Testimony of

Dale Wilson

On behalf of the

Texas Bankers Association

before the

Committee on Financial Services

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July 23, 2014

Chairman Hensarling, Ranking Member Waters, my name is Dale Wilson, Chairman and Chief Executive Officer of the First State Bank of San Diego in San Diego, Texas. We are a rural community bank with just under $80 million in assets serving the needs of a South Texas town of approximately 5,000 people. Our local economy is based upon agriculture and energy. Demographically, our community is 85% Hispanic. I appreciate the opportunity to be here to present the views of the Texas Bankers Association (TBA) on the impact of the Dodd-Frank Act. TBA is the voice of Texas banking, representing 500 small, regional and large banks, employing over 150,000 people and providing over $205 billion in loans.

Let me start by thanking my own Congressman, Ruben Hinojosa, who serves on this committee. Congressman Hinojosa has always sought out the views of the community bankers in his district and has even taken time to meet with our Board of Directors. His dedication to the concerns of his South Texas constituents is deeply appreciated.

Community banks make up 95 percent of all U.S. banking organizations and have been the backbone of Main Streets across America. Our presence in small towns and large cities everywhere means we have a personal stake in the economic growth, health, and vitality of nearly every community. A bank's presence is a symbol of hope, a vote of confidence in a town's future. When a bank sets down roots, communities thrive.

The sad fact is that over the course of the last decade 1,500 community banks have disappeared. This is why hearings like today's are so important. It is an opportunity to change the dialogue from just talking about how important community banks are to what can be done to stop the rapid decline in the number of community banks and start taking action to assure we have a healthy and vibrant community banking sector.

During the last decade the regulatory burden for community banks has multiplied tenfold, with more than 50 new rules in the two years ***before*** Dodd-Frank. Dodd-Frank is already adding to that burden for all institutions with 5,933 pages of proposed regulations and 8,002 pages of final regulations (as of May 29, 2014) and we're only half way through the 398 rules that must be promulgated and is poised to add hundreds more affecting all banks. Managing this tsunami of regulation is a significant challenge for a bank of any size, but for a small bank with only 17 employees, it is overwhelming.

Today, it is not unusual to hear bankers—from strong, healthy banks—say they are ready to sell to larger banks because the regulatory burden has become too much to manage. Since the passage of Dodd-Frank there are 80 fewer Texas banks. These banks did not fail. Texas has one of the healthiest economies in the country – we call it the Texas miracle. These were community bankers – and I have talked to many of them personally – that could not maintain profitability in an environment where the regulatory compliance costs are increasing between 50 and 200 percent.

These are good banks that for decades have been contributing to the economic growth and vitality of their towns, cities, and counties but whose ability to serve their communities is being undermined by excessive regulation and government micro-management. Each bank that disappears from the community makes that community poorer. The real costs of the increased regulatory burden are being felt by small town borrowers and businesses that no longer have access to credit. There are other costs as well. When a small town loses its only bank, it loses its lifeblood. The town finds it more difficult to improve the schools, hospitals and other infrastructure needs like water projects if there is no local bank. I know it was not the intent of Congress when it passed Dodd-Frank to harm community banks, but that is the awful reality.

One issue in particular that has hindered the ability of community banks to serve their communities are the new Qualified Mortgage (QM) rules. I understand the reasoning for a lot of the new mortgage regulations. Ten years ago there were a lot of mortgage lenders originating toxic mortgages, securitizing them and selling them. But the community banks did not engage in any of these activities and I would respectfully urge this committee to consider legislation to exempt banks like mine from a lot of these new regulations. (For example, banks holding loans in portfolio should not have to meet the QM requirements.) It seems to me that community banks are being made to pay for the sins of others.

The QM rules carry significant penalties. If, for example, a bank is found to have made an error in calculating a borrower's ability to repay a loan, the bank could be forced to repay fees to the borrower, and to lose the recourse to foreclose on the loan should the borrower default. This is in addition to whatever penalties the regulators or state attorneys general might seek.

As a result of the QM rules, our bank no longer makes mortgage loans, as the costs and the risks are just too high. Make no mistake, the true cost is felt by my community. I used to make, on average, about two mortgage loans a month averaging $50,000 each. I would first urge the customer to find a lender that would get them a 30 year fixed note because it would be cheaper than the balloon note that I would provide them and hold in my portfolio. Many of these prospective borrowers could not qualify with other lenders and, frequently, I would be able to help them. Under the new regulations I cannot offer balloon notes and these same types of borrowers are being shut out of homeownership because of the Ability to Repay (ATR) rules. I am not the only bank in South Texas to exit the mortgage business. Another bank in my county has stopped as well as a community bank in an adjacent county. This is occurring in Texas and across the country. The real victims here are working class and middle class prospective homebuyers.

Bankers want to make safe, profitable mortgage loans. Denying mortgage loans to borrowers – otherwise considered creditworthy – goes against every sound business instinct a banker has.

Accordingly, we support H.R. 2673, the Portfolio Lending and Mortgage Access Act and H.R. 4521, the Community Institution Mortgage Relief Act of 2014. These bills would exempt any mortgage held on a bank's balance sheet from ATR requirements and exempt loans held by small creditors with less than $10 billion in assets from the escrow requirements imposed under DFA. No bank is going to hold the loan of a borrower it does not believe has the ability to repay that loan.

I would be remiss if I did not mention that there was at least one beneficial aspect of the law. My FDIC insurance premiums were cut in half and I am grateful for that. However, the increased compliance costs for traditional banks far outweigh any cost savings.

I. The Costs To Implement New Regulations Are Substantial, Weighing Most Heavily On Community Banks

Community banks, as do all banks, work hard every day to meet the credit and financial needs of their customers and communities. Community banks have a presence much greater than their

total assets suggests. According to FDIC's Community Banking Study released in December 2012, community banks accounted for just 14 percent of the U.S. banking assets in our nation, but held 46 percent of all the small loans to businesses and farms made by FDIC-insured institutions. In 629 U.S. counties—or almost one-fifth of all U.S. counties—the only banking offices are operated by community banks. Without community banks, many rural areas, small towns and urban neighborhoods would have little or no physical access to mainstream banking services.

The ability to meet local needs has not been easy with the increased regulatory costs and second-guessing by bank examiners. During the last decade, the regulatory burden for community banks has multiplied tenfold and it is no surprise that nearly 18 percent of community banks have disappeared in that period.

Unfortunately, the cumulative impact of years of new regulations and the proliferation of non-bank and non-taxed and subsidized competitors (such as credit unions and the Farm Credit System) are combining into a potent mixture that will surely, if left unchecked, lead to more and more consolidations of small banks.

Make no mistake about it, this burden is keenly felt by all banks, but particularly small banks that do not have as many resources to manage all the new regulations and the changes in existing ones. Besides the real hard dollar costs, there are important opportunity costs related to the products and services that cannot be offered or offered only at higher costs to our customers. In dramatic illustration of this point, a 2011 ABA survey of bank compliance officers found that compliance burdens have caused almost 45 percent of the banks to stop offering loan or deposit accounts. In addition, almost 43 percent of the banks decided to not launch a new product, delivery channel or enter a geographic market because of the expected compliance cost or risk.

Furthermore, research by the Federal Reserve over the years has confirmed that the burden of regulations falls disproportionately on smaller banks. The Federal Reserve Bank of Minneapolis has estimated that hiring one additional employee to respond to the increased regulatory requirements would reduce the return on assets by 23 basis points for the median bank with total assets of $50 million or less. To put this estimate in perspective, ***such a decline could cause about 13 percent of the banks of that size to go from being profitable to unprofitable.***

For the median-sized bank in this country with $173 million in assets and 40 employees, the burden is magnified tremendously. I was shocked to learn recently about a $70 million bank in Kansas that has three and a half FTE compliance employees out of a total of 23 employees. He was

particularly frustrated to have 15 percent of his staff dealing with government regulations that do nothing for lending in his small community. Besides internal audits, banks now have to have outside audits for compliance which is a significant expense for smaller banks. Then, the regulators spend time auditing the audits. Checkers checking checkers is a costly and wasteful exercise that provides no value-added for the safety and soundness of the bank and does nothing to protect the bank's customers.

II. The QM rule limits mortgage lending because the QM guidelines narrow lending parameters and impose high risks on those lending outside of these parameters

The mortgage market comprises a substantial portion of the GDP in our economy and touches the lives of nearly every American household. The new Ability to Repay (ATR) and Qualified Mortgage (QM) rule represent a fundamental change in the housing-finance market. It is critical that these rules make sense and do not end up hurting creditworthy Americans that want to own a home.

Unfortunately, the Ability to Repay/QM rule, however well intentioned, will end up restricting mortgage credit making it more difficult for our nation's community banks to serve a diverse and creditworthy population. Under the ATR rule, underwriters must consider a borrower's ability to repay a mortgage loan, despite having no binding guidance on how to determine ability to repay. Qualified Mortgages are designed to offer a "safe harbor" within which loans are assumed to meet the ATR requirement. However, the definition of QM—which covers only a segment of loan products and underwriting standards and serves only a segment of well qualified and relatively easy to document borrowers—could undermine the housing recovery and threaten the redevelopment of a sound mortgage market.

The problem is three-fold: First, the general non-QM segment is very unclear and compliance is uncertain. More pointedly, the heightened penalties and liabilities applicable in the Ability to Repay rule are tremendously burdensome. Given the legal and reputational risks imposed by this regulation, banks are not likely to venture outside the bounds of the QM safe harbors.

Second, the new rules create a narrowly defined box that consumers must fit in to qualify for a QM-covered loan. Since banks will make few, if any, loans that do not meet QM standards, many American families across the country that are creditworthy but do not fit inside the QM "box," will

be denied access to credit. In practice, this also likely means that less affluent communities may not be given the support they need to thrive. These rules may leave many communities largely underserved in the mortgage space.

Third, even if banks choose to make loans only inside the QM framework, they will still face a number of risks and uncertainties that create disincentives to lend. Some loans that fit within the QM framework are only partially covered by the protections offered by QM. These loans, specifically higher interest rate loans, still carry both higher credit risk and now, under QM's rebuttable presumption, liability risk, and as a result, banks will be hesitant to offer them. This means that banks will be limited to offering loans to only the best qualified borrowers. The end result of this will be limiting credit to credit-challenged communities or demographics. Thus, in practice, the QM box ironically may conflict with fair lending rules and goals of the Community Reinvestment Act.

Conclusion

In conclusion, I would ask this committee to look at the unintended consequences of the Dodd-Frank Act and make changes so that community banks can go back to what they have always been good at: Meeting the credit needs of their local borrowers and depositors. Unless major changes are made, compliance costs will continue to drive massive consolidation within our industry and limit the ability of our nation's community banks to drive main street growth across the country.