ICBA
INDEPENDENT COMMUNITY BANKERS of AMERICA
One Mission. Community Banks.®

Plan for Prosperity

A Pro-Growth Agenda to Reduce the Onerous Regulatory Burden on Community Banks and Empower Local Communities

2015

Plan for Prosperity: An Agenda to Reduce the Onerous Regulatory Burden on Community Banks and Empower Local Communities

America's 6,500 community banks are vital to the prosperity of the U.S. economy, particularly in smaller towns and rural communities. Providing more than half 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 serve 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. An end to the exponential growth of onerous regulatory mandates is critical to this objective. Regulation is suffocating nearly every aspect of community banking and changing the very nature of the industry away from community investment and community building to paperwork, compliance, and examination. A fundamentally new approach is needed: Regulation must be calibrated to the size, lower-risk profile, and traditional business model of community banks.

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 reducing 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 a set of detailed legislative priorities positioned for advancement in Congress. A subset of these priorities is specifically dedicated to strengthening community bank viability by creating new options for capital raising and capital preservation. A number of regulatory relief measures would be tiered, with different thresholds for Consumer Financial Protection Bureau rules (generally $10 billion and under) and safety and soundness regulation (generally $50 billion and under). The recommended thresholds are based on existing levels and statutory provisions, which may vary by provision.

ICBA is committed to advancing and enacting the provisions of the Plan with all due vigilance and the aggressive use of every resource at our disposal. 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 are described below.

ACCESS TO CAPITAL: CREATING NEW OPTIONS FOR THE CREATION AND PRESERVATION OF COMMUNITY BANK CAPITAL

ICBA is proposing a set of options to strengthen community bank viability by enhancing access to capital.

Basel III Amendments: Restoring the Original Intent of the Rule. Basel III was originally intended to apply only to large, internationally active banks. ICBA proposes the following amendments for banks with assets of $50 billion or less.

- *Exemption from the capital conservation buffer.* The new buffer provisions impose dividend restrictions that have a chilling effect on potential investors. This is particularly true for Subchapter S banks whose investors rely on dividends to pay their pro-rata share of the bank's tax. Exempting community banks from the capital conservation buffer would make it easier for them to raise capital.
- *Full capital recognition of allowance for credit losses.* Provide that the allowance for credit losses is included in tier 1 capital up to 1.25 percent of risk weighted assets with the remaining amount reported in tier 2 capital. This change would reverse the punitive treatment of the allowance under Basel III. The allowance should be captured in the regulatory capital framework since it is the first line of defense in protecting against unforeseen future credit losses.
- *Amend risk weighting to promote economic development.* Provide 100 percent risk weighting for acquisition, development, and construction loans. Under Basel III, these loans are classified as high volatility commercial real estate loans and risk weighted at 150 percent. ICBA's proposed change would treat these loans the same as other commercial real estate loans and would be consistent with Basel I.

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, which makes it easier for small bank and thrift holding companies to raise additional capital by issuing debt, would be revised to increase the qualifying asset threshold from $1 billion 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.

Relief from Securities and Exchange Commission Rules. ICBA recommends the following changes to SEC rules which would allow community banks to commit more resources to their communities without putting investors at risk:

- Provide an exemption from internal control attestation requirements for community banks with assets of less than $1 billion. The current exemption applies to any company with market capitalization of $75 million or less. 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.

- Due to an oversight in the 2012 JOBS Act, thrift holding companies do not have statutory authority to 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 1,200 shareholder deregistration threshold as well as the new 2,000 shareholder registration threshold.
- Regulation D should be reformed 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.

TARGETED REGULATORY RELIEF

Supporting a Robust Housing Market: 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 properly underwritten, affordable and responsibly serviced. Relief would include:

- Providing "qualified mortgage" safe harbor status for loans originated and held in portfolio 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.
- An exemption from the higher risk mortgage appraisal requirements for loans of $250,000 or less provided they are held in portfolio by the originator for a period of at least three years.
- New information reporting requirements under the Home Mortgage Disclosure Act should not apply to community banks.

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.

Reforming Bank Oversight and Examination to Better Target Risk. ICBA makes the following recommendations to allow bank examiners to better target their resources at true sources of systemic risk:

- A two-year exam cycle for well-rated community banks with up to $2 billion in assets would allow examiners to better target their limited resources toward banks that pose systemic risk. It would also provide needed relief to bank management for whom exams are a significant distraction from serving their customers and communities.
- Banks with assets of $50 billion or less should be exempt from stress test requirements.
- Community banks should be allowed to file a short form call report in the first and third quarters of each year. The current, long form call report would be filed in the second and fourth quarters. The quarterly call report now comprises some 80 pages supported by almost 700 pages of instructions. It represents a growing burden on community banks without being an effective supervisory tool.

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 by mail 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.

Balanced Consumer Regulation: More Inclusive and Accountable CFPB Governance. The following changes would strength CFPB accountability, improve the quality of the agency's rulemaking, and make more effective use of its examination resources:

- Change the governance structure of the CFPB 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.
- The Financial Stability Oversight Council'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.
- All banks with assets of $50 billion or less should be exempt from examination and enforcement by the CFPB; and CFPB backup (or "ride along") authority for compliance exams performed by a bank's primary regulator should be eliminated.

Eliminate Arbitrary "Disparate Impact" Fair Lending Suits. Amend the Equal Credit Opportunity Act and the Fair Housing Act to bar "disparate impact" causes of action. Lenders that uniformly apply neutral lending standards should not be subject to frivolous and abusive lawsuits based on statistical data alone. Disparate impact forces lenders to consider factors such as race and national origin in individual credit decisions, which are specifically precluded by law.

Ensuring the Viability of Mutual Banks: New Charter Option. 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.

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 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.

Cutting the Red Tape in Small Business Lending: Eliminate Burdensome 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.

Preserve Community Bank Mortgage Servicing. The provisions described below would help preserve the important role of community banks in servicing mortgages and deter further industry consolidation, which is harmful to borrowers:

- Increase the "small servicer" exemption threshold to 20,000 loans (up from 5,000). To put this proposed threshold in perspective, the average number of loans serviced by the five largest servicers subject to the national mortgage settlement is 6.8 million. An exemption threshold of 20,000 would demarcate small servicers from both large and mid-sized servicers.
- For banks with assets of $50 billion or less, reverse the punitive Basel III capital treatment of mortgage servicing rights (MSRs) and allow 100 percent of MSRs to be included as common equity tier 1 capital.

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 more than 6,500 community banks across the country, including minority banks that lend in underserved markets, are given appropriate and balanced consideration in the policy making process.

Modernize Subchapter S Constraints. 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 2,200 Subchapter S banks to raise capital and increase the flow of credit.

Five-Year Loss Carryback Supports Lending During Economic Downturns. Banks with $15 billion or less in assets should be allowed to use a five-year net operating loss (NOL) carryback**.** The five-year NOL carryback is countercyclical and will support community bank capital and lending during economic downturns.

Risk Targeting the Volcker Rule. Exempt banks with assets of $50 billion or less from the Volcker Rule. The Volcker Rule should apply only to the largest, most systemically risky banks. Proposals to apply the rule to community banks carry unintended consequences that threaten to destabilize segments of the community banking industry.

The Independent Community Bankers of America®, the nation's voice for 6,500 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.