Testimony of

Thomas N. Richards

On behalf of the

American Bankers Association

before the

Subcommittee on Financial Institutions and Consumer Credit
of the
Committee on Financial Services

United States House of Representatives

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Chairman Capito, Ranking Member Meeks, and members of the Subcommittee, I am Thomas Richards, Assistant Vice President of Owingsville Banking Co., headquartered in Owingsville, KY. I appreciate the opportunity to represent the American Bankers Association at this hearing. ABA represents banks of all sizes and charters and is the voice for the nation's $14 trillion banking industry and its two million employees.

My bank is a small $63 million community bank that has been serving the county of Bath for 120 years. Bath County is a rural area on the edge of the Bluegrass Region and eastern Kentucky. My bank primarily extends credit to consumers and small farmers, with very little commercial activity taking place. We serve a vital role in our community making loans for houses, tractors, and even tailpipes for people trying to get back and forth to work. At my bank, we have no minimum loan request because we feel that it is our duty to take care of our customers no matter how small their need may be.

I am pleased to comment on several bills: the Clarity in Regulations Discussion Draft, introduced by Chairman Capito (R-WV); H.R. 2672, the CFPB Rural Designation Petition and Correction Act, introduced by Rep. Barr (R-KY); and H.R. 3584, introduced by Rep. Stivers (R-OH), which would authorize privately insured credit unions to become members of a Federal Home Loan Bank. I will address each in turn.

Eliminate Duplicative and Conflicting Regulations

ABA supports the Clarity in Regulations Discussion Draft, introduced by Chairman Capito, which would require a review and reconciliation of existing regulations that may be in conflict with or duplicative of new rules being promulgated by the banking agencies. As this subcommittee knows from ABA's previous testimonies, the mountain of banking regulations continues to grow. For my bank, with only 26 employees, managing this large and costly compliance burden has real consequences for our ability to meet the credit and financial service needs of our customers. The Dodd-Frank Act alone has created over 6,800 pages of final regulations and guidance papers, and there are still many more regulations yet to be finalized. This bill would help to eliminate conflicts among different regulations, thereby eliminating additional compliance burdens and considerable aggravation as banks struggle to reconcile differences that exist. In essence, this bill would help me and my colleagues get back to doing the business of banking.

Inevitably, with such a large and complex bill like Dodd-Frank, there will be many elements that result in implementation or policy conflicts. The mortgage regulations are the most obvious example. For instance, Dodd-Frank created a potential conflict for the Qualified Mortgage (QM) rule, the Qualified Residential Mortgage (QRM) rule, and banks' abilities to serve all communities. Fortunately, the regulators have been working to make the approaches consistent, but there is no affirmative responsibility for them to do so which has caused considerable anxiety and uncertainty within the industry. Hopefully the regulators will finalize the QRM regulations in a manner consistent with QM, as they outlined in their recent re-proposal of the QRM rules.

There is also a great amount of overlap that arises under the new Dodd-Frank provisions and existing mortgage rules that can lead to duplication, complication and potential conflict—all of which increases the cost of credit to borrowers and the costs of compliance for lenders. For example, new Dodd-Frank regulations address possible abuses by affiliated entities in various ways—the fees of affiliates must be counted towards triggers and de-facto price ceilings, and affiliate fees get less favorable tolerance treatment in terms of fee disclosures. These provisions are added to existing protections that require extensive disclosures of the participation of affiliates in the transaction, and criminal penalties against improper referrals. These different provisions are spread across RESPA, TILA and HOEPA, and lead to duplication and heavy penalizing for the use of affiliated services—services that may often be beneficial for consumers. In addition, TILA's APR tolerance rule and RESPA's fee disclosure variance limits aim at mostly the same fees and serve the same objective. There is no reason to have varying fee limitations under statutes that cover the same exact fees.

We suggest the bill should also cover not only instances where a new regulation conflicts with or is duplicative or inconsistent with ***existing*** regulations or orders, but cover instances where a new regulation is in conflict with, duplicative or inconsistent with ***new*** guidance or regulations. Moreover, the bill should enable regulators to address instances where a targeted rule may have created an unintended compliance obligation for banks not engaged in the activity in question.

For example, consider the compliance obligations of small banks under the Volcker Rule. As proposed, the rule would require every bank to create a compliance program even if they do not conduct any activities identified as being covered under the Volcker Rule. There is no systemic issue here and this is one area where there should be no monitoring obligation or requirement for community banks, in effect, to prove their innocence. Rather, as part of the supervisory process examiners would be able to assess whether there are activities that might fall under the Volcker Rule.

Another example of an unintended compliance obligation which may hinder lending in ways not contemplated under Dodd-Frank is the ability to repay (ATR) requirements. These ATR requirements were intended to prevent lenders from originating loans without regard to a borrower's ability to repay the loan, in order to generate origination fees. Such lending was often undertaken by brokers and others who then passed the loans through the securitization chain with little or no consequence to the originator if the loan failed. Portfolio lenders, by virtue of their business model, did not engage in such activity. It was—and remains—essential to their success that the loans they originate are able to be repaid. Nevertheless, the ATR rule currently applies to portfolio lenders as well as those who sell loans, and imposes standards that many good loans simply cannot meet. Portfolio lenders, willing to make a loan to a borrower who they view as a reasonable credit risk and willing to hold those loans on their own books, should not be required to meet the Dodd-Frank requirements.

A portfolio lender's own self-interest in maintaining a safe and sound portfolio, along with safety and soundness regulation and supervision, provide adequate regulation in this area. My bank is a portfolio lender, and I have never understood why it is necessary for the ability to repay requirements to be imposed upon us. We retain all of the credit risk, so the last thing my bank wants is for one of our borrowers to default. In my opinion, self-preservation and the time-tested prudential safeguards required by the regulators are sufficient to motivate portfolio lenders to make safe and sound loans, and an additional layer of regulatory burden is completely unnecessary.

Furthermore, the imposition of the Dodd-Frank requirements on portfolio lenders will make it impossible to serve some otherwise creditworthy customers and will significantly harm certain borrowers and populations which would otherwise be well served by portfolio lenders. Regulators should have the authority to exempt portfolio lenders from this mis-applied rule, but they have no flexibility to do so under current law. The best approach, of course, is to enact legislation that exempts portfolio lenders from the ATR entirely. Enacting new laws to resolve every potential conflict or unintended conflict is not practical and is why this bill is important to help resolve, in a timely and straightforward manner, overlaps and conflicts that arise.

The issue of crushing regulation is a deeply personal one for me. Community banking is not only my livelihood, but also a large part of my family history over the past 120 years. It would be a travesty if the burden of unnecessary and duplicative regulation was to make my bank, and those like it, extinct. It is my hope that the Clarity in Regulations Discussion Draft will help stem the tide of overly burdensome regulation, and allow community banks across the country to continue to serve the needs of their customers.

Rural Designation for CFPB

ABA supports H.R. 2672, the CFPB Rural Designation Petition and Correction Act, introduced by Rep. Barr (R-KY). Many of the reasons cited above—to eliminate unintended consequences in the implementation of new regulations—are applicable to this bill as well.

The Dodd-Frank Act provided the Consumer Financial Protection Bureau (CFPB) with discretionary authority to exempt certain loans from the qualified mortgage rule. The CFPB has exercised this authority to accommodate community banks that make short-term balloon loans as a means of hedging against interest rate risk. The exemption applies only if, during the preceding calendar year, the creditor extended more than 50 percent of its total covered transactions that provide for balloon payments in one or more counties designated by the Bureau as "rural" or "underserved." Thus, the definition of rural and underserved is critical and can dramatically affect banks like mine and the communities they serve.

I would note that the CFPB has struggled with an appropriate definition. I understand there are dozens and dozens of different definitions of "rural" used for various federal government purposes. The CFPB's original definition of rural—which the Bureau has appropriately put on hold—was far too narrow and was inconsistently applied which would have had a dramatic impact on small lenders and communities.

In fact, under CFPB's original definition, Bath County—which covers 284 square miles, has 12,000 residents, 4,400 households, and a median income of $30,000—does <u>not</u> qualify, while Bourbon, Boyle, and Rowan Counties, with much larger and more urban populations <u>do</u> qualify. Charles Vice, the Commissioner of the Kentucky Department of Financial institutions, when asked at a prior Financial Services Committee hearing if in his opinion Bath County was non-rural, responded by saying that Bath County is one of the most rural places in the United States. This is a perfect example to illustrate the potential negative and unintended consequences that arbitrary definitions can have. My bank is not alone in being erroneously classified as operating in a non-rural county, and there are surely many more bankers just like myself who are dumbfounded as to how such a mistake could occur and how there could be no mechanism to appeal the decision.

The CFPB does acknowledge the narrowness of its original definition of rural and, importantly, the willingness of small portfolio lenders to serve borrowers with specialized needs, and the necessity for protection in order for these lenders to continue to make loans meeting these needs. In the short term, CFPB has delayed application of the rural and underserved requirements for two years to allow small lenders to continue to make these loans, while the Bureau refines its definitions. This approach has advantages, but it is too narrow and would exclude lenders that are meeting the mortgage needs of their small communities in a safe and sound manner. Real estate loans make up the vast majority of my bank's portfolio; in fact, over 80 percent of our loans are for real estate. Again, my bank is not alone. This will impact many small banks and will limit their ability to serve their community.

To reiterate, the key point here is that unnecessary restrictions will lead to some qualified borrowers not receiving the credit that they deserve. Not every borrower can qualify for a secondary market loan, whether it is due to an insufficient credit score, an irregular property such as a mobile home or a large tract of land, or a lack of comparable properties that satisfy appraisal standards. In such cases, balloon loans serve as a viable alternative credit product, and under the rules proposed by the CFPB many banks will no longer be able to offer this option, thus restricting the flow of credit.

I can tell you that from a small community's standpoint, this can be devastating to the livelihood of that area. Thus, an appropriate exemption is critical to our ability to meet our community's needs. The CFPB has wide discretion in defining "rural and underserved" and it should ensure that any future definition not exclude banks from offering deserving customers access to credit. H.R. 2672 would help to assure that whatever definition of rural is ultimately used by the CFPB, there would be an avenue to appeal to the Bureau in those inevitable cases where a county may have been inappropriately excluded.

Membership Access by Privately-Insured Credit Unions to a Federal Home Loan Bank

The ABA has concerns about privately-insured credit unions being allowed to join a Federal Home Loan Bank, as provided for in H.R. 3584, introduced by Rep. Stivers (R-OH). We acknowledge that the FHLBs play an important role providing advances to portfolio mortgage lenders. The issue of concern is the financial viability of the private insurer to a failure of a non-federally-insured credit union that has a significant level of secured advances from the Federal Home Loan Bank (FHLB).

First, advances provided by the FHLBs are secured and have priority in any financial institution failure. The FHLB claims can be and have been accommodated within a pool numbering thousands of participants. But the FHLB claim preference could be a significant blow in the context of a small pool. This concern is obvious from the number of privately insured credit unions. The number of privately insured credit unions has dropped by one-third over the last decade, from 212 institutions to 137. This is in contrast to the FDIC which insures 6,891 banks and the NCUSIF which insures 6,681 credit unions.

Given the limited resources of the private insurer, any failure would have a significantly larger impact (relative to that faced by the Federal Deposit Insurance Corporation (FDIC) or the National Credit Union Share Insurance Fund (NCUSIF)). The small pool limits the ability of the private insurer to spread the risk in contrast to both the FDIC and NCUSIF. But with higher losses from secured FHLB borrowings, the cost would be far more difficult to absorb given the smaller pool of privately-insured credit unions.

The FDIC and NCUSIF also have the full faith and credit backing of the Federal government. Moreover, only nine states actively authorize state-chartered credit unions to have private primary share insurance. Five states (California, Illinois, Indiana, Ohio and Nevada) account for almost 95 percent of the deposits. As the last recession showed, banking problems are driven by local and regional economic downturns and, therefore, this concentration means that the private insurer faces an even greater solvency risk than the FDIC or NCUSIF which have large and diversified memberships.

Furthermore, while we appreciate the bill's acknowledgement that the financial health of the privately-insured credit union is an important consideration in allowing FHLB membership, it is clear that such a designation may not hold over time. Therefore, the provision provides little in terms of protecting the private insurer or in terms of the potential equity benefit to the FHLBs.

Conclusion

I appreciate the opportunity to comment on these important bills. The banking industry is prepared to work with this subcommittee to identify changes that truly will help banks meet the daily financial and credit needs of our customers.