Testimony of

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On behalf of the

Independent Community Bankers of America

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"How Regulations Stifle Small Business Growth"

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Chairman Kim, Ranking Member Hern, and members of the subcommittee, my name is Christopher Jordan, and I am President and CEO of the Farmers State Bank, a $114 million asset community bank headquartered in Stigler, Oklahoma.

I testify today on behalf of the community banks represented by the Independent Community Bankers of America, with more than 52,000 locations nationwide. I am a former member of the Executive Committee of ICBA and remain active in the leadership of the association. Thank you for convening this hearing on "How Regulations Stifle Small Business Growth." With 40 employees, Farmers State Bank is a small business that, by creating access to credit, helps other small businesses to thrive. Regulatory burden on Farmers State Bank and other community banks harms us as well as the other small businesses we serve. The success of small businesses, including farms, in Oklahoma and across the country is vital to the prosperity of rural, urban, and suburban America. A favorable regulatory environment is a critical ingredient to this success.

Farmers State Bank was founded in 1908 and has been in my family since 1969. I am a third-generation community banker. Today, Farmers State Bank serves four rural communities in southeastern Oklahoma: Stigler, Quinton, Red Oak, and Eufaula. Our business model is fairly typical of a rural community bank, with a mix of small business, agricultural, and residential mortgage lending. We maintain a diverse portfolio because specializing in any one of these areas would be too risky. Like other community banks, we have thrived across generations by maintaining a simple capital structure, conservative lending practices, and being dedicated to the success of our communities.

Community Banks and Small Business Lending

Community banks are prodigious small business lenders. Though we hold 16 percent of U.S. banking industry assets, we hold a disproportionate market share of small business loans – 47 percent – supporting a sector responsible for more job creation than any other. We provide small business credit in good times as well as challenging times. Federal Reserve data shows that while overall small business lending contracted during the recession of 2008 and 2009, lending by a majority of small community banks (those of less than $250 million in assets) actually increased, and small business lending by banks with asset sizes between $250 million and $1 billion declined only slightly. By contrast, small business lending by the largest banks dropped off sharply. The viability of community banks is linked to the success of our small business customers in the communities we serve, and we don't walk away from them when the economy tightens.

The type of small business lending community banks do simply cannot be duplicated by a bank based outside the community. As noted in a comprehensive study by scholars at the Harvard Kennedy School, "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]

Regulatory Overkill Poses a Grave Threat to the Community Bank-Small Business Partnership

The exponential growth of regulation in recent years is suffocating community banks' ability to serve their small business customers. Compliance has become a major distraction for community bank managers. In recent years, my job as a community banker has fundamentally shifted from lending

[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.

and serving customers to struggling to stay on top of ever-changing rules and guidance. This experience is typical of community bankers I talk to across the country. Every aspect of community banking is subject to new regulation.

Banks need more scale to accommodate the increasing expense of compliance which includes hiring, training, software, and other costs. I believe this increase in regulatory burden has contributed significantly to the decrease of 2,332 community banks in the U.S. since 2010. The number of banks with assets below $100 million shrunk by 52 percent, while the number of banks with assets between $100 million and $1 billion fell by 24 percent. A financial landscape with fewer, larger banks will reduce access to credit for small businesses.

ICBA's legislative and regulatory recommendations are contained in Community Focus 2020: The Community Bank Agenda for Expanding Economic Opportunity. A copy of Community Focus 2020 is attached to this statement.

In this statement, I will focus on four areas of Community Focus 2020 regulatory relief which I believe would provide the greatest impact in strengthening community banks so that they may better serve small businesses: Frist, modernization of the Bank Secrecy Act, including reporting of beneficial ownership information; second, eliminating small business data collection; third, reforming Securities and Exchange Commission (SEC) regulation that creates barriers to capital raising for community banks; and forth, a safe harbor for legal cannabis banking, which will protect even banks like mine that do not serve the cannabis industry. Regulatory reform in each of these areas would reduce the cost of regulatory compliance and allow community banks to redirect scarce financial and management resources to better serve our customers and communities.

Bank Secrecy Act Modernization

Community bankers are committed to supporting balanced, effective measures that will prevent terrorists from using the financial system to fund their operations and prevent money launderers from hiding the proceeds of criminal activities. However, Bank Secrecy Act/Anti-Money Laundering compliance has increasingly burdened community banks with identifying, investigating, policing, and reporting potential criminal activity.

However, because BSA/AML requirements become outdated, community banks increasingly doubt their effectiveness in combating financial crime. ICBA supports BSA/AML reforms that will ease compliance while providing more useful data to law enforcement.

Each year, Farmers State Bank must invest more time, money, and resources in BSA/AML compliance. My bank files an unusually large number of currency transaction reports (CTRs), which is perhaps true of other rural banks as well, though I have not seen data to confirm it.

Reporting thresholds are significantly outdated and capture far more transactions than originally intended. The currency transaction report (CTR) threshold was set in 1970 at $10,000 and has not be adjusted for inflation. A higher threshold would produce more targeted, useful information for law enforcement.

Suspicious activity reporting is the cornerstone of the BSA system and is a way for banks to provide leads to law enforcement. Unfortunately, in the current regulatory environment, community bankers have a strong incentive to protect themselves from examiner criticism and liability by over-filing of

Suspicious Activity Reports (SARs) as a defensive practice, which dilutes their value to law enforcement. Regardless of the degree of offense, community banks are required to follow the same SAR procedure for every suspicious transaction alert. This mechanical approach makes community bankers doubtful that SARs have real value for law enforcement.

Reforming the SAR process to a truly risk-based system with appropriate threshold increases would enable community banks to provide more targeted and valuable leads to law enforcement. Similar to the CTR thresholds, the SAR filing thresholds have not been adjusted since becoming effective in 1992.

ICBA calls for a CTR threshold of $30,000, significantly less than the threshold would be if it had kept pace with inflation, and a suspicious activity report (SAR) threshold of $10,000.

ICBA supports the Coordinating Oversight, Upgrading and Innovating Technology, and Examiner Reform Act (H.R. 2514), sponsored by Representative Emanuel Cleaver. H.R. 2514 recognizes the outdated currency transaction report (CTR) thresholds and would begin to address the filing of CTRs by indexing this threshold to inflation with adjustments made in five-year increments.

While indexing this threshold to inflation is a welcome first step, ICBA believes immediate and more robust relief is needed. CTR filings are a primary source of community bank compliance burden and expense, diverting resources that could be better directed toward community lending. For this reason, we strongly support the Financial Reporting Modernization Act (H.R. 388), introduced by Representative Barry Loudermilk, which would raise the CTR and SAR thresholds to $30,000 and $10,000.

Customer Due Diligence Rule

On May 11, 2018, FinCEN's Customer Due Diligence Rule became effective. The purpose of the rule, which requires banks to collect information on the beneficial owners of legal entities that open accounts, is to create more transparency and thereby deter the abuse of anonymous legal entities for money laundering, corruption, fraud, terrorist financing and sanctions evasion.

We agree that such transparency is important. We strongly disagree that bank collection of beneficial ownership information is an effective means of creating this transparency. For banks, collection of beneficial ownership information for all legal entity customers is difficult to implement and an onerous and inefficient task for both the customer and the employee. Front-line bank staff is required to conduct several additional intermediate steps during the account-opening process to ensure they have a reasonable belief of the true identity of each beneficial owner. While the ownership interest and management responsibility of a business may be straightforward in certain cases and specified in a legal organizational document in other cases, certain legal structures make determining ownership equity extremely difficult, at best. Obtaining this information and assessing the risk requires a sophisticated understanding of various legal structures and ownership interests that is well beyond the training of a typical community bank loan officer.

For this reason, we support the Corporate Transparency Act (H.R. 2513), sponsored by Representative Carolyn Maloney, which would require corporations and limited liability companies to disclose their beneficial owners to the Financial Crimes Enforcement Network (FinCEN) at the time the company is formed. FinCEN collection of beneficial owner information, as opposed to its collection by banks, would provide uniformity and consistency across the United States. Making the

formation of an entity contingent on receiving beneficial owner information more directly would create a strong incentive for equity owners and investors to provide such information.

Furthermore, information regarding beneficial owners could be more easily shared between law enforcement and government agencies than between banks and law enforcement. Privacy laws do not permit banks to share personal information with a government agency absent a subpoena or similar directive. Information should be collected by the party that can make the most effective use of it to deter the criminal use of legal entities. This is the government.

H.R. 2513 passed the House Financial Services Committee on June 11 on a strong bipartisan vote. I encourage the members of this committee to support the bill when it comes to the House floor.

Cutting the Red Tape in Small Business Lending: Eliminate Data Collection

Community banks are strongly concerned by a forthcoming rule that should be of particular interest to this committee because it is directly related to small business lending. Under a Section 1071 of the Dodd Frank Act, which has yet to be implemented, whenever a business seeks credit at a financial institution, the institution must inquire whether the business is women-owned, minority-owned, or a small business. The financial institution must maintain a record of the response to the inquiry together with additional information such as the census tract of the business and its gross annual revenues, whether or not a loan is subsequently approved. These records must be compiled and submitted annually to the CFPB, which will make the data available to any member of the public upon request. In addition, the records must be kept separate from the credit application and accompanying information and shielded from access by the underwriters or anyone involved in making credit determinations. In other words, the requirement creates a separate bureaucracy within the financial institution that cannot be integrated with lending operations.

I appreciate and sympathize with the motivation behind the new requirement. Lending discrimination, which is illegal under fair lending laws, must not be tolerated. But this new data collection requirement is especially inefficient and may not be feasible in certain cases such as in organizations that are too small to accommodate fire wall structures. Community banks will be disproportionately burdened by this requirement because they concentrate more on small business lending than other financial institutions. Further, data collected by community banks and subsequently made public by the CFPB could compromise the privacy of applicants in small communities where an applicant's identity may be easily deduced, despite the suppression of personally identifying information. For these reasons, ICBA believes community banks should be excluded from new small business data collection requirements.

Regulatory Barriers to Capital Access

Finally, ICBA supports regulatory relief measures that would improve capital access for community banks so that they have more capital to deploy in community lending. In particular, SEC regulations deter community banks from raising capital by going public or remaining public. ICBA supports relief for community banks under $5 billion in asset size from the internal control attestation requirements of Section 404(b) of the Sarbanes-Oxley Act. Under current law, only companies with market capitalization of less than $75 million are exempt from Section 404(b).

In addition, ICBA support relief for community banks with assets of less than $5 billion from a requirement under the FDIC Improvement Act (FDICIA) that they submit an annual report containing management assessment of the bank's internal controls, an external auditor's attestation, and audited financial statements, among other items. Under current law, institutions with assets of less than $1 billion are exempt from the FDICIA requirement.

For community banks, the external audit requirement is redundant because their internal control systems are monitored continually by bank examiners. This threshold increase would account for recent industry consolidation which has resulted in fewer, larger banks. Almost 90 percent of banking assets would remain subject to the FDICIA reporting requirements. When FDICIA was first adopted in 1993, only 75 percent of banking assets were subject to its reporting requirements.

With regard to banks such as mine that remain privately held, ICBA recommends reforming SEC Regulation D, which governs private sales of unregistered securities, to broaden the definition of "accredited investors" who may purchase such securities to include the value of investors' primary residence in determining whether they meet the $1 million net worth threshold. Current Regulation D requires exclusion of the value of an investor's primary residence. The accredited investor net worth definition has not kept pace with inflation. In addition, we recommend that up to 70 non-accredited investors be permitted to purchase the unregistered securities of a private company. Current law limits the number of non-accredited investors to 35. Transactions under Regulation D would remain subject to antifraud, civil liability, or other provisions of the federal securities laws.

Safe Harbor for Legal Cannabis Banking

ICBA and I support the Secure and Fair Enforcement Banking Act of 2019 (SAFE Banking Act, H.R. 1595), bipartisan legislation introduced by Representatives Ed Perlmutter, Denny Heck, Steve Stivers, and Warren Davidson to create a safe harbor from federal sanctions for financial institutions that serve cannabis-related businesses (CRBs) in states and other jurisdictions where cannabis is legal.

While cannabis remains illegal at the federal level, an increased number of states have legalized it for medical and/or recreational use. As you know, Oklahoma has legalized cannabis for medical use. To date, Farmers State Bank does not have any relationships with CRBs nor do we have plans to initiate any. However, as these businesses continue to mature they require access to the traditional banking system, the conflict between state and federal law has created increasingly significant legal and compliance concerns for banks that wish to provide banking services to CRBs in jurisdictions where it is currently legal. Legal and regulatory uncertainty has curtailed access to the traditional banking system for CRBs and forced them to operate mostly in cash. Cash-only businesses, especially those with a high volume of revenue, pose a significant risk to public safety.

ICBA does not advocate for legalization of cannabis at the federal level or otherwise, but we do support the creation of an effective safe harbor from federal sanctions for banks that choose to serve CRBs in states and jurisdictions where these businesses are legal. The SAFE Banking Act would create such a safe harbor by providing that in jurisdictions where cannabis is legal federal banking regulators may not threaten or limit a bank's deposit insurance, downgrade a loan, prohibit or discourage the provision of banking services, or take any other prejudicial action solely because a bank customer is a CRB.

Importantly, this safe harbor would extend to banks that serve the many ancillary businesses that serve CRBs such as landlords, accountants, utilities providers, and others that may be paid in funds ultimately derived from cannabis sales. These ancillary businesses may be difficult to identify in states that have legalized cannabis, and potentially create a legal and regulatory trap for even those banks that choose not to serve CRBs directly.

H.R. 1595 passed the House Financial Services Committee on March 28 on a strong bipartisan vote. I encourage the members of this subcommittee to support this important bill when it is considered on the House floor.

Closing

Thank you again for the opportunity to testify today. ICBA hopes this testimony, while not exhaustive, gives this subcommittee a sense of the sharply increasing resource demands placed on community banks by regulation and the destructive impact they have on small business lending. ICBA hopes to work with this subcommittee to craft urgently needed legislative solutions.

ATTACHMENTS

- **ICBA's Community Focus 2020**