Testimony of

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Independent Community Bankers of America

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"The Dodd-Frank Act: Impact on Small Business Lending"

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Chairman Walsh, Ranking Member Schrader, and members of the Subcommittee, I am Greg Ohlendorf, and I am President and CEO of First Community Bank and Trust, a $147 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 the Dodd-Frank Act and its impact on small business lending. Small business lending will play an essential role in the economic recovery and in creating desperately needed job growth.

Community banks are prodigious small business lenders. We provide small business credit in good times as well as challenging times – supporting the sector responsible for more job creation than any other. In his recent speech before the ICBA annual convention, Federal Reserve Chairman Ben Bernanke shared new Federal Reserve Bank research that 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.

Community Banks Remain Strong

The past few years have been tumultuous for community banks, but the vast majority of them are well capitalized and are helping to lead the economic recovery. Still, community banks were affected by the financial collapse. Both businesses and consumers have struggled significantly during the recent economic downturn. But, despite the wave of bank failures and consolidations since the financial crisis, I fully expect the community bank business model will thrive in the future, to the benefit of consumers, small business, and the economy. Many ICBA members have been in business for more than 100 years (my bank celebrates its 95th anniversary this year) and our members have survived the Great Depression and numerous other recessions. While I believe the community banking sector will remain vibrant, policymakers must help by providing relief from overly-burdensome regulations.
Community banks have little in common with Wall Street firms, mega-banks, or shadow banks and did not cause the financial crisis or engage in abusive consumer practices. Community banks have a much different risk profile because their business model is built on long-term customer relationships, and we cannot succeed without a reputation for fair treatment. We make loans often passed over by the large banks because a community banker's personal knowledge of the borrower which gives us firsthand insight into the true credit quality of a loan, in stark contrast to a statistical model used by a large bank in another state or region of the country. These localized credit decisions, made one-by-one by thousands of community bankers, will restore our economic strength.

Tiered Regulation Needed

ICBA believes it is appropriate to tier regulation and supervision of the financial services industry. The Dodd-Frank Act has proven to be a mixed outcome for community banks, combining both punitive and helpful provisions, but it did recognize community banks as a separate category of financial services providers with a distinct business model, risk profile and mode of relating to customers. A number of provisions of the law make a separate accommodation for community banks. Notable examples include:

- An exemption for banks under $10 billion in assets from primary examination and enforcement by the Consumer Financial Protection Bureau.
- An exemption from the so-called "Collins Amendment," which will make it harder for bank holding companies to raise Tier 1 capital. Bank holding companies of less than $500 million in assets are exempt, and trust preferred securities (TRUPS) – an important source of capital for many banks – issued by bank holding companies of less than $15 billion in assets are grandfathered.
- Community banks are shielded from the impact of new regulation of derivatives. Community banks may continue to offer interest rate swaps to their customers and to hedge their own interest rate risks for proper financial risk management.

Yet much more must be done to address the large and growing regulatory burden on community banks. Overly prescriptive regulations and overly harsh exams only reduce community banks' flexibility in serving the unique needs of their customers. Moreover, regulation has a disproportionate impact on community banks as we have fewer resources to dedicate to compliance due to our smaller size.

Oppressive Examination Environment

You are correct, Mr. Chairman, in observing that the current oppressive exam environment is hampering small business lending. The misplaced zeal and arbitrary demands of examiners are having a chilling effect. Good loan opportunities are passed over for fear of examiner write downs and the resulting loss of income and capital. The contraction in credit is having a direct, adverse impact on the recovery. Exams could be greatly improved by being made more consistent and rational. This would encourage prudent lending without loosening standards. There needs to be more thoughtful and systematic ways to reduce risk without discouraging sound lending.

I'm fortunate to enjoy a cooperative and constructive working relationship with my regulator, the Federal Reserve Bank of Chicago. I value this relationship very highly. It is an important part of the success of my bank and has allowed me to weather the financial crisis. I understand that examiners have a difficult job with a great deal at stake. The stakes were raised sharply after the financial crisis, but I believe many examiners have overreacted and now the pendulum has swung too far in the direction of over-regulation. I've met with thousands of community bankers from every part of the country in recent years, and I can tell you there is an unmistakable trend toward arbitrary, micromanaged, and unreasonably harsh examinations that have the effect of suffocating lending.

This has not always been the case. Before the crisis, examiners frequently worked in partnership with the banks they examined. They were a resource in interpreting often ambiguous guidance. Where corrections were needed, opportunity was given to make them, and compliance was a mutual goal. This is the best means of achieving safety and soundness without interfering with the business of lending. Currently, these relationships are too often adversarial. Understandably, an examiner does not want to be blamed for the next crisis. Examiners are not evaluated on banks' contributions to the economy. At all costs, they want to avoid a bank failure that would put a black mark on their record. As a result, the examiner's incentive is to err on the side of writing down too many loans and demanding additional capital. The crisis was not caused by a failure to adequately examine community banks.

Disconnect Between Washington and Local Exams

A particularly frustrating aspect of the exam environment is the disconnect between the examiners in the field and the directives from Washington. A November 2008, Interagency Statement on Meeting the Needs of Creditworthy Borrowers established a national policy for banks to extend credit to creditworthy borrowers in order to help initiate and sustain an economic recovery. It stated, "The agencies expect all banking organizations to fulfill their fundamental role in the economy as intermediaries of credit to businesses, consumers, and other creditworthy borrowers." Unfortunately, this policy is often overlooked, especially in the regions most severely affected by the recession. Field examiners are second guessing bankers and independent professional appraisers and are demanding unreasonably aggressive write-downs and reclassifications of viable commercial real estate loans and other assets.

Furthermore, examiners are demanding capital levels higher than those required by regulation. To bankers, the process feels arbitrary and punitive. Many community banks complain that the required capital level goalpost is unpredictable and regulators simply keep moving it further, making it nearly impossible to satisfy capital demands in a difficult economy and capital marketplace. As a result, bankers are forced to pull in their horns and pass up sound loan opportunities in order to preserve capital. This is not helpful for their communities and for overall economic growth.

Additionally, bankers used to receive prompt feedback following their exams which they could act on immediately as part of the exam process. Today examination reports arrive months after the examiner's visit, with little opportunity for the banker to sit down with the examiner, go over the results, and respond to the examiner's concerns on the spot.

Legislative Help is Needed

ICBA supports legislation to bring more consistency to the examination process. With regard to loan classifications, for example, one of community bankers' greatest concerns, a bill recently introduced in the House would establish criteria for determining when a loan is performing and thereby provide for more consistent classifications. When loans become troubled often the best course for the borrower, the lender, and the community is a modification that will keep the loan

out of foreclosure. But in recent years, many examiners have penalized loan modifications by aggressively placing loans on non-accrual status following a modification – even though the borrower has demonstrated a pattern of making contractual principal and interest payments under the loan's modified terms. This adverse regulatory classification results in the appearance of a weak capital position for the lender, which dampens further lending in the community and puts a drag on economic recovery. Rep. Bill Posey's Common Sense Economic Recovery Act of 2011 (H.R. 1723) would establish conservative commonsense criteria for loan classifications.

Community bankers enthusiastically support this bill because it resonates with their experience from examinations. If it becomes law, it will give bankers the flexibility to work with struggling but viable borrowers and help them maintain the capital they need to support their communities.

Communities First Act

The ICBA-backed Communities First Act (CFA, H.R. 1697) captures many reforms the community banking sector deems necessary to address the difficult regulatory burden they face, including a change to the FSOC veto standard for CFPB rules, which is nearly impossible to meet under the Dodd-Frank Act. This legislation was recently introduced in the House and cosponsored by members from both sides of the aisle. ICBA is working to introduce a similar bill in the Senate. Notably CFA would:

- Increase the threshold number of bank shareholders from 500 to 2,000 that trigger SEC registration. Annual SEC compliance costs are a significant expense for listed banks.
- Require the SEC to conduct a cost/benefit analysis for any proposed accounting change.
- Lower Small Business Administration origination and program fees for rural and small business borrowers.
- Provide relief from new Dodd-Frank data collection requirements in connection with loan applications from women-owned and minority-owned businesses.
- Extend the 5-year net operating loss (NOL) carryback provision to free up community banks capital now when it is most needed to boost local economies.

These and other provisions would improve the regulatory environment and community bank viability, to the benefit of their customers and communities.

The Communities First Act (CFA), a bill meeting the broad objectives outlined above, was introduced and advanced during the 109th and 110th Congresses with bi-partisan support. In the 110th Congress, CFA was introduced in the House by then-Small Business Committee Chairwoman Nydia Velazquez (D-NY).

Small Business Lending Fund

ICBA fully supports the $30 billion Small Business Lending Fund (SBLF) program. This program will provide capital for interested community banks to increase small business lending in their communities and boost economic growth. With the private capital markets for small and mid-sized banks still largely frozen since the financial crisis, SBLF can provide an important alternative source of capital for interested healthy banks, structured to incentivize increased lending. We're pleased that Treasury has now completed all the term sheets and hope that the first round of funding will be disbursed soon.

The Dodd-Frank Act

The Dodd-Frank 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. Undeniably, it will result in additional compliance burden for community banks and will be challenging for them. 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 some 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.

Debit Interchange

The most troubling aspect of the Dodd-Frank Act, by a wide margin, is the debit interchange, or "Durbin," amendment. Despite the statutory exemption for institutions with less than $10 billion in assets, we believe small financial institutions cannot be effectively carved out. We were very disappointed by the failure of the Tester-Corker amendment in the Senate last week. The outcome was a blow to consumers and community bankers who, absent change, will bear a significant cost as a result of the flawed debit interchange rule. ICBA will continue to fight to improve the rule through every avenue available to us.

Consumer Financial Protection Bureau

While we are pleased 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 are in the best position to balance the safety and soundness of banking operation with the need to protect consumers from unfair and harmful practices and provide them with the information they need to make informed financial decisions.

There are different ways of strengthening the voice of the prudential regulators in CFPB rule writing. One example is a bill recently passed by the House Financial Services Committee. The Consumer Financial Protection Safety and Soundness Improvement Act, sponsored by Rep. Sean Duffy, would strengthen prudential regulatory review of CFPB rules, which is extremely limited

under the Dodd-Frank Act. Prudential regulators have 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, the Financial Stability Oversight Council (FSOC) determines that a rule "puts at risk safety and soundness of the banking system or the stability of the financial system," a standard that is nearly impossible to meet. A rule that doesn't meet this high standard could nevertheless do extraordinary harm to banks and consumers. H.R. 1315 would change the voting requirement for an FSOC veto 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." While this change would improve CFPB rulemaking, ICBA has proposed language that would further broaden the standard to allow FSOC to veto a rule that could adversely impact a subset of the industry in a disproportionate way. We believe that this standard would give prudential regulators a more meaningful role in CFPB rule writing.

ICBA also supports additional legislation passed by the Financial Services Committee to strengthen the CFPB. Chairman Spencer Bachus's bill, the Responsible Consumer Financial Protection Regulations Act of 2011 (H.R. 1121) would change the governance of the CFPB from a single Director to a Commission. 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 would be absent in a single director form of governance. Congresswoman Shelley Moore Capito's Bureau of Consumer Financial Protection Transfer Clarification Act (H.R. 1667) would postpone transfer of functions to the CFPB until its Director is confirmed. The CFPB's impact on the financial sector, consumers, and the economy should be matched by the highest standard of accountability. Ultimately, accountability for the actions of the CFPB resides with its Director, appointed by the President and confirmed by the Senate. This basic mechanism of good governance would be undermined if the CFPB were to be operative before its Director is confirmed by the Senate.

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. The Dodd-Frank Act is a mixed outcome for community banks. I've noted some of our concerns, but the legislation also gave us an opportunity to advance long sought priorities which will improve our ability to serve small businesses.

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. 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 too-big-to-fail status gives them funding advantages. For this reason, we're pleased the Act takes steps to mitigate too-big-to-fail.

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 are pleased that Dodd-Frank provides for enhanced prudential standards for systemically risky firms, including higher capital, leverage, and liquidity standards, concentration limits and contingent resolution plans. Firms subject to these higher standards should include, but not necessarily be limited to, large investment banks, insurance companies, hedge funds, private equity funds, venture capital firms, mutual funds (particularly money market mutual funds), industrial loan companies, special purpose vehicles, and nonbank mortgage origination companies.

We also support the FDIC's new resolution authority to 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. Powerful interest groups are lobbying doggedly to undermine the too-big-to-fail provisions of Dodd-Frank, which are essential to creating a robust and competitive financial services sector to the benefit of consumers, businesses, and the economy. We urge this committee to ensure that these provisions are upheld and enforced.

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 and will save community banks $4.5 billion over the next 3 years. The deposit insurance limit increase to $250,000 per depositor and the two-year extension of the Transaction Account Guarantee (TAG) Program, which provides unlimited deposit insurance coverage for non-interest bearing transaction accounts, will help to offset the advantage enjoyed by the too-big-to-fail mega-banks in attracting deposits.

Closing

Thank you again for your commitment to small businesses and your interest in the institutions that partner with them and ensure they have the credit they need to grow, thrive, and create jobs. I've outlined some of the more significant regulatory challenges we face in the months ahead. Negotiating these challenges will help us to serve our communities and promote the economic recovery – a goal we share with this committee. Thank you for hearing our concerns. We look forward to working with you.