House Committee on Financial Services,
Subcommittee on Oversight and Investigations

Testimony of Michael Flores
CEO, Bretton Woods, Inc.
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Thank you Chairman Neugebauer, Ranking Member Capuano, and Members of the Committee. I'm Michael Flores, CEO of Bretton Woods, Inc. a management consulting and research firm that specializes in financial institutions, primarily commercial banks and alternative financial service providers. I have more than 30 years' experience in the banking and consulting focusing on strategy and earnings improvement programs. Additionally, I have published several articles and studies on the financial services industry, including overdrafts, short-term credit alternatives and general purpose reloadable and payroll prepaid cards.

Because this hearing is about both the intended and unintended consequences of the Dodd–Frank Wall Street Reform and Consumer Protection Act on communities, small businesses and individuals, I am here to describe both my analysis of the issues as well as relate comments from my clients and others in the industry about their assessment.

In general, while Dodd-Frank was written to address the causes of the financial meltdown of 2008, the end result of the legislation and promulgated regulations are having a disproportionate and negative impact on financial service providers that played no role in the cause of the problems.

Simply stated, Dodd-Frank has and will:

- Substantially increased compliance costs for banks
- Increased fees to small businesses and consumers
- Decreased products and services such as the limited functionality prepaid card offered by banks over $10 billion in assets
- Increased the number of under-banked and the newly coined term, de-banked individuals
- Decreased number of branch offices as in low to moderate income markets as banks attempt to reduce expenses and focus on profitable markets

Contrary to making financial services more available, affordable and consumer friendly, the increased restrictions and compliance costs are reducing services to small businesses and consumers, which have a negative effect on the economic well-being of the communities they serve.

Additionally, the 6,700 community banks (under $1 billion assets) and the 7,000 credit unions are burdened with legacy operating costs and dated technologies that inhibit their ability to profitably serve their constituencies, The 60 million to 70 million low to moderate income consumers and local small businesses are particularly hard hit.

Resources that could be used to update technologies and create more efficient operations are now allocated to regulatory and compliance purposes. Staff dedicated to non-revenue or non-customer service activities is the fastest growing area of most banks and credit unions.

Both transaction accounts (checking) and credit options are impacted. Our own studies indicate that it is unprofitable for most banks and credit unions to individually underwrite loans under $5,000. The traditional options of overdrafts, credit card advances and home equity loans are no longer viable because of the poor economy and regulations. With the reduction of overdraft and interchange fees, many banks have eliminated free checking accounts. The new fee structures are complex making transparency more difficult.

The reduction of interchange fees has actually resulted in a “wealth transfer” from consumers to merchants. The lack of the savings being passed on the consumers is not just large merchants increasing their profit margins; there are also processing issues that do not allow identifying individual cost savings, but also contractual limitations that do not allow any cost reductions (e.g. convenience fees to accept cards as payments).

I contacted several of my clients as well as others in the industry to solicit their feedback on these issues. Because on non-disclosure agreement with my clients, I cannot identify the individuals and organizations, however, they represent community and large banks as well as large card issuers.

The following items highlight their quotes of key concerns:

1. “The basic story is (1) more fees, (2) a reduction in free checking, (3) an increase in the number of de-banked and unbanked households, and (4) a shift from credit cards and bank accounts to traditionally non-mainstream products. The next shoe that is dropping is also a reduction in the number of bank branches.”
2. “The unintended consequences (of Dodd-Frank) cannot be fully determined because according to the law firm Davis Polk of the almost 400 rulemakings required by the law, only a quarter have been finalized, while 36% have not even been proposed.”
3. “The greatest potential unintended consequence will be the demise of traditional community banks and the impact on access to credit for consumers and small businesses in small communities. Community banks will be forced to consolidate because they cannot afford the compliance costs.”
4. “There has been a significant decline of traditional wholesale purchasers of residential mortgages from mortgage bankers/brokers. Some large have left the business which significantly reduces access to mortgage credit particularly for those without an established relationship with a bank. The compliance requirements contained in Dodd Frank are causing many community banks to get out of the mortgage business or only offer variable rate products underwritten to strict credit quality guidelines. Many banks are

reluctant to sell to Fannie and Freddie because of the potential repurchase risk which is also why many of the wholesale purchasers are getting out of that business."

5. "Consumer and mortgage banking will be consolidated in the largest banks which can afford the compliance costs which will reduce access to credit for the under-banked."
6. "The requirement to get new appraisals and update Credit Reports on renewals and existing loans creates extra costs to the customer. This requirement is regardless of the market or strength of the customer."
7. "There is substantial reduction in fee income sources to banks, primarily the result of the Durbin Amendment. To address this, banks are raising fees and charging fees for products previously offered for free which has a disproportionate impact on the under-banked. In essence this is creating a new class of consumers, the de-banked."
8. "The rules implementing Section 1071 of Dodd Frank have not been promulgated but will have a chilling effect on small business lending. To ensure that lenders aren't discriminating against minority groups based on price, this rule will significantly limit lenders' ability to structure loans to meet the specific needs of the customer."
9. "Painting Alternative Financial Service providers with a broad regulatory brush will reduce access to credit and payments services to those who need options most."
10. "Dodd Frank will drive up the cost of credit for consumers and small business borrowers especially as loan demand picks up."
11. "The wild card is the repeal of Regulation Q and the impact on a bank's cost of funds and in turn (increase) the cost of credit as interest rates start to rise."
12. "Dodd Frank will result in the biggest banks getting bigger which is 180 degrees from the original intent."
13. "There is negative impact on the unaffiliated network routing on government benefit programs. Many government programs do <u>not</u> want cash access and therefore are signature only. Adding a PIN network to comply with the network routing provisions opens the programs up to cash back at point-of-sale, which is not what the governments' sponsoring the programs intend or want. Cash access makes it much harder to restrict card-based benefits to designated uses."
14. "Consumers are not benefiting from the reduction of interchange fees. Even if a merchant wanted to pass the savings to the consumer, transaction bundling for processing and contractual agreements for assessing convenience fees precludes the possibility of identifying and passing any savings to the consumer. For example, the IRS has negotiated a flat fee of $3.89 to $3.95. This has not changed since the implementation of Durbin."
15. "From a large prepaid card issuer perspective (i.e. $10B+), there are the unintended consequences that has come as a result of Durbin.
    a. Convenience Checks for payroll. It is anti-consumer that they can only be cashed to the total in the account and only the cardholder can be the

payee. While limited in usage, its usefulness to cardholder is even more limited now.

b. Removal of Pay Anyone Bill Pay - less utility for the cardholder so now they have to find an alternative means to pay bills which will probably cost them a fee
c. Card Access Only to Accounts that eliminated Card to Card and Card to Account Transfers
d. Since overdraft is eliminated, issuers have had to raise the pre authorization at the Automated Fuel Dispenser to $75. If you don't have at least $75, you have to go inside and tell the attendant how much gas you want to pump."

16. Referencing General Purpose Reloadable Prepaid Cards, "…the impact on the rollback of federal preemption for agents, and now program managers that want to offer product and reloads at retail are having to run out and get state money transmitter licenses, which is turning out to be a huge cost and compliance obligation. The remittance rule is going to drive up costs and reduce competition for consumer remittances to foreign countries."

Congressman Frank, in a letter to Chairman Ben Bernanke, dated February 29, 2012, states that "…the Board's decision to condition the reloadable prepaid card exemption from interchange fee restrictions on the card being 'the only means to access underlying funds' associated with the card – might inadvertently result in consumers not having access to useful features or services.".

In conclusion, the causes of the financial crisis have been identified and there was plenty of blame to go around. However, Dodd-Frank with the Durbin Amendment and the CFPB, we have layered significantly more regulation over existing regulation to the point of making the traditional business model for community banks almost unworkable. Historically, it is the community banks that understand the needs of their markets and have been a catalyst to local and regional economic growth.

At the same time, Dodd-Frank is creating roadblocks to innovators such as alternative financial service providers who are working diligently to address the under-banked segment of our society. Without relief, these entrepreneurial innovators will be severely hampered in the development and distribution of the products and services that the low to moderate income consumers require.

Many provisions of Dodd-Frank are threatening the existence of community banks and other financial innovators and do not to address the causes of the 2008 financial crisis. In essence, some provisions of Dodd-Frank are solutions looking for problems – problems that do not exist for the majority of financial institutions in the Unites States.

Thank you and I look forward to answering your questions.