



Testimony of

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On behalf of the
Independent Community Bankers of America

Before the

United States Senate
Committee on Banking, Housing, and Urban Affairs

Hearing on

**“Regulatory Relief for Community Banks
and Credit Unions”**

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Washington, D.C.

Chairman Shelby, Ranking Member Brown, and members of the Committee, my name is John H. Buhrmaster, and I am President and CEO of First National Bank of Scotia, a \$425 million asset bank in Scotia, New York. I am also Chairman of the Independent Community Bankers of America and testify today on behalf of more than 6,500 community banks nationwide. Thank you for convening today's hearing on "Regulatory Relief for Community Banks and Credit Unions."

The 114th Congress provides a unique opportunity to provide meaningful regulatory relief for community banks. What's at stake is the future of the American banking industry. Do we want a system with fewer, larger megabanks, more systemic risk, less consumer choice, and commodified product offerings? Should large swathes of rural and small town America be deprived of access to essential banking services to support their prosperity? Small town America is built on community bank credit. The rich tradition of community banking – built on personal relationships, customized offerings, and local decision making – is at risk today because of regulatory overkill grossly out of proportion to any systemic or consumer risk posed by community banks.

A community bank is not simply a megabank on a smaller scale. A community bank is distinct from a megabank in its simplified business model, traditional products and services, and community-orientated character. The fundamental financial policy error of recent years has been applying monolithic regulatory mandates to community banks without recognition of these critical differences. Meaningful regulatory relief is critical to sustaining community bank prosperity and independence which supports the economic vitality of the thousands of communities served primarily by community banks. Such relief is needed in the short term, not medium term or the long term. I urge this committee not to let this opportunity slip.

ICBA's regulatory relief agenda is embodied in our newly released "Plan for Prosperity for the 114th Congress," which I will describe in this testimony. But at the outset, I would like to thank the members of this committee for their efforts and leadership in the adoption of H.R. 3329 at the end of the 113th Congress, which raised the qualifying asset threshold under the Federal Reserve's Small Bank Holding Company Policy Statement from \$500 million to \$1 billion. This law will provide significant relief for nearly 650 bank holding companies. I asked for this, on behalf of community bankers, in my testimony before this Committee last September, and you delivered. Already in the 114th Congress, you passed an amendment to the Terrorism Risk Insurance Act to ensure community bank representation on the Federal Reserve Board of Governors. That too is now law. On behalf of my bank and all community banks, thank you. You've earned our gratitude.

In addition to the ICBA's Plan for Prosperity (attached), my testimony will be dedicated to legislation that, with this Committee's support, will be appropriately deliberated and vetted in the 114th Congress. Before getting to that, let me note another legislative issue already backed by broad consensus and ripe for enactment: privacy notice relief. The Privacy Notice Modernization Act from the 113th Congress (S. 635), sponsored by Senators Sherrod Brown (D-OH) and Jerry Moran (R-KS), had more than 70 cosponsors.

A similar bill passed the House under suspension. ICBA urges the Committee's assistance in obtaining swift passage of legislation to provide relief from annual privacy notice mailings when a bank has not changed its privacy policies. These notices are a source of confusion: customers who receive the annual notice often assume our policies have changed when they have not.

America's community banks are critical to the prosperity of the U.S. economy, particularly in small and rural communities. As the FDIC Community Banking Study showed, in one out of every five counties in the United States, the only physical banking presence is offices operated by community banks.¹ Community banks provide 60 percent of all small business loans under \$1 million and 77 percent of agricultural loans, according to a newly released study from Harvard's Kennedy School.² Agricultural lending in particular is a very specialized form of lending that requires extensive knowledge of farming, crops, and local conditions.³ This form of credit simply cannot be duplicated by larger banks that operate from outside the community. Community banks also offer customized mortgages suited to the unique characteristics of their local communities, while experiencing lower default rates than larger banks. Well capitalized with an average Tier 1 ratio of 10.5 percent,⁴ 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.

First National Bank of Scotia serves rural and suburban communities in the area of Albany, Schenectady, and Saratoga in upstate New York. We are a closely-held bank, employing 140 people and offering a full range of traditional banking services. First National Bank of Scotia has served these communities since 1923 and I'm a fourth generation community banker. Our story, our culture of relationship banking, and the role we play in our communities are typical of thousands of community banks.

The onerous regulatory burden on community banks is growing both in volume and complexity, suffocating the true potential of community banks to spur economic growth and job creation in their communities. My compliance officers have documented 153 final regulations, from a spectrum of federal agencies, implemented since 2007. These final regulations run the gamut from Bank Secrecy Act to credit card regulation to the multiple code sections that govern mortgage lending and servicing. In addition, there are 87 compliance changes in the form of guidance and statements and 59 annual adjustments to thresholds, lists of communities, and other data needed to maintain compliance. During that time period, more than 103 proposed regulations were issued which need to be reviewed as well. While not all of these changes apply to my bank, we nonetheless have to evaluate each one to determine to what extent our organization is impacted. Every change requires software updates, a lengthy process that includes a risk

¹ FDIC Community Banking Study. December 2012.

² "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.

³ Ibid.

⁴ Esther George, President, Federal Reserve Bank of Kansas City (speech at the Community Banking in the 21st Century conference, Federal Reserve System & Conference of State Bank Supervisors, St. Louis, Mo., September 2014. Quoted in Lux and Greene.

assessment, installation on a test network, testing, installation on a production network, more testing, procedural review, training and audit. What's more, policy revisions require committee review and Board approval. Compliance changes result in legal and audit expenses and sometimes the expense of printing and mailing new disclosures. But most significant is the drain on staff time. Banks the size of First National Bank of Scotia, in contrast to the larger banks, do not have dedicated compliance departments. We have to divert valuable staff from other duties, including serving customers, to implement new rules and other changes, a process that can take weeks or months depending on the complexity of the change and the bank processes impacted. On behalf of all community bankers, I appeal to you for relief from the volume and complexity of regulation that is threatening the viability of the community bank business model.

The experience of First National Bank of Scotia is typical of community banks, as confirmed by ICBA's 2014 Community Bank Lending Survey (Survey) which surveyed over 500 community banks nationwide. Seventy-eight percent of respondents reported they had increased the number of staff dedicated to lending compliance in the past five years. In a lightly staffed community bank, any additional hiring is significant. Hiring dedicated to compliance, rather than serving customers, is a deadweight loss that diverts resources from community lending. I will share more results from the Survey later in this testimony. Let me just say here the survey clearly illustrated the negative impact new rules are having on credit availability and consumer choice. An Executive Summary of the Survey and Infographic are attached to this statement.

Working with community bankers from across the nation, ICBA developed its Plan for Prosperity for the 114th Congress, a platform of legislative recommendations that will provide meaningful relief for community banks and allow them to thrive by doing what they do best – serving and growing their communities. Each provision of the Plan was crafted to preserve and strengthen consumer protections and safety and soundness.

In this testimony, I will describe the major elements of the Plan and note examples of legislation that embodies Plan provisions. In the 113th Congress, more than 20 such bills were introduced in the House and the Senate. These bills, most of which enjoyed strong bipartisan support, set the stage for action in the 114th Congress. A complete listing of Plan for Prosperity bills introduced in the 113th Congress and their progress is attached to this testimony.

The Plan is organized around three broad themes: relief from mortgage regulation to promote lending, improved access to capital to sustain community bank independence, and reforming oversight and examination practices to better target the true sources of financial sector risk.

Mortgage Reform for Community Banks

Every aspect of mortgage lending is subject to new, complex, and expensive regulations that are upending the economics of this line of business. In ICBA's recent Community Bank Lending Survey, 44 percent of respondents said they made fewer first lien residential mortgage loans in 2014 when the CFPB's qualified mortgage rules were in

effect than they made in 2013. In a strengthening housing market, more banks should have been making more loans. More troubling, 73 percent of respondents said regulatory burdens were preventing them from making more residential mortgage loans.

Key provisions of the Plan for Prosperity are designed to keep community banks in the business of mortgage lending. ICBA was very pleased that two Plan for Prosperity mortgage provisions were included in the **Community Lending Enhancement and Regulatory Relief Act of 2013 (the CLEAR Relief Act, S. 1349)**. The CLEAR Act, sponsored by Sens. Jerry Moran (R-KS), Jon Tester (D-MT), and Mark Kirk (R-IL), was the Senate bill that best represented the scope of the Plan for Prosperity in the last Congress. With more than 40 bipartisan cosponsors, the bill represented a set of genuinely consensus solutions to ensure continued access to consumer credit and other banking services. We are grateful to the members of this committee that sponsored and cosponsored the CLEAR Act. The bill's mortgage provisions were:

- “Qualified mortgage” status under the CFPB’s ability-to-repay rules for any mortgage originated and held in portfolio for at least three years by a lender with less than \$10 billion in assets.
- An exemption from any escrow requirements for any first lien mortgage held in portfolio by a lender with less than \$10 billion in assets.

The principal rationale for these provisions, and the reason they can be safely enacted, is they apply only to loans originated and held in portfolio by community banks. QM defines mortgages that are either “conclusively” or “presumptively” deemed to comply with the Dodd-Frank Act “ability-to-repay” requirements. As relationship lenders, community bankers are in the business of knowing their borrowers and assessing their ability to repay a loan. What’s more, when a community bank holds a loan in portfolio it holds 100 percent of the credit risk and has an overriding incentive to ensure the loan is well underwritten and affordable to the borrower. In a typical community bank portfolio, even a small number of defaults can put a bank at risk. Community bank portfolio lenders ensure they understand the borrower’s financial condition and structure the loan accordingly. If the borrower has trouble making payments due to job loss or other unforeseen circumstances, a community bank portfolio lender will work with the borrower to restructure the loan and keep the borrower in their home. By the same token, portfolio lenders will protect their collateral by ensuring borrowers remain current on tax and insurance payments. For this reason, the escrow requirement, which must be outsourced at a relatively high cost by community banks with a low volume of mortgages, is an unnecessary burden when a loan is held in portfolio. ICBA supports the CFPB’s recent proposed rule that would expand the definitions of “small creditor” and “rural area.” A “small creditor” mortgage held in portfolio may obtain QM status without regard to the 43 percent debt-to-income test. A small creditor that lends predominantly in rural or underserved areas can obtain QM status for balloon loans held in portfolio. However, ICBA urges Congress to revise the statute and pave the way for additional relief from the complex new mortgage rules by granting QM status to all portfolio loans held by community banks with up to \$10 billion in assets. This will help ensure access to community bank mortgage credit.

The Plan for Prosperity contains additional mortgage provisions that were embodied in House legislation introduced in the last Congress. The **Community Bank Mortgage Servicing Asset Capital Requirements Study Act (H.R. 4042)** would have provided relief from the punitive capital treatment of mortgage servicing assets under the Basel III rule. The **Community Institution Mortgage Relief Act (H.R. 4521)** would have raised the CFPB's small servicer exemption threshold to give more community banks flexibility to use methods proved successful in holding down delinquency rates. This provision was also included in a number of other House bills (**H.R. 1750** and **H.R. 5786**). Together, these bills would have preserved community bank servicing and deter further industry consolidation. Another bill, the **Access to Affordable Mortgages Act (H.R. 5148)**, would have allowed for in-house appraisals for higher priced mortgages of \$250,000 or less provided they are held in portfolio. New appraisal standards have forced many community banks to hire appraisal management companies that frequently use appraisers from outside the area and produce lower quality appraisals than could be produced in-house. Portfolio lenders have every incentive to ensure appraisals are accurate. These additional mortgage provisions are discussed in more detail in the attached Plan for Prosperity. ICBA is hopeful many of these bills will be reintroduced in the 114th Congress.

ICBA also supports legislation that would exempt community banks from new information reporting requirements under the Home Mortgage Disclosure Act. Recent statutory requirements imposed the collection and reporting of 17 new HMDA data fields. Now, the CFPB is proposing financial institutions collect and report an additional 20 data fields beyond those included in the statute. The proposal will at least double the amount of information currently requested. Small community banks that manage the process manually will have to consider costly automation of the tasks associated with preparing the HMDA data file. Additionally, the type of data being proposed for collection is personal (i.e., age, credit score, debt-to-income, reasons for denial) and could make a customer more easily identifiable to the public. In sum, this new requirement represents a significant expense, puts customer privacy at risk, and is especially unwarranted when added to the already crushing burden of regulation.

Access to Capital

A second major theme of the Plan for Prosperity is capital access and preservation for community banks. A number of the provisions are dedicated to strengthening community bank viability by creating new options for capital raising and capital preservation.

One such provision, which was also included in S. 1349, would provide relief for community banks under \$1 billion in asset size from the internal control attestation requirements of Section 404(b) of the Sarbanes-Oxley Act. Since community bank internal control systems are monitored continually by bank examiners, they should not have to incur 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.

Three capital provisions of the Plan for Prosperity would amend Basel III for banks with assets of \$50 billion or less to restore the original intent of the accord which was intended to apply only to large, internationally active banks.

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

ICBA also recommends reforming Regulation D so any person 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. These Regulation D amendments have not previously been put into legislation.

These provisions were newly added to the Plan for Prosperity for the 114th Congress based on community banker feedback after reviewing and planning implementation of the new rule. None have yet been included in legislation.

Reforming Bank Oversight and Examination to Better Target Risk

A third major theme of the Plan for Prosperity is improving the exam environment for community banks. This includes three provisions as described below.

Call Reports

The quarterly call report filed by community banks now comprises 80 pages of forms and 670 pages of instructions. Implementation of the new Basel III capital standards may add nearly 60 additional pages to the already burgeoning call report. In September, nearly 15,000 community bankers representing 40 percent of all community banks nationwide

signed an ICBA petition to the regulatory agencies calling for more streamlined quarterly call report filings.

ICBA's recent Community Bank Call Report Burden Survey empirically demonstrates this problem. Eighty-six percent of survey respondents said the total cost of preparing the quarterly call report has increased over the last 10 years.⁵ Thirty percent said it had increased significantly. A typical \$500 million asset community bank, such as First National Bank of Scotia, spends close to 300 hours a year of senior level, highly-compensated staff time on the quarterly call report. By contrast, in 2001 my bank filed a 31 page call report. Our most recent call report was 80 pages. Though our bank has grown in asset size since 2001, no change in our basic business model justifies the addition of 50 pages to our call report. The growth of this burden has been dramatic.

Only a fraction of the information collected is actually useful to regulators in monitoring safety and soundness and conducting monetary policy. The 80 pages of forms contain extremely granular data such as the quarterly change in loan balances on owner-occupied commercial real estate. Whatever negligible value there is for the regulators in obtaining this type of detail is dwarfed by the expense and the staff hours dedicated to collecting it. To put things in perspective, consider this contrast: some large credit unions file a less-than-30 page call report. Surely, regulators can supervise community banks with significantly less paperwork burden than they currently demand.

For this reason, ICBA is calling on the agencies to allow highly-rated community banks to submit a short form call report in the first and third quarters of each year. A full call report would be filed at mid-year and at year-end. The short form would contain essential data required by regulators to conduct offsite monitoring, including income, loan growth, changes in loan loss reserves, and capital position. In the recent survey noted above, community bank respondents overwhelmingly agreed that instituting a short-form call report in certain quarters would provide a great deal of regulatory relief. Seventy-two percent of respondents indicated the relief would be substantial.

ICBA is seeking legislation that would require the banking agencies to institute call report reform as described above.

Extended Exam Cycle

Under current agency rules, a bank with assets of less than \$500 million that has a CAMELS rating of 1 or 2 is eligible for an exam cycle of 18 months. Banks that do not meet these criteria are examined on a 12 month cycle. The extended exam cycle allows examiners to focus their limited resources on the banks that pose the greatest systemic risk. In order to more fully reap the benefit of risk-focused exams, the exam cycle can and should be further extended to 24 months and available to banks with assets up to \$2 billion, provided they have a CAMELS rating of 1 or 2. Preparations for bank exams, and the exams themselves, distract bank management from serving their communities to their

⁵ 2104 ICBA Community Bank Call Report Burden Survey.
<http://www.icba.org/files/ICBASites/PDFs/2014CallReportSurveyResults.pdf>

full potential. ICBA will pursue legislation in the 114th Congress to create an extended exam cycle as described above.

Strengthen Accountability in Examinations

The trend toward oppressive, micromanaged regulatory exams is an ongoing concern to community bankers nationwide. ICBA believes the best means of creating a more balanced exam environment is to create a workable appeals process. ICBA's Plan for Prosperity calls for the creation of an independent body 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.

The current appeals process is arbitrary and frustrating. Appeals panels, or other processes, routinely lack the independence and market expertise necessary to reach a fair, unbiased decision.

The **Financial Institutions Examination Fairness and Reform Act (S. 727)**, introduced in the last Congress by Senators Moran and Manchin, would go a long way toward improving the oppressive examination environment by creating a workable appeals process and consistent, commonsense standards for classifying loans. This legislation would improve the appeals process by taking it out of the examining agencies and empowering a newly created Ombudsman, situated in the Federal Financial Institutions Examination Council, to make final appeals decisions. Though we favor additional measures to bring a higher level of accountability to the regulators and their field examiners, we are pleased to support the intent of this legislation. ICBA also thanks Senators Brown and Vitter for including this provision in the **Terminating Bailouts for Taxpayer Fairness Act of 2013 (S. 798)**.

Additional Plan for Prosperity Provisions

Cost-Benefit Analysis of Proposed Rules

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

ICBA is grateful to Chairman Shelby for introducing the **Financial Regulatory Responsibility Act of 2013 (S. 450)**, which closely mirrors the Plan for Prosperity provision. A similar bill (**H.R. 1060**) focused on SEC rulemakings passed the House in the 113th Congress. In addition, ICBA is pleased to support Section 9 of the **Startup Act**

(S. 181), recently introduced by Senators Moran and Warner, which would require prior agency review of proposed rules including a thorough assessment and quantification of the costs and benefits among other requirements. Each of these bills would offer welcome relief to community banks by putting a reasonable check on new regulations and ensuring that they do not jeopardize community banks' viability by imposing costs that outweigh any benefit.

Eliminate Burdensome Data Collection

The Plan for Prosperity calls for exempting banks with assets below \$10 billion from the new small business data collection requirements. This requirement, which is in statute but has yet to be implemented by the CFPB, requires the reporting of information regarding every small business loan application. Think of it as HMDA for small business lending. Adding to the complexity, records of applications must be kept separate from records of the responses to applications and must be kept separate from the underwriting process. In other words, the requirement creates a separate bureaucracy within the bank that cannot be integrated with lending operations. This is especially inefficient, and may not be feasible in organizations that are too small to accommodate fire wall structures. 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.

ICBA is grateful to Senators Vitter and Brown for including in the **Too-Big-To-Fail Act (S. 798, 113th Congress)** a provision that would exempt banks with assets of \$10 billion or less from the new small business data collection requirement. ICBA also supported the **Right to Lend Act (H.R. 2323)**, introduced in the 113th Congress by Rep. Pittenger, which would repeal the small business data collection requirement.

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.

The Mutual Bank Choice and Continuity Act (H.R. 4252), introduced in the 113th Congress by Rep. Rothfus (R-PA) would have provided a national charter option for mutual banks, among other provisions.

Risk Targeting the Volcker Rule

The Plan for Prosperity calls for exempting banks with assets of \$50 billion or less from the Volcker Rule. The Volcker Rule should apply only to the largest, most systemically risky banks. Approximately one year ago today we saw a vivid example of the unintended consequences of applying the Volcker Rule to community banks. The final

Volcker Rule, issued December 2013, required, in most instances, community banks to divest their holdings of collateralized debt obligations (CDO) TruPs by July 2015. This provision was unanticipated. Community banks would have been required to sell their investments at fire sale prices. Accounting standards require community banks to recognize immediately an impairment of their investments. Left unaddressed, this implementation of the Volcker Rule would have caused a significant and permanent loss of capital to hundreds of community banks. ICBA is grateful to this Committee for your support in persuading the agencies to reverse course on the Volcker Rule CDO TruPs provision. This episode should convince all parties that banks with assets of \$50 billion or less should be completely exempt from the Volcker Rule.

The Economic Growth and Regulatory Paperwork Reduction Act Review

While this statement has focused on legislative recommendations, I would also like to address the opportunity for agency regulatory relief presented by the 10-year review required under the Economic Growth and Regulatory Paperwork Reduction Act of 1996 (EGRPRA).

The OCC, the Federal Reserve Board, and the FDIC are required to identify outdated, unnecessary or unduly burdensome regulation on insured depository institutions. This review will be conducted over a two-year period and will proceed by soliciting comment on twelve categories of regulation. This process holds real promise, if the agencies commit themselves to carrying it out in earnest and according to the terms of the statute.

Community bankers were significantly engaged in the last EGRPRA review, completed in 2006. More than 500 community bankers attended meetings around the country and many more submitted comment letters. Their input was substantive and detailed and should have formed the basis of significant regulatory relief. Unfortunately, the process was a lost opportunity and community bankers were deeply disappointed and disillusioned with the results. Though the process fully demonstrated the urgent need for relief, only minimal regulatory changes were made.

For this reason, ICBA is making specific recommendations with regard to the process to increase the chances the results match what was intended by Congress. These recommendations are detailed in our attached comment letter to the agencies. We urge this Committee to support our recommendations and to actively ensure the process results in significant regulatory relief. Community banks cannot afford another missed opportunity.

Closing

Thank you again for the opportunity to testify today. ICBA hopes this testimony, while not exhaustive, gives the Committee a sense of the sharply increasing resource demands

placed on community banks by regulation and examination and what's at stake for the future of community banking.

We urge that ICBA's Plan for Prosperity for the 114th Congress – as well as the CLEAR Relief Act and the other bills embodying Plan provisions introduced in the 113th Congress – serve as a guide to this committee. ICBA encourages you to reach out to the community bankers in your states. Ask them about the current regulatory environment and needed reforms. ICBA looks forward to working with this Committee to craft urgently needed legislative solutions.

ATTACHMENTS

- ICBA Plan for Prosperity. January 2015
- ICBA 2014 Community Bank Lending Survey Executive Summary and Infographic. January 2015
- List of Community Bank Regulatory Relief Bills from the 113th Congress
- ICBA Comment Letter Regarding the Economic Growth and Regulatory Paperwork Reduction Act Process. September 2, 2014



INDEPENDENT COMMUNITY
BANKERS *of* AMERICA

One Mission. Community Banks.®

Plan for Prosperity



**A Pro-Growth Agenda to Reduce the Onerous
Regulatory Burden on Community Banks and
Empower Local Communities
2015**

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

America's 6,500 community banks are vital to the prosperity of the U.S. economy, particularly in smaller towns and rural communities. Providing more than half of all small business loans under \$1 million, as well as customized mortgage and consumer loans suited to the unique characteristics of their local communities, community banks serve a vital role in ensuring the economic recovery is robust and broad based, reaching communities of all sizes and in every region of the country.

In order to reach their full potential as catalysts for entrepreneurship, economic growth, and job creation, community banks must be able to attract capital in a highly competitive environment. An end to the exponential growth of onerous regulatory mandates is critical to this objective. Regulation is suffocating nearly every aspect of community banking and changing the very nature of the industry away from community investment and community building to paperwork, compliance, and examination. A fundamentally new approach is needed: Regulation must be calibrated to the size, lower-risk profile, and traditional business model of community banks.

ICBA's Plan for Prosperity provides targeted regulatory relief that will allow community banks to thrive by doing what they do best – serving and growing their communities. By reducing unsustainable regulatory burden, the Plan will ensure that scarce capital and labor resources are used productively, not sunk into unnecessary compliance costs, allowing community banks to better focus on lending and investing that will directly improve the quality of life in our communities. Each provision of the Plan was selected with input from community bankers nationwide and crafted to preserve and strengthen consumer protections and safety and soundness.

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

ICBA is committed to advancing and enacting the provisions of the Plan with all due vigilance and the aggressive use of every resource at our disposal. The Plan is a flexible, living document that can be adapted to a rapidly changing regulatory and legislative environment to maximize its influence and likelihood of enactment. Provisions are described below.

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

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

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

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

Additional Capital for Small Bank Holding Companies: Modernizing the Federal Reserve's Policy Statement. Require the Federal Reserve to revise the Small Bank Holding Company Policy Statement – a set of capital guidelines that have the force of law. The Policy Statement, which makes it easier for small bank and thrift holding companies to raise additional capital by issuing debt, would be revised to increase the qualifying asset threshold from \$1 billion to \$5 billion. Qualifying bank and thrift holding companies must not have significant outstanding debt or be engaged in nonbanking activities that involve significant leverage.

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

- Provide an exemption from internal control attestation requirements for community banks with assets of less than \$1 billion. The current exemption applies to any company with market capitalization of \$75 million or less. Because community bank internal control systems are monitored continually by bank examiners, they should not have to sustain the unnecessary annual expense of paying an outside audit firm for attestation work. This provision will substantially lower the regulatory burden and expense for small, publicly traded community banks without creating more risk for investors.

- Due to an oversight in the 2012 JOBS Act, thrift holding companies do not have statutory authority to take advantage of the increased shareholder threshold below which a bank or bank holding company may deregister with the SEC. Congress should correct this oversight by allowing thrift holding companies to use the new 1,200 shareholder deregistration threshold as well as the new 2,000 shareholder registration threshold.
- Regulation D should be reformed so that anyone with a net worth of more than \$1 million, including the value of their primary residence, would qualify as an “accredited investor.” The number of non-accredited investors that could purchase stock under a private offering should be increased from 35 to 70.

TARGETED REGULATORY RELIEF

Supporting a Robust Housing Market: Mortgage Reform for Community Banks. Provide community banks relief from certain mortgage regulations, especially for loans held in portfolio. When a community bank holds a loan in portfolio, it has a direct stake in the loan’s performance and every incentive to ensure it is properly underwritten, affordable and responsibly serviced. Relief would include:

- Providing “qualified mortgage” safe harbor status for loans originated and held in portfolio by banks with less than \$10 billion in assets, including balloon mortgages.
- Exempting banks with assets below \$10 billion from escrow requirements for loans held in portfolio.
- An exemption from the higher risk mortgage appraisal requirements for loans of \$250,000 or less provided they are held in portfolio by the originator for a period of at least three years.
- New information reporting requirements under the Home Mortgage Disclosure Act should not apply to community banks.

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

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

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

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

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

- Change the governance structure of the CFPB to a five-member commission rather than a single Director. Commissioners would be confirmed by the Senate to staggered five-year terms with no more than three commissioners affiliated with any one political party. This change will strengthen accountability and bring a diversity of views and professional backgrounds to decision-making at the CFPB.
- The Financial Stability Oversight Council's review of CFPB rules should be strengthened by changing the vote required to veto a rule from an unreasonably high two-thirds vote to a simple majority, excluding the CFPB Director.
- All banks with assets of \$50 billion or less should be exempt from examination and enforcement by the CFPB; and CFPB backup (or "ride along") authority for compliance exams performed by a bank's primary regulator should be eliminated.

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

Ensuring the Viability of Mutual Banks: New Charter Option. The OCC should be allowed to charter mutual national banks to provide flexibility for institutions to choose the charter that best suits their needs and the communities they serve.

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

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

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

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

Creating a Voice for Community Banks: Treasury Assistant Secretary for Community Banks.

Economic and banking policies have too often been made without the benefit of community bank input. An approach that takes into account the diversity and breadth of the financial services sector would significantly improve policy making. Creating an Assistant Secretary for Community Banks within the U.S. Treasury Department would ensure that the more than 6,500 community banks across the country, including minority banks that lend in underserved markets, are given appropriate and balanced consideration in the policy making process.

Modernize Subchapter S Constraints. Subchapter S of the tax code should be updated to facilitate capital formation for community banks, particularly in light of higher capital requirements under the proposed Basel III capital standards. The limit on Subchapter S shareholders should be increased from 100 to 200; Subchapter S corporations should be allowed to issue preferred shares; and Subchapter S shares, both common and preferred, should be permitted to be held in individual retirement accounts (IRAs). These changes would better allow the nation’s 2,200 Subchapter S banks to raise capital and increase the flow of credit.

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

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

The Independent Community Bankers of America®, the nation’s voice for 6,500 community banks of all sizes and charter types, is dedicated exclusively to representing the interests of the community banking industry and its membership through effective advocacy, best-in-class education and high-quality products and services. For more information, visit www.icba.org.

2014 ICBA Community Bank Lending Survey

Executive Summary

January 2015



2014 ICBA Community Bank Lending Survey – Executive Summary

In 2014, ICBA conducted a survey of community banks on their lending activities. The survey provides a valuable benchmark to help gauge community banks' outlook toward areas of lending in the year ahead, real-world data to help policymakers assess the impact of recent rulemaking and insights into barriers that are preventing community banks from better serving their communities.

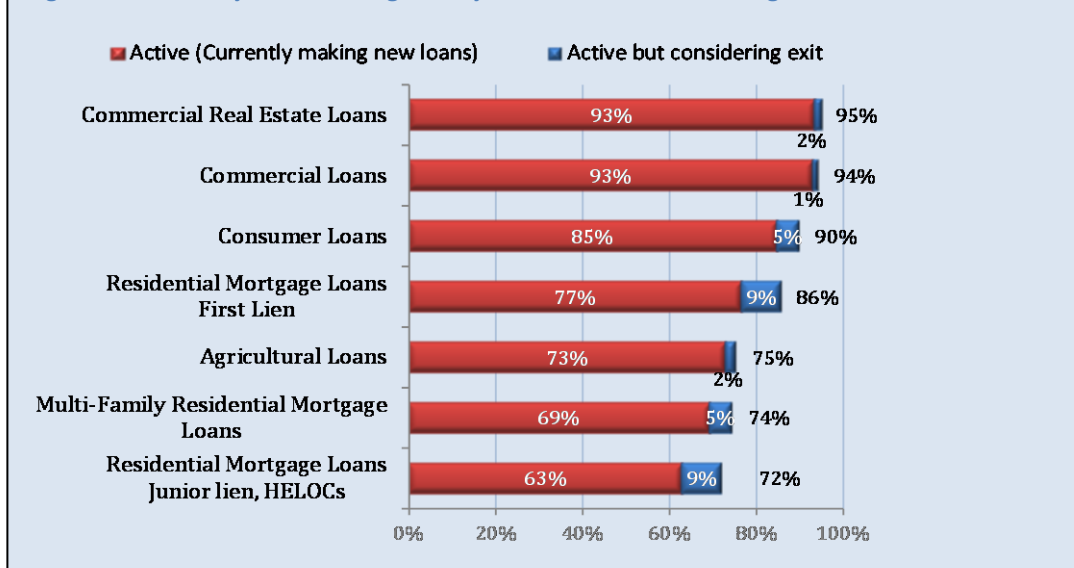
Key Findings:

- Most community banks are full-service lenders, providing many different types of loans to meet their customers' needs.
- Despite challenges, community banks maintain a positive outlook towards most areas of lending.
- The regulatory burden is putting pressure on community banks' residential mortgage lending activities.
- Exemptions from the Consumer Financial Protection Bureau Qualified Mortgage (QM) rule for small and rural creditors are too narrow and risk limiting consumer access to mortgage credit.
- Community banks perceive making non-QM mortgages as a significant risk and are reluctant to do so.
- Community banks' loan underwriting trended towards tighter standards across all lines of lending.

Analysis:

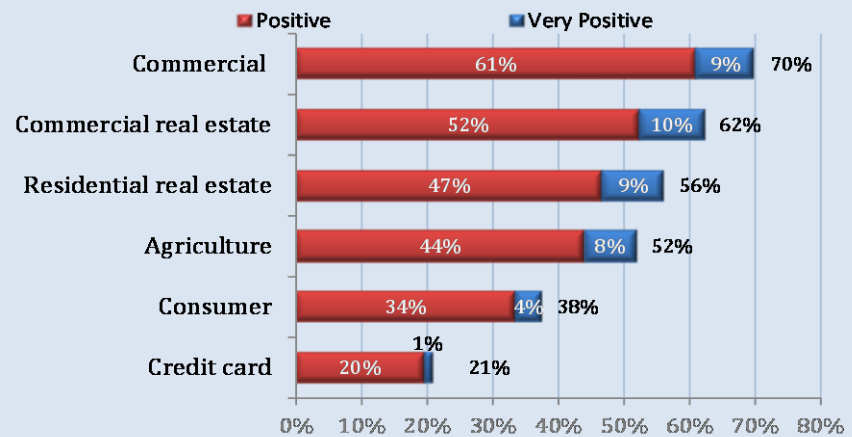
Most community banks are full-service lenders, providing many different types of loans to meet their customers' needs. Almost all banks are active in the area of commercial real estate (95%), commercial, (94%) and consumer lending (90%), Figure 1).

Figure 1: Community Bank Lending Activity in 2013-14 – Active Lending Areas



Despite many challenges, community banks maintain a positive outlook towards most areas of lending over the next two years. The most positive outlook was for commercial lending (70%) and commercial real estate lending (62%). Fewer respondents, though still a majority, had a positive outlook for residential real estate (56%) and agriculture (52%) loans. Only a minority of respondents had a positive outlook for consumer loans and credit cards (Figure 2).

Figure 2: Community Bank Lending Outlook by Area – Positive

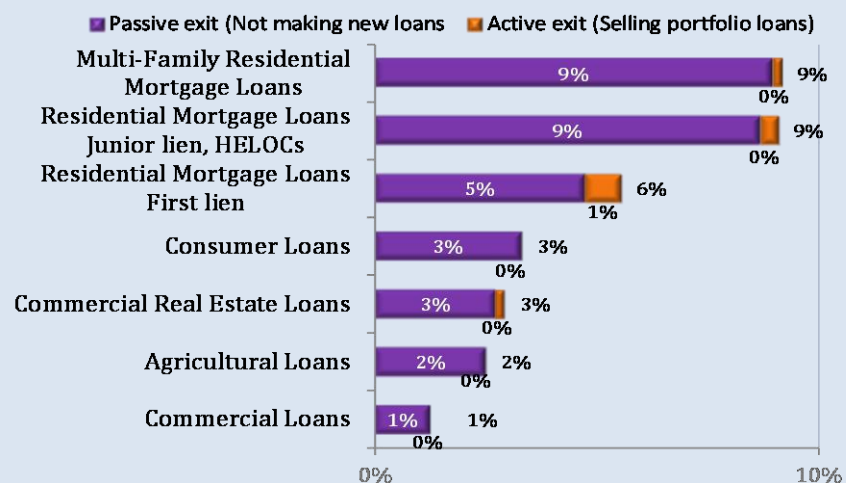


Regulatory burden is putting pressure on community banks' residential mortgage lending activities. The regulatory burden of new rules and requirements was the most cited (73%) barrier to making more residential mortgage loans (Figure 5). (Relatively few banks cited this factor for consumer (26%) or commercial (21%) lending.) Additionally, while most banks (86%, Figure 1) remain active residential mortgage lenders, a significant percentage are considering an exit (9%), are exiting from this line of lending (6%, Figure 3) or are not active (9%, Figure 4). A majority of banks reported tighter underwriting in residential mortgage lending (57%) and many reported decreases in originations (44%). Most community banks reported having increased staffing for lending compliance in the last five years (78%).

Exemptions from the Consumer Financial Protection Bureau Qualified Mortgage (QM) rule for small and rural creditors are too narrow. Though they meet the asset threshold test of \$2 billion or less, two-thirds of banks with \$500 million to \$2 billion in assets make too many loans (more than 500 a year) to qualify (66%). Half of banks that serve rural areas do not qualify for the "rural" exception (50%).

Community banks perceive making non-QM mortgages as a significant

Figure 3: Community Bank Lending Activity in 2013-14 – Exit Lending Areas



risk and are reluctant to do so. Only one-quarter of community banks routinely make non-QM loans (25%). Two-thirds of community banks simply do not make non-QM mortgage loans (44%) or only do so in special cases (22%).

While most community banks reported underwriting standards remained unchanged in 2013-14 compared to the previous two-year period, many more banks reported tighter underwriting standards than looser. About one-in-three banks reported tighter underwriting standards in commercial real estate (38%), commercial loans (32%), agricultural loans (32%) and consumer loans (30%). Less than 1 in 20 reported looser underwriting for any type of lending.

The majority of banks reported increased loan originations in 2014 compared to the previous year for commercial loans (52%), commercial real estate (52%) and agricultural loans (51%). In contrast, a significant number of community banks experienced decreases in consumer loan originations (27%).

Market factors prevented community banks from making more commercial and consumer loans. Lack of borrower demand was cited by a majority of respondents for commercial loans (57%). Just under half of respondents cited this factor for mortgage (47%) and consumer lending (46%). Lack of qualified borrowers was cited by more than four-in-ten banks for consumer (45%), commercial (44%) and mortgage lending

Figure 4: Community Bank Lending Activity in 2013-14 – Inactive Lending Areas

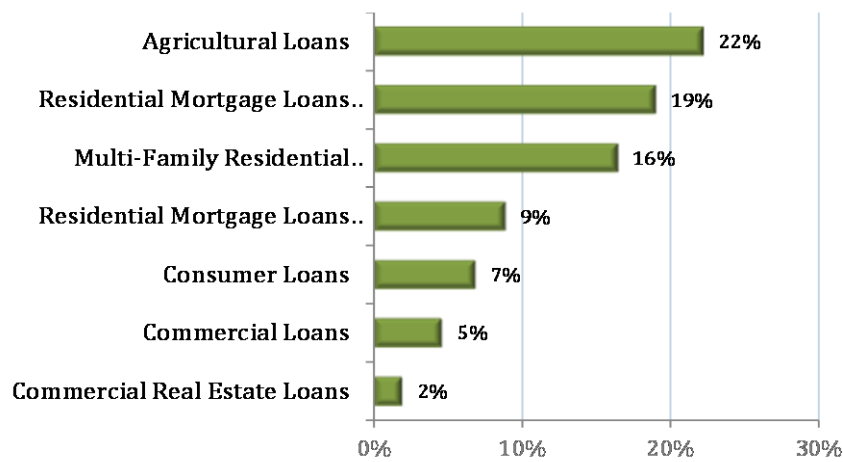
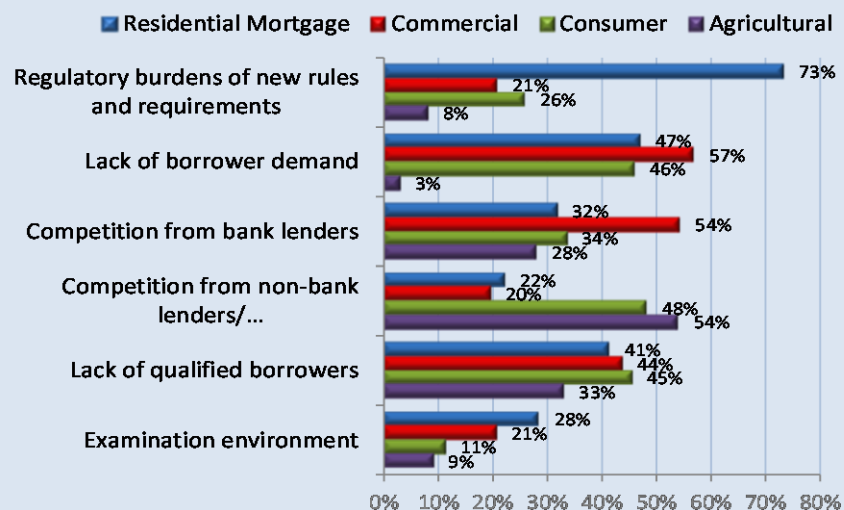


Figure 5: Factors Preventing Community Banks from Making More Loans



(41%, Figure 5).

Competition from other banks, non-banks and government agencies is also an important limiting factor in community bank lending. Competition from non-bank lenders was the top factor preventing banks from making more consumer loans (48%) and competition from bank lenders was the second most cited factor in commercial loans (54%). Agricultural lenders cited competition from the Farm Credit System as the top factor (54%, Figure 5).

Survey Methodology:

The ICBA Community Bank Lending Survey was distributed by email to 6,500 community banks. Between September 15 and October 3, 2014, 519 unique responses were collected on a one response per bank basis, for a response rate of 8.0%. Most responses (79%) came from either the bank president and CEO (59%) or the chief lending officer (20%).

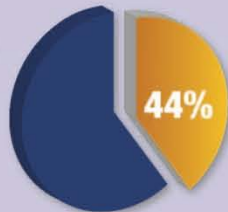
The survey sample slightly over-represents community banks between \$50 million and \$500 million in assets and under-represents community banks above \$500 million in assets compared to the industry below \$10 billion in assets. In terms of regulator, charter and ownership type, survey respondents closely reflect the make-up of the industry below \$10 billion in assets. When asked to indicate the types of geographic areas they served (multiple selections were allowed), 20% of respondents indicated urban areas, 39% suburban areas and 76% serve rural areas.

Infographic: ICBA 2014 Community Bank Lending Survey



Regulatory Burden: Impact on Community Banks

44% of community banks said they originated fewer first-lien residential mortgage loans in 2014 compared with the year before.



39% said they originated fewer junior-lien loans and home equity lines of credit.

58%

52%

58% and 52% of respondents reported tighter underwriting standards for first-lien and junior-lien loans, respectively.



73% said regulatory burdens are preventing them from making more residential mortgage loans.



78% of respondents reported increasing the number of staff members dedicated to lending compliance over the past five years.



1/2 of all rural banks said they do not qualify for the Qualified Mortgage rule's "rural" exception.



66% of respondents said they do not provide loans that are outside the CFPB's QM definition or would only do so in special cases.



Just **25%** of community bankers said they are providing loans that do not fit the CFPB's QM definition, showing that the new restrictions have shrunk the credit box and taken away lender discretion in granting credit.



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More information: www.icba.org/PFP2015

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Statistics generated from ICBA's 2014 Community Bank Lending Survey

Community Bank Regulatory Relief Bills in the 113th Congress

Bills Enacted in the 113th Congress

Title, Bill #, Date of Passage	Sponsor(s)	Description
H.R. 3329, 5/6/14	Luetkemeyer	Requires the Federal Reserve to revise the Small Bank Holding Company Policy Statement by increasing the qualifying asset threshold from \$500 million to \$1 billion

Bills Passed the Senate

Community Bank Preservation Act (S. 2252) <i>Passed as an amendment to S. 2244. Subsequently enacted in the 114th Congress.</i>	Vitter	Requires that at least one member of the Board of Governors of the Federal Reserve has experience as a community banker or as a supervisor of community banks.
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Senate Bills Introduced

Consumer Financial Protection Bureau Examination and Reporting Threshold Act of 2014, S. 2732	Toomey, Donnelly	Raises the exemption threshold for CFPB examinations from \$10 billion to \$50 billion
HELP Rural Communities Act, S. 1916	McConnell	Creates a petition process with regard to the CFPB's designation of an area as "rural"
CLEAR Relief Act of 2013, S. 1349	Moran, Tester, Kirk	Portfolio QM for banks under \$10 billion, escrow exemption for portfolio loans held by banks under \$10 billion, SARBOX 404(b) exemption for banks under \$1 billion, raise SBHC threshold to \$5 billion
Terminating Bailouts for Taxpayer Fairness Act of 2013, S. 798	Brown, Vitter	Broadens "rural" definition, bank exam reform (provisions of S. 727), privacy notice relief, shareholder threshold fix for thrift holding companies, mutual holding company dividend relief, raise SBHC threshold to \$5 billion, exemption from small business data collection for banks under \$10 billion
Financial Institutions Examination Fairness and Reform Act, S. 727	Moran, Manchin	Create an Ombudsman within the Federal Financial Institutions Examination Council to hear appeals of exam findings
Privacy Notice Modernization Act, S. 635	Brown, Moran	Privacy notice relief
Municipal Advisor Relief Act, S. 710	Toomey, Warner	Exempt banks and bank employees from registration

Responsible Financial Consumer Protection Regulations Act, S. 205	Moran	Replaces the single CFPB Director with a Senate-confirmed, five-person Commission, among other provisions
Holding Company Registration Threshold Equalization Act, S. 872	Toomey, Pryor	Allows thrift holding companies to use the new shareholder registration and deregistration thresholds
The Financial Regulatory Responsibility Act of 2013, S. 450	Shelby	Prohibits any federal financial regulatory agency from publishing a notice of final rulemaking if it determines that the quantified costs are greater than the quantified benefits
S. 2641	Landrieu	Provides QM status to any mortgage held in portfolio by a bank of less than \$10 billion

Bills Passed by the House

Title, Bill #, Date of Passage	Sponsor(s)	Description
Eliminate Privacy Notice Confusion Act, H.R. 749, 3/12/13	Luetkemeyer	Eliminate the requirement that financial institutions mail annual privacy notices when no change in policy has occurred
SEC Regulatory Accountability Act, H.R. 1062, 5/17/13	Garrett	Requires the Chief Economist of the SEC to determine that the benefits of any proposed regulation justify the costs before adopting such regulation
Holding Company Registration Threshold Equalization Act H.R. 801, 1/14/14	Womack, Himes	Allows thrift holding companies to use the new shareholder registration and deregistration thresholds
Consumer Financial Protection Commission Act, H.R. 3193, 2/27/14	Duffy	Replaces the single CFPB Director with a five-person Commission, strengthens FSOC review of CFPB rules, among other provisions
Helping Expand Lending Practices in Rural Communities Act, H.R. 2672, May 6, 2014	Barr	Creates a petition process with regard to the CFPB's designation of an area as "rural"

Passed by the Financial Services Committee but not House

Path Act, H.R. 2767, 7/24/13	Garrett, Hensarling	Portfolio QM, escrow relief, raise servicing exemption threshold, exam relief, QRM repeal
Portfolio Lending and Mortgage Access Act of 2013, H.R. 2673, 5/7/14	Barr	Portfolio QM
Community Institution Mortgage Relief Act, H.R. 4521, 5/7/14	Luetkemeyer	Escrow relief for portfolio loans for banks under \$10 billion, raise small servicer exemption to 20,000 loans

Financial Regulatory Clarity Act, H.R. 4466	Capito, Meeks	Requires financial regulators, before issuing any new rule, to consider whether it is in conflict, is inconsistent with, or is duplicative of an existing rule
Access to Affordable Mortgages Act, H.R. 5148	Luetkemeyer	Creates an exemption from the higher risk mortgage appraisal requirement for loans of \$250,000 or less provided they are held in portfolio.
Community Bank Mortgage Servicing Asset Capital Requirements Study Act, H.R. 4042	Luetkemeyer	Delays the effective date of the Basel III rule with respect to MSAs for nonsystemic banking institutions and requires the banking agencies to conduct a joint study of the appropriate capital treatment of MSAs.

House bills introduced but not considered in Committee

CLEAR Relief Act, H.R. 1750	Luetkemeyer	Portfolio QM, escrow relief, raise servicing exemption threshold, appraisal relief, privacy notices, SARBOX 404(b) exemption, SEC cost-benefit, SBHC threshold
JOBS Act, H.R. 4304	Scalise	All provisions of H.R. 1750, the CLEAR Act
Financial Institutions Examination Fairness and Reform Act, H.R. 1553	Capito, Maloney	Create an Ombudsman within the Federal Financial Institutions Examination Council to hear appeals of exam findings
Municipal Advisor Oversight Improvement Act, H.R. 797	Stivers	Exempts enumerated traditional banking activities from triggering the registration requirement
Mutual Community Bank Competitive Equality Act, H.R. 1603	Grimm, Meeks, King	Allows the OCC to charter mutual national banks. Permits a mutual holding company to waive dividends paid by its stock subsidiary if specified conditions are met
Mutual Bank Choice and Continuity Act, H.R. 4252	Rothfus	Provides a national charter option for mutual banks and allow mutual banks to issue Mutual Capital Certificates (MCCs) that would qualify as Tier 1 common equity capital
Right to Lend Act, H.R. 2323	Pittenger	Repeals Section 1071 of the Dodd-Frank Act, which requires HMDA-like data collection for commercial lending
Small Financial Institutions Regulatory Relief Act H.R. 5786	Lankford, Welch	QM status and escrow relief for portfolio mortgages held by lenders under \$10 billion; raise small servicer threshold to 10,000 loans; privacy notices, Small Bank Holding Company; Fed governor; create application process for rural designation
S Corporation Modernization Act, H.R. 892	Reichert, Kind	Allows S corporation shares to be held in an individual retirement account



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Immediate Past Chairman
CAMDEN R. FINE
President and CEO

September 2, 2014

Robert deV. Frierson, Secretary
Board of Governors
Federal Reserve System
20th Street and Constitution
Washington, DC 20551

Robert E. Feldman, Executive Secretary
Federal Deposit Insurance Corporation
550 17th Street NW
Washington, DC 20429

Legislative and Regulatory Activities Division
Office of the Comptroller of the Currency
400 7th Street SW
Washington, DC 20219

Re: Regulatory Publication and Review Under the Economic Growth and Regulatory Paperwork Reduction Act of 1996 (EGRPRA), Docket No. FFIEC-2014-0001; Fed Docket No. OP-1491;

Dear Sirs or Madam:

The OCC, the Federal Reserve Board, and the FDIC are conducting a review of the regulations they have issued to identify outdated, unnecessary or unduly burdensome regulation on insured depository institutions. This review is required under the Economic Growth and Regulatory Paperwork Reduction Act of 1996 (EGRPRA) and will be conducted over a two year period. The Independent Community Bankers of America (ICBA)¹ appreciates the opportunity to comment on the first notice that was published by the banking agencies under EGRPRA to help identify those regulations in the first three categories of regulations that are outdated, unnecessary or unduly burdensome.

¹ *The Independent Community Bankers of America® (ICBA), the nation's voice for more than 6,500 community banks of all sizes and charter types, is dedicated exclusively to representing the interests of the community banking industry and its membership through effective advocacy, best-in-class education and high-quality products and services.*

ICBA members operate 24,000 locations nationwide, employ 300,000 Americans and hold \$1.3 trillion in assets, \$1 trillion in deposits and \$800 billion in loans to consumers, small businesses and the agricultural community. For more information, visit www.icba.org.

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Under EGRPRA, the banking agencies will review more than a hundred subject areas of regulations. The banking agencies have grouped these regulations into twelve regulatory categories. Over the next two years, the agencies plan to publish four Federal Register notices, each addressing one or more categories of rules. Our understanding is that the CFPB will not be a part of this process, but is required to review its significant rules and publish a report of its review no later than five years after they take effect.

This letter will comment not only on the first three categories of regulations—Applications and Reporting, Powers and Activities, and International Operations—but will also comment generally on the EGRPRA process and also the severe regulatory environment that community banks now face.

EGRPRA Process

ICBA and its members were very actively engaged during the first EGRPRA review process which was conducted from 2004 to 2006. ICBA members and staff attended many of the outreach meetings and extensively commented on all six of the published EGRPRA notices. According to the final EGRPRA report that the FFIEC published in the Federal Register and sent to Congress in 2007², there were sixteen EGRPRA outreach sessions around the country involving more than five hundred participants, most of whom were community bankers. At the St. Louis outreach session, for instance, there were almost one hundred community banks represented. The agencies received 850 letters from bankers, consumer and community groups, trade associations, and other interested parties in response to their comment requests.

Despite the strong involvement and input from community banks during the first EGRPRA review process, community banks and the ICBA were deeply disappointed and disillusioned with the outcome. Since few substantive regulations were repealed, eliminated or substantially amended by the banking agencies, many community bankers have concluded that EGRPRA is no more than a “check the box” regulatory process. On the major issues raised by the bankers in 2004 to 2006, such as repealing the right of rescission under the Truth in Lending Act, raising the \$10,000 Currency Transaction Report threshold, or reducing disclosures under the Home Mortgage Disclosure Act, the banking agencies either rejected the recommendations outright or deferred action until further study could be completed.

Overall, the banking agencies believed that their first EGRPRA review had been a success because they were able to eliminate some duplicative regulation, or accomplish such things as redesigning their financial institution letters, or streamlining their branch application procedures. However, these changes hardly made an impact on the overall regulatory burden that now confronts community banking.

If the new EGRPRA process is to have any chance at success, there must be a strong commitment by the heads of the banking agencies to do what is necessary to eliminate regulation that is outdated, unnecessary or unduly burdensome. The

² See the Federal Register, Volume 72, No. 211 on November 1, 2007.

EGRPRA statutory mandate requires the agencies to go beyond merely streamlining regulations, tweaking certain regulations, eliminating duplication, or deferring action until some further interagency study can be completed. Rather, the mandate requires the agencies to thoroughly review each regulation and eliminate it if it is outdated, unnecessary or unduly burdensome.

This will require the agencies to consider the costs and benefits of each regulation and to carefully consider the input they receive from community bankers. Furthermore, even if there are some benefits to having a regulation, it should be eliminated under the EGRPRA process if it can be shown to be unduly burdensome.

Furthermore, ICBA urges the banking agencies to hold at least six outreach meetings around the country to gather the input and testimony of community banks. At these outreach meetings, community bankers should be allowed to discuss the overall regulatory burden and how it could be reduced. For those bankers that are unable to attend the outreach meetings, they should be permitted to participate remotely by phone. The best way to truly assess the costs and benefits of banking regulation is to hear the personal experiences and testimony of bankers.

The banking agencies also should set up an EGRPRA.gov website as they did during the first review. On the website, the agencies can post the comment letters they receive, post the notices that are published in the Federal Register, and list the regulations that bankers mention the most as being outdated, unnecessary or unduly burdensome. There could be a top ten list of the most burdensome regulations which would include those regulations that are mentioned the most at the outreach meetings and in banker comment letters. The EGRPRA.gov website could also post notices about the outreach meetings and summaries of each meeting.

Finally, there should be an overall director of the current EGRPRA interagency review process—an EGRPRA czar—who has a strong commitment to reducing unnecessary and unduly burdensome regulation and who can, in certain situations, overcome the objections of individual agencies to specific recommendations and resolve interagency disputes. Too often during the last EGRPRA review process, burden reducing recommendations were rejected because of the objection of one agency or because the agencies could not achieve a consensus. This director or EGRPRA czar should have the authority to overrule such objections where it is clear that the regulation is unduly burdensome. There will always be someone who can find some reason to preserve a regulation so, to ensure an effective process, there should be a director who can overcome such objections.

The Overall Regulatory Burden on Community Banks

In the preface to the last EGRPRA report in 2007, John Reich, who at that time was not only the Director of the Office of Thrift Supervision but also the leader of the interagency EGRPRA program, warned of the consequences to community banking if the regulatory burden was not reduced. He said:

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“Financial institutions of all sizes suffer under the weight of unnecessary regulatory burden, but small community banks unquestionably bear a disproportionate share of the burden due to their more limited resources. While it is difficult to accurately measure the impact regulatory burden has played in industry consolidation, numerous anecdotal comments from bankers across the country as well as from investment bankers who arrange merger and acquisition transactions indicate it has become a significant factor. Accordingly, I am deeply concerned about the future of our local communities and the approximately 8,000 community banks under \$1 billion in assets...”

Since John Reich’s statement in 2007, the number of community banks has dropped to about 6,500 due mainly to consolidation, and the amount of regulation has grown exponentially.

Several recent studies have attempted to quantify the overwhelming regulatory burden on community banking. For instance, according to a recent KPMG Banking Industry Outlook Survey³, sixty percent of bankers said that regulatory requirements account for as much as 10 percent of their total operating costs and that 22 percent said that complying with the regulation is responsible for as much as 11 to 20 percent of their total operating costs. As KPMG concludes, “This significantly adds to the pressure that banks are already feeling to keep costs down to deliver the returns investors expect while also raising the higher levels of capital now required.”

The Mercatus Center at George Mason University recently produced a high quality empirical study⁴ on the impact of regulations on community banks since the Dodd-Frank Act was enacted in 2010. The study, which is based on a survey of approximately 200 community banks in 41 states with less than \$10 billion in assets, is largely consistent with the anecdotal evidence. Broad findings from the study include:

- **Additional costs.** Approximately 90 percent of respondents reported that compliance costs have increased since 2010. 83 percent reported that they had increased by more than 5 percent.
- **Outside consultants.** More than half of surveyed community banks (51%) anticipate engaging with outside consultants in connection with the Dodd-Frank Act requirements, and an additional 21 percent are unsure.
- **Additional compliance personnel.** Since 2010, the respondent banks said they have hired additional compliance/legal personnel. 27 percent of respondents plan to hire additional compliance/legal personnel in the next 12 months, and an additional 28 percent 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.

³ The KPMG study can be found at:

http://www.kpmginfo.com/industryoutlooksveys/2014/pdfs/KPMGBankingIndustrySurvey_072414.pdf

⁴ “How are Small Banks Faring Under Dodd-Frank?” Hester Peirce, Ian Robinson, and Thomas Stratmann. Mercatus Center Working Paper. February 2014.

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- **Regulation is driving consolidation.** 26 percent of respondents anticipate that their bank will engage in merger activity in the next five years, and another 27 percent are unsure. 94 percent of banks anticipate further industry consolidation.

The anecdotal evidence is also compelling. ICBA established an EGRPRA website so that its members could give some feedback online about EGRPRA and regulatory burden. One banker expressed the frustrations of many community banks with this comment:

“Banking has become the most highly regulated industry in the world. Legislation and regulation created to address problems caused by the largest banks has been foisted upon all banks. As such, we are seeing the life-blood sucked out of our local communities. Meanwhile, un-taxed credit unions, already held to a much lower standard of compliance, are allowed seemingly unbridled growth. They now boast membership exceeding 100 million... When coupled with the Farm Credit System loaning any amount to anyone at any rate they choose, you have a serious problem for the continued viability of community banking in this country. Meanwhile, "back at the ranch", you have community bankers, many of whose institutions have been in business for 100+years, seriously considering folding up their tent. I would add that the creation of the Consumer Financial Protection Bureau, with its annual payroll now exceeding \$200 million, will do nothing but increase costs to consumers and make the problems worse. We need less regulation, not more; less government, not more; more action and less talk.

The Mercatus Study noted above also reported narrative comments from respondents about regulation. Here are a few examples:

- “We don’t have the number of employees or the financial resources to keep up with [new] 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.”
- “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 and 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, illustrate how increasing regulatory burden is fundamentally changing the nature of the business of community banking.

Community banks play a crucial role in the economic life of rural areas and small communities passed over by larger banks. The credit and other financial services they provide in these communities will help advance and sustain the economic recovery and ensure that it reaches every corner of the country. Community banks are responsible for 60 percent of all small business loans under \$1 million. As the economic recovery

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strengthens, small businesses will lead the way in job creation with the help of community bank credit.

The role of community banks in advancing and sustaining the recovery is jeopardized by the increasing expense and distraction of regulation drastically out of proportion to any risk they pose. **Community banks didn't cause the recent financial crisis, and they should not bear the weight of new, overreaching regulation intended to address it.**

ICBA urges the regulatory agencies as part of the EGRPRA process to conduct their own empirical study of the regulatory burden on community banks to quantify the burden and confirm what the KPMG, Mercatus and other studies are showing—that the burden is significant and is driving community banks out of the business of banking. Such a study could also identify those regulations that are the most burdensome. The FDIC attempted to conduct such a study as part of its 2012 Community Bank Study. In the appendix to that study, the FDIC summarized its interviews with community bankers concerning regulatory compliance costs but failed to quantify the costs, after concluding it would be difficult.

We urge the FDIC, the OCC, and the Federal Reserve to confirm what community bankers are also saying anecdotally—that each new regulation is not only reducing the franchise value of their banks but also impairing the ability of their banks to lend to the communities they serve.

Specific Comments on the Three Categories of Regulations

ICBA has a number of specific burden reducing recommendations regarding the first two of the three categories of regulation that the agencies have requested comments on—Applications and Reporting and Powers and Activities. We have no comments on International Operations regulations.

Call Report Burden. With 80 pages of forms to complete and over 670 pages of instructions, the call report has become a significant regulatory burden for community banks to prepare. In fact, as new regulations are issued and old ones are amended, the call report just gets more complicated and more burdensome to prepare. From that perspective, the call report really has become a symbol of the overall regulatory burden community banks currently experience.

For instance, the call report has grown from 18 pages in 1986 to 29 pages in 2003 to nearly 80 pages today! Just recently the regulators proposed another 57 pages of instructions because of the new Basel III regulatory capital framework. The call report—which community banks submit every 65 business days—has more pages than the typical U.S. community bank has employees. Community banks have very limited resources available to tackle the challenges faced when trying to meet ever changing regulatory reporting requirements that do not properly consider the size and complexity of the institution.

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ICBA's recently released its 2014 Community Bank Call Report Burden Survey.⁵ According to the survey, 86 percent of community bank respondents said that the annual cost of preparing the report has increased over the past ten years. Further, 98 percent of respondents said ICBA's proposed short-form call report, which qualifying community banks would be able to submit for the first and third quarters of each year, would reduce their regulatory burden. Seventy-two percent said the burden reduction would be substantial. The survey also showed that over the last ten years the number of hours required to complete the call report and the resources involved with meeting reporting obligations has increased.

Recent expansions of the use of the call report as an information gathering tool for consumer protection regulation further damage the effectiveness of the information provided and the use of the report as a safety and soundness metric. ICBA notes that regulated credit unions are not required to produce anywhere near the level of detail that is required by community banks even though their depositors are offered the same levels of protection and they engage in similar and in some cases identical activities as community banks. For example, in the first quarter of 2014, the smallest community bank was required to submit a call report that is 80 pages in length while the largest credit union in the country with over \$58 billion in assets submitted a call report with only 28 pages.

ICBA believes that highly rated, well-capitalized community banks would benefit greatly from a call reporting structure that allows them to file a short-form call report covering the first and third quarters and a long-form call report for the second and fourth quarters of each year. Preparers of community bank call reports believe that preparing a short-form call report with limited schedules in certain quarters would reduce the overall time required to meet call reporting obligations and reduce regulatory burden substantially. Without immediate relief for community banks that reduces the current regulatory burden including the increasingly taxing call report requirements, consolidation of community banks in the United States will occur at a rapid rate.

ICBA strongly urges the banking agencies to work actively together to amend the current call report burden by allowing community banks to make use of the short-form call report solution. With only approximately 60 business days between reporting periods, instituting the short-form call report solution will greatly alleviate limited community bank resources that would be better deployed meeting the needs of local communities without compromising on the valuable metrics needed to efficiently assess safety and soundness. ICBA is proposing that in the community bank's fiscal first and third quarters, the complete call report would be replaced by a short-form call report that includes only limited financial schedules such as the income statement, balance sheet, and statement of changes in bank equity capital. These schedules would provide the agencies with sufficient information to detect any significant changes in condition that might warrant additional follow up.

⁵ ICBA's 2014 Community Bank Call Report Burden Survey can be found at <http://www.icba.org/files/ICBASites/PDFs/2014CallReportSurveyResults.pdf>

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We also encourage the Federal Reserve to streamline the FRY-9 for shell holding companies of community banks. The current FRY-9 requires too much information in cases where the holding company has no other assets but the stock of the bank.

Small Bank Holding Company Policy Statement. Appendix C of Regulation Y includes the Small Bank Holding Company Policy Statement on Assessment of Financial and Managerial Factors (Policy Statement). This Policy Statement applies only to bank holding companies with pro forma consolidated assets of less than \$500 million that (1) are not engaged in any nonbanking activities involving significant leverage and (2) do not have a significant amount of outstanding debt that is held by the general public.

ICBA strongly believes that the asset threshold under the Policy Statement should be raised to at least \$5 billion. In addition, we recommend the debt-to-equity ratio threshold of 1:1 be increased to 3:1. Increasing the exemption to \$5 billion would improve the ability of small local institutions to sell their stock locally, keeping the financial decisions affecting the community in the local area.

Access to capital for community banks has never been more difficult than it is today. Since 2007, the public capital markets have been either unavailable or unattractive to many community bank and holding companies. Many community banks have had to rely more on existing shareholders, directors and insiders for capital raises and less on new investors, including institutions and private equity investors. Furthermore, many community banks will need to raise additional capital not only for business purposes but also to ensure compliance with regulatory requirements including the new Basel III requirements. Those community banks that have not redeemed their Troubled Asset Relief Program (TARP) or Small business Lending Fund (SBLF) securities, or that have been deferring dividends on their trust preferred securities, have additional reasons for needing capital.

Allowing a larger number of community bank holding companies to qualify under the Policy Statement (i.e., those with consolidated assets of up to at least \$5 billion) would make it easier for these community bank holding companies to issue debt and equity on an unconsolidated basis that could be used to support the capital needs of their banking subsidiaries or to redeem their TARP or SBLF securities. We also believe a 3:1 debt to equity ratio is a reasonable holding company leverage ratio and would also facilitate the raising of capital at the holding company level. Small savings and loan holding companies should also have the ability to benefit from using the Policy Statement.

De Novo Bank Applications. ICBA appreciates the meetings we have had with FDIC staff about de novo bank application process. However, we continue to hear from our members and others that FDIC policies and practices are inhibiting the formation of de novo institutions.

For example, it has been reported to us that the requirement that a state nonmember de novo bank is subject to FDIC approval for any material change or deviation in its business plan during the fourth through seventh years serves as a major deterrent to

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organizing groups and their efforts to raise sufficient capital in their communities. There are also reports that at pre-filing meetings with the FDIC, the organizers have been advised that they need to raise capital upfront in amounts sufficient to maintain a leverage ratio of at least 8 percent for a seven year period.

We have also heard from others that the increasingly lengthy and uncertain application process serves as a deterrent to forming de novo banks. Apparently, some would-be applicants are overwhelmed by the uncertainty of approval and timely processing of the applications, and thus decide not to take the considerable risk of subjecting themselves to those uncertainties.

Given the continuing dearth in de novo applications, ICBA urges the FDIC to streamline the application process. Furthermore, the FDIC should advise staff that meet with de novo bank applicants and process applications that it is not requiring initial capital to cover the full seven year period, that the application process will not overwhelm applicants, and that the FDIC will not question the judgment of the organizing group of the need for a de novo bank in the market unless it is clearly erroneous.

Also given the misperceptions surrounding the FDIC's policies and practices, **ICBA recommends that the FDIC issue a new Financial Institutions Letter or FIL to help dispel misconceptions and reaffirm the FDIC's support for the formation of de novo banks.**

Simplification and Update of Regulation O. Federal Reserve Regulation O still continues to confuse community bankers. The rules on prior approval of extensions of credit, on additional restrictions on loans to executive officers, and the definition of what is an "extension of credit" need to be clarified and simplified. Furthermore, it is time to revisit some of the loan limits, such as the \$100,000 aggregate credit limit to executive officers in Section 215.5.

ICBA suggests also easing some of the requirements for community banks with CAMELS composite ratings of "1" or "2" and management ratings of not lower than "2." We also think that the agencies should issue a Regulation O summary chart to capture the limitations on loans to various types of insiders in an easy comprehensive way, with cross references to Federal Reserve Regulation W.

Conclusion

ICBA hopes that this EGRPRA review process will be more of a success than the last one which failed to make any substantive changes to banking regulations. We strongly recommend that as part of the current EGRPRA process (1) the agencies hold at least six outreach meetings to solicit the comments and testimony of community banks to the regulatory burden, (2) the agencies establish an EGRPRA.gov website to post the comments received and list those regulations that community banks consider the most burdensome, and (3) establish an "EGRPRA czar" who could resolve interagency disputes over the regulations. But more importantly, a strong commitment at the top is

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needed to do what is necessary to eliminate regulation that is outdated, unnecessary or unduly burdensome. Otherwise, the whole EGRPRA process will be a meaningless, regulatory check-the-box exercise.

The overall regulatory burden has increased dramatically since 2007 when the last EGRPRA report was issued and when the EGRPRA director, John Reich, expressed his concerns about the future of community banking. We encourage the regulators to conduct their own empirical research confirming what other studies are showing—that community banks are exiting the business because the regulatory burden is so severe.

ICBA has a number of burden-reducing recommendations concerning the first two categories of regulations. With regard to call reports, we urge the agencies to adopt a streamlined call reporting system that would allow highly rated, well-capitalized community banks to file a short-form call report covering the first and third quarters and a long-form call report for the second and fourth quarters of each year. This would greatly reduce the call report burden.

ICBA also recommends amendment of the Small Bank Holding Company Policy Statement so that bank holding companies with consolidated assets of up to \$5 billion could benefit from it. In addition, we recommend the debt-to-equity ratio threshold under the Policy Statement of 1:1 be increased to 3:1. Increasing the exemption to \$5 billion and easing the leverage ratio would improve the ability of small local institutions to sell their stock locally and would allow them to more easily issue debt at the holding company level to support the capital needs of their banking subsidiaries.

ICBA still hears from our members and others that FDIC policies and practices are inhibiting the formation of de novo institutions. We believe the process should be streamlined and urge the FDIC to issue a FIL to help dispel misconceptions and reaffirm the FDIC's support for the formation of de novo banks.

ICBA also supports the simplification of Regulation O and recommends that the requirements be eased for those community banks with high management and CAMELS ratings. Some of the loan limits should be reviewed and updated, and the regulators should issue a simplified summary of the regulation for community banks.

ICBA appreciates the opportunity to comment on the first notice that was published by the banking agencies under EGRPRA to help identify those regulations in the first three categories of regulations that are outdated, unnecessary or unduly burdensome and to discuss the EGRPRA process and the regulatory burden on community banks. If you have any questions or would like additional information, please do not hesitate to contact me by email at Chris.Cole@icba.org.

Sincerely,
/s/ Christopher Cole
Christopher Cole
Executive Vice President and Senior Regulatory Counsel

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