



Testimony of

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On behalf of the

Independent Community Bankers of America

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“An Overview of the SBA’s 7(a) Loan Program”

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Chairman Kelly, Ranking Member Adams, and members of the subcommittee, I am Cynthia Blankenship, Vice Chairman, Chief Financial Officer, and Corporate President of Bank of the West in Grapevine, Texas. Bank of the West is a \$450 million asset community bank serving the Dallas-Fort Worth suburban area with rural branches in Ponder and Vernon, Texas. We have 105 employees, eight full service branches, and two mortgage company locations.

I am also a former Chairman of the Independent Community Bankers of America, and I am pleased to testify today on behalf of the more than 5,800 community banks represented by ICBA at today's hearing titled "An Overview of the SBA's 7(a) Loan Program." A robust and sustainable 7(a) program with broad community bank participation will help small businesses thrive and create jobs, strengthening and extending a sluggish economic recovery. We are grateful for this committee's strong support for the 7(a) program, and I am pleased to offer the community bank perspective on it.

America's community banks are prolific small business lenders. We play an outsized role in funding small businesses and the jobs they create. While community banking organizations represent 17 percent of all U.S. bank assets, we make more than half of all small business loans. Small businesses account for over half of all U.S. employment and nearly two thirds of all employment growth.

What sets community banks apart is their first-hand knowledge of the borrower, the community, and the local economy. Community bank small business lending simply cannot be duplicated by a bank based outside the community. As noted in a recent study by scholars at Harvard's Kennedy School of Government: "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 The Small Business Administration's 7(a) loan program allows community banks to leverage their unique underwriting skills to more effectively serve the small businesses in their communities.

Bank of the West's Longstanding Partnership with the SBA

Bank of the West is a 30-year partner with the Small Business Administration and has been strongly committed to helping small businesses in our communities using the flagship 7(a) program as well as the 504-loan program. We are a leading SBA lender in the Dallas-Fort Worth SBA District. We underwrite approximately \$20 million in 7(a) loans annually and currently hold and service nearly \$100 million in SBA loans in our portfolio, which represent about 20 percent of our total loans. These are high quality loans with minimal loss ratio. We use the program to provide credit to a broader range of borrowers and ensure sound underwriting.

Bank of the West uses the SBA 7(a) program to supplement our lending and credit services. We actively encourage our loan officers to consider whether we can use the program to serve small business credit applicants with flexible terms available under the program who would not otherwise qualify for a conventional loan. To safeguard the program from abuse, the SBA's

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.

“Credit Elsewhere Test” requires us to fully substantiate and document the reasons a given applicant cannot be served with conventional credit.

The 7(a) program allows us to leverage our lending dollars and provide more small business credit. We also highly value the option of selling the guaranteed portion of 7(a) loans into the secondary market, which provides an alternative source of liquidity should we need it.

Historically, Bank of the West’s 7(a) loans have created thousands of jobs in the communities we serve and helped to sustain and strengthen our local economy.

While community banks are not the only lenders that provide small business credit, we are the most steadfast. Community banks provide small business credit in good times as well as challenging times. During the financial crisis of 2008 and 2009, while overall small business lending contracted, 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.² 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.

This is probably one of the reasons that community banks received the highest lender satisfaction scores in the most recent Small Business Credit Survey, a collaboration among seven Federal Reserve Banks, which surveyed almost 3,500 small businesses in 26 states.³ The community bank satisfaction score of 75 percent exceeded the scores of other categories of lenders by a wide margin.

The 7(a) Program Helps Community Banks Reach Additional, Credit-Worthy Borrowers

I would like to provide a couple of examples of 7(a) loans made by Bank of the West that illustrate the value of the program. Some years ago, my hair stylist, Kim, wanted to purchase the salon she worked at in Las Colinas, Texas following the death of the owner. Without the help of a loan to purchase the salon, it likely would have closed and she would have been forced into the job market. Kim was not a good candidate for conventional credit because of the low value of the collateral. However, Bank of the West was able to offer her a 7(a) loan based on historical and projected cash flow, underwriting factors which the SBA program allows. The salon thrived and Kim hired eight additional stylists. Her cash flow was so strong that she made early and additional payments, paying off the loan early.

In another SBA success story, Bank of the West helped a gentleman who ran a pet boarding business near Love Field in Dallas. He had an SBA loan from another bank but his business was in leased space. We made a loan to refinance his original SBA loan and finance the purchase of the building he occupied. Our loan saved him money on rent, improved his cash flow, and allowed him to build more equity in the business. A couple of years later we financed the

² “Community Banking in a Period of Recovery and Change.” Speech by Federal Reserve Chairman Ben S. Bernanke before the ICBA Annual Convention. March 23, 2011.

³ 2015 Small Business Credit Survey: Report of Employer Firms. December 2016.

expansion of his building to add more kennels, which dramatically increased his cash flow and profits.

Success stories like these and numerous others are why I'm passionate about community banking. These loans would not have been possible without the SBA.

Longer Loan Maturities Reduce Borrower Payments and Increase Flexibility

A typical, conventional small business loan has a maturity of one to three years. This maturity is determined by the lenders' need to fund the loan with short-term deposits. However, 7(a) program loans have average maturities of 12 years or more. Importantly, SBA lending allows longer loan terms of up to 25 years. These longer terms lower the entrepreneur's loan payments and free up needed cash flow to hire, invest, and grow the small business. When another recession occurs, the longer loan term offered by an SBA loan will help numerous small businesses weather the crisis.

Bank of the West is an SBA Preferred Lender

Bank of the West has been a preferred SBA lender for 30 years. This program is available to lenders with a proven track record of successful SBA lending whose lending policies and procedures have been thoroughly vetted by the agency. Once approved, a preferred lender can use streamlined procedures for processing SBA loans and make final credit decisions in-house. This is a critical advantage because it allows us to avoid a delay of up to three weeks at the SBA Office of Credit Risk Management. As an SBA preferred lender we can be responsive to our credit applicants and, if they meet or underwriting criteria, get them the funds they need to grow their businesses in a timely fashion. Our preferred lender status is subject to recertification every two years, which gives us a strong incentive to make sound loans and minimize our loss ratio.

Stable Funding is Critical

Stable funding is critical to the success of the 7(a) program and the thousands of borrowers that rely on it. As is well known to this committee, program funding came to abrupt halt in the summer of 2015 when it reached its authorization cap well before the end of the fiscal year.

The 7(a) program is fully funded by user fees. No taxpayer dollars are appropriated. Nevertheless, a program authorization level must be approved by Congress each year, and once that level is reached, no more loans can be approved. In July 2015, Congress was forced to pass an emergency increase to the authorization cap to restart the program so that the program hiatus was short-lived. ICBA greatly appreciates the support and responsiveness of this committee in passing that emergency increase. A longer program shutdown would have cut off the thousands of small businesses that rely on this program for payrolls, investment, and expansion. Small business owners often put their entire net worth at risk to make their businesses succeed. If, at the time they are ready to take on a loan, the SBA reaches their funding cap, it could be devastating for the borrower. Instable program funding also discourages lenders from getting into the SBA market. Lenders need to know they can rely on stable funding.

We must work together to ensure that program funding is never disrupted again. One way we might achieve better funding stability is by creating a two-year funding commitment for the program that would be renewed every year.

Community Banks Need Regulatory and Tax Relief to Sustain and Grow Small Business Credit

I have focused my remarks up to this point on the 7(a) program. Taking a broader perspective, I urge this committee to support regulatory and tax relief that would strengthen community banks and enable more small business lending in SBA programs and in the conventional markets.

ICBA's Plan for Prosperity, which we released in January, is a robust set of legislative recommendations, many of which serve the same goal as the SBA – creating more small business credit that will in turn create economic growth and jobs. A copy of the Plan is attached to this statement. While I won't describe the Plan in detail, I would like to note a couple of recommendations that are directly relevant to community bank small business lending.

Small Business Lending Data Collection

Dodd-Frank Section 1071 requires the CFPB to implement rules for the collection and reporting of data on financial institutions' small business lending under the Equal Credit Opportunity Act. Section 1071 requires the collection and reporting of 12 pieces of data in connection with credit applications made by women- or minority-owned businesses of any size as well as all small businesses regardless of ownership, including the race, sex, and ethnicity of the principal owners of the business. Section 1071 also gives the CFPB discretion to require the reporting of any additional information that would assist the Bureau in fulfilling the purposes of the statute.

If the CFPB proceeds with implementation of this onerous data collection requirement, it will impose significant new burdens on community banks at a time when they are absorbing numerous other regulatory requirements. It will likely require the reporting of information regarding every small business loan application and will fall disproportionately upon smaller banks that lack scale and compliance resources.

Tax Incentives for Targeted Community Bank Lending

Carefully designed tax incentives for community bank lending would lower credit costs for targeted borrowers and help community banks diversify their loan portfolios and comply with the Community Reinvestment Act. ICBA believes tax incentives should support community bank lending to low-to-middle income individuals, small businesses, and small farms.

Preserve Interest Deduction for Business Borrowers

Debt financing plays a critical role in economic growth and job creation. ICBA opposes the removal or limitation of current law interest deduction for business borrowers. Any change to this deduction has the potential to stunt the formation and expansion of small businesses that are vital to the American economy.

Community bank credit is a critical – and frequently the only viable – source of capital for small businesses, which typically have very limited or no access to equity capital, especially in the early stages of their development. Moreover, community bank credit allows small business owners to invest and grow their businesses without diluting their control. Many small businesses are closely held to retain control over strategic decision making and direction. Outside equity capital would change the essential character of these businesses.

Conclusion

Thank you again for convening this hearing and for your ongoing support for an SBA program that will play a critical role in strengthening our economic recovery and creating jobs. Bank of the West and many other community banks are fully committed to the future of the 7(a) program and will continue to dedicate the resources needed to make it work.

I'm happy to answer any questions you may have.

Attachment: ICBA's Plan for Prosperity

Plan for Prosperity: The Community Bank Agenda for Economic Growth

America's community banks stand ready to join with the 115th Congress and the incoming administration in creating a new era of economic growth and prosperity.

Providing nearly half of all small business loans as well as customized mortgage, consumer, and agricultural loans suited to the unique characteristics of their local communities, America's nearly 6,000 community banks serve a vital role in creating and sustaining economic growth in communities of all sizes and in every region of the country.

To reach their full potential as catalysts for entrepreneurship, economic growth, and job creation, community banks need relief from suffocating regulatory mandates. The exponential growth of these mandates affects nearly every aspect of community banking. The very nature of the industry is shifting away from community investment and community building to paperwork, compliance, and examination. The new Congress has a unique opportunity to simplify, streamline and restructure every aspect of the regulatory and tax environment.

ICBA's Plan for Prosperity ("the Plan") is an agenda for regulatory relief that will allow community banks to thrive by doing what they do best — serving and growing their communities one loan at a time. 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 developed with input from community bankers nationwide and crafted to preserve consumer protections and bank safety and soundness. ICBA and community bankers are committed to working with Congress and the administration to enact the provisions of the Plan with the use of every resource at our disposal. If we act boldly and make fundamental reforms, the American economy will grow and prosper for the benefit of generations to come.

Capital: Simplified Rules and New Options for the Creation and Preservation of Community Bank Capital

The Plan for Prosperity would strengthen community bank viability and independence by enhancing access to capital and simplifying capital regulation. New capital options for community banks would fuel economic growth and prosperity for all Americans.

Basel III Amendments: Restoring the Original Intent of the Rule. Basel III was originally intended to apply only to large, internationally active banks. Non-systemically important financial institutions (non-SIFIs) should be fully exempt from the rule.

In lieu of a full Basel III exemption for all community banks (which is ICBA's strong preference) ICBA proposes the following amendments:

- *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 non-SIFIs 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 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 (HVCRE) 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.
- *Reverse punitive capital treatment of mortgage servicing.* 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

More Accurate Identification of "Systemic Risk." The current threshold of \$50 billion for the identification of "systemically important financial institutions" (SIFIs) under Title I of the Dodd-Frank Act is too low and sweeps in too many banks that pose no systemic risk and should not be subject to higher prudential standards. A higher threshold and a more flexible SIFI definition under Title I would more accurately identify those institutions that pose systemic risk.

Additional Capital for Small Bank Holding Companies: Modernizing the Federal Reserve's Policy Statement. The Federal Reserve Board should be required 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, should be revised to increase the qualifying asset threshold from \$1 billion to \$10 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. The following SEC rule changes would allow community banks to commit more resources to their communities without putting investors at risk:

- Provide an exemption from internal control audit requirements for banks with a market capitalization of \$350 million or less. 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. This provision would substantially lower the regulatory burden and expense for small, publicly traded banks without creating more risk for investors.
- 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.

Repeal Collins Amendment for Non-SIFIs. The Collins Amendment to the Dodd-Frank Act (Section 171) was originally intended to equalize large bank and community bank capital treatment. In practice, however, the amendment limits regulators’ discretion in implementing Basel III and has proved to be a stumbling block to simpler capital rules for community banks. ICBA supports full repeal of the Collins Amendment for non-systemically important financial institutions (non-SIFIs).

Address Minority Bank Capital Challenges. ICBA will work with Congress to explore options for addressing capital challenges faced by minority banks. These banks serve a critical role in providing credit, capital and financial services to low-to-moderate income and minority communities in urban, rural and suburban areas that are economically distressed.

Regulatory Relief

Community bank regulation, which has steadily increased for decades, is a cumulative, oppressive burden that limits access to credit in our communities and drives industry consolidation that will directly harm consumers and small businesses. Regulatory relief for community banks will promote greater economic growth in our local communities.

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

- The CFPB should be granted additional statutory authority to exempt or tier regulatory requirements for community banks and/or community bank products and services.
- The governance structure of the CFPB should be changed to a five-member commission rather than a single director. This change would 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.

Eliminate Arbitrary “Disparate Impact” Fair Lending Lawsuits. Amend the Equal Credit Opportunity Act and the Fair Housing Act to bar “disparate impact” causes of action and to require discriminatory intent for fair lending violations. Disparate impact describes differential results that arise despite the use of practices that are facially neutral in their treatment of different groups. Lenders must consider factors such as race and national origin in individual credit decisions to protect themselves from fair lending regulatory enforcement actions and lawsuits. Legislation is needed to require discriminatory intent for a finding of fair lending violations. This would ensure lenders that uniformly apply neutral lending standards are not subject to unnecessary regulatory enforcement actions or frivolous and abusive lawsuits under the Equal Credit Opportunity Act or the Fair Housing Act.

Ensuring the Viability of Mutual Banks: New Charter and Capital Options. A new national charter for mutual banks would allow institutions to choose the charter that best suits their needs and the needs of the communities they serve. Mutual institutions should be authorized to issue mutual capital certificates, an additional option for raising capital. Existing federal savings associations chartered under the Home Owners’ Loan Act should be able to elect to have the rights and privileges of a national bank without changing charters.

Rigorous and Quantitative Justification of New Rules: Cost-Benefit Analysis. The financial regulatory agencies should not be allowed to issue notices of proposed rulemaking unless they first determine that quantified costs are less than benefits. The analysis should 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 should be required to identify and assess available alternatives including modifications to existing regulations. They should also be required to ensure that proposed regulations are consistent with existing regulations, written in plain English, and easy to interpret.

Modernizing the Bank Secrecy Act. ICBA recommends raising the currency transaction report (CTR) threshold from \$10,000 to \$30,000 and indexing future increases on an annual basis for inflation. The current threshold, set in 1970, is significantly dated and captures far more transactions than originally intended. A higher threshold would produce more targeted, useful information for law enforcement. ICBA also supports the creation of a tax credit to offset the cost of BSA compliance. (See “Tax Relief” below.) In addition, beneficial ownership information should be collected and verified at the time a legal entity is formed by either the Internal Revenue Service or other appropriate federal or state agency, rather than by financial institutions. This would provide uniformity and consistency across the United States.

Cutting the Red Tape in Small Business Lending: Eliminate Burdensome Data Collection. ICBA supports full repeal of the statutory authority (Dodd-Frank Section 1071) for new small business loan data collection requirements. This provision, which will likely require the reporting of information regarding every small business loan application, will fall disproportionately upon smaller banks that lack scale and compliance resources.

Risk Targeting the Volcker Rule. Non-systemically important financial institutions (non-SIFIs) should be exempt from the Volcker Rule, which should apply only to the largest, most systemically risky banks. Proposals to apply the rule to non-SIFIs carry unintended consequences that threaten to destabilize segments of the banking industry.

Preserve Access to Investment Advice for Middle Class Savers. ICBA supports full repeal of the Department of Labor’s misguided fiduciary rule, which, if allowed to go into effect, would raise costs, limit choices, and reduce access to sound retirement investment advice for thousands of low and middle income Americans.

Mortgage Reform for Community Banks

Every aspect of mortgage lending is subject to new, complex, and costly regulations that are driving community banks out of this line of business. The Plan for Prosperity would support a robust housing market by providing relief from new 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.

Safe Harbor from Onerous Underwriting. Loans originated and held in portfolio by banks with less than \$50 billion in assets, including balloon mortgages, should be granted “qualified mortgage” (QM) safe harbor status from the underwriting requirements of the ability-to-repay rule. In addition, any loan transferred to Fannie Mae, Freddie Mac, or a Federal Home Loan Bank should be automatically granted QM safe harbor status.

HMDA Relief. A recent Home Mortgage Disclosure Act (HMDA) rule more than doubled the number of data fields lenders must report in connection with every loan application, forcing community banks to overhaul their systems and retrain staff at significant cost. ICBA supports repeal of the Dodd-Frank authority for expanded HMDA reporting. In addition, the loan-volume threshold for HMDA reporting should be increased to 1,000 closed-end mortgages and 2,000 open-end lines of credit. The current reporting threshold exempts a maximum of 34,000 loans, according to a CFPB estimate, a minimal fraction of the nearly 10 million annual mortgage applications reported through HMDA last year. ICBA’s recommended threshold would provide relief for many more small lenders without significantly impacting the mortgage data available to the CFPB or impairing the purpose of the HMDA statute.

Escrow Relief. Banks with assets of less than \$50 billion should be exempt from escrow requirements for loans held in portfolio. Such banks have direct stake in protecting their collateral by ensuring taxes and insurance are paid on a timely basis.

Appraisals. In recent years, appraisal requirements have become more costly, and rural America is experiencing a critical shortage of appraisers. When a mortgage is held in portfolio, a bank should be able to substitute an in-house “property evaluation” for a full residential property appraisal completed by a licensed appraiser.

Preserve Community Bank Mortgage Servicing. Simplified servicing regulation would help preserve the important role of community banks in servicing mortgages and deter further industry consolidation, which is harmful to borrowers. The “small servicer” threshold should be raised from 5,000 loans serviced to the greater of 30,000 loans serviced or \$5 billion in unpaid principal balance on loans serviced. To put this proposed threshold in perspective, the average number of loans serviced by each of the five largest servicers subject to the national mortgage settlement is 6.8 million, and each has an unpaid principal balance of more than \$300 billion.

Reform of Closing Process and Paperwork. The TILA-RESPA Integrated Disclosure (TRID) rule, which governs the residential mortgage closing process and paperwork, is a uniquely complex rule with unclear liabilities. The rule has caused some community banks to cease offering mortgages and has greatly increased compliance expenditures for others. TRID reform should: (i) make waiting periods waivable at the request of the consumer; (ii) limit liability to violations that cause consumers actual, material harm; (iii) permit creditors to cure errors and make consumers whole before allowing the consumer the right to file a lawsuit; and (iv) exempt loans secured by large, mixed-use properties.

Bank Oversight and Examination

A trend toward oppressive, micromanaged regulatory exams is suffocating community banks' ability to serve their customers and communities. The following reforms would allow community banks to lead an economic revival on Main Streets across America.

Strengthening Accountability in Bank Exams: A Workable Appeals Process. An independent body should 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 banks with up to \$5 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.
- Non-systemically important financial institutions (non-SIFIs) 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 and file the current, long-form call report only in the second and fourth quarters. The quarterly call report represents a growing burden on community banks without being an effective supervisory tool.
- The Community Reinvestment Act (CRA) asset thresholds should be modernized. The “small bank” and “intermediate small bank” thresholds determine how a bank is assessed. A separate threshold determines how often a bank is assessed. These thresholds do not reflect consolidation in the community banking industry and should be increased. Community banks prosper by reinvesting local deposits and serving all customers in their communities. Too frequent or intrusive CRA exams are unnecessary and force banks to expend resources that could otherwise be dedicated to serving customers.
- All banks with assets of \$50 billion or less should be exempt from examination and enforcement by the CFPB and instead be examined and supervised by their prudential regulators for compliance with consumer protection regulation. CFPB backup (or “ride along”) authority for compliance exams performed by a bank’s primary regulator should be eliminated.

Community Bank Tax Relief

The 115th Congress presents a unique opportunity to restructure, modernize and simplify our complex and inefficient tax code. Tax reform and community bank tax relief, done properly, have the potential to strengthen our economy and spur job creation for a generation or more.

Lower Marginal Rates Needed for Individuals, Corporations, and Businesses. ICBA strongly supports tax rate relief for American individuals, corporations, and businesses. Significant tax relief will provide a much-needed boost to a sluggish economic recovery and possibly help stave off another recession by spurring consumer purchasing, business investment, and hiring. Rate relief must be a part of any tax reform package.

Incentivizing Credit for Low- and Middle-Income Customers and American Agriculture. ICBA supports the creation of new tax credits or deductions for community bank lending to low- and middle-income individuals, businesses, farmers, and ranchers. Such tax credits or deductions would help to sustain and strengthen lending to low- and moderate-income customers and America's farmers and ranchers, and would help offset the competitive advantage enjoyed by tax-exempt credit unions and Farm Credit System lenders.

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. Congress should: increase the limit on Subchapter S shareholders from 100 to 200; allow Subchapter S corporations to issue preferred shares; and permit the holding of Subchapter S shares, both common and preferred, in individual retirement accounts (IRAs). These changes would improve the ability of the nation's 2,200 Subchapter S banks to raise capital and increase the flow of credit within their communities.

Limited Liability Corporation Option for Community Banks. In addition to modernization of Subchapter S for banks (as described above), ICBA supports the creation of a limited liability company (LLC) option for community banks. The LLC election would allow pass-through tax treatment for community banks without the limitations of Subchapter S organization.

Estate Tax Repeal. ICBA supports full, permanent repeal of the estate tax, which jeopardizes the succession of many family-owned community banks from generation to generation. A family estate should never be forced to sell its interest in a community bank to pay a transfer tax. Forced sales of once-family-owned community banks to other community banks or, frequently, to larger regional or national banks, coupled with a recent surge in regulatory burden, accelerate the current trend toward consolidation in the banking sector.

Update Bank Qualified Bond Issuer Limitation. Since 1986, the tax code has provided a special incentive for banks to purchase bonds issued by municipalities, school districts, sanitation districts, and other public entities, provided the issuer expects to issue no more than \$10 million of bonds annually. These are known as "bank qualified bonds." Because the \$10 million limitation has been severely eroded by inflation, today only a small number of issuers are eligible to take advantage of lower interest rates by issuing bank qualified bonds. The limitation was temporarily increased to \$30 million by the American Recovery and Reinvestment Act of 2009. ICBA supports a permanent increase in the limitation to \$50 million to be indexed prospectively. A higher limitation would allow local bank deposits to support needed, local public infrastructure investments at a lower interest rate, as originally intended by the 1986 Tax Reform Act.

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.

Tax Credit for Bank Secrecy Act Compliance Costs. For community banks, BSA compliance represents a significant expense in terms of both direct and indirect costs. BSA compliance, whatever the benefit to society at large, is a purely governmental, law enforcement function with no direct benefit to the bank or its customers. As such, the costs should be borne by the government. ICBA supports the creation of a tax credit to offset the cost of BSA compliance.

Agriculture & Rural America

A vibrant rural economy is vital to America's prosperity. Community banks, which fund nearly 80 percent of all agricultural loans, serve a critical role in creating and sustaining rural economic prosperity. The following provisions will help rural America thrive by strengthening the community banks that serve agricultural enterprises.

Agricultural Loan Concentration Limits. Regulatory agencies and bank examiners should not treat agency guidance as official agency rule making, particularly with regard to concentration limits that could unnecessarily restrict community bank lending. Many banks in rural areas do not have economic choices beyond agriculture and such guidance, if interpreted as rule making, could dramatically increase their risks as they venture into new lending markets.

Tax Relief for Rural Lending. ICBA supports the creation of tax incentives to support agricultural lending and residential mortgage lending in rural areas. See Community Bank Tax Relief for more information.