most serious challenge in dealing with troubled CRE loans. Many community banks and regional banks have high concentrations of CRE loans in their portfolios.[24] Moreover, a high percentage of those CRE loans are secured by commercial properties located in regional and local markets that cannot attract new financing from issuers of commercial mortgage-backed securities ("CMBS"). Issuers of CMBS have focused primarily on newer and larger office and retail projects in affluent urban areas. While a limited number of CMBS refinancings have occurred since 2007, virtually all of those transactions have been done for higher-quality and more prestigious properties. In contrast, most of the smaller and older office and retail buildings in less desirable neighborhoods and smaller cities have been unable to attract new credit since the outbreak of the financial crisis.[25]

Unfortunately, federal regulators seem to have few concerns about the prospect of continued community bank failures due to losses on troubled CRE loans. A major reason for this apparent lack of concern is that CRE losses currently do not threaten the viability of TBTF megabanks. For example, a senior Fed official recently stated that "while

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[23] Happel & Lynch, *supra* note 4 (stating that regulators have required many community banks to maintain equity capital ratios equal to 10% of total assets, compared to a standard of 6% for the largest banks); Thecla Fabian, "Bank Supervision: House Financial Services Panel Analyzes Complaints of Bank Examination Practices," 97 *BNA's Banking Report* 62 (July 12, 2011) (describing congressional support for the "frustration" expressed by community bankers with "an increasingly harsh examination environment created by federal bank regulators in the wake of the recent financial crisis").

[24] *See* Congressional Oversight Panel, February Oversight Report: Commercial Real Estate Losses and the Risk to Financial Stability (Feb. 10, 2010) [hereinafter COP Report], at 38-44; Marsh, *supra* note 4, at 48-55; Harry Terris, "Concentration," *American Banker*, Jan. 19, 2010, at 8.

[25] Marsh, *supra* note 4, at 27-36, 46-55; COP Report, *supra* note 24, at 36-44.

problems in the CRE market will be an ongoing concern for a number of banking organizations and a negative factor in economic growth and lending, [regulators] do not see CRE losses as a threat to systemically important financial institutions."[26]

The current hands-off approach taken by federal regulators with respect to CRE lending problems stands in sharp contrast to the actions of their predecessors during the banking crisis of the 1980s. During that crisis, federal banking agencies adopted carefully-structured forbearance programs to help soundly-managed community banks that were threatened with failure due to heavy concentrations in agricultural and energy loans. Of the 334 banks that participated in those programs, 265 survived or merged without FDIC assistance and 69 failed.[27] The survival of nearly four-fifths of the participating banks indicates that a similar, carefully-targeted forbearance program should be established for soundly-managed commercial banks with high concentrations of CRE loans. As an FDIC study observed, "[t]here are many risks in offering forbearance, but carefully managed programs can prevent institution failures and reduce costs to the [deposit] insurance fund."[28]

3. <u>The Virtues of a Two-Tiered Approach to Regulating Community Banks</u>

The past two decades have made clear that community banks and megabanks follow very different business models. Community banks provide "high touch,"

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[26] Marsh, *supra* note 4, at 52-53 (quoting testimony by Patrick Parkinson, Director of the Fed's Division of Banking Supervision and Regulation, on Feb. 4, 2011 before the Congressional Oversight Panel).

[27] In 1986, federal regulators established a "Capital Forbearance Program" for community and regional banks that were weakened by agricultural and energy loans. "Eligible banks had to have a capital ratio of at least 4 percent, and their weakened capital position had to be the result of external problems in the economy and not mismanagement, excessive operating expenses, or excessive dividends." 1 *Managing the Crisis: The FDIC and RTC Experience* 23-24 (Fed. Deposit Ins. Corp. Aug. 1998).

[28] *Id.* at 24.

relationship-based lending and cash management services to SMEs as well as personalized banking services (including wealth management) to consumers. In contrast, megabanks provide impersonal, highly automated lending and deposit programs to SMEs and consumers, and megabanks also focus on complex, higher-risk transactions in the capital markets.[29] I have therefore proposed that Congress should establish a two-tiered structure for regulating these distinct categories of banks.[30] Other commentators have agreed that Congress should reject a "one size fits all" regulatory policy and instead should adopt a tailored policy that gives due attention to the special requirements of community banks.[31]

At the present time, community banks face particularly difficult challenges in raising new capital and dealing with troubled CRE loans. Several provisions of H.R. 1697 have the potential to help community banks in these areas. Specifically:

Section 205 would enable banks with assets of $10 billion or less to amortize mark-to-market losses on impaired loans secured by real estate or on real estate acquired through foreclosure (in each case, with respect to real estate loans originated from 2003 through 2007). As a practical matter, this section would authorize a forbearance program similar to the program for agricultural banks in the 1980s. To avoid including banks with management problems, this section could be limited to banks that are rated as "well-managed" by their regulators. In addition, residential real estate loans could be excluded

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[29] For discussions of the sharply different business models adopted by community banks and megabanks, see Wilmarth, "Dodd-Frank," *supra* note 10, at 1035-38; Wilmarth, "Transformation," *supra* note 1, at 261-70, 372-407.

[30] Wilmarth, "Dodd-Frank," *supra* note 10, at 1035-52.

[31] *See, e.g.*, William M. Isaac & Robert H. Smith, "Viewpoint: Burying Small Banks Alive," *American Banker*, April 1, 2011, at 8; Barbara A. Rehm, "Editor at Large: It's Time to Right-Size Regulation," *American Banker*, Mar. 24, 2011, at 1; Barbara A. Rehm, "Editor at Large: Reg Hurdle Gets Higher, Small Banks Grow Fewer," *American Banker*, Jan. 26, 2011, at 1.

from this section if there are concerns about any potentially adverse impact on home mortgage foreclosures.

Section 206 would allow banks to average appraisals on real estate securing loans over a rolling five-year period. This scope of this section is not limited to banks with assets of $10 billion or less, but the provision could be modified to accomplish that result. In addition, as indicated above, Congress could require banks to be rated as "well-managed" in order to receive favorable treatment under this section.

Sections 401 through 403 would provide favorable tax treatment to community banks in targeted areas and would thereby assist them in attracting new capital from investors.

Sections 501 through 503 would provide expanded Subchapter S treatment for a larger group of community banks and would allow such institutions to issue preferred stock and to accept investments from IRA shareholders. Again, those sections should provide community banks with increased access to new capital.

Thank you again for the opportunity to present this testimony.

Arthur E. Wilmarth, Jr. (11/15/11)

October 27, 2011

The Honorable John Boehner
Speaker of the House
United States House of Representatives
Washington, DC 20515

The Honorable Nancy Pelosi
House Minority Leader
United States House of Representatives
Washington, DC 20515

Dear Speaker Boehner and Democratic Leader Pelosi:

The undersigned state community banking associations wish to share our strong support for H.R. 1697, the Communities First Act (CFA).

This legislation, introduced by Rep. Blaine Luetkemeyer (R-MO) promotes targeted regulatory and tax relief for community banks and is a critical component of the community banking agenda before the 112th Congress. Regulatory, tax, and paperwork requirements disproportionately burden community banks, which do not have the scale of larger institutions to spread legal and compliance costs. The expense of over-regulation makes it harder for community banks to attract capital and to continue serving the credit needs of their customers and communities.

The CFA will bolster community banks and the communities and customers they serve. It will result in more quality credit in rural areas, small towns, and suburbs across America, create jobs and encourage individual savings. Reducing unnecessary and overly-burdensome tax and regulatory rules on community banks would be a smart and reasonable way to boost economic activity and jobs, and we believe the CFA provides a clear avenue to achieving that goal.

We urge the support of the entire House of Representatives for the Communities First Act. The measured relief provided by CFA would bring more credit to our communities without compromising safety and soundness or consumer protection.

Sincerely,

Community Bankers Association of Alabama
Arkansas Community Bankers
Bluegrass Bankers Association
California Independent Bankers
Independent Bankers of Colorado

Florida Bankers Association
Community Bankers Association of Georgia
Community Bankers of Iowa
Iowa Bankers Association
Community Bankers Association of Illinois
Indiana Bankers Association
Community Bankers Association of Kansas
Louisiana Bankers Association
Massachusetts Bankers Association
Community Bankers of Michigan
Independent Community Bankers of Minnesota
Minnesota Bankers Association
Missouri Independent Bankers Association
Montana Independent Bankers
Nebraska Independent Community Bankers
Independent Community Bankers Association of New Mexico
Independent Bankers Association of New York State
Independent Community Banks of North Dakota
Community Bankers Association of Ohio
Community Bankers Association of Oklahoma
Pennsylvania Association of Community Bankers
Independent Banks of South Carolina
Independent Community Bankers of South Dakota
Tennessee Bankers Association
Independent Bankers Association of Texas
Virginia Association of Community Banks
Community Bankers of Washington
Community Bankers of West Virginia
Community Bankers of Wisconsin

cc: Members of the House of Representatives

MIBA

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JERRY SAGE, Executive Director
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November 14, 2011

The Honorable Shelly Moore Capito
Chairman, Subcommittee on Financial Institutions and Consumer Credit
House Committee on Financial Services
2129 Rayburn House Office Building
Washington, DC 20515

The Honorable Carolyn Maloney
Ranking Member
Subcommittee on Financial Institutions and Consumer Credit
House Committee on Financial Services
2129 Rayburn House Office Building
Washington, DC 20515

Dear Chairman Capito and Ranking Member Maloney:

As CEO/Chairman of the Regional Missouri Bank, Marceline, MO, and President of the Missouri Independent Bankers Association, and on behalf of our 175 community bank members, I would like to register our full support of Congressman Blaine Luetkemeyer's H.R. 1697, called the Communities First Act. The Act contains much needed relief for community bankers and the customers they serve.
Among the worst regulatory offenders are the growing piles of paperwork that sap too much time and effort and threaten to bury staff at their desks. Fortunately, there are several reasonable provisions in the Communities First Act that will help eliminate some of these unnecessary paperwork requirements.

For starters, let's consider the call report. Despite their size, community banks are required to file long-form call reports with their regulators on a quarterly basis. The amount of added information on the call report over the years seems endless. There are no special provisions for small or well-capitalized banks. The CFA would help provide some relief by requiring bank regulators to develop a short-form call report that is "significantly and materially less burdensome" to prepare. Highly rated, well-capitalized banks with assets of $10 billion or less would be able to file the shorter report twice a year, which would reduce regulatory burdens with little to no impact on their safety and soundness. As a personal note, I recall that 30 years ago when I was Cashier of a Community Bank, I spent 2 to 3 hours preparing the March and September Call Reports and about twice that long on the June and December reports. This was without the aid of a computer. We now spend 30 to 40 hours each quarter completing Call Reports, with the aid of expensive software and equipment. This is time diverted from focusing on our customers and supporting our communities.

A separate provision of the act would reduce data-collection requirements tied to small-business loan applications. The Wall Street Reform Act requires lenders to maintain records of applications from women- and minority-owned businesses and a separate record of the responses to all such applications. These records must be kept separate from the underwriting process. The CFA would exempt community banks with less than $1 billion in assets from the new data-collection requirements. The exemption would remove inefficiencies and additional costs for these community banks and ensure that the privacy of applicants is not compromised.

Also included in the CFA is an update of capital guidelines for small bank holding companies. Some small bank holding companies are exempt from Federal Reserve capital guidelines for BHCs via the small bank holding company policy statement. However, the threshold, last revised in 2006, is only $500 million.

In addition to falling below the asset threshold, BHCs must meet debt-related tests to qualify. Small BHCs with a debt-to-equity ratio of more than 1:1 may not pay corporate dividends or qualify for expedited processing of acquisition applications or applications to engage in nonbanking activities.

To ease and simplify capital requirements on small BHCs that do not have nonbanking activities, the CFA would raise the qualifying threshold to $1 billion under the small bank holding company policy statement. CFA would also raise the debt-to-equity ratio test from 1:1 to 3:1 for paying corporate dividends and for qualifying for expedited processing of these applications.

The CFA also addresses counterproductive accounting issues that frustrate community banks and jeopardize their viability. Currently, accounting standards do not take into account the business model of the issuer. The CFA would require the Securities and Exchange Commission to ensure that accounting information, documents and reports accurately and appropriately reflect the business model of the issuer and the scale and complexity of their financial dealings.

The Financial Accounting Standards Board has repeatedly imposed reporting requirements that assume that all banks are high-volume traders in assets and liabilities. This updated treatment would help ensure that regulators recognize that community banks hold assets and liabilities long-term and that frequent revaluations distort their balance sheets and confuse investors. These provisions would help solve the one-size-fits-all regulations that are inappropriate and unwarranted for community banks.

In addition, the SEC would be prohibited from approving any new or amended GAAP standard unless it determined that the benefits significantly outweigh its costs. The SEC also must ensure that the principle would not have a negative economic impact on community banks with assets of $10 billion or less.

Also included in CFA are reasonable tax-reform measures that will help both community banks and their customers. With the nation continuing to struggle because of weak economic growth there has been much political debate about beneficial tax reforms. The Communities First Act's tax reforms would improve community banks' viability and allow them to better serve their customers and compete on a more level playing field with tax-exempt entities like the credit unions and the Farm Credit System.

For their size, community banks have always served a special role in our economy as a prominent lender to small business. At a time when our nation needs stronger growth to boost economic activity and create jobs, community banks are in a key position to help.

One important provision in the legislation would implement a new income tax credit for both Subchapter C and Subchapter S corporation community banks, bank holding companies, savings associations and savings association holding companies. The plan would allow Subchapter C corporation community banks a 20 percent tax credit up to $250,000 and Subchapter S corporations with up to $5 billion in assets to take a 20 percent credit against their taxable income up to a cap of $250,000. Simplified, shareholders of Subchapter S corporations would be able to exclude 20 percent of the distributable income from the financial institution up to an aggregate cap of $1.25 million.

This section of the bill also would create a 50 percent tax credit for community banks with up to $5 billion in assets that are operating in distressed communities, designated enterprise or empowerment zones, or qualifying New Market Tax Credit Census tracts. The credit has a $500,000 cap. Subchapter S corporations operating in these areas would be able to exclude 50 percent of distributable income not to exceed $2.5 million of income.

These important tax-relief provisions would help community bankers continue to support the economic recovery and help equalize the tax treatment of all financial institutions.

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The Communities First Act includes a variety of other tax benefits that help the individual customer. The bill would allow community bank customers to defer recognition of interest income earned on CDs of more than 12 months until maturity. This income also would be taxed at the long-term capital gains rate, rather than as ordinary income, which will give consumers a boost on their traditional savings.

The bill also would increase the $10 million annual issuance limitation for the widely purchased tax-exempt "bank-qualified" muni-bond obligations to $30 million. It also would index the cap prospectively, which will reflect the increased size of tax-exempt bond issues.

Raising capital remains a pressing issue for the community banking sector as regulators seek strong capital levels. To further help on this front, CFA would allow Subchapter S banks to have a greater number of shareholders—raising the current cap from 100 to 200 shareholders. It would also allow S Corp. banks to issue preferred stock and allow IRA shareholder investment, neither of which are currently allowed, hindering community banks' ability to raise additional capital.

Additionally, this legislation would allow community banks and thrifts to be treated for tax purposes as limited liability companies. It also would allow privately held financial institutions to convert their state or federal charters to an LLC charter in a tax-free transaction. This change would increase flexibility for community banks in their tax planning and would allow pass-through tax treatment without the shareholder limitations of Subchapter S tax status.

I urge your committee's favorable consideration and advancement of this critical legislation. Thank you for your consideration.

Sincerely,

Don Reynolds
President, Missouri Independent Bankers Association
& CEO/Chairman, Regional Missouri Bank, Marceline, Missouri

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BILL CHENEY
President & CEO

November 21, 2011

Representative Steve Stivers
U.S. House of Representatives
1007 Longworth House Office Building
Washington, D.C. 20515

Dear Representative Stivers:

Thank you for the opportunity to respond to a question you posed to me doing the joint hearing of the Financial Institutions and Consumer Credit and Capital Markets and Government Sponsored Enterprises Subcommittees entitled **"H.R. 1697, The Communities First Act."** You had asked whether it is profitable for a financial institution to foreclose on a property and the average cost associated with a foreclosure. The short answer to your question is no, it is not profitable to foreclose on any property. I have provided additional information below.

In further response to your question, we conducted an informal survey of members of CUNA's Lending Council. Lenders tell us that a static number is not an accurate reflection of the cost associated with a foreclosure because some foreclosure costs are not fixed; rather, the value of the collateral determines some significant liquidation expenses. Realtor fees, for example, increase with collateral values. Generally, some credit unions have used a factor of 15% in projecting the expenses. This has been fairly accurate; however, depending on the local market conditions, credit unions have found it can be as high as 20-25% of the property value. The total cost of a foreclosure would also include any deficiency balance on the loan itself.

To put this in context, the median home price in the United States today is $170,000, 15% of that is $25,000, which would correspond to the statement of cost by the witnesses testifying on behalf of the Independent Community Bankers Association. For example, according to Zillow.com, the Ohio home value index at the end of September 2011 was $101,500. The average cost of foreclosure then would be approximately $15,000. In the Columbus area, the median home price index is $128,000, so the cost would be closer to $19,000. In Toledo, the median home price index is $98,000, so the cost would be closer to $14,700.

I hope this helps answer your questions. Certainly, if you require more information, please do not hesitate to contact me.

Best regards,

Bill Cheney
President & CEO

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November 30, 2011

Representative Lynn Westmoreland
U.S. House of Representatives
2433 Rayburn House Office Building
Washington, D.C. 20515

Dear Representative Westmoreland:

Thank you for your insightful questions at the Financial Services Committee's joint subcommittee hearing on H.R. 1697, the Communities First Act, earlier this month. I appreciate the opportunity to further expand on a question you had posed to me.

You had asked for a statutory definition of "underserved areas" as it relates to credit unions. It is important to note that "underserved areas" are not primary fields of membership under the Federal Credit Union Act ("FCU Act"), but only serve to supplement the fields of membership of multiple common bond Federal credit unions. Allow me to explain by first explaining precisely how a credit union is defined in terms of its mission and how its service may include, but is not limited to, underserved areas.

Credit Union Definition and Mission

The FCU Act, 12 U.S.C. §§ 1751-1795k, provides statutory definitions for credit unions. Specifically, 12 U.S.C. § 1752(1) defines the term "Federal credit union" as a "cooperative association organized in accordance with the provisions of this chapter for the purpose of promoting thrift among its members and creating a source of credit for provident or productive purposes…" Section 1.15 of the American Association of Credit Union League's Model Credit Union Act for State-Chartered Credit Unions also defines credit unions to mean "a cooperative, not for profit corporation, organized under this Act, for the purposes of providing provident and beneficial services to its members including, but not limited to: encouraging thrift, creating a source of credit at reasonable rates of interest, and providing an opportunity for its members to use and control their own money on a democratic basis in order to improve their economic and social condition."

In 1998, Congress specifically included in the FCU Act key findings regarding credit unions' purposes:

> The Congress finds the following: (1) The American credit union movement began as a cooperative effort to serve the productive and provident credit needs of individuals of modest means. (2) Credit unions continue to fulfill this public purpose, and current members and

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> membership groups should not face divestiture from the financial services institution of their choice as a result of recent court action. (3) To promote thrift and credit extension, a meaningful affinity and bond among members, manifested by a commonality of routine interaction, shared and related work experiences, interests, or activities, or the maintenance of an otherwise well understood sense of cohesion or identity is essential to the fulfillment of the public mission of credit unions. (4) Credit unions, unlike many other participants in the financial services market, are exempt from Federal and most State taxes because they are member-owned, democratically operated, not-for-profit organizations generally managed by volunteer boards of directors and because they have the specified mission of meeting the credit and savings needs of consumers, especially persons of modest means. (5) Improved credit union safety and soundness provisions will enhance the public benefit that citizens receive from these cooperative financial services institutions.[1]

Both federal statute and regulation envision credit unions as financial cooperatives that exist to serve all members, especially, but not limited to, those of modest means. While credit unions serve areas that meet the federal regulatory definition of "underserved," credit unions are not limited to providing services to those areas alone.

Field of Membership, including underserved areas

In order for a member to join a credit union, the member must be within the credit union's field of membership, which for State-chartered credit unions is defined under state law or regulations. Field of membership for Federal credit unions is defined in 12 U.S.C. § 1759. The membership field includes:

- Single common bond credit unions – one group that has a common bond of occupation or association
- Multiple common-bond credit union – more than one group, each of which has a common bond of occupation or association and the number of members, each of which (at the time the group is first included within the field of membership of a credit union described in this paragraph) does not exceed any numerical limitation applicable under subsection (d).
- Community credit union – persons or organization within a well-defined local community, neighborhood, or rural district.

[1] Credit Union Membership Access Act, Pub. L. No. 105-219, Note to § 1751 (August 7, 1998).

Federal credit unions must be designated as having one of these fields of membership. Technically, underserved areas are treated under the FCU Act as an exception to the field of membership criteria. As a result of banker-group litigation, only multiple common bond Federal credit unions may include underserved areas at this time.

The statutory definition of underserved areas is found in 12 U.S.C. §1759(c)(2), but concerned about litigation challenging its previous more expansive treatment, the National Credit Union Administration Board has, by regulation, limited significantly the areas that can be considered "underserved" based on a census tract-by-census tract analysis. The statutory definition is as follows:

> Exception for underserved areas.- Notwithstanding subsection (b), in the case of a Federal credit union, the field of membership category of which is described in the subsection (b)(2), the Board may allow the membership of the credit union to include any person or organization within a local community, neighborhood, or rural district if –
>
> (A) The Board determines that the local community, neighborhood, or rural district –
>
> (i) is an "investment area', as defined in section 103(16) of the Community Development Banking and Financial Institutions Act of 1994, and meets such additional requirements as the Board may impose; and
>
> (ii) is underserved, based on data of the Board and the Federal banking agencies (as defined in section 3 of the Federal Deposit Insurance Act), by other depository institutions (as defined in section 19(b)(1)(A) of the Federal Reserve Act; and
>
> (B) The credit union establishes and maintains an office or facility in the local community, neighborhood, or rural district at which credit union services are available.

The NCUA Board in 2008 set the current regulatory definition for "underserved areas" in Interpretive Ruling and Policy Statement (IRPS) 08-2.[2] NCUA's regulatory definition of "underserved areas" adds numerous stringent criteria not found in the statute. These criteria are as follows:

[2] Available at http://www.ncua.gov/Legal/Documents/IRPS/IRPS2008-2.pdf

To meet the "local community, neighborhood, or rural district" criteria, credit unions must comply with the Community Charter Requirements contained within Ch. 3, §§ V.A.1 and V.A.2, within NCUA's Chartering and Field of Membership Manual.

To meet the definition of an "investment area," credit unions must also comply with separate Investment Area criteria as outlined within Ch. 3, §§ III.B.2, III.B.2.a, and III.B.2.b of NCUA's Chartering and Field of Membership Manual.

Finally, credit unions must adhere to additional criteria and requirements outlined in Ch. 3, § III.B.3 to meet the "Underserved by Other Depository Institutions" portion of the statutory definition.

Taking both the statutory as well as regulatory provisions and requirements into account, credit unions are then required to obtain approval from NCUA to service an "underserved area," and will be issued an amendment to Section 5 of its charter upon such approval.
We believe Congress intended for credit unions to be able to serve underserved areas without having to jump through the numerous regulatory hoops that now exist. In September, NCUA Executive Director Dave Marquis testified before the House Financial Services Subcommittee in support of legislative efforts that would allow more federal credit unions to serve underserved areas than are currently permitted. CUNA strongly supports those efforts as well.

Thank you again for taking the time to request clarification on this issue. Should you have additional questions, please do not hesitate to contact me.

Best regards,

Bill Cheney
President & CEO