February 27, 2018

The Problem of Red Tape: The Community Bank Perspective

On behalf of the nearly 5,700 community banks represented by ICBA, we thank Chairman Chabot, Ranking Member Velazquez, and members of the Small Business Committee for convening today's hearing titled "How Red Tape Affects Community Banks and Credit Unions: A GAO Report." ICBA is pleased to have the opportunity to offer this statement for the hearing record.

We hope that this hearing will highlight the need for enactment of meaningful regulatory relief for community banks before the close of the 115th Congress. As discussed below, S. 2155 presents the best and most realistic opportunity for enacting this relief. We ask the members of this committee to support expeditious consideration of this critical legislation when it is sent over from the Senate.

Community Banks and the American Economy

Community banks are locally operated and often closely held institutions with simple, conservative balance sheets and strong capitalization. Located in urban, suburban and rural areas, they are funded primarily by local deposits and deeply rooted in their communities. Community banks have a vital stake in the success of their local economies because the fortunes of the local bank and the local economy are closely linked.

The economic life of thousands of American communities depends on customized financial products and services that only community banks provide. According to a 2016 report by the Federal Deposit Insurance Corporation (FDIC), more than 20 percent of our nation's 3,100 counties are exclusively served by community banks.[1] Collectively, community banks provide nearly 50 percent of all small business loans in the country and 77 percent of all agricultural loans, according to a study from Harvard's Kennedy School.[2] Community banks are playing a vital

[1] https://www.fdic.gov/regulations/resources/cbi/conference/cbi-book12-19-16.pdf.
[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.

role in ensuring the economic recovery is robust and broad-based, reaching communities of all sizes and in every region of the country.

Overregulation a Critical Challenge for 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 and across the nation. These regulations are issued by a spectrum of federal agencies and run the gamut from Bank Secrecy Act to credit card regulation to the multiple code sections that govern mortgage lending and servicing.

Even when a regulation does not apply to a particular bank, that bank must still evaluate each one to determine to what extent its organization is impacted. Every change requires software updates, a lengthy process that includes a risk 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. In contrast to larger banks, community banks have limited resources to devote to compliance. They must 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.

ICBA's 2014 Community Bank Lending Survey surveyed over 500 community banks nationwide.[3] 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. The survey clearly illustrated the negative impact new rules are having on credit availability and consumer choice.

Consolidation

This increase in regulatory burden has contributed significantly to the rapid pace of consolidation in recent years. Banks need scale to amortize compliance costs. As these costs have grown dramatically in recent years, banks have acquired or merged with other banks to achieve this scale. Today there are 1,700 fewer community banks in the United States than there were in 2010. Regulatory-driven consolidation has particularly reduced the ranks of the smallest community banks. The number of banks with assets below $100 million shrunk by 32 percent, while the

[3] 2014 ICBA Community Bank Lending Survey. January 2015.

number of banks with assets between $100 million and $1 billion fell by 11 percent.

Of course, consolidation would be less of a concern if there were an influx of de novo charters to replenish lost banks. In the years before the financial crisis, de novo bank formation averaged over 170 per year. Even in the depths of the savings and loan crisis in the 1980s, when 1,800 banks and savings institutions failed, an average of 196 de novo banks and savings institutions were formed annually from 1984 through 1992. In recent years, by contrast, de novo formation has ground to a virtual halt. The current regulatory environment for community banks acts as a strong deterrent to potential de novo applicants.

What are the consequences of consolidation without the creation of de novo charters? More communities are stranded without a dedicated, locally-based community bank to invest in their growth and prosperity. These communities will be challenged in the current economic recovery and in future economic cycles. In addition, there will be less competition in financial services in every American community. Less competition means lower rates paid on deposits, higher rates charged on loans, higher fees, and ultimately an erosion in the quality of service.

There are additional consequences to consolidation that must be considered. A financial system with fewer, larger banks is more vulnerable to the risk of another financial crisis. Consolidation makes the megabanks even larger, securing their implicit too-big-to-fail status, inducing risk taking, and ultimately leading to taxpayer bailouts.
For the sake of our communities and the stability of our financial system, it is imperative that we slow the pace of consolidation and restart the de novo process. There is a direct linkage from regulatory burden to consolidation to consumer harm, too-big-to-fail megabanks and taxpayer bailouts. We must provide regulatory relief for community banks that will break this dangerous cycle. Regulation should be tiered and proportionate to the systemic and consumer risk posed by classes of banks.

Solutions

ICBA is grateful for the dozens of bills passed by the House in the 115th Congress that would alleviate regulatory burden for community banks. The Small Business Committee has played a critical role in promoting these bills by highlighting the problem of regulatory burden for community banks and all small businesses. Members of the committee have sponsored and cosponsored many of these bills, many of which have bipartisan support. The Financial Choice Act (H.R. 10), passed by the House in June 2017, contains some two dozen community bank provisions. We hope that before the close of the 115th Congress meaningful community bank regulatory relief legislation can be signed into law. This will require bicameral and bipartisan agreement.

S. 2155 Presents the Best Opportunity to Enact Community Bank Regulatory Relief

ICBA anticipates Senate passage of S. 2155 in the coming weeks with a strong bipartisan vote. S. 2155 contains robust regulatory relief for community banks, including relief from HMDA reporting, short form call reports, deemed qualified mortgage status for mortgages held in portfolio by community banks, a lengthened exam cycle for banks with less than $3 billion in assets, and numerous other provisions that would strengthen economic growth and job creation.

It is clear that S. 2155 owes a great deal to the work of the House. The numerous hearings, markups, and House floor votes on community bank regulatory relief in this Congress and recent Congresses have all contributed to the recent work of the Senate Banking Committee. Regulatory relief is a multi-year effort spanning both sides of the Capitol. With this in mind, ICBA urges the members of this committee and the House to seize this opportunity by quickly taking up S. 2155 following Senate passage without amendments that would split the bipartisan coalition needed to enact this long-awaited regulatory relief for community banks.

Closing

Thank you again for convening this hearing and raising the profile of a critical issue for the American economy. ICBA looks forward to working with this to enact meaningful, comprehensive regulatory relief for community banks.