*Testimony of*

**William B. Grant**

*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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**May 9, 2012**

Chairman Capito, Ranking Member Maloney, and members of the Subcommittee, my name is William Grant, Chairman and CEO of First United Bank and Trust. My bank is a 112-year old community bank, headquartered in Oakland, Maryland—a rural town in Appalachia with a population of about 2,000. We have assets of $1.38 billion, and serve four counties in Maryland and four counties in West Virginia. I also serve as Chairman of the Community Bankers Council at the American Bankers Association. ABA represents banks of all sizes and charters and is the voice of the nation's $13 trillion banking industry and its two million employees.

Every day community banks make loans to small businesses in your states and provide financial services to all your constituents. For decades—and in my bank's case more than a century—community banks have been the backbone of all the 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.

Unfortunately, the cumulative impact of years of new regulations and the proliferation of non-bank and non-taxed competitors (such as credit unions) are combining into a potent mixture that is threatening the very existence of community banks.

Banks appreciate the importance of regulation that protects the safety and soundness of the bank and protects the interests of our customers. We know that there will always be regulations that control our business – but the reaction to the financial crisis has layered on regulation after regulation that does nothing to improve safety or soundness and only raises the cost of providing credit to our customers. As a banker, I feel like Mickey Mouse as the Sorcerer's Apprentice in Disney's famous cartoon Fantasia. Just like Mickey with bucket after bucket of water drowning him, new rules, regulations, guidances, and requirements flood in to my bank page after page, ream after ream. With Dodd-Frank alone, there are 3,894 pages of proposed regulations and 3,633 pages of final regulations (as of April 13) and we're only a quarter of the way through the 400-plus rules that must be promulgated.

While community banks pride themselves on being flexible and meeting any challenge, there is a tipping point beyond which community banks will find it impossible to compete. 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. Over the last decade 1,500 community banks have disappeared from communities. Each new law or regulation in isolation might be manageable, but wave after wave, one on top of another, will certainly over-run many more community banks.

Without quick and bold action to relieve regulatory burdens we will witness an appalling contraction of the banking industry, at a pace much faster than we've witnessed over the last decade. 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. 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.

I know that my credit union colleagues at this hearing share many of the same concerns as community banks regarding the monumental task in dealing with any new law or regulation or a change in existing ones. Excessive regulation affects all lenders. While not the subject of this hearing, we do differ with the credit union trade associations on the issue of expanding the business lending cap for credit unions. As this Subcommittee is well aware, the banking industry is strongly opposed to an expansion of credit union business lending authority. It is hard enough for community banks to compete without Congress giving special privileges to a direct, taxpayer-subsidized, competitor. Simply put, a vote for expanding the cap on credit union business lending would be a vote against community banks.

***Congress must be vigilant in overseeing regulatory actions. If left unchecked excessive regulation will surely negatively affect our customers.*** Holding oversight hearings like this one is critical to ensure that banks are allowed to do what they do best—namely, meet the financial needs of their communities.

There are three points I would like to make today.

- The costs to implement new regulations are substantial and weigh most heavily on community banks;
- The opportunity costs and unintended consequences of Dodd-Frank have far-reaching effects; and
- Dodd-Frank may drive many community banks out of lines of business altogether.

## I. The Costs to Implement New Regulations are Substantial and Weigh Most Heavily on Community 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.

For my bank, we very conservatively estimate nearly $2.5 million in hard dollar compliance costs per year. This includes salaries attributable to compliance, annual bank-wide compliance training, legal and compliance consulting services, compliance software and other IT expenses, printing expenses and privacy mailing costs, and various record-keeping requirements. And there are other costs that we simply cannot capture. We have several dedicated compliance officers just to handle all the legal and paperwork requirements and, in addition, estimate that another 244, or 64 percent of our total staff, have compliance obligations they must fulfill. Historically, the cost of regulatory compliance as a share of operating expenses is two-and-a-half times greater for small banks than for large banks.

Changes in existing regulations and the new regulatory requirements that will flow from Dodd-Frank have forced us to add another full-time compliance person. That cost, plus many other ancillary costs of these new changes will add another $275,000 to the overall cost. Of course, we are only in the early stages of the Dodd-Frank implementation, so we are bracing for additional costs that must somehow be borne. All these extra expenses could have been more productive if they were devoted to providing services to our customers.

As a $1.38 billion bank, we are better able to spread some of the compliance costs than our smaller brethren. For the median-sized bank in this country with $166 million in assets and 38 employees, the burden is magnified tremendously. One $70 million bank in Kansas that I spoke to recently 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.

For larger banks, Dodd-Frank imposes significant changes that are already driving an entire reevaluation of business lines and models. Together with the new Basel capital and liquidity rules these added costs total in the hundreds of millions of dollars.

For the industry, a very conservative estimate of all the hard dollar costs would be about $50 billion annually, or about 12 percent of total operating expenses. Given all the new obligations, it is likely that the cost is far greater particularly as new processes and systems are being implemented.

## II. The Opportunity Costs and Unintended Consequences of Dodd-Frank Have Far-Reaching Effects

The direct out-of-pocket expenses are just part of the story when one realizes the significance of the opportunity costs. Instead of teaching staff to reach out to new markets, trainers are bringing the employees up to speed on the latest regulations. Instead of money being used to make loans to hardworking people and businesses in our communities, it is being spent on consultants, lawyers, and auditors. Instead of investing precious capital into new products to meet the ever-changing demands of our customers, banks are paying for changes to software to assure compliance with all the new changes. Excessive regulation saps staff and resources that should have gone to meeting the needs of our customers. Even a small reduction in the cost of compliance would free up billions of dollars that could facilitate loans and other banking services.

New regulations just keep being piled on top of older outdated requirements. Just to give you one example, many of my colleagues from Michigan to Georgia and in states from coast to coast are being targeted by enterprising lawyers for not having vigilantly maintained redundant paper signage on our ATMs alerting customers about the possibility of fees when any actual fees are fully disclosed on the screen before any transaction is completed. That there is a statutory requirement for such an outdated rule and a statutory private cause of action for its enforcement is mind-boggling, but worse it causes our bank employees to chase around to all our ATMs in an effort to assure that stickers that have no real value to today's customers have not been peeled off or been removed by vandals. That is why ABA supports H.R. 4367 and we thank Representatives Luetkemeyer and Scott for sponsoring this important piece of legislation. We hope this overdue fix becomes law as soon as possible.

Businesses—including banks—cannot operate in an environment of uncertainty. Unfortunately, Dodd-Frank increases the legal and regulatory uncertainty for banks. For example, consider the new "abusive" standard added in Dodd-Frank. Banks know that the definition will involve not just a new regulation, but years of court battles in many states before a standard emerges that is clear.

Let me highlight another example of unintended consequences. We thought that the Volcker rule was something that only our colleagues in the largest banks had to attend to.

Instead, the regulators have proposed to implement the Volcker rule in a way that requires even a bank of our size to carefully examine any security we buy to manage our mix of assets and liabilities so that we do not accidentally do something that the implementing rule may not permit. We will also have to review every community investment we make for the same reason. Both asset and liability management and community reinvestment are basic banking activities that our regulators expect us to do day to day. Now we have to develop policies and procedures to make sure we are evaluating those activities regularly in light of some 300 pages of technical regulatory guidance that is intended to address activities it wouldn't even occur to us to conduct.

These and other changes will have a pernicious impact on banks and their communities. They raise credit costs and litigation costs (for even minor compliance issues), lead to less hiring or even a reduction in staff, make hedging risks more difficult and costly, and restrict new business outreach. In fact, banks' biggest risk has become regulatory risk.

## III. Dodd-Frank Rules May Drive Community Banks Out of Lines of Business

Congress must be vigilant in its oversight of the efforts to implement the Dodd-Frank Act to ensure that rules are adopted only if they result in a benefit that clearly outweighs the burden. Already we are seeing proposals—such as those implementing the rules regarding municipal advisors and swaps transactions—that fail that simple test. Some rules under Dodd-Frank, if done improperly, ***will literally drive banks out of lines of business.*** New rules on mortgage lending and on registration as municipal advisors are two particularly problematic provisions. Before discussing these, let me begin with a real situation where the potential legal risks—which are magnified by changes in Dodd-Frank—forced us out of a line of business.

First United serves customers in rural Maryland and West Virginia in the Appalachian Mountains, a region dotted with mobile homes. We use to offer the loans that enabled people to buy those mobile homes, but no more. Mobile home financing entails a great deal more risk than a mortgage on a single family dwelling. Late payments on mobile homes are consistently higher than nearly all other consumer credit products. Moreover, mobile home prices always tend to decline in a slow economy, not just in the severe recession that we have witnessed recently. As you are well aware, the way that all financial markets—not just banks—handle risk is to price for it. As a consequence, mobile home loans cost customers more. Since the customer base that purchases mobile homes tends to be lower income, such pricing for risk can be misconstrued as predatory lending. For First United, this posed a very large legal risk and we decided it was not worth even the expense of refuting unfounded law suits to offer this product. Now people in our area have one less option in their search for home financing.

This story may be about to repeat itself in the ***entire*** mortgage market. One of the changes required in the Dodd-Frank Act is that lenders must show that borrowers meet an “ability to repay” test—***which can be challenged in court for the entire life of the loan***, raising the risk of litigation tremendously. It also imposes broad risk retention requirements on most loans sold into the secondary market. These requirements have the potential to make it much more costly for banks to make loans and could have the unintended consequence of denying quality loans to creditworthy borrowers.

Dodd-Frank does provide that banks can show they have met the ability to repay test by making loans that fall into a category known as a Qualified Mortgage or QM. The QM is intended to be a category of loans with certain low risk features made to borrowers shown to be creditworthy and able to meet the payment terms. The Consumer Financial Protection Bureau (CFPB) is tasked with finalizing a rule setting forth exactly what will qualify as a QM, but a number of concerns have arisen with regard to the approach which the CFPB may take. If the QM category is made too narrow by excluding too many loan types or by requiring borrowers to meet too high a standard of creditworthiness, then credit will contract and potential borrowers will be denied credit for which they would otherwise qualify. HUD Secretary Shaun Donovan shares this concern, noting in comments on April 19th that credit standards today are far tighter than those which led to the financial crisis, and that, in his own words: “I am very concerned that some of the proposals that have been out there would go too far in restricting credit going forward."

We also have grave concerns about the level of legal protection that the QM category will provide. The proposed rule, which was set forth by the Federal Reserve Board last year—but which will be finalized by the CFPB, set out two different options—for either a full safe harbor or for only a rebuttable presumption. Without the protections in a full safe harbor, banks will be forced to make loans that stay well within the boundaries of the rule to limit litigation risk.

Mortgage credit will contract, and many qualified borrowers who, while creditworthy, would see their hopes of homeownership vanish.

In order for QM to work, lenders must have the predictable, unambiguous legal protections that only a safe harbor provides. A broadly defined QM with a safe harbor will enable lenders to preserve flexibility. It will ensure that the largest number of creditworthy borrowers is able to access safe, quality loans for all housing types. It also will allow for quick disposition of lawsuits in cases where the borrower's ability to repay should not be in question. Borrowers also benefit: a safe harbor protects a borrower's ability to sue in cases of fraud, misrepresentation and wrongdoing. A safe harbor also minimizes litigation costs that would add to the cost of borrowing and divert resources that would otherwise be used for lending—ultimately a boon to both lender and borrower.

Much like the ability to repay rule's QM category, the risk retention rules required by Dodd-Frank also contain a category of loans, known as the Qualified Residential Mortgage or QRM, which would be exempt from risk retention requirements. The QRM is intended to include loans with certain characteristics that are proven to be well underwritten and of low risk to the borrower. However, the proposed risk retention rule, released last year by the federal banking regulators along with the SEC, HUD and FHFA, is far too restrictive in defining the QRM. The proposal would require a minimum twenty percent down payment by borrowers to meet the QRM definition—placing the vast majority of potential borrowers outside the QRM. The result will be unnecessarily higher costs for those borrowers—or an inability to qualify at all. Over 360 Members of the House and Senate have raised objections to this overly restrictive proposal, and we continue to press the regulators to revise this rulemaking.

As you can see, how these exceptions are defined will dramatically impact the willingness and ability of banks to make mortgage loans, and of consumers' ability to qualify for credit.

Let me make this very clear: in my interactions with bankers on ABA's Community Banker's Council, I have already heard bankers say that they are considering ***ceasing their mortgage lending activities***. These are vibrant institutions with strong consumer lending programs who will conduct a risk/return analysis to determine whether it is worth the risk to continue offering one of the most basic bank products, home mortgages.

The thought of quality institutions being forced from the mortgage market and of otherwise creditworthy borrowers being denied credit because of overly broad regulations is chilling—especially at a time when our housing economy has been severely battered and is just beginning to show signs of recovery.

Another example of how Dodd-Frank rules may drive banks out of business is the implementation of the rules on municipal advisors. If done improperly, it will drive community banks out of providing basic banking products to local and state governments.

ABA believes that Dodd-Frank intended to establish a regulatory scheme for ***unregulated*** persons providing advice to municipalities with respect to municipal derivatives, guaranteed investment contracts, investment strategies or the issuance of municipal securities. Most community banks do not deal in bonds or securities. But community banks do offer public sector customers banking services and we are regulated closely by several government agencies.

The Securities and Exchange Commission has proposed a very broad definition of "investment strategies" that would cover traditional bank products and services such as deposit accounts, cash management products and loans to municipalities. This means that community banks would have to register as municipal advisors and be subject to a whole new layer of regulation on bank products for no meaningful public purpose. The result of this duplicate and costly regulation: community banks like mine may decide not to provide banking services to their local muncipalities, forcing these local and state entities to look ***outside*** of their community for the services they need. This proposal flies in the face of efforts to streamline federal oversight and avoid new regulations that impede innovation, diminish U.S. competitiveness, and restrain job creation and economic expansion.

We support H.R. 2827, introduced by Representative Dold. This legislation would exempt banks from Section 975 of the Dodd-Frank Act. If Congress fails to enact this legislation we urge you to oversee this implementation and ensure that the rule addresses ***unregulated*** parties and that ***neither*** Section 975 of Dodd-Frank or its implementing regulation should reach through to bank products and services.

## Conclusion

The consequences of excessive regulation are real. Costs are rising, access to capital is limited for community banks, and revenue sources have been severely cut. It means a weaker economy. It means slower job growth. With the regulatory overreaction, piles of new laws, and uncertainty about government's role in the day-to-day business of banking, meeting local community needs is difficult at best.

My bank's philosophy—shared by community banks everywhere—has always been to treat our customers right and do whatever we can to make sure that they understand the terms of the loans they are taking on and their obligations to us. We will continue to do this, but now there will be many new hurdles that we will have to jump to serve our customers' most basic needs that will inevitably add cost, time, and hassle for my customers.