Testimony of

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On behalf of the

Independent Community Bankers of America

Before the

United States Senate
Committee Banking, Housing, and Urban Affairs

Hearing on

"Fostering Economic Growth: The Role of Financial Institutions in Local Communities"

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Opening

Chairman Crapo, Ranking Member Brown, and members of the Committee, my name is Scott Heitkamp, and I am President and CEO of ValueBank Texas in Corpus Christi, Texas. I am also Chairman of the Independent Community Bankers of America, and I testify today on behalf of the more than 5,800 community banks we represent. Thank you for convening today's hearing on "Fostering Economic Growth: The Role of Financial Institutions in Local Communities."

What ValueBank and other community banks do from *inside* a local community cannot be replicated from *outside* the community. This isn't just my opinion; this is what a number of empirical studies have found.[1] With a direct knowledge of the borrower, the community, and local economic conditions, community banks offer customized terms and make loans passed over by larger lenders based outside of the community or that rely on algorithms and other impersonal methods of evaluating credit. This is the community bank competitive advantage and the reason we must be part of any plan to foster local economic growth.

Before I discuss ICBA's plan for fostering local economic growth, I'd like to give you some background on my bank. ValueBank Texas was chartered in 1967 and later acquired by my father. I'm proud to carry on his legacy as a second-generation community banker. Today, ValueBank Texas is a $213 million-dollar bank with 10 offices in Corpus Christi and suburban Houston with 114 employees. We specialize in small business and residential mortgage lending. As our name suggests, we are dedicated to creating value for our customers and our community.

The economic recovery has been painfully slow and has failed to reach many individuals and communities. Today, a customer with a pristine credit score or a large, established business can get a loan. But this isn't the measure of a strong economy. When the credit box is artificially tight, we have subpar economic growth. To break out of this rut and strengthen economic growth, we must expand credit availability to millions of hardworking households and would-be borrowers with less-than-perfect credit scores. Many of these borrowers are on the middle-to-lower end of the income scale.

Community banks are uniquely suited to reach struggling households and small businesses. An intangible, yet critical, factor that separates community banks from other financial institutions is the direct stake and vested interest we have in the success of our communities. We cannot thrive in a community that is failing or stagnant. Every loan we make is a vote of confidence in the community and a deepening of our commitment to it, not a one-off transaction. Unfortunately, in recent years, a sharp growth in regulatory burden has made it increasingly difficult for community banks to lend and foster local economic growth.

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[1] See "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. This paper discusses a number of studies, both governmental and academic, that have found a community bank advantage based on their proximity to the communities they serve.

Regulatory overreach has created two problems in particular. First, it has contributed to rapid consolidation. Banks need a larger scale to amortize the increasing cost of compliance, and this has been driving many mergers and acquisitions. At the same time, a daunting compliance burden and heightened legal risk deter the formation of de novo charters. As a result, today there are some 1,700 fewer community banks than there were in 2010 and only a handful of new bank charters. This often harms competition and leaves many small communities stranded without a local community bank.

Second, over regulation has created a very tight credit box by choking off community banks' capacity to take on and manage reasonable credit risk. Too many would-be borrowers – often people with lower credit scores and lower income or newly-established small businesses who are still creditworthy – are being denied credit in today's environment.

Solutions

The good news is that solutions are at hand. ICBA's "Plan for Prosperity" includes over 40 recommendations that will allow Main Street and rural America to prosper. A copy of the Plan is attached to my written statement. In April of this year, at the request of Chairman Crapo and Ranking Member Brown, ICBA submitted a short list of recommendations, drawn from the Plan for Prosperity, which were selected based on two criteria: their positive impact on local communities and their history of bipartisan support. What follows is a discussion of these recommendations.

Access to Mortgage Credit

The following recommendations would enhance access to mortgage credit and support a robust housing market by providing relief from new mortgage regulations, especially for loans held in portfolio.

1. Expand Exemption Thresholds Under the Home Mortgage Disclosure Act (HMDA) and Repeal New Data Points

The CFPB's new rule under HMDA, when it becomes effective, will require covered banks and credit unions to collect and report 48 unique data points on each mortgage loan they make, more than double the number of data points covered lenders are currently required to collect. The proliferation of data points will amplify the number of inadvertent data entry errors and penalties, especially among institutions that upload data manually, including many community banks and small credit unions.

ICBA believe the exemption thresholds should be increased to provide relief for small lenders without materially impacting the mortgage data available to the CFPB or impairing the purpose of the HMDA statute. Specifically, ICBA recommends that:

- Depository institutions that have originated 1,000 or fewer closed-end mortgages in each of the two preceding calendar years be exempt from reporting on such loans; and
- Depository institutions that have originated 2,000 or fewer open-end lines of credit in each of the two preceding calendar years will be exempt from reporting on such loans.

The exemption thresholds should be applied separately so that a lender may be exempt from reporting on its closed-end mortgages but not on its open-end lines of credit, or vice versa.

ICBA also recommends that statutory authority under Dodd-Frank for the additional data points be repealed.

2. Automatic Qualified Mortgage Status for Loans Held in Portfolio

The “qualified mortgage” (QM)/ability-to-repay rule is overly complex and prescriptive and excludes otherwise creditworthy mortgages. When a community bank holds a mortgage in portfolio, it has every incentive to ensure it understands the borrower’s financial condition and to work with the borrower to structure the loan properly and make sure it is affordable. For this reason, mortgages held in portfolio by a community bank should have automatic “qualified mortgage” (QM) status under the CFPB’s ability-to-repay rule.

3. Ease Escrow and Appraisal Requirements for Community Bank Portfolio Lenders

Mandatory escrow requirements raise the cost of credit for those borrowers who can least afford it, and impose additional, unnecessary compliance costs for community bank lenders. Appraisal requirements have become costly in recent years, and rural American is experiencing a shortage of licensed appraisers. Escrow and appraisal requirements deter community bank mortgage lending and reduce borrower choice. Portfolio lenders have every incentive to ensure that collateralized properties are accurately appraised and that taxes and insurance are paid on a timely basis. Community bank employees often understand local real property values better than licensed appraisers who operate from outside of the county or state where the property is located. When a mortgage is held in portfolio by a community bank, it should be exempt from escrow requirements and the lender should be able to substitute an in-house “property evaluation” for a full residential property appraisal completed by a licensed appraiser.

Access to Capital

Community banks need better access to capital and simplified capital regulation to best serve the lending needs of their communities.

4. Exempt Non-Systemically Important Financial Institutions from Basel III

Basel III was originally intended to apply only to the largest, systemically important and internationally active banks. Imposing complex and excessive capital standards on the nation’s community banks will limit lending, investment, and credit availability in local communities.

Community banks should be exempt from Basel III and subject to Basel I, a capital framework that more accurately aligns community banks’ regulatory capital with the types of assets they hold and the relationship model they follow. Basel I has served the relationship-based banking model well for over a generation.

Community Bank Small Business Lending

5. Repeal New Small Business Loan Data Collection Requirement for Small Financial Institutions

Section 1071 of the Dodd-Frank Act requires the collection and reporting of 12 pieces of data in connection with credit applications made by women- or minority-owned businesses of any size as well as all small businesses regardless of ownership, including the race, sex, and ethnicity of the principal owners of the business. Section 1071 also gives the Bureau discretion to require the reporting of any additional information that would assist it in fulfilling the purposes of the statute. Section 1071 is fraught with unintended consequences that will only harm small business borrowers.

Small businesses create more new jobs in the American economy than any other sector. They rely heavily on credit to fund their payrolls, working capital, inventory, and capital investments. Any new compliance burden of the magnitude contemplated under Section 1071 will likely drive smaller creditors out of the marketplace and shrink access to credit for the most credit-dependent businesses. Because the compliance costs would be fixed, the smallest borrowers would be at the greatest risk. Data collection and reporting for a small loan application would cost a lender the same as for a larger loan application, giving lenders a strong incentive to forgo smaller borrowers.

Pending Legislation

The recommendations listed above, as well as other recommendations of the Plan for Prosperity, are found in a number of bills introduced in the House and Senate.

The Clear Relief Act (S. 1002), a bipartisan bill introduced by Senators Moran and Tester, provides “qualified mortgage” status and escrow relief for mortgages held in portfolio by institutions with assets of less than $10 billion. S. 1002 also includes three other provisions from the Plan for Prosperity: Relief for community banks with assets of $1 billion or less from redundant internal controls assessment mandates of Sarbanes-Oxley 404(b); an exemption for banks with assets of $10 billion or less from the Volcker Rule; and a waiver from the mandatory waiting period prior to closure that is triggered when a lender extends a second offer of credit with a lower interest rate.

ICBA strongly supports S. 1002 and thanks the members of this Committee who have cosponsored this bill: Senators Heitkamp, Tillis, and Donnelly.

I would also like to recommend a bill Senator Rounds introduced last Congress, Community Bank Access to Capital Act, which included an exemption from Basel III for banks with assets of $50 billion or less; SOX 404(b) relief similar to what is included in S. 1002; and amendments to the Securities and Exchange Commission’s Regulation D that would make is easier for community banks to raise equity capital through private securities offerings. These critical capital provisions would result in more robust community lending and local economic growth. ICBA looks forward to the reintroduction of the Community Bank Access to Capital Act.

We strongly encourage this committee to consider S. 1002, the Community Bank Access to Capital Act, and other bills that include meaningful regulatory relief for community banks.

Closing

Thank you again for the invitation to testify today on behalf of ICBA and community banks nationwide. The 115th Congress has an opportunity to comprehensively rethink, restructure, and modernize the regulation of the American financial services industry to ensure that it promotes local economic growth, prosperity, and job creation. Regulatory relief for community banks is a critical part of this effort. Today's hearing will set the parameters for the important work ahead of us.