INDEPENDENT COMMUNITY BANKERS of AMERICA®

April 8, 2014

Community Bank Regulatory Relief Will Grow Economy and Create Jobs

On behalf of the nearly 7,000 community banks represented by ICBA, thank you for convening today's hearing on "Who's In Your Wallet: Examining How Washington Red Tape Impairs Economic Freedom." Community banks nationwide have identified regulatory burden as a top concern and impediment to their viability and ability to provide credit in their communities. We welcome this opportunity to submit ICBA's statement for the record.

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

ICBA "Plan for Prosperity" Outlines Regulatory Relief Recommendations

In order to reach their full potential as catalysts for entrepreneurship, economic growth, and job creation, community banks must have regulation that is calibrated to their size, lower-risk profile, and traditional business model. A one-size-fits-all regulatory system for the banking sector is tremendously detrimental to community banks and the local economies they serve and support. Working with community bankers from across the nation, ICBA has developed its Plan for Prosperity, a platform of legislative recommendations that will provide reasonable and meaningful relief for community banks and allow them to thrive by doing what they do best – serving and growing their communities. By rebalancing unsustainable regulatory burden, the Plan will ensure that scarce capital and labor resources are used productively, and not sunk into unnecessary compliance costs, thus 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 crafted to preserve and strengthen consumer protections and safety and soundness. The Plan for Prosperity is attached to this testimony.

ICBA is grateful to this committee for advancing many key provisions of the PFP. To date this committee has passed seven bills that contain PFP provisions, be they single provision bills or multiple provision bills. Four of those bills have gone on to pass the full House. We encourage this committee to continue its consideration of community bank regulatory relief legislation, in particular the CLEAR Relief Act (H.R. 1750), introduced by Rep. Blaine Luetkemeyer, himself a former community banker, which contains many of the provisions discussed in this statement.

New Empirical Study Illustrates Regulatory Impact

While we have recommended specific regulatory relief measures in our Plan for Prosperity, the problem is a cumulative one. As regulations have accreted steadily over the past few decades, they are rarely removed or modernized, resulting in a redundant and sometimes conflicting burden.

ICBA is grateful to the Mercatus Center for producing a high quality empirical study on the impact of recent regulations on community banks.[1] The study, which is based on a survey of survey of approximately 200 community banks in 41 states with less than $10 billion in assets, is largely consistent with what we've heard firsthand from community bankers across the country. Broad findings from the study include:

- **Additional costs.** Approximately 90% of respondents reported that compliance costs have increased since Dodd-Frank. 83% reported that they had increased by more than 5%. (Because the survey question does not capture cost changes of magnitude greater than 5%, costs could have increased by a much higher percentage, as anecdotal accounts suggest.)
- **Outside consultants.** More than half of surveyed community banks (51%) anticipate engaging with outside consultants in connection with Dodd-Frank, and an additional 21% are unsure.
- **Additional compliance personnel.** Dodd-Frank has caused respondent banks to hire additional compliance/legal personnel. 27% of respondents plan to hire additional compliance/legal personnel in the next 12 months, and an additional 28% are unsure. The survey also finds that employees not exclusively dedicated to compliance, including CEOs and senior managers, are forced to spend more time on compliance issues.
- **Dodd-Frank is driving consolidation.** 26% of respondents anticipate that their bank will engage in merger activity in the next five years, and another 27% are unsure. 94% of banks anticipate further industry consolidation.

Overall, new rules comprise a significant new burden for community banks and will negatively impact their customers. In addition to providing empirical analysis, the study reports narrative comments provided by survey respondents at their discretion. Here are a few examples:

- "This piece of regulation is written so unclearly with so many trip wires that serve no benefit to customers that we anticipate not offering a mortgage product."
- "We don't have the number of employees or the financial resources to keep up with Dodd-Frank and [its] rules ... Why make it harder for community banks to do business and survive? We fill a niche that larger banks can't and won't."

[1] "How are Small Banks Faring Under Dodd-Frank?" Hester Peirce, Ian Robinson, and Thomas Stratmann. Mercatus Center Working Paper. February 2014.

- "Community banks that know their customers will struggle to be able to continue to lend to good, long-term customers."
- "Many concerned, conscientious community bankers are selling out or just retiring due to the maddening pace of illogical & unnecessary regulation. Not one of the regulations we've seen would have done anything to prevent the 2008 collapse."

These comments, offered anonymously by bankers charged with real world implementation of the new rules, illustrate how increasing regulatory burden is fundamentally changing the nature of the business of community banking.

This statement will include more empirical findings from the Mercatus Center study in the context of specific regulations discussed below, beginning with our recommendations to preserve community bank mortgage lending.

Plan for Prosperity Mortgage Reform for Community Banks

Every aspect of mortgage lending is subject to new, complex, and expensive regulations that will upend the economics of this line of business. These regulations have been enacted in response to the worst abuses of the pre-crisis mortgage market – abuses in which community banks did not engage.
Key provisions of the Plan for Prosperity are designed to keep community banks in the business of mortgage lending. The Plan for Prosperity focuses on those reforms that will have the greatest impact and are ripe for enactment, including:

- "Qualified mortgage" safe harbor status for loans originated and held in portfolio for the life of the loan by banks with less than $10 billion in assets, including balloon mortgages;
- Exempting banks with assets below $10 billion from escrow requirements for loans held in portfolio;
- Increasing the "small servicer" exemption threshold to 20,000 loans (up from 5,000); and
- Reinstating the FIRREA exemption for independent appraisals for portfolio loans of $250,000 or less made by banks with assets below $10 billion.

ICBA appreciates the CFPB's efforts to accommodate community banks in their recent rulemakings. However, we believe that it did not go nearly far enough in providing for needed tiered regulation, as does the Plan for Prosperity, that will preserve the role of community banks in the mortgage marketplace.

Community banks represent approximately 20 percent of the mortgage market, but more importantly, much of this mortgage lending is concentrated in the small towns and rural areas of

our country, which are not effectively served by megabanks. As the FDIC Community Banking Study showed, in one out of every five counties in the United States, the only physical banking offices are those operated by community banks.[2]

Community banks have a starkly different business model than that of larger mortgage lenders, which are driven by volume and margins. Community banks, by contrast, are relationship lenders with deep roots in their communities. Their mortgages are well underwritten because they know their customers, their businesses or employers, and the local economic conditions. The strength of their underwriting is confirmed by Federal Reserve data. In recent years, the delinquency rate of mortgages held by community banks never exceeded 4 percent, compared to 22 percent for fixed rate subprime mortgages and 46 percent for subprime variable rate mortgages. In fact, community bank mortgages have outperformed fixed rate prime loans, thought to be the best performing category of all loans.[3] New mortgage rules for community banks are unwarranted. A host of new, expensive, complex, and unworkable mortgage rules will only drive further industry consolidation until we are left with only a handful of mega-mortgage lenders. That outcome would only decrease competition and increase systemic risk in the mortgage and housing markets.

A chief characteristic of community bank mortgages in small and rural communities is that they are often collateralized by unique properties without adequate comparable sales and don't fit the inflexible requirements of the secondary market. In addition, the borrowers may be farmers or small business owners whose debt-to-income ratios fall outside of secondary market parameters, despite their personal net worth and means to repay the loan. Large lenders shun such loans because they don't fit their automated underwriting models and require first-hand assessment of the property and the borrower. Only community banks are willing to extend credit to such borrowers, often through the use of balloon loans held in portfolio. Because holding a fixed rate 15 year or 30 year mortgage on the books would expose a community bank to unmanageable interest rate risk, these loans are made typically for 3 or 5 years, and repriced and renewed when they come due. Community banks have safely made balloon mortgages for many decades.

In a recent survey of community banks, 50 percent of respondents indicated they hold all of their mortgage loans in portfolio, and 72 percent of respondents hold at least half of their mortgage loans in portfolio.[4] While secondary market sales are a significant line of business for an important segment of the community banking industry, ICBA estimates that community banks under $10 billion in assets may hold as much as $412 billion in balloon payment mortgages for

[2] FDIC Community Banking Study. December 2012.
[3] "Community Banks and Mortgage Lending," Remarks by Federal Reserve Governor Elizabeth Duke. November 9, 2012.
[4] ICBA Mortgage Lending Survey, September 2012.

as many as 5.5 million borrowers.[5] For many community banks, portfolio lending is a function of the types of mortgages they underwrite – mortgages that cannot be securitized.

Another function of community bank customized underwriting is that the loans often meet the regulatory definition of "higher priced mortgage loans" (HPML). Because these loans cannot be securitized they must be funded through retail deposits which include higher cost certificates of deposits, and this results in a higher interest rate. The regulatory definition of HPML is heavily weighted toward the pricing that Fannie Mae and Freddie Mac set based on their ability to access capital and funding markets that are not available to community banks. In addition, in today's historically-low interest rate environment, it is more likely that a reasonably-priced loan will meet the Federal Reserve's definition of "higher priced." Almost half of survey respondents (44 percent) said that more than 70 percent of their loans fell within this definition of "higher priced."

This lending model – customized balloon loans held in portfolio and, due to a higher cost of funds, priced higher than securitized loans – has worked well for decades and is a proven private market solution that serves certain borrowers and communities that cannot access the secondary market. If this lending model is made infeasible by new regulation, rural borrowers will have no place to turn and will be deprived of credit. The communities they live in will stagnate.

This community bank model of providing mortgages and making home ownership possible to those who, in many cases, would have no other option is under direct threat because the loans share superficial characteristics with subprime loans such as balloon terms and relatively high rates – loan terms that have been targeted by new mortgage regulation. The new ability-to-repay regulations will expose lenders to litigation risk unless their loans meet the definition of "qualified mortgage."

Similarly, "higher priced" loans – even when that pricing is aligned with the lender's cost of funds, risk, and other factors – are excluded from the conclusive presumption of compliance (or "safe harbor") protections under "qualified mortgage" and instead carry only a "rebuttable presumption of compliance," a much weaker protection which exposes the lender to unacceptable litigation risk for the life of the loan. HPMLs are also subject to escrow requirements, which many community banks cannot comply with. We appreciate that the CFPB adopted a higher price trigger for the safe harbor for community bank loans – 3.5 percent above average prime rate offer (APOR) – though we remain concerned that even this higher trigger does not fully capture a community bank's cost of funds.

[5] This estimate is based on recent call report data which shows that community banks under $10 billion in assets hold a total of $550 billion in residential 1-4 family mortgages. Assuming that balloon payment mortgages account for 75% of community bank mortgages assets, which is consistent with survey results, the result is $412 billion in balloon payment mortgages. Assuming an average loan balance of $75,000, the result is 5.5 million borrowers.

The QM rule poses a daunting challenge, is changing the way that community banks lend, and reducing access to credit in our communities. According to the Mercatus Center study, 56% of respondents reported that the QM rule will have a significant negative impact on mortgage lending. An additional 29% report that these factors will have a slight negative impact.

CFPB "small creditor" accommodations do not go far enough

The final QM rule makes accommodations for "small creditors," defined as banks that originate fewer than 500 mortgage loans annually and have less than $2 billion in assets. Loans originated and held in portfolio by small creditors receive QM status -- provided they meet a number of limiting conditions and subject to a prescriptive compliance analysis. However, the small creditor accommodations do not go far enough. For example, for a balloon loan to qualify for a small creditor QM, the bank must have made at least 50 percent of its first lien mortgages in rural or underserved counties under unreasonably narrow definitions of "rural" and "underserved." According to an anonymous community banker quoted in the Mercatus Center study: "I am located in a county listed as an MSA, and while I watch a corn field and grain bins from my window, I can't be considered a rural bank. It makes no sense." Though the CFPB has suspended application of the rural definition for small creditors until 2016, this deferral does not provide community bankers with the certainty required for long-term business planning. In addition to balloon loans, small dollar loans, which are common in many parts of the country for purchase or refinance, face an unreasonably low ceiling on closing fees in order to qualify under the current QM rule.[6]

Finally, the QM rule requires a very prescriptive and fully documented analysis of the borrower's income and debt, which is particularly difficult for first time homebuyers. All of the above hurdles apply even under the broader terms available to "small creditors." Community banks need a solution that will provide for more clarity and simplicity in QM designations without tortuous analysis.

In addition, many banks that fail either the loan volume or the asset test or both of the small creditor definition are in fact community banks with all the characteristic features including local deposit funding, narrow footprint, personalized service, and specialization in traditional products and services. What's more, the loan volume test is not consistent with the asset test. A $400 million ICBA member bank, well below the "small creditor" threshold, has an annual loan volume which, while variable from year to year depending on demand, is uncomfortably close to the 500 loan threshold. Under the current rule, this community bank has no incentive to increase its loan volume and thereby lose its small

[6] The fee cap is applied on a sliding scale. A loan between $60,000 and $100,000, for example, would face a $3,000 cap, which is not feasible for a community bank.

creditor status. While we don't have data comparing loan volume to asset size, we do not believe this bank is atypical.

Plan for Prosperity Solution: "Qualified Mortgage" Status for Community Bank Portfolio Loans

The Plan for Prosperity solution to this new regulatory threat is reasonable, simple, straightforward and will preserve the community bank lending model described above – safe harbor "qualified mortgage" status for community bank loans held in portfolio, including balloon loans in rural and non-rural areas and without regard to their pricing. When a community bank holds a loan in portfolio it holds 100 percent of the credit risk and has every incentive to ensure it understands the borrower's financial condition and to work with the borrower to structure the loan properly and make sure it is affordable. Withholding safe harbor status for loans held in portfolio, and exposing the lender to litigation risk, will not make the loans safer, nor will it make underwriting more conservative, it will merely deter community banks from making such loans in the many counties that do not meet the definition of rural and where a bank's cost of funds results in "higher priced mortgages." Many community banks will be forced to make a risk-reward calculation to determine whether they will continue providing mortgage financing in their communities.

Plan for Prosperity Solution: Escrow Requirement Exemption for Community Bank Portfolio Loans

Escrow requirements for property taxes and insurance are an additional deterrent to community bank mortgage lending. Loans held in portfolio by community banks should be exempt from such requirements. When loans are held in portfolio, lenders have every incentive to protect their collateral by ensuring that tax and insurance payments are current. The escrow requirement for higher priced loans is unnecessary, impractical, and a significant expense for a community bank. A large majority of community banks do not currently escrow because of the cost and requiring them to do so will only deter them from making higher cost loans. In a September 2012 ICBA survey of more than 430 community banks, 55 percent of the bankers stated they decreased their mortgage business or completely stopped providing higher-priced mortgage loans due to the expense of complying with escrow requirements for higher priced mortgages that took effect in 2010. Many community banks do not have the resources to do it in house. Outsourcing escrow services may not be an affordable option either. For third party servicers it is simply not economical to offer escrow-only services, not packaged with other services, to low volume lenders. The Plan for Prosperity calls for an exemption from escrow requirements for community bank loans held in portfolio.

Introduced Legislation

ICBA is very pleased that portfolio loan relief has been included in four bills introduced in the House.

- The Protecting American Taxpayers and Homeowners Act (H.R. 2767), introduced by Chairman Jeb Hensarling and Representative Scott Garrett, would provide QM status to any mortgage originated and held in portfolio; among other mortgage reform provisions.
- The CLEAR Relief Act (H.R. 1750), noted above, would grant QM status to mortgages originated and held in portfolio for at least three years by a lender with less than $10 billion in assets; among other mortgage reform provisions.
- The JOBS Act (H.R. 4304), introduced by Rep. Steve Scalise (R-LA), incorporates the CLEAR Relief Act in full; among other provisions.
- The Portfolio Lending and Mortgage Access Act of 2013 (H.R. 2673), sponsored by Rep. Andy Barr (R-KY), would grant QM status to any residential mortgage loan held in the originator's portfolio.

Plan for Prosperity Solution: Small Servicer Exemption

The relationship lending model, so important to community banks, extends beyond underwriting to servicing. Community banks frequently service the loans they originate, whether they are held in portfolio or sold into the secondary market. For community banks that sell their loans, retention of servicing is important to maintaining long-term relationships with customers and the opportunity to meet their future banking needs.

The community bank practices that strengthen underwriting and result in better loan performance also produce stronger servicing. Bankers that know their customers and the economic trends in their communities can better anticipate borrowers' potential difficulties and intervene early and effectively. As is true with underwriting, the data clearly show that community bank serviced mortgages perform better. Public policy should keep community banks in the business of servicing mortgages and deter further consolidation among servicers.

In this regard, community banks are deeply concerned about the impact of servicing standards that are overly prescriptive with regard to the method and frequency of delinquent borrower contacts, reducing community banks' flexibility to use methods that have proved successful in holding down delinquency rates. Examples of difficult and unnecessary requirements include new monthly statements; additional notices regarding interest rate adjustments on ARM loans; rigid timelines for making contacts that leave no discretion to the servicer; and restrictions on

forced placed insurance. Community banks' small size and local presence in the communities they serve make many of these requirements unnecessary.

The CFPB's recent servicing rule provides a small servicer exemption for banks that service fewer than 5,000 loans. We appreciate recognition that the rule is not appropriate for smaller servicers but believe that the CFPB set the threshold too low. Many community banks service larger portfolios that should qualify for an exemption because they use the community bank servicing practices and obtain the strong performance results. For example, a West Virginia community banker is not exempt because he services 6600 accounts, yet has a very low delinquency rate, less than 4 percent. This banker estimates the monthly statement requirement alone will cost him about $181,500 annually. He will also have to hire an additional collector, even with his low delinquency rate, to comply with the new early intervention requirements. ICBA's Plan for Prosperity calls for raising the small servicer exemption threshold to 20,000 loans. 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.[7] An exemption threshold of 20,000 would more clearly demarcate small servicers from both large and mid-sized servicers. It would help preserve the important role of community banks in servicing mortgages and deter further industry consolidation which is harmful to borrowers.

Introduced Legislation

ICBA is very pleased that the CLEAR Relief Act (H.R. 1750), which is noted above, as well as the JOBS Act (H.R. 4304), raise the small servicer threshold to 20,000 loans. The CFPB has authority to raise this threshold without legislation and should do so.

Plan for Prosperity Solution: Appraisal Exemption for Community Bank Portfolio Mortgages

Appraisal standards have changed significantly over the past few years. First as a result of the Home Valuation Code of Conduct from Fannie Mae and Freddie Mac, and more recently as a result of the Dodd-Frank Act. These standards are well intentioned, having been designed to prevent abuses by unregulated mortgage brokers that contributed to the collapse of the housing market. However, they have made it nearly impossible for many banks to use local appraisers. The only practical option for a community bank mortgage lender is to use an appraisal management company, which significantly increases appraisal costs for borrowers. ICBA's Plan for Prosperity calls for reinstating the FIRREA exemption for independent appraisals for portfolio loans of $250,000 or less made by banks with assets below $10 billion.

[7] Source: Office of Mortgage Settlement Oversight (www.mortgageoversight.com).

Introduced Legislation

The CLEAR Relief Act (H.R. 1750), which is noted above, as well as the JOBS Act (H.R. 4304), provide an exemption from the independent appraisal requirement for mortgages of less than $250,000.

Plan for Prosperity Solution: Relief from Accounting and Auditing Expenses for Publicly Traded Community Banks and Thrifts

Another provision of the Plan for Prosperity would increase the current exemption from the internal control attestation requirements of Section 404(b) of the Sarbanes-Oxley Act. Because community bank internal control systems are monitored continually by bank examiners, they should not have to sustain the unnecessary annual expense of paying an outside audit firm for attestation work. This provision will substantially lower the regulatory burden and expense for small, publicly traded community banks without creating more risk for investors.
Separately, due to an inadvertent oversight in the recently-passed JOBS Act, thrift holding companies cannot take advantage of the increased shareholder threshold by which a bank or bank holding company may deregister as an SEC reporting company under Section 12 of the Securities Exchange Act of 1934.

Introduced Legislation

The CLEAR Relief Act (H.R. 1750) and the JOBS Act (H.R. 4304) exempt community banks with assets of less than $10 billion from the Sarbanes-Oxley 404(b) internal-controls assessment mandates. The exemption threshold would be adjusted annually to account for any growth in banking assets.

The Holding Company Registration Threshold Equalization Act (H.R. 801), introduced by Reps. Steve Womack and Jim Himes, which will correct the oversight in the JOBS Act and allow thrift holding companies to use the new 1200 shareholder deregistration threshold. ICBA is grateful to this committee and the House for passing H.R. 801.

Plan for Prosperity Solution: New Charter Option for Mutual Banks

Mutual community banks are among the safest and soundest financial institutions. They remained strong during the financial crisis and continued to provide financial services to their customers. The Plan for Prosperity calls for the creation of a new OCC charter for mutual national banks. This option would provide flexibility for institutions to choose the charter that best suits their needs and the communities they serve.

Introduced Legislation

The Mutual Community Bank Competitive Equality Act (H.R. 1603), introduced by Reps. Michael Grimm (R-NY), Gregory Meeks (D-NY), and Peter King (R-NY), allows the OCC to charter mutual national banks. The Mutual Bank Choice and Continuity Act (H.R. 4252), introduced by Rep. Keith Rothfus (R-PA), also provides a national charter option.

Plan for Prosperity Solution: Cost-Benefit Analysis for New Rules

The Plan for Prosperity calls for legislation to prevent the financial regulatory agencies from issuing notices of proposed rulemaking unless they first determine that quantified costs are less than quantified benefits. The analysis must take into account the impact on the smallest banks which are disproportionately burdened by regulation because they lack the scale and the resources to absorb the associated compliance costs. In addition, the agencies would be required to identify and assess available alternatives including modifications to existing regulations. They would also be required to ensure that proposed regulations are consistent with existing regulations, written in plain English, and easy to interpret.

Introduced Legislation

The SEC Regulatory Accountability Act (H.R. 1062), introduced by Rep. Scott Garrett (R-NJ), which would require the Chief Economist of the SEC to determine that the benefits of any proposed regulation justify the costs before adopting such regulation. ICBA thanks this committee and the House for passing H.R. 1062.

The CLEAR Relief Act (H.R. 1750) and the JOBS Act (H.R. 4304) would require the SEC to conduct a cost-benefit analysis of new or amended accounting principles.

Plan for Prosperity Solution: Consumer Financial Protection Bureau Reform

The CFPB is a source of concern to community bankers. According to the Mercatus Center study, 70% of respondents reported that their banks' business activities have been affected by CFPB initiatives. 37% percent of respondents reported hiring additional legal or compliance personnel specifically in response to these initiatives. Finally, 78% of respondents anticipate that their customers will be affected by CFPB initiatives.

The Plan for Prosperity calls for legislation that would help insulate community banks from unnecessary CFPB regulatory burden. Specifically, the Plan would strengthen the accountability

of the CFPB by (i) reforming the structure of the CFPB so that it is governed by a five member commission rather than a single director; (ii) strengthening prudential regulatory review of CFPB rules by reforming the voting requirement for an FSOC veto from a two-thirds vote to a simple majority, excluding the CFPB Director; and (iii) 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" – a much more realistic standard than under current law. Combined, these changes would better protect community banks and the safety and soundness of the financial system.

Introduced Legislation

The provisions noted above are contained in the Consumer Financial Protection Safety and Soundness Improvement Act (H.R. 3193), sponsored by Rep. Sean Duffy (R-WI). We thank this committee and the House for passing this legislation.

Plan for Prosperity Solution: Modernize the Federal Reserve's Small Bank Holding Company Policy Statement

Bank regulators and the new Basel III standards continue to force many banks to bolster their capital levels. Closely held and non-publically traded community banks have extremely limited means to raise additional capital. However, there are reasonable ways to help address this challenge. The Plan for Prosperity calls for 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 holding companies to raise additional Tier 1 capital by issuing debt, would be revised to apply to both bank and thrift holding companies and to update the qualifying asset threshold from $500 million to $5 billion. Qualifying bank and thrift holding companies must not have significant outstanding debt or be engaged in nonbanking activities that involve significant leverage. This will help ease capital requirements for small bank and thrift holding companies.

Introduced Legislation

H.R. 3329, sponsored by Rep. Luetkemeyer (R-MO), would require the Federal Reserve to revise the Small Bank Holding Company Policy Statement by increasing the qualifying asset threshold from $500 million to $1 billion. We thank this committee for passing H.R. 3329 and urge prompt passage by the full House.

The CLEAR Relief Act (H.R. 1750) and the JOBS Act (H.R. 4304) would raise the asset threshold $5 billion.

FDIC Policy Should Encourage De Novo Community Bank Formation

As the number of community banks dwindles and more communities lose their local bank, ICBA is concerned that the FDIC has approved deposit insurance for only one de novo bank since 2010. This is a dramatic shift from many years of de novo bank formation averaging over 170 per year. The recent economic downturn and challenges specific to community banking, including narrowing margins, asset quality issues, and substantial compliance costs, have all been factors deterring the formation of de novo banks. However, ICBA believes that the FDIC's policy on de novo banks, which was adopted in 2009, has been too restrictive. The FDIC's one-size-fits-all policy effectively prohibits qualified individuals and communities across the United States from establishing de novo institutions.

The FDIC standard policy requires de novo applicants for deposit insurance to raise capital prior to opening that would be sufficient to maintain its leverage ratio at a minimum of 8% for the first three years of operation based on the pro forma financials and the business plan of the applicant. In addition, the institution is expected to present a business plan in its third year showing how it would maintain capital for years 4 through 7 of its operation.

ICBA supports a more flexible and tailored supervisory policy with regard to de novo banking applicants. Capital standards, exam schedules, and other supervisory requirements should be based on the pro forma risk profile and business plan of the applicant and not on a standard policy that applies to all de novo bank applicants.

Closing

Left unaddressed, the increasing burden of regulation will discourage the chartering of new community banks and lead to further industry consolidation. Consolidation will lead to higher loan interest rates and fees for borrowers, lower rates paid on deposits, and fewer product choices – especially in the rural areas and small towns currently served by community banks. A more concentrated industry, dominated by a small number of too-big-to-fail banks, will jeopardize the safety and soundness of the financial system and expose taxpayers to the risk of additional costly bailouts. That's why it's so important to enact sensible regulatory reforms. We hope that ICBA's Plan for Prosperity will continue to serve as a guide to this committee. Thank you again for the opportunity to provide this written statement for the record. We look forward to continuing to work with this committee to craft urgently needed legislative solutions. We also thank you for emphasizing our concerns with the regulatory agencies.

Attachments

- **ICBA Plan for Prosperity**

Plan for Prosperity

A Regulatory Relief Agenda to Empower Local Communities

2013

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

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

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

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

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

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

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

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

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

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

1615 L Street NW, Suite 900, Washington, DC 20036 ▪ 202-659-8111 ▪ Fax 202-659-9216 ▪ www.icba.org

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

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

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

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

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

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

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