Testimony of

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On behalf of the

Independent Community Bankers of America

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Subcommittee on Economic Growth, Tax and Capital Access

Hearing on

"Financing Main Street: How Dodd-Frank is Crippling Small Lenders and Access to Capital"

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Chairman Rice, Ranking Member Chu, and members of the subcommittee, my name is Doyle Mitchell, and I am President and CEO of Industrial Bank, a $370 million asset bank headquartered in the District of Columbia. Industrial Bank was founded in 1934, in the depth of the Great Depression, and is the oldest and largest African American-owned commercial bank in the metropolitan Washington, D.C. area. We have over 100 employees. I testify today on behalf of the more than 6,000 community banks represented by the Independent Community Bankers of America. Thank you for convening this hearing on the destructive impact of new regulation on small business lending.

In addition to being a member of ICBA, I am also the Immediate Past Chairman of the National Bankers Association, a trade association for the nation's minority and women-owned banks. While many community banks serve rural areas and small towns, there is also an important segment of community banks like mine that serve urban areas and that were founded to serve minority communities that were historically ignored by other financial institutions.

At the outset of this statement, I would like to thank the members of this committee for your leadership in increasing in the legal lending limit for the Small Business Administration's (SBA's) 7(a) guaranteed lending program before it reached its cap this summer. Community banks make up the majority of SBA lenders. This committee acted with all due haste to prevent a disruption in vital credit to thousands of small businesses.

Community Banks and Small Business Lending

Community banks are prodigious small business lenders. Though we hold less than 20 percent of U.S. banking industry assets, we hold a disproportionate market share of small business loans – 55 percent – supporting a sector responsible for more job creation than any other. We provide small business credit in good times as well as challenging times. Federal Reserve data shows that while overall small business lending contracted during the recent recession, lending by a majority of small community banks (those of less than $250 million in assets) actually increased, and small business lending by banks with asset sizes between $250 million and $1 billion declined only slightly. By contrast, small business lending by the largest banks dropped off sharply. The viability of community banks is linked to the success of our small business customers in the communities we serve, and we don't walk away from them when the economy tightens.

The type of small business lending community banks do simply cannot be duplicated by a bank based outside the community. As a recent study by my fellow panelist Marshall Lux noted: "In certain lending markets, the technologies larger institutions can deploy have not yet proven effective substitutes for the skills, knowledge, and interpersonal competencies of many traditional banks." [1]

[1] "The State and Fate of Community Banking." Marshall Lux and Robert Greene. Mossavar-Rahmani Center for Business and Government at the Harvard Kennedy School. February 2015.

Regulatory Overkill Poses a Grave Threat to the Community Bank-Small Business Partnership

The exponential growth of regulation in recent years is suffocating community banks' ability to serve their small business customers. Compliance has become a major distraction for community bank managers. Any community banker will tell you that their job has fundamentally shifted from lending and serving customers to struggling to stay on top of ever-changing rules and guidance. Every aspect of community banking is subject to new regulation, but the impact is especially severe in the area of mortgage lending.

Banks need more scale to accommodate the increasing expense of compliance which includes hiring, training, software, and other costs. I believe this increase in regulatory burden has contributed significantly to the decrease of 1,342 community banks in the U.S. since 2010. The number of banks with assets below $100 million shrunk by 32 percent, while the number of banks with assets between $100 million and $1 billion fell by 11 percent.[2] A financial landscape with fewer, larger banks will reduce access to credit for small businesses.

Legislative Solutions Are Needed

The good news is that there are readily available legislative solutions to this pending crisis. Working with community bankers from across the nation, ICBA developed its Plan for Prosperity, a platform of legislative recommendations that will provide meaningful relief for community banks and allow them to thrive by doing what they do best – serving and growing their communities. Each provision of the Plan was crafted to preserve and strengthen consumer protections and safety and soundness. I encourage the members of this Committee to review the Plan, which is attached to this statement.

While the Plan contains nearly 40 separate legislative recommendations, they are organized around three pillars: Relief from mortgage regulation to promote lending; improved access to capital to sustain community bank independence; and reforming oversight and examination practices to better target the true sources of risk. Each of these pillars helps small businesses by preserving and strengthening the community banks that partner with them. I will note a few of the recommendations under each pillar.

Mortgage Reform for Community Banks

Every aspect of mortgage lending is subject to new, complex, and expensive regulations that are upending the economics of this line of business. In ICBA's 2014 Community Bank Lending Survey, which surveyed over 500 community banks nationwide, 44 percent of respondents said that they made fewer first lien residential mortgage loans in 2014 when the CFPB's qualified mortgage rules were in effect than they made in 2013. The improved housing market should have created more loans, not fewer. More troubling, 73 percent of respondents said that regulatory burdens were preventing them from making more residential mortgage loans.

[2] Parsons, Richard J. Bank Think. American Banker, Feb. 16, 2015.

Small business owners often use home equity loans to finance their businesses. However, small business owners may have difficulty complying with the income documentation requirements under the ability-to-repay rule, despite their excellent credit. The underwriting requirements of the "qualified mortgage" (or QM) rule – which shields lenders from litigation under the ability-to-repay rule by defining mortgages that are deemed to comply with the rule – are inflexible and do not afford the lender discretion to use judgment or to weigh compensating factors such as high net worth in making credit decisions. You hear the same story again and again from community bankers all over the country.

Key provisions of the Plan for Prosperity are designed to keep community banks in the business of mortgage lending and to give them more flexibility in extending credit. Plan provisions include:

- "Qualified mortgage" status under the CFPB's ability-to-repay rules for any mortgage originated and held in portfolio for at least three years by a lender with less than $10 billion in assets.
- An exemption from any escrow requirements any first lien mortgage held in portfolio by a lender with less than $10 billion in assets.

The principal rationale for these provisions, and the reason they can be safely enacted, is they apply only to loans originated and held in portfolio by community banks. As relationship lenders, community bankers are in the business of knowing their borrowers and assessing their ability to repay a loan. What's more, when a community bank holds a loan in portfolio it holds 100 percent of the credit risk and has an overriding incentive to ensure the loan is well underwritten and affordable to the borrower. In a typical community bank portfolio, even a small number of defaults can put a bank at risk. Community bank portfolio lenders ensure they understand the borrower's financial condition and structure the loan accordingly. If the borrower has trouble making payments due to job loss or other unforeseen circumstances, a community bank portfolio lender will work with the borrower to restructure the loan and keep the borrower in their home. By the same token, portfolio lenders will protect their collateral by ensuring borrowers remain current on tax and insurance payments. For this reason, the escrow requirement, which must be outsourced at a relatively high cost by community banks with a low volume of mortgages, is an unnecessary burden when a loan is held in portfolio.

Access to Capital

The second pillar of the Plan for Prosperity is capital access and preservation for community banks. A number of the provisions are dedicated to strengthening community bank viability by creating new options for capital raising and capital preservation.

One such provision would provide relief for community banks under $1 billion in asset size from the internal control attestation requirements of Section 404(b) of the Sarbanes-Oxley Act. Since community bank internal control systems are monitored continually by bank examiners, they should not have to incur the unnecessary annual expense of paying an outside audit firm for attestation work. This provision will substantially lower the regulatory burden and expense for small, publicly traded community banks without creating more risk for investors.

Three capital provisions of the Plan for Prosperity would amend Basel III for banks with assets of $50 billion or less to restore the original intent of the accord which was intended to apply only to large, internationally active banks.

ICBA also recommends reforming Regulation D, which governs private offerings of shares, so that anyone with a net worth of more than $1 million, including the value of their primary residence, would qualify as an "accredited investor." The number of non-accredited investors that could purchase stock under a private offering should be increased from 35 to 70.

Reforming Bank Oversight and Examination to Better Target Risk

The third pillar of the Plan for Prosperity is improving the exam environment for community banks. This includes three provisions as described below.

Call Reports

The quarterly call report filed by community banks now comprises 80 pages of forms and 670 pages of instructions. Implementation of the new Basel III capital standards may add nearly 60 additional pages to the already burgeoning call report. In September of last year, nearly 15,000 community bankers representing 40 percent of all community banks nationwide signed an ICBA petition to the regulatory agencies calling for more streamlined quarterly call report filings. ICBA's recent Community Bank Call Report Burden Survey empirically demonstrates this problem. Eighty-six percent of survey respondents said the total cost of preparing the quarterly call report has increased over the last 10 years.[3] Thirty percent said it had increased significantly. A typical $500 million asset community bank spends close to 300 hours a year of senior level, highly-compensated staff time on the quarterly call report.

Only a fraction of the information collected is actually useful to regulators in monitoring safety and soundness and conducting monetary policy. The 80 pages of forms contain extremely granular data such as the quarterly change in loan balances on owner-occupied commercial real estate. Whatever negligible value there is for the regulators in obtaining this type of detail is dwarfed by the expense and the staff hours dedicated to collecting it. To put things in perspective, consider this contrast: some multi-billion dollar credit unions filed a less than 30 page call report in the first quarter of 2014. Surely, regulators can supervise community banks with significantly less paperwork burden than they currently demand.

For this reason, ICBA is calling on the agencies to allow highly-rated community banks to submit a short form call report in the first and third quarters of each year. A full call report would be filed at mid-year and at year-end. The short form would contain essential data required by regulators to conduct offsite monitoring, including income, loan growth, changes in loan loss reserves, and capital position. In the recent survey noted above, community bank respondents

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[3] 2104 ICBA Community Bank Call Report Burden Survey.
http://www.icba.org/files/ICBASites/PDFs/2014CallReportSurveyResults.pdf

overwhelmingly agreed that instituting a short-form call report in certain quarters would provide a great deal of regulatory relief. Seventy-two percent of respondents indicated the relief would be substantial.

Extended Exam Cycle

Under current agency rules, a bank with assets of less than $500 million that has a CAMELS rating of 1 or 2 is eligible for an exam cycle of 18 months. Banks that do not meet these criteria are examined on a 12 month cycle. The extended exam cycle allows examiners to focus their limited resources on the banks that pose the greatest systemic risk. In order to more fully of reap the benefit of risk-focused exams, the exam cycle can and should be further extended to 24 months and available to banks with assets up to $2 billion, provided they have a CAMELS rating of 1 or 2. Preparations for bank exams, and the exams themselves, distract bank management from serving their communities to their full potential.

Strengthen Accountability in Examinations

The trend toward oppressive, micromanaged regulatory exams is an ongoing concern to community bankers nationwide. ICBA believes that the best means of creating a more balanced exam environment is to create a workable appeals process. ICBA's Plan for Prosperity calls for the creation of an independent body to receive, investigate, and resolve material complaints from banks in a timely and confidential manner. The goal is to hold examiners accountable and to prevent retribution against banks that file complaints.

The current appeals process is arbitrary and frustrating. Appeals panels, or other processes, routinely lack the independence and market expertise necessary to reach a fair, unbiased decision.

Cutting the Red Tape in Small Business Lending: Eliminate Data Collection

Before closing I would like to note an additional Plan for Prosperity provision that should be of particular interest to this committee because it is directly related to small business lending. Under a forthcoming regulation, whenever a business seeks credit at a financial institution, the institution must inquire whether the business is women-owned, minority-owned, or a small business. The financial institution must maintain a record of the response to the inquiry together with additional information such as the census tract of the business and its gross annual revenues, whether or not a loan is subsequently approved. These records must be compiled and submitted annually to the CFPB, which will make the data available to any member of the public upon request. In addition, the records must be kept separate from the credit application and accompanying information and shielded from access by the underwriters or anyone involved in making credit determinations. In other words, the requirement creates a separate bureaucracy within the financial institution that cannot be integrated with lending operations.

I appreciate and sympathize with the motivation behind the new requirement. Lending discrimination, which is illegal under fair lending laws, must not be tolerated. But this new data collection requirement is especially inefficient, and may not be feasible in certain cases such as

in organizations that are too small to accommodate fire wall structures. Community banks will be disproportionately burdened by this requirement because they concentrate more on small business lending than other financial institutions. Further, data collected by community banks and subsequently made public by the CFPB could compromise the privacy of applicants in small communities where an applicant's identity may be easily deduced, despite the suppression of personally identifying information. For these reasons, ICBA believes community banks should be excluded from new small business data collection requirements.

Introduced Legislation

The 114th Congress provides a unique opportunity to provide meaningful regulatory relief for community banks. ICBA urges this Committee and all House members not to let this opportunity slip.

We're encouraged by the bills that have been introduced in the Senate and House so far, several of which are noted below.

The Community Lending Enhancement and Regulatory Relief Act of 2015 (the "CLEAR Act", H.R. 1233), introduced by House Small Business Committee Vice Chair, Rep. Blaine Luetkemeyer, contains seven provisions spanning all three pillars of ICBA's Plan for Prosperity and has been endorsed by 34 state community bank associations. These provisions include qualified mortgage status for any mortgage held in portfolio; an exemption for loans held in portfolio from new escrow requirements for higher priced mortgages for any lender with less than $10 billion in assets; an increase in the CFPB's small servicer exemption threshold from 5,000 loans to 20,000 loans; allowing well rated banks to file a short form call report in the first and third quarter of each year and to be examined on a 24 month examination cycle; and eliminating the annual privacy notice requirement when a bank has not changed it privacy policies.

The Community Bank Access to Capital Act (H.R. 1523), introduced by Rep. Scott Garrett, includes provisions to exempt banks with assets of $50 billion or less from the Basel III regulatory capital rule, which was originally intended to apply only to large, internationally active banks, and provide an exemption from internal control attestation requirements for community banks with assets of less than $1 billion. Community bank internal control systems are monitored continually by bank examiners.

The Portfolio Lending and Mortgage Access Act of 2015 (H.R. 1210), introduced by Rep. Andy Barr, would provide QM status to any residential mortgage held in portfolio by the originator. H.R. 1210 passed the House Financial Services Committee in July.

The Community Institution Mortgage Relief Act (H.R. 1529), introduced by Rep. Brad Sherman, would providethat any mortgage held in portfolio by a financial institution with assets of $10 billion or less is exempt from escrow requirements. H.R. 1520 would also raise the CFPB small servicer exemption threshold to 20,000 mortgages serviced annually. H.R. 1529 passed the House Financial Services Committee in March.

The Right to Lend Act (H.R. 1766), introduced by Rep. Robert Pittenger, would repeal Section 1071 of the Dodd-Frank Act, which contains the onerous small business data collection requirement discussed above.

The Small Bank Exam Cycle Reform Act (H.R. 1553), introduced by Rep. Scott Tipton, would allow a highly rated bank with assets of less than $1 billion to use an 18 month exam cycle. H.R. 1553 passed the House Financial Services Committee in July.

The Financial Products Safety Commission Act of 2015 (H.R. 1266), introduced by Rep. Randy Neugebauer, would change the structure of the CFPB so that it is governed by a five member commission rather than a single director. Commission governance would allow for a variety of views and expertise on issues before the CFPB and thus build in a system of checks and balances that is absent in a single director form of governance.

The **Financial Institutions Examination Fairness and Reform Act (H.R. 1941)**, introduced by Reps. Lynn Westmoreland and Carolyn Maloney, would go a long way toward improving the oppressive examination environment by creating a workable appeals process. This legislation would improve the appeals process by taking it out of the examining agencies and empowering a newly created Independent Examination Review Director, situated in the Federal Financial Institutions Examination Council, to make final appeals decisions.

ICBA urges the members of this Committee to cosponsor the bills noted above.

Closing

Thank you again for the opportunity to testify today. ICBA hopes this testimony, while not exhaustive, gives the Committee a sense of the sharply increasing resource demands placed on community banks by regulation and examination and the destructive impact they have on small business lending. ICBA hopes to work with this committee to craft urgently needed legislative solutions.

ATTACHMENTS

- ICBA Plan for Prosperity

Plan for Prosperity

A Regulatory Relief Agenda to Empower Local Communities

2013

Plan for Prosperity: A Regulatory Relief Agenda to Empower Local Communities

America's 7,000 community banks are vital to the prosperity of the U.S. economy, particularly in micropolitan and rural communities. Providing 60 percent of all small business loans under $1 million, as well as customized mortgage and consumer loans suited to the unique characteristics of their local communities, community banks are playing a vital role in ensuring the economic recovery is robust and broad based, reaching communities of all sizes and in every region of the country.

In order to reach their full potential as catalysts for entrepreneurship, economic growth, and job creation, community banks must be able to attract capital in a highly competitive environment. Regulation calibrated to the size, lower-risk profile, and traditional business model of community banks is critical to this objective. ICBA's Plan for Prosperity provides targeted regulatory relief that will allow community banks to thrive by doing what they do best – serving and growing their communities. By rebalancing unsustainable regulatory burden, the Plan will ensure that scarce capital and labor resources are used productively, not sunk into unnecessary compliance costs, allowing community banks to better focus on lending and investing that will directly improve the quality of life in our communities. Each provision of the Plan was selected with input from community bankers nationwide and crafted to preserve and strengthen consumer protections and safety and soundness.

The Plan is not a bill; it is a platform and set of legislative priorities positioned for advancement in Congress. The provisions could be introduced in Congress individually, collectively or configured in whatever fashion suits interested members of Congress. The Plan is a flexible, living document that can be adapted to a rapidly changing regulatory and legislative environment to maximize its influence and likelihood of enactment. Provisions of the Plan include:

Support for the Housing Recovery: Mortgage Reform For Community Banks. Provide community banks relief from certain mortgage regulations, especially for loans held in portfolio. When a community bank holds a loan in portfolio, it has a direct stake in the loan's performance and every incentive to ensure it is affordable and responsibly serviced. Relief would include: Providing "qualified mortgage" safe harbor status for loans originated and held in portfolio for the life of the loan by banks with less than $10 billion in assets, including balloon mortgages; exempting banks with assets below $10 billion from escrow requirements for loans held in portfolio; increasing the "small servicer" exemption threshold to 20,000 loans (up from 5,000); and reinstating the FIRREA exemption for independent appraisals for portfolio loans of $250,000 or less made by banks with assets below $10 billion.

Strengthening Accountability in Bank Exams: A Workable Appeals Process. The trend toward oppressive, micromanaged regulatory exams is a concern to community bankers nationwide. An independent body would be created to receive, investigate, and resolve material complaints from banks in a timely and confidential manner. The goal is to hold examiners accountable and to prevent retribution against banks that file complaints.

Redundant Privacy Notices: Eliminate Annual Requirement. Eliminate the requirement that financial institutions mail annual privacy notices even when no change in policy has occurred. Financial institutions would still be required to notify their customers when they change their privacy policies, but when no change in policy has occurred, the annual notice provides no useful information to customers and is a needless expense.

Serving Local Governments: Community Bank Exemption from Municipal Advisor Registration. Exempt community bank employees from having to register as municipal advisors with the SEC and the Municipal Securities Rulemaking Board. Community banks provide traditional banking services to small municipal governments such as demand deposits, certificates of deposit, cash management services, loans and letters of credit. These activities are closely supervised by state and federal bank regulators. Municipal advisor registration and examination would pose a significant expense and regulatory burden for community banks without enhancing financial protections for municipal governments.

Creating a Voice for Community Banks: Treasury Assistant Secretary for Community Banks. Economic and banking policies have too often been made without the benefit of community bank input. An approach that takes into account the diversity and breadth of the financial services sector would significantly improve policy making. Creating an Assistant Secretary for Community Banks within the U.S. Treasury Department would ensure that the 7,000 + community banks across the country, including minority banks that lend in underserved markets, are given appropriate and balanced consideration in the policy making process.

Balanced Consumer Regulation: More Inclusive and Accountable CFPB Governance. Change the governance structure of the CFBP to a five-member commission rather than a single Director. Commissioners would be confirmed by the Senate to staggered five-year terms with no more than three commissioners affiliated with any one political party. This change will strengthen accountability and bring a diversity of views and professional backgrounds to decision-making at the CFPB. In addition, FSOC's review of CFPB rules should be strengthened by changing the vote required to veto a rule from an unreasonably high two-thirds vote to a simple majority, excluding the CFPB Director.

Relief from Accounting and Auditing Expenses: Publicly Traded Community Banks and Thrifts. Increase from $75 million in market capitalization to $350 million the exemption from internal control attestation requirements. Because community bank internal control systems are monitored continually by bank examiners, they should not have to sustain the unnecessary annual expense of paying an outside audit firm for attestation work. This provision will substantially lower the regulatory burden and expense for small, publicly traded community banks without creating more risk for investors. Separately, due to an inadvertent oversight in the recently-passed JOBS Act, thrift holding companies cannot take advantage of the increased shareholder threshold below which a bank or bank holding company may deregister with the SEC. Congress should correct this oversight by allowing thrift holding companies to use the new 1200 shareholder deregistration threshold.

Ensuring the Viability of Mutual Banks: New Charter Option and Relief from Dividend Restrictions. The OCC should be allowed to charter mutual national banks to provide flexibility for institutions to choose the charter that best suits their needs and the communities they serve. In addition, certain mutual holding companies – those that have public shareholders—should be allowed to pay dividends to their public shareholders without having to comply with numerous "dividend waiver" restrictions as required under a recent Federal Reserve rule. The Federal Reserve rule makes it difficult for mutual holding companies to attract investors to support their capital levels. Easier payment of dividends will ensure the viability of the mutual holding company form of organization.

Rigorous and Quantitative Justification of New Rules: Cost-Benefit Analysis. Provide that financial regulatory agencies cannot issue notices of proposed rulemakings unless they first determine that quantified costs are less than quantified benefits. The analysis must take into account the impact on the smallest banks which are disproportionately burdened by regulation because they lack the scale and the resources to absorb the associated compliance costs. In addition, the agencies would be required to identify and assess available alternatives including modifications to existing regulations. They would also be required to ensure that proposed regulations are consistent with existing regulations, written in plain English, and easy to interpret.

Additional Capital for Small Bank Holding Companies: Modernizing the Federal Reserve's Policy Statement. Require the Federal Reserve to revise the Small Bank Holding Company Policy Statement – a set of capital guidelines that have the force of law. The Policy Statement, makes it easier for small bank holding companies to raise additional capital by issuing debt, would be revised to apply to both bank and thrift holding companies and to increase the qualifying asset threshold from $500 million to $5 billion. Qualifying bank and thrift holding companies must not have significant outstanding debt or be engaged in nonbanking activities that involve significant leverage. This will help ease capital requirements for small bank and thrift holding companies.

Cutting the Red Tape in Small Business Lending: Eliminate Data Collection. Exclude banks with assets below $10 billion from new small business data collection requirements. This provision, which requires the reporting of information regarding every small business loan application, falls disproportionately upon community banks that lack scale and compliance resources.

Facilitating Capital Formation: Modernize Subchapter S Constraints and Extend Loss Carryback. Subchapter S of the tax code should be updated to facilitate capital formation for community banks, particularly in light of higher capital requirements under the proposed Basel III capital standards. The limit on Subchapter S shareholders should be increased from 100 to 200; Subchapter S corporations should be allowed to issue preferred shares; and Subchapter S shares, both common and preferred, should be permitted to be held in individual retirement accounts (IRAs). These changes would better allow the nation's 2300 Subchapter S banks to raise capital and increase the flow of credit. In addition, banks with $15 billion or less in assets should be allowed to use a five-year net operating loss (NOL) carryback through 2014. This extension of the five-year NOL carryback is countercyclical and will support community bank capital and lending during economic downturns.

The Independent Community Bankers of America®, the nation's voice for nearly 7,000 community banks of all sizes and charter types, is dedicated exclusively to representing the interests of the community banking industry and its membership through effective advocacy, best-in-class education and high-quality products and services. For more information, visit www.icba.org.

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