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Committee on Financial Services of the House of Representatives

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Mr. Chairman, Ranking Member Clay and Members of the Subcommittee, thank you for inviting me to appear at this hearing and to submit written testimony. I have been a practicing lawyer for over thirty years and during those years have represented community banks, their shareholders, directors, officers and related entities on a wide range of corporate, regulatory and tax matters. Over those years and together with my various law partners, our firm has represented over 30 de novo charter groups. We are honored to be representing a group of Florida businessmen who have filed the first national bank charter in the US since 2008.

I also am President and founder of the Subchapter S Bank Association, which is primarily an educational organization, which provides substantive advice and content to shareholders and directors and officers of banks that have elected or are considering subchapter S tax treatment under the Internal Revenue Code (IRC). There are approximately 2,100 banks in the US which maintain an S election – accounting for approximately one third of the bank charters in the US. Ninety percent of these Sub S banks are under $1 billion in total assets and 90% of that number are located in rural communities across the US.

In 2008 there were 101 applications for new bank insurance filed with the FDIC of which 28 were approved; 33 were filed in 2009 but none were approved. The filings dropped to 6 in 2010 and a total of 10 from 2011 through June 30, 2016, with only 3 charters being approved during that time. In my opinion, the reasons for the significant decline of new bank charters is a direct result of a decision made by the FDIC in 2009 to require that applicants for FDIC insurance provide a 7 year business plan and evidence of capital sufficient to maintain a comfortable cushion over and above the required minimum capital ratios for that period of time. In addition to this application requirement, the FDIC also mandated that the initial conditions and enhanced supervisory monitoring imposed on new banks would also extend from the previous 3 to 7 years. One of the many conditions required the new bank to avoid deviations from its business plan including financial projections and required the bank to obtain prior approval of any change or deviation. The FDIC also began imposing similar conditions on banks that had recently undergone a change in control, and we witnessed the difficult experience of those banks in complying with these conditions and obtaining approval for deviations in business plans, many times requiring such banks to increase their capital ratios significantly above well capitalized minimums as an additional condition for approval of the change.

In addition, the significant increase in bank regulatory oversight and examination practices post 2008 created additional capital and regulatory pressures on most banks during this period. Capital ratios began to be informally increased 1 to 2% even though banks were operating at or above the regulatory minimums for well capitalized banks.

In addition to this discretionary increase in regulation, Congress enacted Dodd Frank which unleashed a plethora of new requirements and restrictions on banks and led to further significant increased costs. Many in the industry began to wonder whether they could survive these heavy costs and regulatory burden, and it became commonly discussed at banking conferences that to survive banks would have to be at least $500MM in total assets. While I personally do not believe that is the case, there is no question that regulatory compliance costs have increased significantly, some suggesting that it increased operating costs by one third.

The announcement by the three federal bank regulatory agencies in June 2012 that they intended to impose the international large bank capital standard known as Basel III on every bank in the US regardless of size sent a tremor through the industry, and we immediately noticed a significant shift in our community bank clients' attitudes. Many began to believe that continuing to operate their community banks would be marginally profitable, if at all, and with the lack of capital access to meet these new requirements and costs, many began to look for an exit through merger or sale. Thus began the current decline in the number of banks.

In response to the Chairman's specific request, these added costs occasioned by Dodd Frank, Basel III and discretionary supervisory action significantly impaired existing financial institution's ability to provide financial services and products to consumers in the communities they serve. Many banks exited the mortgage loan business because of the complexity and uncertainty resulting from Dodd Frank, the CFPB and related rulemaking. The costs are significant and it is generally known in the industry that the cost of making a loan of less than $100,000.00 is not covered by the interest earned, including the cost of capital and loan reserves required to support such a loan, unless the bank has some very unique processes that can be employed to lower costs.

Over the past few years, we have heard regulators explain the lack of new charters being the result of low interest rates and the expectation that a new charter would not be viable; however, in my opinion, the 7 year business plan and compliance period as well as the significant increase in regulation have been the primary reasons. We observed banks which were chartered at the beginning of the financial crisis in 2008 which managed to grow and become profitable within the three year timeframe that was the norm for many years.

At the urging of many in the industry, the FDIC issued revised Questions and Answers to its Insurance Application, required of de novo banks in November of 2014 which returned the business plan requirement back to 3 years from 7; however, the FDIC did not change its 7 year conditional period of enhanced supervision until April of 2016, when it specifically reverted back to the pre-2009 three year period. Despite these changes and Chairman Gruenberg's public remarks in April of 2016 announcing that increasing de novo charters was one of FDIC's top three priorities, widespread skepticism abounds throughout the industry, including many industry experts who advance the often discussed theory that the regulatory agencies would prefer to do away with community banks and concentrate banking in the US in the hands of a few. While I have personally held meeting with each of the three agencies together with bank clients and colleagues over the past several years and have always had this question about community banks answered in the negative – meaning there is no agency policy or plan to reduce the number of community banks, these theories continue to be discussed.

Mr. Chairman, while we represent larger community banks with multi-billions in assets, we have a long history of representing many smaller and rural based community banks and can firmly testify to the value of such community banks and the importance of doing everything we can to provide access to capital, reduce regulation and promote new bank charters and new bank ownership. This is particularly true in rural America where the large banks simply do not wish to locate or provide services. As you well understand, we are very fortunate to have as many community banks in the US as we do and in my view we should do everything we can to encourage new bank formation and entry.

I would be remiss not to highlight the importance of the ability of banks to elect subchapter S tax treatment which was granted by Congress 20 years ago through an amendment to the IRC. While it is anecdotal, I believe that the availability of flow through tax treatment for banks is one of the reasons we have as many community banks today as we do. Before banks could elect Sub S, an owner had to sell the bank in order to get value from it; whereas Sub S tax treatment is an efficient form of business organization which permits current cash flow to be received by owners without double taxation. Indeed the most popular form of new business organization in the US today is the limited liability company; but banks cannot be organized in this fashion as a result of IRS regulations, though the FDIC has authorized banks to be organized as LLCs. Banks must use the S election in order to achieve pass through taxation; however, the current limits on number and type of shareholder constrains banks which are by nature capital intensive businesses, especially in this regulatory environment. During the last Congress, Representative Marchant joined by Chairman Luetkemeyer and others in introducing HB 2789 to increase the number of bank Sub S shareholders from 100 to 500 and permit the issuance of preferred stock, a popular means for banks to raise capital. Congressman Marchant also introduced HR 3287 to permit banks to organize as limited liability companies which would create significantly greater organizational flexibility and opportunities to raise bank capital. We anticipate similar bills being introduced in both the House and Senate this Congress. Indeed, we have held detailed discussions with Chairman Brady and most of the members and staff of the Ways and Means Committee and have heard no opposition to these proposals. Similar discussions have been taking place recently with members of the Senate Finance committee and staff.

These bills are also a means of promoting more new bank charters since they would provide the opportunity for flow through tax treatment. As I mentioned before, our firm is privileged to represent the first new national bank charter filed since 2008, and it is being organized as an S corporation for purposes of enhancing shareholder value without the need to sell the bank. And while the organizers of this bank are confident in their ability to raise the necessary capital, they would prefer not to be constrained by the 100 shareholder limit.

While the charter application is still under review by the FDIC and the Office of the Comptroller of the Currency (OCC), I can testify that both agencies have been very welcoming and helpful during the entire process, from the first introductory meetings we held in Washington with senior officials at the OCC and the FDIC through our current stage in the process. Each agency has been very responsive and encouraging and have expressed genuine interest in seeing our client's application succeed.

I would also note that the OCC issued new and updated bank charter licensing guidance in September of 2016 which provides clear and current information on the new national bank charter requirements and process. In December 2016, the FDIC issued a publication for comment entitled *Applying for Deposit Insurance – A Handbook for Organizers of De Novo Institutions* which is a very readable and "user-friendly" guide to potential new bank organizers. Both of these publications provide current and useful information are clear evidence of regulator's desire to see more new bank charters.

I applaud the Chairman and members of the committee for holding this hearing and hope that my testimony has given the committee some additional insight and will also promote new bank charter activity. We also encourage Congress to adopt the above referenced bills to increase capital access for community banks and to continue to encourage less regulation so that shareholders can cause their banks to be managed efficiently and effectively. One further specific suggestion would be to permit Subchapter S banks, and if authorized limited liability company banks, to pay dividends to their shareholders in an amount equal to the personal taxable income derived from bank earnings. The regulatory authorities have prohibited this and demanded that no dividends be paid to shareholders even in the face of taxable income being recognized by shareholders of S corp banks and bank holding companies. I thank the Chairman for his leadership in encouraging the regulatory authorities to eliminate this inequality.