June 9, 2016

Testimony of

Roger Beverage

On Behalf of the

AMERICAN BANKERS ASSOCIATION

before the

The Committee on Small Business

Subcommittee on Economic, Growth, Tax and Capital Access

of the

United States House of Representatives

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Chairman Huelskamp, Ranking Member Chu and members of the subcommittee, my name is Roger Beverage, and I am the President and Chief Executive Officer of the Oklahoma Bankers Association. I appreciate the opportunity to present the views of the American Bankers Association (ABA) on the impact of regulations on rural communities. This is a subject near to my heart. The ABA is the voice of the nation's $16 trillion banking industry, which is composed of small, regional and large banks that together employ more than 2 million people, safeguard $12 trillion in deposits and extend nearly $8 trillion in loans.

ABA appreciates the opportunity to be here today to speak on how the growing volume of bank regulation—particularly for America's hometown banks—is negatively impacting consumers because these same, perhaps well-intentioned rules and regulations limit the ability of banks throughout the nation to meet the needs of our customers[2] and communities[2]. This is not a new subject, yet the imperative to do something grows every day.

America's hometown banks are resilient, and have found ways of meeting our customers' needs in spite of the ups and downs of the economy. But it is a job that has become much more difficult because of the avalanche of new rules, guidances and seemingly ever-changing expectations of the regulators.

This new regulatory atmosphere—not the local economic conditions—is often the tipping point that drives small banks to merge. The fact remains that there are nearly 1,500 fewer banks

today than there were 5 years ago—a trend that will continue until some rational changes are made that will provide some relief to America's hometown banks.

In fact, today in Oklahoma there are 211 banks chartered in the state. When I came to Oklahoma in 1988 —there were well over 400 banks. More frightening is the lack of interest and ability for new charters. There have only been two true de novos since 2010, and none in Oklahoma.

Each and every bank in this country helps fuel our economic system. Each has a direct impact on job creation, economic growth and prosperity in the community it serves.

America's hometown banks are like other businesses – they buy their "product" at wholesale and then sell it at "retail." What that means is credit cycle that banks facilitate is simple: customer deposits provide funding to make loans. These loans allow customers of all kinds—businesses, individuals, governments and non-profits—to invest in their hometown and across the globe.

The profits generated by this investment flow back into banks as deposits and the cycle repeats—creating jobs, wealth for individuals and capital to expand businesses. As those businesses grow, they, their employees and their customers come to banks for a variety of other key financial services such as cash management, liquidity, wealth management, trust and custodial services. For individuals, bank loans and services can significantly increase their purchasing power and improve their quality of life, helping them attain their goals and realize their dreams.

This credit cycle does not exist in a vacuum. Regulation shapes the way banks do business and can help or hinder the smooth functioning of the credit cycle. Bank regulatory changes—through each and every law and regulation, court case and legal settlement—directly affect the cost of providing banking products and services to customers. Even small changes can have a big impact on bank customers by reducing credit availability, raising costs and driving consolidation in the industry that limits consumer choice.

Everyone who uses banking products or services is touched by changes in bank regulation. It is imperative that Congress take steps to ensure and enhance the banking industry's

ability to facilitate job creation and economic growth through the credit cycle. The time to address these issues is now before it becomes impossible to reverse the negative impacts. When a bank disappears everyone is impacted.

Importantly, in rural communities, smaller community banks are (in many instances) the exclusive source of capital farmers, ranchers, small business owners and its residents. Once that capital-access system becomes dysfunctional – as it is today – the community itself begins to encounter more difficult challenges in order to survive.

We urge Congress to work together— Senate and House—to pass legislation that will enhance the ability of community banks to serve their customers. In particular, Congress can take action to ensure credit flows to communities across the country by:

- Supporting tailored regulations for the banking industry;
- Improving access to home loans, and;
- Removing impediments to serving customers.

In the remainder of my testimony, I will highlight some specific actions under each of these suggestions that would help begin the process of providing meaningful relief to help community banks and help bank customers.

I. Support Tailored Regulation for the Banking Industry

Banks are in the business of serving customers and communities. Banks are where prospective homeowners obtain home loans, small businesses find capital, and customers receive advice on how to manage their nest eggs for a financially secure future.

But the role banks play serving their communities has been placed in jeopardy by the broad array of new regulations. For example, the typical small bank with one compliance officer has recently had to contend with more than 2,000 pages of new regulations, and that is just the housing, capital and remittance areas.

Moreover, the Dodd-Frank Act has charged federal financial regulators with writing and enforcing 398 new rules, resulting in at least 13,644 pages of proposed and final regulations, and

that's with regulators only halfway through the rulemaking process. While not all of those rules apply to all banks, many do. Even the rules that do not, tend to have trickle down and become "best practices" as determined by the bank's primary federal banking regulator. Those regulators then apply those requirements to thousands of banks otherwise not subject to the rule.

The key to changing the consolidation trend is to stop treating all banks as if they are the same or as if all banks operate in the same manner as the largest and most complex institutions. They don't. Financial regulation and examination should not take a one-size fits all approach. To do so, only layers on unnecessary requirements that add little to improve safety and soundness, but add much to the cost of providing services—a cost which bank customers ultimately bear.

Instead, ABA has urged for years that a better approach to regulation is to tailor bank supervision to take into account the charter, business model, and scope of each bank's operations. This would ensure that regulations and the exam process add value for banks of all sizes and types.

Regulators should be empowered – and directed – to make sure that rules, regulations and compliance burdens only apply to segments of the industry where it is warranted. Only then can America's hometown banks be freed up to best serve their communities.

Tailor Regulation to a Bank's Business Model

The ABA recommends that Congress ensure that regulation is tailored to a bank's business model. Time and again, I hear from bankers wondering why the complex set of rules, reporting requirements, and testing that are imposed upon the largest most diverse and global institutions become the standard applied to the smaller community banks in the country. The approach seems to be: "If it's the 'best practice' for the biggest banks it must be the best practice for all banks." Such an approach makes no sense in our diverse banking system with different business models and strategies.

Of course, the supervisory process should assure risk is identified and managed prudently. This risk assessment must be appropriate to the type of institution. In the aftermath of the financial crisis, the pendulum of bank examination has swung to the extreme—affecting every sized bank. Overbroad, complicated restrictions supplant prudent oversight. Inconsistent

examinations hinder lending, increase costs, and create procedural roadblocks that undermine the development of new products and services for bank customers.

The banking agencies should move towards customized examinations that consider the nature of a bank's business model, charter type, and perhaps most important, bank management's success at managing credits, including a borrower's character, prior repayment history and strength of personal guarantees. In today's complex banking environment, an array of risk factors has had a far greater impact on a banks' ability to serve its customers—as well as its likelihood to get in trouble—than an arbitrary asset size.

The ABA encourages Congress to support legislation that would ensure banks are regulated according to their business model, such as H.R. 2896, the Taking Account of Institutions with Low Operation Risk Act (TAILOR Act) of 2015, introduced by Rep. Scott Tipton (R-Colo.). This legislation would require regulators to tailor regulatory actions so that they apply only when the bank's business model and risk profile require them—not just based on asset size. This legislation empowers regulators to make sure that rules, regulations and compliance requirements only apply to segments of the industry where warranted.

II. Improve Access to Home Loans

The mortgage market touches the lives of nearly every American household. Banks help individual consumers achieve lifelong goals of homeownership by giving them access to the funding they need. Without home loans most Americans would not be able to purchase a home.

Banks are a major source of mortgage loans—holding more than $2 trillion in one-to-four family home loans on their books and originating others under government guarantees. In addition, banks support the housing industry with construction and development loans, and homeowners with home equity lines of credit. These critical services of banks results in more income and jobs in communities, along with a larger tax base for local governments.

Borrowers across the country—served by banks of all sizes—should be able to obtain safe, sound and well underwritten home loans. However, it is clear that new restrictive regulatory requirements have kept some creditworthy borrowers, particularly first-time homebuyers, from obtaining much needed mortgage credit. The complex and liability-laden maze of compliance has made home loan origination more difficult, especially for borrowers with little or weak credit history. Over-regulation of the mortgage market has reduced credit available to bank customers,

raised the cost of services, and limited bank products. The result has been a housing market still struggling to gain momentum.

In Oklahoma, approximately 25 percent of the state's banks have simply elected to get out of the home mortgage lending business. They have concluded that both the litigation and regulatory risks they would encounter are simply too great given the limited number of such loans they normally would make in a given year. That means their customers are either denied credit or must search for an alternative source of capital. This is especially true for rural areas.

Congress can help reduce needless impediments to mortgage lending that have constrained the banking industry's ability to help first-time homebuyers and dampened the growth of prosperity across the nation's communities. For example, Congress should:

Treat Loans Held in Portfolio as Qualified Mortgages

The Dodd-Frank Act (DFA) is very restrictive in its definition of "ability to repay" (ATR) and Qualified Mortgage (QM)—having a detrimental impact on the market and consumer access to credit. Portfolio lending is among the most traditional and lowest-risk lending in which a bank can engage.

Loans held in portfolio are well underwritten because if a loan is to be held in a bank's portfolio, the bank carries all of the credit and interest rate risk associated with that loan until it is repaid. Therefore it must be conservative to protect the safety and soundness of the bank, and these loans are made with no risk to the nation's taxpayers.

ABA supports H.R. 1210, the Portfolio Lending and Mortgage Access Act, introduced by Rep. Andy Barr (R-Ky.), which passed the House on Nov. 18, 2015. It would treat any loan made by an insured depository institution and held in that lender's portfolio as compliant with the Ability-to-Repay/Qualified Mortgage requirements and would provide an important and much needed correction to the restrictive standards that now exist.

This legislation is fully consistent with the intent behind the Dodd-Frank Act in that it encourages "skin in the game" or risk retention by the originating lender. By encouraging banks to hold these loans on their books, the act will expand safe, affordable lending for more borrowers who look to America's hometown banks for safe, affordable credit.

TILA-RESPA Integrated Disclosure Rule (TRID)

The TILA-RESPA Integrated Disclosure Rule (TRID) became effective in October 2015 and changed all residential mortgage origination disclosures as well as systems which generate and track originations. The new rules are extremely lengthy and technical, and carry substantial administrative and legal liabilities.

ABA has expressed high concerns that this rule contains inadequacies that require immediate clarification and resolution for the Consumer of Financial Protection Bureau (CFPB). Uncertainty about the treatment of minor errors and oversights has broadly affected mortgage originators. Current legal uncertainties ultimately harm the consumer. Such uncertainties threaten liquidity in key portions of the market possibly restricting consumers' access to mortgage credit. In addition, lack of legal uncertainty poses risks that ultimately inflate prices to the consumer.

ABA and various industry partners have communicated to Director Cordray that immediate action is urgently needed to allay lender and investor concerns regarding TRID liabilities. We have requested that the CFPB: (1) formally publish authoritative guidance clarifying the scope and extent of TRID legal liabilities and assuring stakeholders that there are viable cure provisions for correcting technical errors and mistakes; (2) form an internal Task Force to engage with industry stakeholders to identify compliance and legal problems to be addressed via published guidance or interpretive rulemaking, and; (3) extend the current "good faith" implementation period for TRID until all regulatory issues and fixed and banks are granted a reasonable period to adapt compliance systems. Such actions will ensure a healthy bank mortgage lending environment, while ensuring consumers have access to well-priced financial options.

III. Remove Impediments to Serving Customers

Rules and requirements surround every bank activity. When it works well, bank regulation helps ensure the safety and soundness of the overall banking system. When it does not, it constricts the natural cycle of facilitating credit, job growth and economic expansion. Finding the right balance is key to encouraging growth and prosperity as unnecessary regulatory requirements lead to inefficiencies and higher expenses which reduce resources devoted to serving customers and communities.

Regulatory requirements for the banking industry have grown dramatically in recent years, hindering in particular rural banks' ability to take care of their customers and serve local communities. By reducing or minimizing regulatory requirements for these rural community banks, Congress would allow banks to provide more credit, products and services to meet the needs of their local communities.

Address the Cumulative Impact of the Increasing Number of Regulations

The ABA supports many bills that would address banks' concerns with growing regulatory requirements on consumers and especially rural areas. Several bills incorporating provisions which would provide regulatory relief to America's hometown bank have been introduced in the House and Senate, such as:

- H.R. 1389, the American Jobs and Community Revitalization Act of 2015, introduced by Rep. Andy Barr (R-Ky.), and;
- H.R. 1233, the Community Lending Enhancement and Regulatory Relief Act (CLEARR Act), introduced by Rep. Blaine Luetkemeyer (R-Mo.)

American Jobs and Community Revitalization Act of 2015

ABA supports Rep. Andy Barr's (R-Ky.) American Jobs and Community Revitalization Act of 2015 legislation which contains a number of provisions that will reduce the regulatory requirements for America's rural hometown banks around the county in ways that make it easier for them to meet their customers' needs. For example, the legislation includes provisions that would:

- **Require a review and reconciliation of existing regulations.** Congress should require a review and reconciliation of existing regulations that may be in conflict with or duplicative of new rules being promulgated by the banking agencies, or which in their application badly fit the variety of institutions that make up the banking industry.

- **Streamline currency transaction reporting.** Anti-money laundering efforts by financial institutions can be improved by eliminating needless currency transaction reporting through a "qualified customer" exemption to the Currency Transaction Reporting (CTR) rules. This would significantly reduce the more than 13 million CTRs filed annually, saving banks many hours each year in filling out unneeded and unused forms. Importantly, it would give them more time to devote to what they do best: take care of their customers and communities.

- **Ensure Subchapter S banks are treated equitably.** Banks are required to build capital under the Capital Conservation Buffer requirements of the agencies' Basel III regulations. However, the current regulations do not take into consideration the unique cash flows applicable to S Corporation banks where income is calculated prior to consideration of distributions for payment of taxes arising from S Corporation activities. This puts S Corporation banks at a disadvantage when compared to C Corporation banks.

Community Lending Enhancement and Regulatory Relief Act

ABA supports Rep. Blaine Luetkemeyer (R-Mo.) Community Lending Enhancement and Regulatory Relief Act (CLEARR Act) which contains a number of provisions that would lift or modify many unnecessary restrictions, better allowing community banks to meet the needs of their customers. In particular, this legislation would:

- **Ensure the costs and benefits are considered before issuing new regulation.** The bill also would require the Securities and Exchange Commission (SEC) to conduct an analysis of the costs and benefits, including economic benefits, of any new or amended accounting principle. Benefits to investors would have to outweigh costs before the SEC could recognize the principle.

- **Improve Access to Home Loans.** This bill also contains a number of provisions to ensure consumers have access to home loans as discussed above.

Evaluate Necessity of Basel III Complex Capital Requirements

In addition, Basel III poses ~~a~~ significant compliance requirements on most rural community banks. The banking agencies estimate that the direct compliance cost of ***only*** the risk weighted asset portion of the final rules to be $43,000 ***per institution*** for banks under $500 million in assets.

While complex, the risk weighted asset portion of Basel III is just one component of the final rules. The overall cost for banks over $500 million is almost certainly significantly higher. Unnecessarily, complex capital requirements force banks to devote resources away from lending opportunities.

Although the industry is over a year into implementation, many institutions continue to struggle with understanding the rule's complexities. The sections of Basel III ABA members most commonly cite as creating the greatest compliance burden include: (1) new definition of High Volatility Commercial Real-Estate (HVCRE); (2) new risk weighting methodology for private label securitizations, and: (3) new credit conversion factors for short-term lines of credit. Furthermore, even as America's hometown banks are working through Basel III implementation, the international Basel Committee has issued a steady stream of new proposals that could be adopted in the United States.

ABA believes that highly capitalized banks and particularly those that serve rural America, should be exempt from Basel III and any potential future changes to the Basel framework. Using data from the Federal Deposit Insurance Corporation (FDIC), ABA estimates that some 4,000 banks may already have far more capital than Basel III would require. For these banks, the considerable and costly work of Basel III compliance yields no additional supervisory or safety and soundness benefits, and provides no services to customers.

Conclusion

America's hometown banks have been the backbone of communities across nation. Our presence in small towns and large cities everywhere means we have a personal stake in the

economic growth, health and vitality of nearly every community. Once again, this is particularly true for those banks that serve rural America.

A bank's presence is a symbol of hope, a vote of confidence in a town's future. When a bank sets down roots, communities thrive. When they leave or reduce services, communities, and consumers do not thrive. It's that simple.

We urge Congress to act now and pass legislation to help turn the tide of community bank consolidation and protect communities from losing a key partner supporting economic growth.