Testimony
by
Terry Jorde
President/CEO
CountryBank USA
Cando, ND
&
Chairman-Elect
Independent Community Bankers of America
Washington, DC

"Financial Services Regulatory Relief: Private Sector Perspectives"

United States House of Representatives
Financial Services Committee, Subcommittee on Financial Institutions and Consumer Credit

May 19, 2005

Mr. Chairman, Ranking member Sanders and members of the committee, my name is Terry Jorde, President and CEO of CountryBank USA. I am also Chairman-Elect of the Independent Community Bankers of America.[1] My bank is located in Cando, North Dakota, a town of 1,300 people where the motto is, "You Can Do Better in Cando." CountryBank has 27 full time employees and $39 million in assets. We are a small, but diversified organization with nine of my employees working in our insurance agency, two employees devoted to retail sales of non-deposit investment products, and the remaining 16 devoted to traditional banking products and services. I split my time between two locations. ICBA appreciates the opportunity to testify on proposals to reduce the regulatory burden on banks, thrifts and credit unions, a topic this committee has addressed repeatedly. We are especially pleased that the committee is apparently open to expand on previously passed regulatory relief bills, such as H.R. 1375, since those bills included little true relief for community banks.

That is one reason that ICBA worked closely with Rep. Jim Ryun on his Community Banks Serving Their Communities First Act. The Communities First Act (H.R. 2061) includes regulatory and tax relief that is critical to community banks and their customers. It includes additional provisions that apply to all banks and bank customers. Virtually all of the regulatory provisions in the bill were also endorsed by other financial groups that have been working with FDIC Vice Chairman John Reich on the regulatory burden reduction project mandated by the Economic Growth and Paperwork Reduction Act of 1996 (EGRPRA). ICBA hopes that Rep. Hensarling will include many items from H.R. 2061 in the bill he is developing for this committee.[2]

Our testimony will focus on the specific proposals in the Communities First Act and explain why they should be included in this committee's new regulatory relief bill. Before that, I will briefly explain why regulatory relief is so important to community banks, their customers, and the communities they serve.

---

[1] The Independent Community Bankers of America represents the largest constituency of community banks of all sizes and charter types in the nation, and is dedicated exclusively to representing the interests of the community banking industry. ICBA aggregates the power of its members to provide a voice for community banking interests in Washington, resources to enhance community bank education and marketability, and profitability options to help community banks compete in an ever-changing marketplace. For more information, visit ICBA's website at www.icba.org.

[2] In a similar vein, ICBA plans to work with the Ways and Means Committee on the tax relief components of H.R. 2061.

Community Banks Need Regulatory Relief

Since 1992, the market share of community banks with less than $1 billion in assets has dropped from about 20 percent of banking assets to 13 percent. And the market share of large banks with more than $25 billion in assets has grown from about 50 percent to 70 percent. Community bank profitability also lags large banks. Obviously part of the reason is due to economies of scale that community banks have always accepted as a fact of life. However, in recent years, the disproportionate impact of the ever-mounting regulatory burden is significantly impacting community bank profitability. I agree with FDIC Vice-Chairman Reich that it is a leading cause of consolidation in our industry.

At the same time credit unions, with their unfair tax-exempt advantages and favorable legislation loosening membership restrictions, have made inroads into small banks' market segments. Credit union assets have more than tripled since 1984, from $194 billion to $611 billion, whereas total small bank assets (less than $1 billion) have decreased.

An analysis of these trends conducted by two economists at the Federal Reserve Bank of Dallas concluded that the competitive position and future viability of small banks is questionable.[3] The authors suggest that the regulatory environment has evolved to the point of placing small banks at an artificial disadvantage to the detriment of their primary customers—small business, consumers and the agricultural community.

While larger banks have hundreds or thousands of employees to throw into the regulatory breach, a community bank with $100 million in assets typically has just 30 full time employees, a $200 million bank about 60 employees. If my bank is faced with a new regulation, we must train one or more of our current employees to comply, and complying with the new regulation will take time away from customer service. My compliance officer not only has responsibility for overseeing our compliance program, but she also originated 58 real estate loans last year for sale on the secondary market, she sits on our audit and technology committee, she regularly teaches home-buyer education courses at our community college, and she baby sits my 14-year-old son at times like this when I'm begging for relief. Unlike larger institutions, we can't just add a new person and pass the costs on to our customers.

It's not just smaller community banks like mine that are feeling the pain. Larger community banks as well are drowning in paperwork and regulatory burden. They are hiring 2 or 3 full-time employees to do *nothing* but Bank Secrecy Act compliance. They have had to expend hundreds of thousands of dollars for Sarbanes-Oxley Act compliance.

---

[3] Gunther and Moore, "Small Banks' Competitors Loom Large," *Southwest Economy,* Federal Reserve Bank of Dallas, Jan./Feb. 2004.

This is not just about numbers and costs. I assure you we are not crying "wolf." If we don't get meaningful relief *soon*, more and more community banks will throw up their hands, and give up their independence.

Why should policy makers care about community banks? First, community banks play a strong role in consumer financing and an especially vital role in small business lending. Commercial banks are the leading suppliers of credit to small business, and community banks account for a disproportionate share of total bank lending to small business, the primary job-creating engine of our economy. Banks with less than $1 billion in assets make 37 percent of bank small business loans, more than twice their share (13%) of bank industry assets. And they account for 64 percent of total bank lending to farms.

Second, community banks that fund local businesses are particularly attuned to the needs of their communities and are uniquely equipped to facilitate the local economic development process, which can be time-consuming and resource intensive. Community bankers provide tremendous leadership in their communities, which is critical to economic development and community revitalization.

For example, in a recent week I spent six hours in a hospital board meeting, four hours in an economic development corporation meeting, and another four hours working with other local community bankers to develop a financial incentive package for a potential new business in our community. You could argue that this is not an efficient and cost-effective way to spend my time, but like most community banks, the very survival of my bank depends on the economic vitality of my community. I have a very real incentive to work to assure the success of Cando. Branches of large mega banks do *not* provide this same commitment to the community.

Bank Secrecy Act Compliance

While our testimony today does not include legislative recommendations for changes in the Bank Secrecy Act, this certainly does not mean that community bankers do not have serious concerns about how the act is being enforced. In fact, it is topic 1A when bankers discuss the regulatory burden. However, we believe the agencies have authority to address most of the problems. These center around whether or not there is a "zero tolerance" examination climate, as well as uncertainty about what the agencies expect from banks.

ICBA has just filed a comment letter with the banking agencies under the EGRPRA process with a number of recommendations regarding BSA compliance, including:

- **Bank Secrecy Act Administration**. Issue additional guidelines and provide reference tools for compliance so that bankers *and* examiners know what is expected. (The anticipated June 30, 2005 revised examination procedures and outreach programs for bankers *and* examiners should help, but balance is clearly needed.)
- **BSA Currency Transaction Reporting**. Increase the filing threshold from $10,000 to $30,000 to eliminate unnecessary filing. Improve the CTR exemption process so banks use it.
- **Suspicious Activity Reporting.** Simplify the filing process and issue easily accessible guidance on when banks should report.

At this point, ICBA strongly urges this committee to engage in thorough oversight to ensure that BSA compliance does not impose an unreasonable and unproductive burden on the economy and truly achieves its important goals.

The Credit Union Bill is Not Like the Communities First Act

Last week the credit union industry had introduced what it is calling a regulatory relief bill. Some representatives of that industry compared their bill (H.R. 2317) with the Communities First Act. The bills are not at all comparable. The credit union bill is a charter enhancement proposal, while the Communities First Act includes no new powers for anyone. It is strictly designed to lift the regulatory and tax burden for community banks and help level the playing field. ICBA is unalterably opposed to H.R. 2317, which, among other things, would substantially increase the ability of credit unions to make loans to businesses. Congress should eliminate the credit unions' unfair tax and regulatory advantages over community banks, not give them even more new powers.

Industrial Loan Companies

The regulatory relief bill that the House passed in the last Congress, H.R. 1375, included provisions permitting *de novo* interstate branching and permitting banks to pay interest on business checking accounts. The branching provision included the Gillmor/Frank compromise that would prohibit predominantly commercial firms from buying or establishing an industrial loan company and using the new branching authority. ICBA is pleased that this committee has added the Gillmor/Frank language to the business-checking bill now pending before the House. While we believe that the best way to deal with and eliminate the mixing of banking and commerce made possible by the ILC loophole is to close it by bringing ILCs under the Bank Holding Company Act, the Gillmor/Frank language is a reasonable compromise that should be included in any proposal to relax branch restrictions or permit interest on business checking.

Specific Legislative Recommendations

ICBA strongly supports the bank regulatory reduction project mandated by the Economic Growth and Paperwork Reduction Act of 1996 (EGRPRA) and commends the EGRPRA task force, led by FDIC Vice Chairman John Reich, for the excellent job it has done to identify those banking regulations that are outdated, unnecessary or unduly burdensome. Through the public comment process, banker outreach meetings and the EGRPRA website, the project has generated a large number of recommendations for reducing the regulatory burden on banks. While the bank regulators have been working hard to identify burdens they can reduce on their own, they report to us that there are severe limits on what they can do without help from Congress. Many burdensome and outdated regulatory requirements are hard-wired into federal statute.

The Communities First Act includes a variety of legislative proposals to reduce the burden of regulation on community banks.[4] Many of the following legislative changes from H.R. 2061 build on the concept of a tiered regulatory and supervision system recommended by Vice Chairman Reich by targeting relief to institutions based on their size. Others would apply to all banks, regardless of size. All would go a long way toward improving community banks' ability to compete and serve local communities.

Home Mortgage Disclosure Act

The Communities First Act would make several changes to the Home Mortgage Disclosure Act. Section 101 would increase two reporting exemption levels from $30 million and $34 million[5]in assets to $250 million. While this may appear to be a substantial increase, the vast majority of industry assets would remain covered. In fact, the FDIC reports that as of March 31, 2004, banks and thrifts with $250 million or less in assets held only 6.7% of industry assets. The amendment would index the $250 million level using the existing procedure in HMDA.

Title II of H.R. 2061 makes several additional changes in HMDA that could apply to a bank of any size, depending on its activity or location. Section 202 would exempt banks with fewer than 100 reportable loan applications per year per category. This would lift the burden from banks for which mortgage lending is not a major business line.

Banks that operate outside Metropolitan Statistical Areas are exempt from HMDA. Section 202 would also allow the Federal Reserve to develop a definition

[4] In response to a request from the FDIC for Senator Crapo, who is working on a regulatory relief bill in the Senate, several bank industry trade associations including ICBA identified a list of 78 recommendations—made by various witnesses in testimony to the Senate Banking Committee—that the associations all support. While individual associations may also support additional recommendations not on this consensus list, virtually all of the regulatory provisions of the Communities First Act are on the list.

[5] The $34 million began as a $10 million exemption, but has been increased by statute and by the Federal Reserve using an inflation-based index.

of Metropolitan Statistical Area for HMDA purposes, instead of using Census Bureau definition created for entirely different reasons. This would avoid covering certain rural banks that are close enough to metropolitan areas to be included by the Census Bureau. Current law requires the use of the Census Bureau definition, so certain areas that are truly rural are included in metropolitan statistical areas. This may serve the purposes of the Census Bureau, but the Federal Reserve should have the flexibility to modify these definitions when determining which areas must be covered by HMDA.

Finally, section 202 would benefit all banks that must continue to report HMDA data by requiring the Federal Reserve to review and streamline the data collection and reporting requirements every five years.

It is important to note that the banking industry has included each of these HMDA provisions on its list of consensus items for inclusion in a regulatory relief bill in its response to Senator Crapo's request.

Reports of Condition (Call Reports) & BHC Policy Statement

Section 102 of the Communities First Act would permit highly rated, well-capitalized banks with assets of $1 billion or less to file a short call report form in two quarters of each year. This would reduce the reporting burden for these banks, while still providing the banking agencies with the data they need.

Section 204 would benefit all banks by directing the agencies to reduce or eliminate filings that are not outweighed by the benefits to safety and soundness or the ability of the FDIC and other regulators to accurately determine the financial condition and operations of the reporting institutions. ICBA believes that this Congressional directive would reverse the repeated increases in the reporting burden imposed when agency economists and financial analysts seek to add "just one more" item to the call reports. While many of these items provide interesting information, we question whether private companies – banks – should have to provide non-essential information under threat of government sanction.

The current call report instructions and schedules consist of 458 pages. The fourth highest paid employee in my bank spends the better part of April, July, October, and January working on this report. She never takes a vacation during these months and God help us if she would get sick during these months for any extended period of time.

While extensive and time consuming to produce, these quarterly filings by community banks are not essential to the agencies. The fact is that in banks like mine, the world just doesn't change that dramatically between March 31st and June 30th of each year. The FDIC will not lose track of us if we file a short form every other quarter instead of the extensive report every 90 days and Mr.

Greenspan will still be able to conduct monetary policy without our real time data. On the other hand, this would significantly reduce the reporting burden for banks like mine, while still providing the banking agencies with the data they need.

Section 104 of the Communities First Act would direct the Federal Reserve to make bank holding companies with assets up to $1 billion eligible for the Small Bank Holding Company Policy Statement on Assessment of Financial and Managerial Factors. To qualify, the holding company must also (1) not be engaged in any non-banking activities involving significant leverage, and (2) not have a significant amount of outstanding debt that is held by the general public. This change would reduce the paperwork burden on these small, non-complex, holding companies, while maintaining the Federal Reserve's ability to obtain holding company information for larger institutions.

Again, the banking industry has included each of these recommendations as consensus items on the list for Senator Crapo.

Sarbanes-Oxley Act, Section 404

Section 404 of Sarbanes-Oxley imposes tremendous unexpected costs on virtually all companies. A recent ICBA survey showed that – including outside audit fees, consulting fees, software costs and vendor costs – the average community bank will spend more than $200,000 and devote over 2,000 internal staff hours to comply with Section 404. Section103 of the Communities First Act recognizes that these added costs are unnecessary for community banks. First, unlike other companies, banks have been under similar requirements for years, though with an exemption for banks under $500 million in assets. Congress imposed these requirements on banks after the crises of the 1980s. So, section 404 is redundant when imposed on the banking sector. Second, unlike other companies banks are closely supervised and examined by federal officials on a regular basis. Companies like Enron and WorldCom were not regulated the same way. Not only is this burden redundant and unnecessary for community banks, it is a key factor in undermining their ability to remain independent.

The banking industry has also agreed that this proposal is a consensus item on the list for Senator Crapo.

Director Interlocks and Loans to Officers

Section 105 of the Communities First Act increases the size of bank eligible for an exemption from interlocking director prohibitions from $20 million to $500 million. It has always been a challenge for the smallest institutions to find qualified directors. Now that directors' responsibilities have increased under the Sarbanes-Oxley Act and other requirements, this has become a challenge even for larger community banks.

Section 108 of the Communities First Act allows banks with less than $1 billion in total assets to make loans to executive officers, in the aggregate, up to two times capital. The current asset size limit is $100 million in deposits. This is not a tenfold increase, because a bank with $1 billion in assets could have considerably less than that in deposit liabilities.

Section 205 would help all banks by increasing the special regulatory lending limit on loans to executive officers for loans other than those for housing, education, and certain secured loans to $250,000.[6] This limit has not been adjusted for over ten years, so this amendment simply makes an appropriate adjustment for inflation.

These adjustments are all included in the banking industry's consensus recommendations to Senator Crapo.

Protection for Community Banks Under SIPC

The Securities Investor Protection Act does not provide immediate protection to community banks that suffer losses when a securities firm fails. Current law exempts commercial banks from SIPC coverage and assumes that all commercial banks are in a position to fend for themselves in such cases. This may be true for large commercial banks, but it is less so for community banks.

My bank was one of those affected after September 11th when MJK Clearing failed and I discovered to my great surprise that the local North Dakota nursing home bonds that I thought I owned were not really safe kept, but in fact were used to cover a multi-million dollar securities trade that failed to settle. Up until then, my biggest worry was whether the nursing home would be able to make its semi-annual payments. Instead, $100,000 of my bank's assets were frozen for more than a year during MJK Clearing's bankruptcy proceedings. I had little reason to think of SIPC prior to 9-11, but I quickly learned that SIPC was one of those agencies that protects innocent victims and credit unions, but not community banks.

Section 106 of the Communities First Act would provide banks with assets up to $5 billion the same protection afforded other investors and other depository institutions for their brokerage account assets under the SIPA.

This is included in the banking industry's consensus recommendations to Senator Crapo.

Examination Schedules

---

[6] Executive officers would remain subject to the same limit on directors and principal shareholders, the loans-to-one-borrower limit, and to the requirement that loans to insiders not be on preferential terms

Section 107 of the Communities First Act would give federal regulators flexibility to determine the examination interval for well-rated, well-capitalized banks with up to $1 billion in assets. This would replace the current 18-month exam schedule for banks with less than $250 million in assets. The banking industry supported this as a consensus recommendation

Section 110 would increase CRA examination intervals for banks up to $1 billion.[7]

Both of these changes would help strong, well-run community banks focus on service to their communities rather than responding to unnecessarily frequent examinations.

Truth in Lending Right of Rescission

Section 201 of the Communities First Act calls for several changes that would expedite consumers access to their funds without undermining the protection that the 3-day right of rescission provides. They would apply without regard to the size of the institution involved.

Subsection (a) directs the Federal Reserve to provide exemptions when the lender is a federally insured depository institution. The right of rescission was imposed to protect consumers against high-pressure loan sellers often connected with illicit home improvement operations or similar schemes. The loan programs of federally insured institutions are, obviously, run on a far different basis and are subject to regular scrutiny by banking regulators. Our customers know exactly what they have applied for and are receiving. They are frequently annoyed when they hear they have to wait an additional three days for their funds.

Subsection (b) addresses another source of annoyance for consumers, the fact that borrowers have to wait three days to get the benefit of a refinancing transaction even if they are not taking any cash out of the deal. It makes no sense to insist that a consumer wait to begin taking advantage of a lower interest rate or different term, which are the typical purposes of these kinds of transactions.

Finally, subsection (c) eliminates the right of rescission when a borrower is opening up an open-ended line of credit. The very design of the product grants consumers a perpetual right of rescission if that is what they want. The consumer can simply refrain from drawing on the account for three days or longer. On the other hand, consumers who need immediate access to their line of credit should have it.

---

[7] It is important to note that this examination interval is a separate issue from the question of examination procedures for banks under $1 billion in assets. The regulatory agencies have already adopted, or have proposed adopting those streamlined procedures.

The banking industry has included the provisions of section 201 in its consensus recommendations.

Privacy Notices

One of the most wasteful provisions of the Gramm-Leach-Bliley Act has been the requirement that financial institutions send annual privacy notices to their customers. The law requires them to be written in impossible-to-understand legalese. The industry and agencies have been working on ways to simplify this language, but the task is daunting. However, section 203 of the Communities First Act offers an interim measure that would greatly reduce the number of these notices that must be mailed. It simply says that if an institution does not share information (except for narrow purposes, such as providing information to an outside data processing firm) and has not changed its policies, it need not send out the annual notices. While any size institution could take advantage of this provision, community bankers are especially interested in having this option. I can tell you that my customers and their mail carriers would also be grateful.

Like virtually all of the regulatory provisions of the Communities First Act, this section is a banking industry consensus item.

Impact of New Regulations on Community Banks

Neither we—nor you—can anticipate all of the potential new burdens that future laws and regulations may impose on community banks. Therefore, section 109 of the Communities First Act directs the banking agencies to take into account the effect any new regulation, requirement, or guideline would have on community banks. This sends a clear message from Congress to the agencies that the public policy of the United States is firmly committed to maintaining a strong, vibrant, community bank sector for our economy.

Conclusion

ICBA greatly appreciates this opportunity to testify on this important issue. In a major way, the future of community banking depends on what you do. The banking industry is united on the need for regulatory burden relief. Indeed, virtually all the proposals in Rep. Ryun's Communities First Act are included in the industry's recommendations to Senator Crapo. The bill simply highlights those provisions that are important to community banks. We strongly urge Rep. Hensarling to include them in his broader regulatory relief bill. That would provide real benefits to community banks and the communities and customers that they serve.