
IMPACT OF THE REGULATORY REFORM BILL ON COMMUNITY BANKS: HUGE NEW BURDENS

The pending financial reform legislation does contain important reforms that community banks support, such as the creation of a systemic risk oversight body and provisions designed to restrict too-big-to-fail. However, the bill would also impose considerable new burdens on community banks, notwithstanding the widespread recognition that these banks did not cause the financial crisis and notwithstanding the fact that community banks already carry a daunting regulatory burden -- for example, some 1,700 pages of consumer regulations and guidelines -- over 50 pages for each of the 34 people employed by the median-sized community bank. Some of the new burdens proposed by the bill are outlined below. Most significantly, the legislation passed by the Senate Banking Committee would make it much harder for community banks, already struggling with the weak economy and heavy regulatory burdens, to do what is so badly needed to get their local economies on the right track.

Consumer Financial Protection Bureau (CFPB)

- **Broad New Consumer Rules.** All banks, regardless of size, would be subject to the new rules of the CFPB. These rules would apply broad new and untested standards, such as “abusive” or “unreasonable advantage,” to retail bank products. The standards will give the CFPB wide latitude to influence what products are offered, on what terms, and under what circumstances. While the CFPB would not have explicit authority to mandate the offering of “plain vanilla” products, the regulator could make alternatives to CFPB-favored versions so disadvantaged that community banks may well conclude that CFPB-favored versions of checking accounts, savings programs, home equity loans, etc., are the only versions of the products that are safe or cost-effective to offer from a regulatory point of view.
- **Examination and Enforcement by CFPB.** The CFPB would have the authority to send examiners (in addition to the banks’ regular examiners) into any community bank on a “sampling basis” at the CFPB’s discretion. There are no limits placed on this discretion, no definition of “sampling,” and no criteria to be met for the CFPB to exercise this discretion. CFPB may also take enforcement actions against any bank, regardless of size, to obtain whatever information it deems relevant.
- **State Attorney General Actions.** State attorneys general would be given authority for the first time to bring civil actions in state or federal court for any violation of the bill or its regulations against *any* bank.
- **Deposit Reporting Requirements.** All banks would be required to set up an expensive mechanism to gather and report data on the total number and dollar amounts of deposits at all branches, ATMs, and other deposit-taking facilities, geocode the data, and segregate it based on whether the depositor is a residential or commercial customer.
- **Small Business Loan Reporting.** All banks would have to set up an expensive mechanism to gather extensive additional data on all small business loan applicants, including whether the applicant is a woman- or minority-owned business.
- **Added Consumer Account Information.** All banks would be required, potentially at significant cost, to provide consumers with expanded access to account, transaction, fee, and other information.
- **Reports on Other Subjects.** The CFPB may require other reports or information from any bank or banks at any time in any detail on any subject related to consumer products and services, and it has significant latitude to disclose the information as it deems to be in the “public interest.”
- **Uneven Enforcement on Non-Banks.** New consumer rules will also apply to non-banks, but those rules are certain to be enforced strongly on banks (unlike the case with non-banks), because banks already have in place long-established mechanisms for examination and enforcement that do not apply to non-bank competitors. Enforcement on non-banks will be weak to nonexistent in many cases. Some competitors, such as the Farm Credit System, are explicitly exempt.

- ***In sum***, the typical community bank will see increased costs relating to additional regulations that have nothing to do with the financial crisis. These banks will be put at an even further disadvantage to non-banks.

Rules on Securitization

- ***Restricting Credit***. Provisions in the bill designed to address problems in the securitization process are overly broad and will greatly undermine the ability of community banks to move loans off their books to participations or securitizations, although there is no record of there being a problem in this area with community banks. The result will be less profitable and, in fact, more risky community banks; more importantly, less credit will be available.

Preemption

- ***New Barriers to Preemption***. The pending bill would weaken preemption standards by creating potential procedural barriers to obtaining preemption decisions, imposing new substantive requirements, and eliminating the ability of operating subsidiaries of national banks to benefit from preemption determinations. Many community banks have national charters and could suddenly be subject to potentially hundreds of state and local laws as their customers traveled or moved. Banks near state lines would be particularly affected.

Regulatory Dislocation

- ***Strangling the Thrift Charter***. Thrifts would be regulated by either the OCC or FDIC, and federal thrift charters would gradually diminish in number and relevance going forward given that no new federal thrift charters could be granted.
- ***Disrupting Existing Regulatory Jurisdictions***. Many community banks, now regulated by the Federal Reserve, would be forced to have a new federal regulator, creating expensive disruptions and uncertainty for the sake of theoretical regulatory efficiency.
- ***Making the Federal Reserve Focus Only on Big Banks***. Giving the Fed responsibility for only bank holding companies with total assets exceeding \$50 billion will skew the Fed's insights into the banking industry and focus the Fed on the largest firms. For both monetary policy and economic regulation purposes, the Fed will develop a skewed vision of the economy, focused on the largest institutions and money centers to the detriment of community banks and the communities they serve.

New Prudential Standards – More Costly Requirements for Community Banks

- ***New Affiliate Transaction Rules***. All banks would have to comply with more onerous affiliate transaction and insider lending restrictions, including new limits on the purchases of assets subject to repurchase agreements and securities lending transactions. Covered transactions would have to meet collateral requirements at all times (instead of just at the time a transaction is entered into).
- ***New Loan-to-One-Borrower Limits***. National bank loan-to-one-borrower limits would be applied to all banks, thereby lowering the limits for state banks in states that are more flexible.
- ***New Non-Credit Transaction Rules***. New restrictions on non-credit transactions with insiders would apply.
- ***New BHC Capital Requirements***. Holding companies would be subject to new rules imposing minimum capital requirements and duties to serve as a source of strength to a subsidiary bank.
- ***New Risk Committees***. The Fed could require all publicly traded BHCs to create a new risk committee responsible for enterprise-wide risk management.

Executive Compensation and Corporate Governance – More Rules for Community Banks

- ***Say on Pay***. All public companies, including many community banks, would have to comply with new "Say on Pay" rules that give shareholders a non-binding vote on executive compensation.

- ***Independent Compensation Committee.*** All companies listed on an exchange would be required to have a compensation committee composed solely of independent directors.
- ***Employee Compensation Reporting.*** Public companies would be required to disclose, through narrative and graphics, the relationship between executive compensation and company performance and whether company employees are permitted to hedge their equity holdings in the company.

In sum, the legislation – supposedly directed at addressing the issues that caused the financial crisis and preventing future crises – in fact imposes huge, expensive new burdens on innocent community banks. Community banks, already struggling, will be put at an even further disadvantage to non-bank competitors and will find it increasingly difficult to compete and to serve the credit and other financial needs of their communities. Members of Congress, including its leaders, have recently stated clearly that community banks did not cause this crisis and should not be harmed by the legislation. Yet provision after provision of the legislation will harm community banks and undermine their future.