ICBA
INDEPENDENT COMMUNITY BANKERS of AMERICA

Testimony of

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On behalf of the
Independent Community Bankers of America

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Committee on Financial Services

Field Hearing on

"Regulatory Reform: Examining How New Regulations are Impacting Financial Institutions, Small Businesses, and Consumers in Illinois"

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OPENING

Chairman Bachus, Ranking Member Frank, and members of the Committee, I am Greg Ohlendorf, President and CEO of First Community Bank and Trust, a $150 million asset community bank in Beecher, Illinois. 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 “Regulatory Reform: Examining How New Regulations are Impacting Financial Institutions, Small Businesses, and Consumers in Illinois.” It’s good to see the Committee convene here in Chicago to get a first hand view of our region’s economic conditions and to discuss the impact of the legislation and regulation enacted in Washington.

We appreciate your interest on the impact that new regulations have had on financial institutions, including community banks. Community banks are the primary source of credit, depository, and other financial services in thousands of rural areas, small towns, and suburbs across the nation. As such, we will play an essential role in the recovery of our national economy. Regulatory and paperwork requirements impose a disproportionate burden on community banks thereby diminishing their profitability and their ability to attract capital and support their customers and communities. The time they spend on the myriad of new laws and regulations is time that cannot be spent working with small business and consumer borrowers who are trying to work their way out of the difficulties they have suffered through in the recent economic downturn.

The predominant, though not the exclusive, source of new bank regulation is the Dodd-Frank Act, and I will focus my remarks on that new law. This Act was generational legislation and will permanently alter the landscape for financial services. Every provider of financial services – including every single community bank – will feel the effects of this new law to some extent. The community bank business model is based on the strength of our reputation in the small communities we serve and in the long-term customer relationships we cultivate. Community banks don’t engage in abusive consumer practices and did not cause the financial crisis, and we appreciate the support our industry received to shield us from some of the provisions designed to respond to the crisis. Because we pose no risk to consumers or the financial system, 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 and thereby harm the communities we serve.

What’s the impact of the Dodd-Frank Act on community banks? It has proven to be a mixed outcome, combining both punitive and helpful provisions. A law this broad, disparate, and multi-dimensional cannot be easily characterized. Undeniably, the law will result in additional compliance burden for community banks and it will be challenging for them to cope with. The full and ultimate impact won’t be known for years, depending on how the law is implemented and how the market adjusts to it. There’s still an opportunity to improve negative provisions in the law – with the help of this committee and Congress – and provisions that could be helpful to community banks are still at risk of being weakened in the implementation.

It is also important to note that while I will focus my remarks on the Dodd-Frank Act, the Act was just one of a number of legislative and regulatory responses to the nation's financial crisis and resulting recession. The harsh examination environment and changes to credit card and overdraft protection rules, for example, have had a profound impact on community banks. With those caveats, let me turn to the specific provisions of the Act, beginning with our concerns.

Consumer Financial Protection Bureau

While we are pleased that the Dodd-Frank Act allows community banks with less than $10 billion in assets to continue to be examined by their primary regulators, ICBA remains concerned about CFPB regulations, to which community banks will be subject. ICBA strongly opposed provisions in the Dodd-Frank Act that excluded the prudential banking regulators from the CFPB rule-writing process. Bank regulators have long expertise in balancing the safety and soundness of banking operation with the need to protect consumers from unfair and harmful practices.

The Act gives the prudential regulators the ability to comment on CFPB proposals before they are released for comment and an extremely limited ability to veto regulations before they become final. This veto can only be exercised if, by a 2/3 vote, FSOC determines that a rule "puts at risk safety and soundness of the banking system or the stability of the financial system". This is an unreasonably high standard and one that should be amended.

ICBA strongly supported legislation passed by this Committee and the House to strengthen the accountability of the CFPB. The Consumer Financial Protection Safety and Soundness Improvement Act (H.R. 1315), sponsored by Rep. Sean Duffy (R-WI), would reform the structure of the CFPB so that it is governed by a five member commission rather than a single director; strengthen prudential regulatory review of CFPB rules by reforming the voting requirement for an FSOC veto from a 2/3rd vote to a simple majority, excluding the CFPB Director, and change the standard to allow for a veto of a rule that "is inconsistent with the safe and sound operations of United States financial institutions" – a much more realistic standard than under current law. Additionally, H.R. 1315 would postpone transfer of functions to the CFPB until its Director is confirmed. Combined, these changes would better protect the safety and soundness of the financial system, and provide reasonable measures to insulate community banks from additional regulatory burden.

Community banks are already required to spend significant resources complying with voluminous consumer protection statutes. CFPB rules should not add to these costs. The Dodd-Frank Act gives the CFPB authority to exempt any class of providers or any products or services from the rules it writes considering the size of the entity, the volume of its transactions and the extent to which existing law already has protections. ICBA urges the CFPB to use this authority to grant broad relief to community banks and/or community bank products where appropriate.

Risk Retention

Community banks make commonsense mortgages supported by sound, conservative underwriting. As the banking regulatory agencies implement Section 941 of the Dodd-Frank Act, which requires mortgage originators to retain credit risk on non-qualified residential mortgages, ICBA strongly urges them not to define “qualified residential mortgage” too narrowly. An unreasonably narrow definition of QRM will drive thousands of community banks and other lenders from the residential mortgage market, leaving it to only a few of the largest lenders. Too narrow a definition will also severely limit credit availability to many borrowers who do not have significant down payments or who, despite high net worths, have relatively low incomes and high debt-to-income ratios. In ICBA’s view, the definition of QRM should be relatively broad and encompass the largest portion of the residential mortgage market, consistent with the stronger underwriting standards called for by the Act. An unduly narrow definition of QRM will disadvantage community banks because they lack access to the increased capital needed to offset risk retention requirements, despite conservative underwriting. What’s more, community banks operating in rural areas will be driven out of the market by Farm Credit System direct lenders who carry an exemption for the loans or other financial assets that they make, insure, guarantee or purchase.

Escrowing for taxes and insurance would be costly for small lenders

The Act’s new mortgage escrow requirements will be costly to our members. Rural customers have unique credit needs, collateralized by rural properties, which do not lend themselves to securitization. As a result, community banks that serve rural customers tend to hold loans in portfolio, where the lender is exposed to the entire credit risk of the borrower for the full term of the loan. They not only have “skin in game,” but bear the full risk of default. For this reason, portfolio lenders exercise special diligence in underwriting, and we believe that portfolio loans held by banks with assets of less than $10 billion should be exempt from the requirement that first lien mortgage lenders establish escrow accounts for the payment taxes and insurance. There is a significant cost involved with establishing escrow accounts, particularly for community banks that have small lending volumes, and many community banks would need to outsource their escrow services at a significant cost. The costs are such that an escrow requirement could lead many community banks to sharply reduce or eliminate their mortgage businesses.

Community Banks Must Be Able to Rely on Credit Rating Agencies

The Dodd-Frank Act requires the regulatory agencies to replace all references to “credit ratings” with an “appropriate” standard for measuring creditworthiness. Community banks, lacking the resources to independently analyze credit quality, will be disproportionately affected by this provision.

As an alternative approach that addresses the legitimate concern with credit ratings, ICBA recommends amending Dodd-Frank to reintroduce the use of credit ratings, but also give the regulators the authority to confirm the credit ratings in those situations where additional credit analysis is warranted.

Municipal Advisor Registration

Another concern for community bankers is the Dodd-Frank Act municipal advisor registration requirement. Community banks have always provided traditional banking services such as demand deposits, certificates of deposit, cash management services, loans and letters of credit to the municipal governments of the communities they serve. Community banks provide these services under close supervision by state and federal bank regulators. The Dodd-Frank Act provision, if interpreted broadly by the SEC, could force thousands of community banks to register as municipal advisors with the SEC and the Municipal Securities Rulemaking Board and be examined by the SEC in order to continue providing traditional banking services to municipalities. An act as simple as a town treasurer phoning a community bank to inquire about CD rates could be enough to trigger registration. ICBA strongly supports legislation introduced in the Senate, the Private Company Flexibility and Growth Act (S. 1824), sponsored by Senators Pat Toomey (R-PA) and Tom Carper (D-DE), to provide an exemption for banks from this onerous and over-reaching requirement.

ICBA-SUPPORTED PROVISIONS

In representing our members during consideration of the Dodd-Frank Act, ICBA focused on making the Act workable for community banks. This meant seeking exemptions where appropriate. It also meant seizing the opportunity to advocate for long-sought community bank priorities. I will now turn to the provisions of the Act that ICBA supported and that we believe will strengthen community banks over the long term.

Tiered Regulation

First, the Act sets a precedent for tiered regulation of the financial industry. Community banks have little in common with Wall Street firms, mega-banks, or shadow banks and did not cause the financial crisis or perpetrate abusive consumer practices. Community banks have a much different risk profile because their business model is built on long-term customer relationships, and they cannot succeed without a reputation for fair treatment. For these reasons, ICBA believes it's appropriate to tier regulation of the financial services industry. Overly prescriptive regulation would only reduce community banks' flexibility in serving the unique needs of their customers. Moreover, regulation has a disproportionate impact on community banks because they have fewer resources to dedicate to compliance. We are pleased that Congress recognized these facts and our priority during the implementation phase is to press the regulators to carry through on the Act's clear preference for tiered regulation. We will also urge the regulators to use the flexibility they have under other statutes to implement a tiered regulatory system.

Deposit Insurance

ICBA was a leading advocate for the deposit insurance provisions of the Act, including the change in the assessment base from domestic deposits to assets (minus tangible equity), which will better align premiums with a depository's true risk to the financial system. This provision has reduced my bank's FDIC assessment by 25%, and will save all community banks $4.5 billion over the next 3 years.

The Act also permanently increased the deposit insurance limit to $250,000 per depositor and provided a two-year extension of the Transaction Account Guarantee (TAG) Program, which provides unlimited deposit insurance coverage for non-interest bearing transaction accounts. Both of these provisions will help to offset the significant advantage enjoyed by the too-big-to-fail mega-banks in the cost of their deposits.

Too Big To Fail

ICBA has long expressed concerns about too-big-to-fail banks and the moral hazard they pose, well before the financial crisis. A report in last week's Bloomberg Markets Magazine on the financial assistance provided by federal regulators to the nation's largest and riskiest financial institutions at the height of the recent financial crisis vividly demonstrates the hazard and the bitter unfairness of allowing some banks and other financial firms to accumulate such power. Trillions of dollars in secret Federal Reserve Board "no strings attached" loans at rates as low as 0.01% allowed these too-big-to-fail institutions to net $13 billion in additional profits. Community banks are more finely tuned to these concerns because we and our customers feel the direct impact. It's challenging for us to compete against mega-banks whose TBTF status gives them funding advantages. For this reason, we're pleased that the Act takes steps to mitigate TBTF.

ICBA supported the creation of the Financial Stability Oversight Council (FSOC) whose duties include identifying and responding to risks to financial stability that could arise from the failure of a large, interconnected bank or nonbank. We also support the FDIC's new resolution authority that will empower it to unwind large, systemically-risky financial firms. The government must never again be forced to choose between propping up a failing firm at taxpayer expense and allowing it to fail and wreak havoc on the financial system.

These and other provisions will help level the financial services playing field.

Regulation of "Shadow" Bank Competitors

ICBA is pleased that non-banks will be subject to federal examination and enforcement for the first time. The "shadow" financial industry has been most responsible for victimizing consumers while avoiding serious regulatory scrutiny. This segment of the financial services industry should be brought under the same regulatory umbrella as commercial banks. As I mentioned earlier in this testimony, under Dodd-Frank, the

CFPB has discretion in defining non-depository “covered persons” subject to CFPB rules, examination and enforcement. ICBA urges the CFPB to define “covered persons” broadly.

SOX 404(b) Relief

The Act permanently exempts public companies with capitalization of less than $75 million from the auditor attestation requirements of SOX 404(b). ICBA has led the fight to exempt smaller public companies since SOX was enacted in 2002. However, the $75 million exemption threshold is far too low to provide meaningful relief. We are grateful to this committee for passing legislation sponsored by Rep. Stephen Fincher (R-TN), the Small Company Job Growth and Regulatory Relief Act (H.R. 3213), which would exempt all companies with a market capitalization of less than $350 million.

Communities First Act

Many of the legislative ideas highlighted in this testimony have been included in the Communities First Act (H.R. 1697), legislation sponsored by Rep. Blaine Luetkemeyer (R-MO), himself a former community banker, which has over 55 cosponsors from both parties and the strong support of 37 state banking associations. ICBA is grateful to this committee for convening a hearing on CFA on November 16 at which our Chairman had the opportunity to testify. In addition to Dodd-Frank Act amendments, CFA includes a range of provisions that would offer regulatory and tax relief to community banks.

CLOSING

Thank you again for the opportunity to testify today. Like most pieces of legislation, especially those that run to 2,300 pages, the Dodd-Frank Act is a mixed outcome for community banks. I hope that my testimony, while not exhaustive, helps to clarify some of the concerns as well as the bright spots in the Dodd-Frank Act for community banks. Legislation of this breadth and ambition will generally need some modifications or enhancements, and we look forward to working with this committee to improve the law and to ensure that it is implemented in a way that will impose the least burden on community banks.

United States House of Representatives
Committee on Financial Services

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

1. Name:	2. Organization or organizations you are representing:
GREG M. OHLENDORF	INDEPENDENT COMMUNITY BANKERS OF AMERICA

3. Business Address and telephone number:

[redacted]

4. Have you received any Federal grants or contracts (including any subgrants and subcontracts) since October 1, 2008 related to the subject on which you have been invited to testify?	5. Have any of the organizations you are representing received any Federal grants or contracts (including any subgrants and subcontracts) since October 1, 2008 related to the subject on which you have been invited to testify?
☐ Yes ☒ No	☐ Yes ☒ No

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

7. Signature:

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