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Before the House Financial Services Committee, Subcommittee on Financial Institutions and Monetary Policy

Hearing: "Revamping and Revitalizing Banking in the 21st Century"

February 8, 2023

Chairman Barr, Ranking Member Foster, and honorable members of this Subcommittee, thank you for this opportunity to present testimony on behalf of my organization, the Competitive Enterprise Institute (CEI), at this hearing on the vital topics of financial inclusion and financial innovation, and on the regulatory barriers preventing the formation of new banks that could be a vital part of reaching consumers and small businesses that aren't being served adequately by the existing financial system.

CEI is a Washington-based free-market think tank, founded in 1984, that studies the effects of regulations on job growth and economic well-being. It is our mission to advance the freedom to prosper for consumers, entrepreneurs, and investors. At CEI, we have long championed private-sector innovation that promotes financial inclusion and warned about government red tape that contributes to the problems facing the nation's unbanked and underbanked populations. We have sounded the alarm about Dodd-Frank Section 1075, also known as the "Durbin Amendment," which transferred, through price controls, much of the cost of processing debit cards from retailers—including very large retail chains—to some of the nation's poorest consumers, and which prominent economists have found contributed to more than 1 million Americans becoming unbanked.[1]

As "Competitive" is the first word in our name, we are also very concerned about the extraordinary regulatory barriers that have been erected since the Financial Crisis of 2008 to the formation of new, or de novo, banks. In every business sector, new entrants are essential to the functioning of a competitive, free-market economy. As scholars from the respected Kauffman Foundation of Kansas City, Missouri, have stated in summarizing their research findings, "New and young companies are the primary source of job creation in the American economy. Not only that, but these firms also contribute to economic dynamism by injecting competition into markets and spurring innovation."[2]

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[1] Todd J. Zywicki, Geoffrey A Manne, and Julian Morris, "Price Controls on Payment Card Interchange Fees: the U.S. Experience," George Mason University Law and Economics Research Paper Series No. 14-18, https://www.law.gmu.edu/assets/files/publications/working_papers/1418.pdf; John Berlau "Free Checking Nearly Extinct Thanks To Dodd-Frank; Will Credit Card Rewards Follow?," Competitive Enterprise Institute Blog, September 28, 2012, https://cei.org/blog/free-checking-nearly-extinct-thanks-to-dodd-frank-will-credit-card-rewards-follow/.

[2] Jason Wiens and Chris Jackson, "The Importance of Young Firms for Economic Growth," Ewing Marion Kauffman Foundation September 24, 2014, https://www.kauffman.org/resources/entrepreneurship-policy-digest/the-importance-of-young-firms-for-economic-growth/.

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Now when we hear the term "innovation" in regard to any business sector, we often think of things like apps, digital wallets, artificial intelligence, and other high-tech gizmos. But all innovation really means in financial services and other businesses is creating a better way to serve existing customers and bring in new business. With that in mind, it is instructive to look at some innovations of a de novo bank formed in the 21st century that did not involve smartphones and AI, but the horses and buggies associated with everyday life two centuries ago.

The Bank of Bird-in-Hand opened in 2013 in the heart of the Amish country in Pennsylvania. As many of its Amish customers travel by horse, the bank did everything it could to make them feel welcome. The lanes going to the drive-through window were designed to accommodate horses and buggies, and for those customers who needed to enter the bank for business transactions, a wooden barn-like shelter was built in which they could leave their horses.[3] The trek to the bank is still a long trip when riding in a horse-pulled carriage, so the bank now operates mobile branches—called "Gelt buses" after the term for money in Pennsylvania Dutch and other regional language variations of German—that come to 18 different locations loaded with both ATMs and bank employees.[4] The bank now operates both physical and mobile bank branches throughout rural Pennsylvania and has grown from $17 million to more than $1 billion in assets in less than 10 years.[5]

While the Bank of Bird-in-Hand is a success story, it is only one of handful of banks approved by the Federal Deposit Insurance Corporation FDIC since the 2008 financial crisis. That signals a policy failure. When the bank was opened in 2013, it was the first new bank to receive approval from the FDIC in more than three years. In some of the years following the financial crisis, no new banks were approved.[6] By contrast, in the decades before the crisis, the FDIC approved more than 100 new banks – and sometimes more than 200 – in most years going back to 1961. This was the case even in the late 1980s and early 1990s, at the height of the savings-and-loan crisis.[7]

No doubt there was more than one factor in the stunning drop in the number of new banks per year. The costly provisions of the 2010 Dodd-Frank financial overhaul, which imposed a

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[3] "Nice Gig," *The* Economist, May 31, 2018, https://www.economist.com/finance-and-economics/2018/05/31/the-number-of-new-banks-in-america-has-fallen-off-a-cliff; Tim Mekeel, "New Bank of Bird-in-Hand result of long approval process," Lancaster Online, Updated January 14, 2014**,** https://lancasteronline.com/business/new-bank-of-bird-in-hand-result-of-long-approval-process/article_3b1f38d1-5125-54e7-8868-794b5fe303fc.html.
[4] "The 'Gelt Bus' Brings Banking-On-Wheels To Amish In Lancaster County," Amish America, March 10, 2021, https://amishamerica.com/gelt-bus-brings-banking-on-wheels-amish-lancaster-county/.
[5] "The Bank of Bird-in-Hand Surpasses the Billion Dollar Mark," News release, September 20, 2022, https://www.businesswire.com/news/home/20220920005253/en/The-Bank-of-Bird-in-Hand-Surpasses-the-Billion-Dollar-Mark**.**
[6] John Berlau, "A Bird in the Hand and No Banks in the Bush," *Issue Analysis* No. 3, Competitive Enterprise Institute, July 2015, https://www.cei.org/wp-content/uploads/2015/07/John-Berlau-Why-Competition-Offers-a-Solution-to-Too-Big-to-Fail_0.pdf.
[7] Roisin McCord, Edward Simpson Prescott, and Tim Sablik,"Explaining the Decline in the Number of Banks since the Great Recession," *Economic Brief* No. 15-03, Federal Reserve Bank of Richmond, March 2015, p. 4, Figure 3, https://www.richmondfed.org/-/media/richmondfedorg/publications/research/economic_brief/2015/pdf/eb_15-03.pdf.

crushing burden on many existing community banks and credit unions,[8] likely discouraged formation of new banks, and still does so today.

But there was also a new FDIC policy that required de novo banks to put up today 8 percent of the assets they projected to have in seven years. For instance, if those forming a bank thought it might have $500 million in assets in seven years, they would have to come up with $40 million in cash before they could open for business. That requirement, noted a letter from the Independent Community Bankers of America and the American Association of Bank Directors, "effectively prevents the formation of de novo banks at all, or only in severely limited circumstances," as such a large amount of upfront capital "is beyond the reach of many in communities where it is virtually impossible to attract capital from outside sources."[9]

Things have improved slightly in recent years. The FDIC changed the upfront capital policy to a slightly more manageable three-year projection in 2016.[10] Yet even the "high" years after the financial crisis – such as the 15 de novo approvals in 2018 – pale in comparison to the decades before, when the FDIC approved more than 100 new banks in a typical year.[11]

That is why legislative efforts such as Chairman Barr's Promoting Access to Capital in Underbanked Communities Act and Congressman Auchincloss's Promoting New and Diverse Depository Institutions Act are so needed.

The chairman's bill would move the FDIC toward a system of phased-in capital that would allow de novo banks to build capital as they gain customers, rather than having to meet a nearly impossible burden for massive amounts of capital up-front. The bill would also give the FDIC a time limit to approve an application for a new bank or specify where the application falls short and what applicants can do to meet the FDIC's standards of approval.

Congressman Auchincloss's bill would require both the FDIC and bank and credit union regulatory agencies to jointly conduct a study and create a strategic plan to address challenges by applicants to form de novo banks and credit unions.

In finance, or any business sector, there always will be risks when a new business forms. However, unduly restricting the emergence of de novo banks poses its own risks to both the vitality and the long-term solvency of the financial system. A lack of new entrants in the banking sector increases the chances a large bank failure could severely curtail the supply of credit and availability of financial services. That in turn sets the stage for a continuing cycle of government bailouts.[12]

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[8] "Here's What Community Banks and Credit Unions Are Saying About Dodd-Frank," House Financial Services Committee, August 10, 2016, https://financialservices.house.gov/news/documentsingle.aspx?DocumentID=400962

[9] American Association of Bank Directors, "ICBA, AABD Express Concern with Lack of New Bank Charters," News Release, December 12, 2013, http://aabd.org/icba-aabd-express-concern-with-lack-of-new-bank-charters/.

[10] "FDIC Rescinds De Novo Time Period Extension; Releases Supplemental Guidance on Business Planning," News release, April 6, 2016, https://archive.fdic.gov/view/fdic/5121.

[11] Ibid.

[12] Berlau, pp. 5-6.

A competitive market—free of heavy-handed regulation—is one in which all types of entrepreneurs create products and services for all types of consumers, enabling a financial system and an economy that is simultaneously dynamic, inclusive, and resillient.
Thank you again for inviting me to testify. I look forward to your questions.

Mr. Berlau gratefully acknowledges the assistance in preparing this testimony of his CEI colleagues Stone Washington, Ivan Osorio, and Ryan Nabil.