



Testimony of

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On behalf of the

Independent Community Bankers of America

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“The State of Bank Lending in America”

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Chairman Luetkemeyer, Ranking Member Clay, and members of the Subcommittee, 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 Banker 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 "The State of Bank Lending in America."

Despite some recent, positive news on the state of bank lending, now is not the time to be complacent. From my vantage point as a community banker in south Texas, and from my conversations with hundreds of community bankers from around the country, I can assure you that the economic recovery is tepid, uneven and fragile. This view is supported by data that, when disaggregated, depict a recovery that is mixed at best and in need of strong remedies. These remedies include ICBA's Plan for Prosperity and several bills that will soon be introduced.

Today, a customer with a pristine credit score, or a larger, established business, can secure a loan, but this isn't the measure of a dynamic economy. When the credit box is tight, we experience subpar economic growth. To break out of this rut and strengthen economic growth, we must expand credit availability to the millions of hardworking households and would-be entrepreneurs with less than pristine credit scores. These potential borrowers, many of whom are at the middle- or lower- end of the income scale, deserve access to credit to purchase a home or to start a small business. Today's regulatory burden has choked off community banks' capacity to take on and manage reasonable credit risk.

Before I discuss proposed remedies, 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. We are typical of thousands of community banks across the country with a vested interest in the success of the communities they serve, today and for generations to come.

Industry Consolidation Reduces Competition and Threatens Small Communities

Unfortunately, the number of community banks is rapidly dwindling. Today there are more than 1,700 fewer community banks than there were in 2010. Since that date, only three de novo community banks have launched operations. We are grateful to this subcommittee for holding a hearing on this critical topic just last week. The effect of industry consolidation is that many small communities are stranded without a local bank. These are the communities likely to be left behind in the recovery. Lack of competition will lead to fewer choices, lower rates on deposits, and higher fees and rates on loans. Any assessment of the health of the community banking industry must account for consolidation and the lack of de novo banks.

What's driving this consolidation and what is discouraging de novo formation? A significant factor is the rise in regulatory burden. Larger banks are much better able to absorb and amortize the sharply increasing cost of compliance. These same costs have a chilling effect on new charters. Meaningful regulatory relief will slow the consolidation trend and encourage new charters, creating a more vibrant financial system to the benefit of consumers and small business borrowers.

The Community Bank-Small Business Partnership

America's community banks are prolific small business lenders. We play an outsized role in funding small businesses and the jobs they create. While community banking organizations represent 17 percent of all U.S. bank assets, we make more than half of all small business loans. Small businesses account for over half of all U.S. employment and nearly two thirds of all employment growth.

What sets community banks apart is their first-hand knowledge of the borrower, the community, and the local economy. Community bank small business lending simply cannot be duplicated by a lender based outside the community. As noted in a recent study by scholars at Harvard's Kennedy School of Government: "In certain lending markets, the technologies larger institutions can deploy have not yet proven effective substitutes for the skills, knowledge, and interpersonal competencies of many traditional banks."¹

One of the bright spots in today's economy is the surge in optimism among small business owners, as shown in the most recent survey by the National Federation of Independent Businesses.² Though credit demand remains weak, as this optimism translates into expansion and hiring, credit demand will grow. We must ensure the regulatory environment allows community banks to leverage their unique underwriting skills to meet that demand for credit and create economic growth.

A Burdensome Regulatory Environment Inhibits Lending

At ValueBank Texas, new, complex rules touch every aspect of our business and have changed the fundamental nature of our business from lending and investing to compliance with ever changing rules and regulations. Before 2008, our bank did not have dedicated compliance staff. We were able to manage our compliance program as part of the duties of our department heads. Today, that is no longer possible and we've been forced to hire dedicated compliance staff to aid our Chief Operating Officer in compliance management. This hiring has more than doubled our salary expenses related to regulatory compliance. On top of that, we've been forced to expand the scopes of our third-party compliance audits. Our cost for these audits have increased by over 150% since 2008. Unfortunately, these escalating compliance expenses are typical of community banks across the country.

As costly and time consuming as it is for us to stay on top of this burden, I want to focus my testimony on the customer impact. Simply put, regulatory overkill is cutting off access to credit for credit-worthy borrowers. The expense and distraction of regulatory compliance divert scarce funding and management resources from community lending – particularly for those marginal borrowers whose applications warrant closer review and a greater capacity for risk. These are the borrowers who get squeezed out by today's regulatory burden. According to a recent Urban Institute study, overly tight credit killed 1.1 million mortgages in 2015 alone.³ These would-be borrowers are people with lower credit scores and lower income. The study found that tight credit was due in significant part to regulatory restrictions.

In addition to the *indirect* impact of resource diversion, there a number of new rules, particularly in the area of mortgage lending, that *directly* prohibit certain credit-worthy loans from being made by

¹ "The State and Fate of Community Banking." Marshall Lux and Robert Greene. Mossavar-Rahmani Center for Business and Government at the Harvard Kennedy School. February 2015.

² "Small Business Optimism Remains Near Record High." March 2017 Report: Small Business Optimism Index. National Federation of Independent Businesses.

³ "Overly tight credit killed 1.1 million mortgages in 2015." Urban Wire. Urban Institute. November 21, 2016.

ValueBank Texas and other community banks around the country. Let me share a few examples that illustrate this point. In each of these cases, creditworthy individuals that would previously have been served are being turned away because new mortgage rules deny community bankers the flexibility to serve them or impose costs that make certain types of loans unprofitable.

- Customers who relocate for a new job often fail to satisfy the income verification requirements of the ability-to-repay rule (also known as the “qualified mortgage,” or QM rule). Professionals with decades of experience in their fields – teachers, doctors, pharmacists, and others – who relocate to new areas are denied credit because they cannot produce enough pay stubs in their new job. A credit-worthy borrower shouldn’t have to rent, and possibly be forced into a 12-month lease, because they don’t have enough paystubs to qualify for a mortgage.
- Community bankers have to deny mortgage credit to small-business owners who cannot comply with the income-documentation requirements under the ability-to-repay rule, despite their excellent credit. The underwriting requirements of QM are inflexible and do not afford the lender discretion to use judgment or to weigh compensating factors such as a high net worth in making credit decisions.
- Low-dollar loans are typical in many parts of the country for purchase or refinance of residential properties. However, the fees on these loans, though low in absolute terms, often exceed the QM rule fee caps. A community banker from Ohio offers the example of a \$75,000 loan with an 80 percent loan-to-value ratio and a cash-out feature. The closing fee for a QM loan in this dollar range is capped at \$3,000, which is less than the lender’s cost of underwriting and processing the loan. This is a credit-worthy loan that will not be made because the lender is not willing to take a loss. Ironically, the loan could be made and transferred to Fannie Mae or Freddie Mac, thereby receiving automatic QM status, but their fee would exceed \$4,000, in addition to the originator’s fee. QM, far from protecting the customer, causes them to pay significantly more or be denied access to the loan altogether.

I hear these stories again and again from community bankers from Texas and around the country.

Solutions

The good news is that there are readily available legislative solutions to the tepid and uneven economic recovery. Working with community bankers from across the nation, ICBA developed its Plan for Prosperity, 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.

While the Plan contains nearly 40 separate legislative recommendations, they are organized around six broad themes:

- Improved access to capital to sustain community bank independence;
- Regulatory relief to promote lending and growth;
- Mortgage reform to strengthen the housing market;
- Reforming oversight and examination practices to better target the true sources of risk;
- Tax reform to restructure, modernize, and simplify our complex and inefficient tax code; and
- Provisions to create and strengthen economic prosperity in rural America.

Each provision of the Plan was crafted to preserve and strengthen consumer protections and safety and soundness. I encourage the members of this committee to review the Plan, which is attached to this statement.

This committee's work in the last Congress set the stage for enacting meaningful regulatory relief in this Congress. I want to highlight the Clear Act, soon to be reintroduced by Chairman Luetkemeyer. Last Congress's version contained provisions addressing mortgage regulatory relief; capital access; and reform of oversight and supervision. The bill was endorsed by 34 state community bank associations. A key provision of the bill, automatic QM status for any mortgage held in portfolio, is also contained in the Portfolio Lending and Mortgage Access Act introduced by Representative Barr. A portfolio lender that holds 100 percent of the credit risk has every incentive to thoroughly assess the borrower's financial condition. This is a simple, easy-to-apply solution to the threat of QM.

We also look forward to the reintroduction of Chairman Hensarling's Financial Choice Act. Last year's bill contained over two dozen community bank regulatory relief provisions from ICBA's Plan for Prosperity.

These bills, among others before the Committee, are all part of the solution to regulatory burden.

We strongly encourage this committee to complete the work that was begun in the last Congress and enact meaningful regulatory relief for community banks.

Thank you again for the opportunity to testify today. I look forward to your questions.

Plan for Prosperity: The Community Bank Agenda for Economic Growth

America's community banks stand ready to join with the 115th Congress and the incoming administration in creating a new era of economic growth and prosperity.

Providing nearly half of all small business loans as well as customized mortgage, consumer, and agricultural loans suited to the unique characteristics of their local communities, America's nearly 6,000 community banks serve a vital role in creating and sustaining economic growth in communities of all sizes and in every region of the country.

To reach their full potential as catalysts for entrepreneurship, economic growth, and job creation, community banks need relief from suffocating regulatory mandates. The exponential growth of these mandates affects nearly every aspect of community banking. The very nature of the industry is shifting away from community investment and community building to paperwork, compliance, and examination. The new Congress has a unique opportunity to simplify, streamline and restructure every aspect of the regulatory and tax environment.

ICBA's Plan for Prosperity ("the Plan") is an agenda for regulatory relief that will allow community banks to thrive by doing what they do best — serving and growing their communities one loan at a time. 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 developed with input from community bankers nationwide and crafted to preserve consumer protections and bank safety and soundness. ICBA and community bankers are committed to working with Congress and the administration to enact the provisions of the Plan with the use of every resource at our disposal. If we act boldly and make fundamental reforms, the American economy will grow and prosper for the benefit of generations to come.

Capital: Simplified Rules and New Options for the Creation and Preservation of Community Bank Capital

The Plan for Prosperity would strengthen community bank viability and independence by enhancing access to capital and simplifying capital regulation. New capital options for community banks would fuel economic growth and prosperity for all Americans.

Basel III Amendments: Restoring the Original Intent of the Rule. Basel III was originally intended to apply only to large, internationally active banks. Non-systemically important financial institutions (non-SIFIs) should be fully exempt from the rule.

In lieu of a full Basel III exemption for all community banks (which is ICBA's strong preference) ICBA proposes the following amendments:

- *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 non-SIFIs 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 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 (HVCRE) 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.
- *Reverse punitive capital treatment of mortgage servicing.* 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

More Accurate Identification of "Systemic Risk." The current threshold of \$50 billion for the identification of "systemically important financial institutions" (SIFIs) under Title I of the Dodd-Frank Act is too low and sweeps in too many banks that pose no systemic risk and should not be subject to higher prudential standards. A higher threshold and a more flexible SIFI definition under Title I would more accurately identify those institutions that pose systemic risk.

Additional Capital for Small Bank Holding Companies: Modernizing the Federal Reserve's Policy Statement. The Federal Reserve Board should be required 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, should be revised to increase the qualifying asset threshold from \$1 billion to \$10 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. The following SEC rule changes would allow community banks to commit more resources to their communities without putting investors at risk:

- Provide an exemption from internal control audit requirements for banks with a market capitalization of \$350 million or less. 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. This provision would substantially lower the regulatory burden and expense for small, publicly traded banks without creating more risk for investors.
- 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.

Repeal Collins Amendment for Non-SIFIs. The Collins Amendment to the Dodd-Frank Act (Section 171) was originally intended to equalize large bank and community bank capital treatment. In practice, however, the amendment limits regulators’ discretion in implementing Basel III and has proved to be a stumbling block to simpler capital rules for community banks. ICBA supports full repeal of the Collins Amendment for non-systemically important financial institutions (non-SIFIs).

Address Minority Bank Capital Challenges. ICBA will work with Congress to explore options for addressing capital challenges faced by minority banks. These banks serve a critical role in providing credit, capital and financial services to low-to-moderate income and minority communities in urban, rural and suburban areas that are economically distressed.

Regulatory Relief

Community bank regulation, which has steadily increased for decades, is a cumulative, oppressive burden that limits access to credit in our communities and drives industry consolidation that will directly harm consumers and small businesses. Regulatory relief for community banks will promote greater economic growth in our local communities.

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

- The CFPB should be granted additional statutory authority to exempt or tier regulatory requirements for community banks and/or community bank products and services.
- The governance structure of the CFPB should be changed to a five-member commission rather than a single director. This change would 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.

Eliminate Arbitrary “Disparate Impact” Fair Lending Lawsuits. Amend the Equal Credit Opportunity Act and the Fair Housing Act to bar “disparate impact” causes of action and to require discriminatory intent for fair lending violations. Disparate impact describes differential results that arise despite the use of practices that are facially neutral in their treatment of different groups. Lenders must consider factors such as race and national origin in individual credit decisions to protect themselves from fair lending regulatory enforcement actions and lawsuits. Legislation is needed to require discriminatory intent for a finding of fair lending violations. This would ensure lenders that uniformly apply neutral lending standards are not subject to unnecessary regulatory enforcement actions or frivolous and abusive lawsuits under the Equal Credit Opportunity Act or the Fair Housing Act.

Ensuring the Viability of Mutual Banks: New Charter and Capital Options. A new national charter for mutual banks would allow institutions to choose the charter that best suits their needs and the needs of the communities they serve. Mutual institutions should be authorized to issue mutual capital certificates, an additional option for raising capital. Existing federal savings associations chartered under the Home Owners’ Loan Act should be able to elect to have the rights and privileges of a national bank without changing charters.

Rigorous and Quantitative Justification of New Rules: Cost-Benefit Analysis. The financial regulatory agencies should not be allowed to issue notices of proposed rulemaking unless they first determine that quantified costs are less than benefits. The analysis should 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 should be required to identify and assess available alternatives including modifications to existing regulations. They should also be required to ensure that proposed regulations are consistent with existing regulations, written in plain English, and easy to interpret.

Modernizing the Bank Secrecy Act. ICBA recommends raising the currency transaction report (CTR) threshold from \$10,000 to \$30,000 and indexing future increases on an annual basis for inflation. The current threshold, set in 1970, is significantly dated and captures far more transactions than originally intended. A higher threshold would produce more targeted, useful information for law enforcement. ICBA also supports the creation of a tax credit to offset the cost of BSA compliance. (See “Tax Relief” below.) In addition, beneficial ownership information should be collected and verified at the time a legal entity is formed by either the Internal Revenue Service or other appropriate federal or state agency, rather than by financial institutions. This would provide uniformity and consistency across the United States.

Cutting the Red Tape in Small Business Lending: Eliminate Burdensome Data Collection. ICBA supports full repeal of the statutory authority (Dodd-Frank Section 1071) for new small business loan data collection requirements. This provision, which will likely require the reporting of information regarding every small business loan application, will fall disproportionately upon smaller banks that lack scale and compliance resources.

Risk Targeting the Volcker Rule. Non-systemically important financial institutions (non-SIFIs) should be exempt from the Volcker Rule, which should apply only to the largest, most systemically risky banks. Proposals to apply the rule to non-SIFIs carry unintended consequences that threaten to destabilize segments of the banking industry.

Preserve Access to Investment Advice for Middle Class Savers. ICBA supports full repeal of the Department of Labor’s misguided fiduciary rule, which, if allowed to go into effect, would raise costs, limit choices, and reduce access to sound retirement investment advice for thousands of low and middle income Americans.

Mortgage Reform for Community Banks

Every aspect of mortgage lending is subject to new, complex, and costly regulations that are driving community banks out of this line of business. The Plan for Prosperity would support a robust housing market by providing relief from new 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.

Safe Harbor from Onerous Underwriting. Loans originated and held in portfolio by banks with less than \$50 billion in assets, including balloon mortgages, should be granted “qualified mortgage” (QM) safe harbor status from the underwriting requirements of the ability-to-repay rule. In addition, any loan transferred to Fannie Mae, Freddie Mac, or a Federal Home Loan Bank should be automatically granted QM safe harbor status.

HMDA Relief. A recent Home Mortgage Disclosure Act (HMDA) rule more than doubled the number of data fields lenders must report in connection with every loan application, forcing community banks to overhaul their systems and retrain staff at significant cost. ICBA supports repeal of the Dodd-Frank authority for expanded HMDA reporting. In addition, the loan-volume threshold for HMDA reporting should be increased to 1,000 closed-end mortgages and 2,000 open-end lines of credit. The current reporting threshold exempts a maximum of 34,000 loans, according to a CFPB estimate, a minimal fraction of the nearly 10 million annual mortgage applications reported through HMDA last year. ICBA’s recommended threshold would provide relief for many more small lenders without significantly impacting the mortgage data available to the CFPB or impairing the purpose of the HMDA statute.

Escrow Relief. Banks with assets of less than \$50 billion should be exempt from escrow requirements for loans held in portfolio. Such banks have direct stake in protecting their collateral by ensuring taxes and insurance are paid on a timely basis.

Appraisals. In recent years, appraisal requirements have become more costly, and rural America is experiencing a critical shortage of appraisers. When a mortgage is held in portfolio, a bank should be able to substitute an in-house “property evaluation” for a full residential property appraisal completed by a licensed appraiser.

Preserve Community Bank Mortgage Servicing. Simplified servicing regulation would help preserve the important role of community banks in servicing mortgages and deter further industry consolidation, which is harmful to borrowers. The “small servicer” threshold should be raised from 5,000 loans serviced to the greater of 30,000 loans serviced or \$5 billion in unpaid principal balance on loans serviced. To put this proposed threshold in perspective, the average number of loans serviced by each of the five largest servicers subject to the national mortgage settlement is 6.8 million, and each has an unpaid principal balance of more than \$300 billion.

Reform of Closing Process and Paperwork. The TILA-RESPA Integrated Disclosure (TRID) rule, which governs the residential mortgage closing process and paperwork, is a uniquely complex rule with unclear liabilities. The rule has caused some community banks to cease offering mortgages and has greatly increased compliance expenditures for others. TRID reform should: (i) make waiting periods waivable at the request of the consumer; (ii) limit liability to violations that cause consumers actual, material harm; (iii) permit creditors to cure errors and make consumers whole before allowing the consumer the right to file a lawsuit; and (iv) exempt loans secured by large, mixed-use properties.

Bank Oversight and Examination

A trend toward oppressive, micromanaged regulatory exams is suffocating community banks' ability to serve their customers and communities. The following reforms would allow community banks to lead an economic revival on Main Streets across America.

Strengthening Accountability in Bank Exams: A Workable Appeals Process. An independent body should 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 banks with up to \$5 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.
- Non-systemically important financial institutions (non-SIFIs) 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 and file the current, long-form call report only in the second and fourth quarters. The quarterly call report represents a growing burden on community banks without being an effective supervisory tool.
- The Community Reinvestment Act (CRA) asset thresholds should be modernized. The “small bank” and “intermediate small bank” thresholds determine how a bank is assessed. A separate threshold determines how often a bank is assessed. These thresholds do not reflect consolidation in the community banking industry and should be increased. Community banks prosper by reinvesting local deposits and serving all customers in their communities. Too frequent or intrusive CRA exams are unnecessary and force banks to expend resources that could otherwise be dedicated to serving customers.
- All banks with assets of \$50 billion or less should be exempt from examination and enforcement by the CFPB and instead be examined and supervised by their prudential regulators for compliance with consumer protection regulation. CFPB backup (or “ride along”) authority for compliance exams performed by a bank’s primary regulator should be eliminated.

Community Bank Tax Relief

The 115th Congress presents a unique opportunity to restructure, modernize and simplify our complex and inefficient tax code. Tax reform and community bank tax relief, done properly, have the potential to strengthen our economy and spur job creation for a generation or more.

Lower Marginal Rates Needed for Individuals, Corporations, and Businesses. ICBA strongly supports tax rate relief for American individuals, corporations, and businesses. Significant tax relief will provide a much-needed boost to a sluggish economic recovery and possibly help stave off another recession by spurring consumer purchasing, business investment, and hiring. Rate relief must be a part of any tax reform package.

Incentivizing Credit for Low- and Middle-Income Customers and American Agriculture. ICBA supports the creation of new tax credits or deductions for community bank lending to low- and middle-income individuals, businesses, farmers, and ranchers. Such tax credits or deductions would help to sustain and strengthen lending to low- and moderate-income customers and America's farmers and ranchers, and would help offset the competitive advantage enjoyed by tax-exempt credit unions and Farm Credit System lenders.

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. Congress should: increase the limit on Subchapter S shareholders from 100 to 200; allow Subchapter S corporations to issue preferred shares; and permit the holding of Subchapter S shares, both common and preferred, in individual retirement accounts (IRAs). These changes would improve the ability of the nation's 2,200 Subchapter S banks to raise capital and increase the flow of credit within their communities.

Limited Liability Corporation Option for Community Banks. In addition to modernization of Subchapter S for banks (as described above), ICBA supports the creation of a limited liability company (LLC) option for community banks. The LLC election would allow pass-through tax treatment for community banks without the limitations of Subchapter S organization.

Estate Tax Repeal. ICBA supports full, permanent repeal of the estate tax, which jeopardizes the succession of many family-owned community banks from generation to generation. A family estate should never be forced to sell its interest in a community bank to pay a transfer tax. Forced sales of once-family-owned community banks to other community banks or, frequently, to larger regional or national banks, coupled with a recent surge in regulatory burden, accelerate the current trend toward consolidation in the banking sector.

Update Bank Qualified Bond Issuer Limitation. Since 1986, the tax code has provided a special incentive for banks to purchase bonds issued by municipalities, school districts, sanitation districts, and other public entities, provided the issuer expects to issue no more than \$10 million of bonds annually. These are known as "bank qualified bonds." Because the \$10 million limitation has been severely eroded by inflation, today only a small number of issuers are eligible to take advantage of lower interest rates by issuing bank qualified bonds. The limitation was temporarily increased to \$30 million by the American Recovery and Reinvestment Act of 2009. ICBA supports a permanent increase in the limitation to \$50 million to be indexed prospectively. A higher limitation would allow local bank deposits to support needed, local public infrastructure investments at a lower interest rate, as originally intended by the 1986 Tax Reform Act.

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.

Tax Credit for Bank Secrecy Act Compliance Costs. For community banks, BSA compliance represents a significant expense in terms of both direct and indirect costs. BSA compliance, whatever the benefit to society at large, is a purely governmental, law enforcement function with no direct benefit to the bank or its customers. As such, the costs should be borne by the government. ICBA supports the creation of a tax credit to offset the cost of BSA compliance.

Agriculture & Rural America

A vibrant rural economy is vital to America's prosperity. Community banks, which fund nearly 80 percent of all agricultural loans, serve a critical role in creating and sustaining rural economic prosperity. The following provisions will help rural America thrive by strengthening the community banks that serve agricultural enterprises.

Agricultural Loan Concentration Limits. Regulatory agencies and bank examiners should not treat agency guidance as official agency rule making, particularly with regard to concentration limits that could unnecessarily restrict community bank lending. Many banks in rural areas do not have economic choices beyond agriculture and such guidance, if interpreted as rule making, could dramatically increase their risks as they venture into new lending markets.

Tax Relief for Rural Lending. ICBA supports the creation of tax incentives to support agricultural lending and residential mortgage lending in rural areas. See Community Bank Tax Relief for more information.