ICBA
INDEPENDENT COMMUNITY
BANKERS of AMERICA

Testimony of

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On behalf of the
Independent Community Bankers of America

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Subcommittee on Financial Institutions and Consumer Credit

Hearing on

"Examining Legislative Proposals to Provide Targeted Regulatory Relief to Community Financial Institutions"

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Opening

Chairman Luetkemeyer, Ranking Member Clay, and members of the Subcommittee, I am Robert Fisher, President and Chief Executive Officer of Tioga State Bank, a $475 million community bank in Spencer, New York. I am pleased to be here today on behalf of the Independent Community Bankers of America and the nearly 5,000 community banks we represent. Thank you for convening this hearing titled: "Examining Legislative Proposals to Provide Targeted Regulatory Relief for Community Financial Institutions." We hope that this hearing sets the stage for legislation needed to strengthen local economic growth and job creation.

Tioga State Bank has deep roots in the communities of Tioga County and surrounding counties in upstate New York. Founded by my great-great grandfather in 1884 to provide badly-needed banking services to local businesses and individuals, Tioga State Bank has weathered the Great Depression and numerous recessions since that time. I am a fifth-generation community banker, proud to carry on our commitment to local prosperity. Today we have 11 offices and approximately $475million in assets. We specialize in consumer mortgage and small business lending. Our footprint is largely rural, but we also have offices in the urban and suburban communities of Binghamton. Many of the communities we serve depend on us as the only financial institution with a local presence. These smaller communities are simply not on the radar of the megabanks.

Like thousands of other community banks across the country, Tioga State Bank provides services than cannot be duplicated by banks that operate from outside the community. The credit and other financial services community banks provide help advance and sustain the economic recovery, which has been painfully slow and uneven, failing to reach many individuals and communities. Community banks are responsible for more than 50 percent of all small business loans nationwide under $1 million. In New York state, community banks hold just 22 percent of total banking assets but make 55 percent of small business loans and 90 percent of small farm loans. Community banks "punch above their weight," well above, in these critical forms of lending. As the economic recovery 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 we pose. Community banks didn't cause the financial crisis, and we should not bear the weight of overreaching regulation intended to address it. I would like to thank this committee for passing a number of important regulatory relief bills this Congress, notably the Financial CHOICE Act (H.R. 10), which contains numerous community bank regulatory relief provisions, many of which reflect ICBA's Plan for Prosperity. We strongly encourage this committee to build on your strong record of regulatory relief by advancing legislation I will discuss today.

Proposed Legislation

I will focus my testimony on four bills before this committee that are of particular interest to community bankers: the "CLEARR Act" (H.R. 2133); the "Financial Institutions Due Process Act" (H.R. 924); the Clarifying Commercial Real Estate Loans Act" (H.R. 2148); and the Access to Affordable Mortgages Act."

The common theme of these bills is government overreach whether it's in the form of prescriptive regulation that unnecessarily escalates the cost of credit, arbitrary capital requirements, or examination practices designed to deter or discourage banking services to legal and legitimate customers. ICBA supports each of these bills for reasons I will discuss below.

The Community Lending Enhancement and Regulatory Relief Act of 2017 (CLEARR Act, H.R. 2133)

The CLEARR Act, introduced by Chairman Luetkemeyer, is a package of 15 provisions designed to provide relief from some of the most egregious aspects of regulatory burden, intrusive government overreach, and legal risk facing community bankers today. Passage of the CLEARR Act, many provisions of which were recommended in ICBA's Plan for Prosperity, will increase community lending and job creation.

Strengthening Community Bank Mortgage Lending

Eight of the CLEARR Act's 15 provisions address different aspects of mortgage lending. No area of community banking has been heaped with more new regulation in recent years than mortgage lending – to the detriment of borrowers everywhere.

Mortgage lending by community banks represents approximately 20 percent of the national mortgage market.[1] However, in many small towns and rural communities the local community bank is the main source of mortgage credit. These markets are often neglected by larger national mortgage lenders that are driven by volume and margins because the markets may not generate enough real estate lending activity. Mortgage lending has always been an important part of Tioga State Bank's businesses model, which as recently as 20 years ago represented some 90 percent of our lending. Today, mortgage lending represents about 45 percent of our lending and commercial lending the other 55 percent.

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[1] The Federal Reserve's analysis of Home Mortgage Disclosure Act (HMDA) data indicates that banks with assets under $10 billion account for 18 percent of home loan originations. See "Community Banks and Mortgage Lending," Remarks by Federal Reserve Governor Elizabeth Duke, November 9, 2012. However, HMDA data does not capture institutions that operate exclusively outside of metropolitan areas. Therefore, we estimate that the community bank mortgage market share is slightly larger than 18 percent.

Flexibility for Portfolio Lenders

Provisions of the CLEARR Act create new flexibility for banks that hold mortgage loans in portfolio. Many residential properties in the small and rural communities served by community banks don't qualify for sale in the secondary market. They may sit on a large plot of land, be mixed-use in nature, or irregular in other ways. They frequently lie outside of city limits. These are not suburban properties and for this reason they often lack adequate comparable sales and don't fit the inflexible requirements of the secondary market. In addition, the borrowers may be farmers or small business owners whose debt-to-income ratios fall outside of secondary market parameters, despite their personal net worth and means to repay the loan. Community banks specialize in serving such borrowers, often with non-conforming loans held in portfolio. At Tioga State Bank, we hold 60 to 65 percent of the mortgages we originate in portfolio. Most of these loans would not qualify for sale into the secondary market.

Portfolio lenders need a more flexible approach to regulatory compliance because they hold 100 percent of the risk of default and have every incentive to ensure they understand the borrower's financial condition and to work with the borrower to structure the loan properly and make sure it is affordable. The same incentives lead portfolio lenders to ensure that collateral properties are accurately appraised and that taxes and insurance premiums are paid on a timely basis.

Automatic QM for Mortgages Held in Portfolio

The "qualified mortgage" (QM)/ability-to-repay rule is overly complex and prescriptive and excludes otherwise creditworthy mortgages. As many community banks are unwilling to assume the legal risk of underwriting non-QM mortgages, the QM rule has the effect of reducing credit availability and even pushing some banks to exit the mortgage market. QM reform is needed to keep community banks in the mortgage market and expand mortgage credit.

CLEARR Act Solution

The CLEARR Act would provide that mortgages held in portfolio by have automatic "qualified mortgage" (QM) status under the CFPB's ability-to-repay rule. This is a simple, clean solution that would avoid the tortuous analysis required under the CFPB's ability-to-repay rule.

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 more costly in recent years, and rural American is experiencing a shortage of licensed appraisers. This is certainly true in our market, where an appraiser shortage is escalating prices and increasing appraisal turnaround times. 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.

CLEARR Act Solution

Under the CLEARR Act, a mortgage held in portfolio by a bank with assets of $50 billion or less would be exempt from escrow requirements. Further, mortgage loans of less than $250,000 held in portfolio would be exempt from appraisal requirements that otherwise apply to "higher-risk" mortgages, as defined by regulation. Community banks are better able to appraise local property values in-house.

I would like to thank Rep. Kustoff for introducing the CLEARR Act appraisal provision described above in a free-standing bill, the **Access to Affordable Mortgages Act of 2017**.

Home Mortgage Disclosure Act Reporting and Recordkeeping

Community bank mortgage lenders are subject to burdensome reporting and recordkeeping requirements under the Home Mortgage Disclosure Act (HMDA). The HMDA burden was sharply increased by a recent CFPB rule that more than doubled the number of data fields – from 23 to 48 – lenders must report for every loan application, forcing community banks to overhaul their systems and retrain staff at significant cost. At Tioga State Bank, we have had an internal task force working on the new data fields for the last six months. Our core processor is still working on the issue as well.

Collection of the new data points begins on January 1, 2018, and reporting of that data begins in 2019. Yet this new data, collected at significant expense, will likely provide little incremental benefit or insight over what is currently reported.

While HMDA does exempt certain lenders, the current exemption thresholds are far too low. Institutions with assets of less than $44 million (adjusted annually) and institutions with no offices in metropolitan statistical areas are exempt from reporting under HMDA. The new rule creates an additional exemption for small volume mortgage lenders that originate fewer than 25 closed-end mortgages and fewer than 100 open-end lines of credit in each of the two preceding years.

This threshold exempts a maximum of 34,000 loans nationwide, according to a CFPB estimate, a miniscule fraction of the nearly 10 million annual mortgage applications reported through HMDA last year.

CLEARR Act Solution

The CLEARR Act would repeal the Dodd-Frank authority for expanded HMDA reporting which provides little additional information of use at significant expense to community bank mortgage lenders.

In addition, the CLEARR Act would increase the loan-volume threshold for HMDA reporting to 1,000 closed-end mortgages and 2,000 open-end lines of credit. These higher thresholds 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.

As a community bank mortgage lender, I can affirm that HMDA reform is a high priority and would free up significant staff time and resources to better focus on serving customers.

Preserve Community Bank Servicing

ICBA believes it is critical to retain and promote the role of community banks in mortgage servicing and adopt policies that will deter further consolidation of the mortgage servicing industry. At Tioga State Bank, servicing is a critical component of our mortgage lending model. We service the loans held in our portfolio and retain servicing on the loans we sell into the secondary market as well. We believe local servicing is one of the major reasons customers come to us for mortgage credit. Servicing helps us to cement long-term customer relationships.

Community banks, which thrive on their reputation for customer focus and local commitment, promote a competitive mortgage servicing industry that is less susceptible to abuses and avoidable foreclosures such as those that have impeded the housing recovery and led to the national mortgage settlement.

Community bank servicers know their communities and intervene early to keep mortgages out of default. Smaller portfolios and better control of mortgage documents also provide an advantage over the large servicers. For these reasons, community banks have generally been able to identify repayment problems at the first signs of distress and work with borrowers one-on-one to keep them in their homes.

Requiring community banks to comply with the same resource-intensive mortgage servicing requirements as the largest national servicers is driving community banks out of the marketplace. New servicing standards are overly prescriptive regarding the method and frequency of delinquent borrower contacts. They have reduced community bank flexibility to use methods that have proved successful in holding down delinquency rates. What’s more, new regulation has approximately doubled the cost of servicing with a direct impact on the consumer cost of mortgage credit.

Compounding the impact of these costly and prescriptive new standards, Basel III punishes community bank mortgage servicers by severely lowering the threshold deduction for holding mortgage servicing assets (MSAs) as well as almost tripling the risk weight assigned to MSAs when they are not deducted.

CLEARR Act Solution

The CLEARR Act would increase the small servicer exemption limit from 5,000 loans to 30,000 loans serviced. Community banks above the 5,000-loan limit have a proven record of strong, personalized servicing and no record of abusive practices. This exemption limit would separate community bank servicers from regional and megabank servicers as well as non-bank servicers with large portfolios. To put the 30,000-loan limit in perspective, consider that the five largest servicers service an average portfolio of 6.8 million loans each and employ as many as 10,000 people each in their servicing departments. The top 5 mortgage servicers each have more than $300 billion in unpaid principal balance on mortgages serviced.

The full benefit of increasing the small servicer exemption limit cannot be realized without corresponding relief from the punitive capital treatment of MSAs under Basel III. The CLEARR would require the federal banking agencies to repeal all regulations that implement Basel III with respect to MSAs and propose a new rule that takes into account (i) the history of the market for MSA, particularly during the financial crisis; (ii) the impact on consumer access to mortgage lending and mortgage servicing; and (iii) competition in the mortgage servicing market, including the role of community and mid-sized financial institutions.

Inflexible TRID Waiting Period a Nuisance to Borrowers

The TILA RESPA Integrated Disclosure (TRID) rule, which governs the mortgage application and closing process, is unique in scope and complexity. Unfortunately, the new rule has unclear liabilities and significant new compliance expenditures which have caused some community banks to exit the mortgage market.

The rule's inflexibility is a burden to both lenders and borrowers. For example, the rule requires a waiting period of three business days after the consumer receives the final disclosure documents and before closing on the loan. Loan closures can be difficult to coordinate between the seller, the buyer, and the lender. No borrower should be rushed into a loan. At the same time, ICBA believes that the borrower should have the flexibility to waive the mandatory waiting period, which in certain cases is not only a nuisance but a hardship.

For example, when a homeowner needs to refinance in order to avoid foreclosure, the waiting period may cause the homeowner to miss a foreclosure deadline. We recently had such a case at Tioga State Bank. In another case, after receiving the pre-closing disclosures, a customer changed his mind about allowing us to create an escrow account. This late decision affected the loan's APR and triggered a restart of the three-business-day waiting period. Lastly, we get complaints from refinance borrowers because the waiting period is added to the three-day rescission period, which means that it takes at least six business days to close a refinance. More flexibility with regard to the waiting period would facilitate transactions and be greatly appreciated by borrowers.

CLEARR Act Solution

The CLEARR Act requires the CFPB to issue regulations establishing a process to waive the TRID waiting period. Consumers can best determine the appropriate timing a potentially-delicate loan closure and should have the option of waiving the three-business day waiting period.

Non-Mortgage Regulatory Relief

Small Business Loan Data Collection

Dodd-Frank Section 1071 requires the CFPB to implement rules for the collection and reporting of data on financial institutions' small business lending under the Equal Credit Opportunity Act. When written, the rules will require the collection and reporting 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. Twelve pieces of data will be required, including the race, sex, and ethnicity of the principal owners of the business. Section 1071 also gives the CFPB discretion to require the reporting of any additional information that would assist the Bureau in fulfilling the purposes of the statute. The Bureau's HMDA rule (see above), which included numerous data fields not required by statute, suggests that it would take a similarly expansive view of its authority under Section 1071.

Small business data collection and reporting will impose significant new burdens on community banks at a time when they are absorbing numerous other regulatory requirements. In the small communities served by community banks, this data collection and publication raises serous privacy concerns. Moreover, commercial lending is complex business that cannot be "commoditized" in the way that consumer lending can. Each individual commercial loan has customized terms based on an analysis of numerous factors.

Complex lending should not be subject to simplified, rigid analysis, which might give rise to unfounded fair lending complaints. For this reason, the rules under Section 1071 will have a chilling effect on lenders' ability to price for risk. This, in addition to the expense of data collection and reporting, may drive community banks from the commercial lending market and curb access to small business credit.

CLEARR Act Solution

The CLEARR Act would fully repeal of Dodd-Frank Section 1071.

Federal Reserve Small Bank Holding Company Policy Statement

The Federal Reserve's Small Banking Holding Company Policy Statement (Policy Statement) is a set of capital guidelines that allows bank and thrift holding companies with assets of less than $1 billion to raise and carry more debt than larger holding companies. Debt carried at the holding company level may be "down streamed," or invested, in subsidiary banks where it counts as equity.

The Policy Statement plays an important role in capital formation for smaller bank and thrift holding companies that have limited access to equity markets. A higher threshold would help more community banks meet their higher capital requirements under Basel III.

The Policy Statement contains safeguards to ensure that it will not unduly increase institutional risk. These include limits on outstanding debt and on off-balance sheet activities (including securitization), a ban on nonbanking activities that involve significant leverage, limitations on dividends, and a requirement that each depository institution subsidiary of a small bank holding company remain well capitalized.

CLEARR Act Solution

The CLEARR Act would raise the Policy Statement qualifying asset limit from $1 billion to $5 billion.

No Fair Lending Violation Without Discriminatory Intent

In June 2015, the United States Supreme Court upheld the application of "disparate impact" under the Fair Housing Act. Disparate impact describes the differential results that arise from "practices that are facially neutral *in their treatment of different groups"* but that may *"fall more harshly on one group than another."* In other words, disparate-impact may arise when the end results of a lender's operations have different demographic results despite the uniform application of sound, neutral financial standards. 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.

Community banks have seen an alarming trend of increased scrutiny in fair lending exams. De minimis pricing disparities that impact few borrowers are being cited as substantial "pattern and practice" fair lending violations. Allegations of disparate treatment require community banks to spend large amounts of time and resources in disproving false fair lending allegations.

Community banks are particularly vulnerable to such allegations. While large, conventional lenders typically take a "check list" approach to granting credit, community banks, by contrast, are committed to working with their customers to provide customized loans under exceptional circumstances. Unfortunately, this form of "exception lending" raises red flags and too often draws fair lending allegations.

CLEARR Act Solution

H.R. 2133 would amend the Equal Credit Opportunity Act and the Fair Housing Act to specify that any discrimination must be "intentional" in order to find a violation of these laws. 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.

Support Use of Reciprocal Deposits as a Stable Source of Funding for Community Lending

Reciprocal deposits allow a community bank to accept a deposit that exceeds the $250,000 insurance limit by distributing it through a network of banks and receiving reciprocal deposits from other banks in the network. This solution allows a large local depositor – such as a local government or foundation – to obtain insurance coverage and allows banks to accept an equivalent amount of deposits to support local lending.

Unfortunately, reciprocal deposits have become caught up in the definition of "brokered deposit" in the Federal Deposit Insurance Act. Brokered deposits are disfavored and discouraged by the FDIC because they are not considered to be a stable source of funding. Brokered deposits could result in higher FDIC insurance premiums and a lower CAMELS rating.

Reciprocal deposits did not exist when the Federal Deposit Insurance Act was enacted and do not act like the type of deposits the law was meant to cover. Studies have shown that reciprocal deposits act similarly to other core deposits: they are from local customers, earn the local interest rate, and are a stable source of funding. Because reciprocal deposits are wrongly governed by the law on brokered deposits, it is difficult for community banks to utilize their full potential.

At Tioga State Bank, municipal deposits represent about one third of our deposits and are a critical source of funding. However, when we keep these deposits on our balance sheet, we are required to pledge bonds for the amount of these deposits above the FDIC insurance limit, which reduces our liquidity. In recent years, we have been using reciprocal deposits to help restore liquidity. In our experience, these reciprocal deposits are stable source of core funding. The negative perception of "brokered deposits" has made us reluctant to use reciprocal deposits to their full potential.

CLEARR Act Solution

The CLEARR Act would create a statutory exception for reciprocal deposits from the definition of a brokered deposit. Such an exception would not compromise safety and soundness protections.

Making Better Use of Limited CFPB Examination Resources

The CFPB does not optimize the use of its limited examination resources by focusing on the largest banks and non-banks that are the greatest source of consumer risk.

CLEARR Act Solution

The CLEARR Act would raise the threshold for banks exempt from direct examination and reporting requirements by the Consumer Financial Protection Bureau (CFPB) from $10 billion to $50 billion in assets. Banks of less than $50 billion in assets would continue to be examined for compliance with CFPB rules by their prudential regulators. Bank supervision is more balanced and effective when a single regulator examines for both safety and soundness and consumer protection.

Prohibit Coercive and Discriminatory Regulator Scrutiny

All legal forms of business should be allowed to operate freely with access to essential banking services, subject to the discretion of banks, and without excessive pressure or intimidation from law enforcement. Law enforcement should focus on law breakers directly, without forcing banks to act as police, and their efforts should be narrowly targeted.

In recent years, bank regulators have applied unwarranted scrutiny to bank relationships with categories of businesses deemed "high risk" or that supposedly create "reputational risk." These businesses include internet-based businesses, short term lenders, telemarketers, debt collectors, and other lawful businesses. Regulators have questioned long-standing relationships with businesses that have been properly screened by the bank's own risk controls. It is beyond the scope of the supervisory process to assess a bank's reputational risk or to prohibit or discourage community banks from providing these services. Community banks are the best judge of their own reputation risk and have every incentive to safeguard their own reputations through proper screening of customers. We conduct due diligence to assess the level of risk of each customer relationship and ensure that controls are in place to identify and monitor these relationships on an ongoing basis.

CLEARR Act Solution

Under the CLEARR Act, the three federal banking regulators, the Federal Deposit Insurance Corporation, the Federal Reserve, and the Office of the Comptroller of the Currency, would be prohibited from suggesting, requesting, or ordering a bank to terminate a customer relationship unless the regulator put the order in writing and specified a material reason for the action. This requirement would limit the opportunity for regulators to abuse their discretion and terminate long-standing banking relationships based on biased, unsubstantiated, or subjective notions of "reputational risk."

The CLEARR Act would preserve the ability of banks to serve legal and legitimate business customers without undue pressure from law enforcement or examiners.

The Financial Institutions Due Process Act (H.R. 924)

H.R. 924, introduced by Rep. Rothfus, would go a long way toward improving the examination environment by creating a workable appeals process. Bank examination reform is a key component of ICBA's Plan for Prosperity.
H.R. 924 would create an Independent Examination Review Panel and give financial institutions a right to an expedited, independent review of an adverse examination determination. Taking the appeals process out of the examining agencies would bring a higher level of accountability to the regulators and their field examiners. The current system, which grants examiners almost unfettered and unassailable authority, begs for checks and balances.

The Clarifying Commercial Real Estate Loans Act (H.R. 2148)

H.R. 2148, introduced by Reps. Robert Pittenger and David Scott, is designed to provide relief from punitive new capital charges for loans for acquisition, development, and construction of commercial projects classified as high-volatility commercial real estate (HVCRE) loans. Under Basel III, these loans are risk weighted at 150 percent for the determination of regulatory capital, compared to 100 percent before Basel III – unless the borrower can contribute at origination 15 percent of the projected appraised value of the project upon its completion in cash or readily marketable assets. This is an unreasonably high bar for a borrower to meet. The borrower must also commit to tying up that capital for the life of the project.

H.R. 2148 would amend the borrower-contribution standard by allowing a lender to consider the appreciated value of land, as opposed to its historic value, in determining whether a developer has contributed enough capital to avoid the 150 percent risk weight requirement. By easing application of the new rule, H.R. 2148 would facilitate community bank lending to credit worthy projects that would promote local economic development and job creation.

Closing

Thank you again for the opportunity to testify today. We appreciate the role of this subcommittee in putting a check on regulatory overreach and rolling back unwarranted regulation that is reducing credit and promoting industry consolidation. This committee has already passed critical regulatory relief legislation. The bills I've discussed today would build on your previous efforts by addressing critical threats to community banking. We look forward to working with this committee to advance them into law.