INDEPENDENT COMMUNITY
BANKERS *of* AMERICA

Testimony of

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On behalf of the

Independent Community Bankers of America

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Mr. Chairman, Ranking Member Bachus, members of the Committee, my name is Michael Washburn, and I am President and CEO of Red Mountain Bank, a $351 million community bank in Hoover, Alabama. I serve on the Board of Directors of the Independent Community Bankers of America[1] (ICBA), and I'm Vice Chairman of ICBA's Policy Development Committee. I am pleased to have this opportunity to testify today on the issue of regulatory restructuring and reform of the financial system.

As this nation continues to struggle with the worst financial collapse since the Great Depression, many Americans are losing confidence in our financial system and questioning our resiliency. I am pleased to report, Mr. Chairman, that the one segment of the financial system that is working and working well is the community banking sector. We are open for business, we are making loans, and we are ready to help all Americans weather these difficult times.

State of Community Banking is Strong

Community banks are strong, commonsense lenders that largely did not engage in the practices that led to the current crisis. Most community banks take the prudent approach of providing loans that customers can repay, which best serves both banks and customers. As a result of this commonsense approach to banking, the community banking industry, in general, is well-capitalized and has fewer problem assets than other segments of the financial services industry.

That is not to suggest that community banks are unaffected by the recent financial collapse. Indeed, the squeeze on interbank lending has raised liquidity issues in some areas, the collapse in the value of the preferred stock of government-sponsored enterprises Fannie Mae and Freddie Mac under the Treasury/Federal Housing Finance Agency conservatorship has affected the bottom lines of some community banks, and the general decline in the economy has caused many consumers to tighten their belts and reduce the demand for credit.

But overall, the state of the community banking industry is strong, and we are confident that this nation's economic fortunes will recover and its economy will regain its resiliency.

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[1] *The Independent Community Bankers of America represents nearly 5,000 community banks of all sizes and charter types throughout the United States and is dedicated exclusively to representing the interests of the community banking industry and the communities and customers we serve. ICBA aggregates the power of its members to provide a voice for community banking interests in Washington, resources to enhance community bank education and marketability, and profitability options to help community banks compete in an ever-changing marketplace.*

With nearly 5,000 members, representing more than 18,000 locations nationwide and employing over 268,000 Americans, ICBA members hold more than $908 billion in assets, $726 billion in deposits, and more than $619 billion in loans to consumers, small businesses and the agricultural community. For more information, visit ICBA's website at www.icba.org.

Right now, however, we are still in financial crisis. These historic times call for level-headed, deliberative and constructive thinking to map a course of action for the future so we never have to go through this again. I congratulate you, Mr. Chairman and Ranking Member Bachus, for initiating this important and difficult process today.

For over three generations, the U.S. banking regulatory structure has served this nation well. Our banking sector has been the envy of the world and is the strongest and most resilient financial system the world has ever known. However, as has become evident, **non-bank financial regulation has been lax**, especially regarding capital adequacy and risk management, leaving wide gaps that must be closed to ensure the future stability of the entire financial system.

Congress Must Address Excessive Concentration

The current crisis has made it painfully obvious that the financial system has become too concentrated, and – for many institutions – too loosely regulated. The doctrine of too big – or too interconnected – to fail, has finally come home to roost, to the detriment of American taxpayers.

Federal Reserve Chairman Bernanke acknowledged such when he said following a recent New York speech: *"We need to have that local knowledge that is incorporated in local lending, local community banking. If we have oversight, if we strengthen the system so that it's less prone to be damaged by the failure of one firm, and if we develop a resolution regime, I think we will at least get our hands around the too-big-to-fail problem."*

Unfortunately, government interventions necessitated by the too-big-to-fail policy have exacerbated rather than abated the long-term problems in our financial structure. Through Federal Reserve and Treasury orchestrated mergers, acquisitions and closures, the big have become bigger. Today, the four largest banking companies in the U.S. control more than 40 percent of the nation's deposits and more than 50 percent of its assets. It is ICBA's view that putting such excessive and concentrated power in the hands of just four banking executives is dangerous and unhealthy.

Congress should seriously debate whether it is in the public interest to have so much power and concentrated wealth in the hands of so few and adopt effective remedies. ICBA would suggest that downsizing these super mega sized institutions should be under consideration.

Emergency Measures Have Been Essential

While painful to us, ICBA was a strong supporter of the Emergency Economic Stabilization Act of 2008 because community banks recognized that a freeze in the credit markets would affect not only Wall Street, but Main Street as well. Doing nothing was not an option. Still, it is unfortunate that circumstances required that this legislation had

to be completed on such an urgent basis, leaving little opportunity for alternative plans to be fully aired and vigorously debated.

We are very grateful to you, Chairman Frank, and to you, Ranking Member Bachus, for your energetic support for including the concerns of community banks in this legislation. Because of your leadership, Congress recognized the threat to the community banking sector and inserted measures to mitigate these threats, such as tax relief for community bank holders of GSE preferred stock, limiting the guarantee for money market mutual funds, and ensuring community bank access to the Troubled Asset Relief Program.

Bank Regulatory Structure is Effective

As you consider a new regulatory model, it would make sense to look at one that has worked rather than just try to fix one that has failed. The community banking model, with decentralized resources, local decision making, and geographically diversified assets has worked well and has to date endured a devastating economic blow not of its making.

Can we construct a regulatory and supervisory model that is better than the one we have? With proper thought and consideration very possibly we can. But the current system should not be summarily scrapped in the zeal for reform. Troubled times call for cool heads and measured responses. Let us learn the lessons of history and not repeat the rush to legislate that are the marks of Sarbanes Oxley, the Patriot Act, and other bills written during crises that pushed the pendulum too far off center.

These Parts of Current System Worth Preserving

For starters, let's look at what is good about the current regulatory system:

- *ICBA Supports Multiple Federal Banking Regulators.* Having more than a single federal agency regulating depository institutions provides valuable regulatory checks-and-balances and promotes "best practices" among those agencies – much like having multiple branches of government. The collaboration that is required by multiple federal agencies on each interagency regulation insures that all perspectives and interests are represented, that no one type of institution will benefit over another, and that the resulting regulatory or supervisory product is superior.

A monolithic federal regulator such as the U.K.'s Financial Service Authority would be dangerous and unwise in a country with a financial services sector as diverse as the United States, with tens of thousands of banks and other financial services providers. Efficiency must be balanced against good public policy. With the enormous power of bank regulators and the critical role of banks in the health and vitality of the national economy, it is imperative that the bank regulatory system **preserves real choice, and preserves both state and federal regulation.**

- *ICBA Supports a Dual Banking System.* ICBA believes strongly in the dual banking system. Having multiple charter options -- both federal and state -- that financial institutions can choose from is essential for maintaining an innovative and resilient regulatory system. The dual banking system has served our nation well for nearly one hundred and fifty years. While the lines of distinction between state and federally chartered banks have blurred in the last twenty years, community banks continue to value the productive tension between state and federal regulators. One of the distinct advantages to the current dual banking system is that it ensures community banks have a choice of charters and the supervisory authority that oversees its operations. **In many cases over the years the system of state regulation has worked better than their federal counterparts. State regulators bring a wealth of local market knowledge and state and regional insight to their examinations of the banks they supervise, particularly in the area of consumer regulation.**

- *All Commercial Banks, Both Federal and State Chartered, Should Have Access to FDIC Deposit Insurance.* Deposit insurance as an explicit government guarantee has been the stabilizing force of our nation's banking system for seventy-five years. It promotes confidence by providing safe and secure depositories for small businesses and individuals alike. **All commercial banks, both federal and state chartered, should have access to FDIC deposit insurance**.

The banking industry has fully funded the FDIC for its entire existence. No insured depositor has ever lost any money. As part of its emergency response to the current crisis, the Treasury instituted a temporary guarantee fund for money market mutual funds. In many ways, this product is superior to FDIC insurance. The government must not continue to offer a superior product through MMMFs that unfairly competes against FDIC-insured banks. Again, we are pleased that the Congress made clear that this must be a temporary program and that Treasury clarified that there are limits.

One of the unfortunate realities of our current system is that the policy of too-big-to-fail creates two classes of uninsured depositors – those that have 100 percent de-facto coverage in too-big-to-fail banks and those who stand to lose money in too-small-to-save institutions. This leaves community banks at a distinct disadvantage in competing for deposits. The temporary increase in deposit insurance coverage mitigates this disadvantage temporarily, but it will return when the temporary increase expires.

- *The Current Federal Bank Regulatory Structure Provides Sufficient Protections for Consumer Customers of Depository Institutions.* One benefit of the current regulatory structure is that the federal banking agencies have coordinated their efforts and developed consistent approaches to enforcement of consumer regulations, both informally and formally, as they do through the Federal Financial Institutions Examination Council (FFIEC). This interagency cooperation has created a system that ensures a breadth of input and discussion that has produced a number of beneficial interagency guidelines, including guidelines on non-traditional mortgages and subprime lending, as well as overdraft protection, community reinvestment and other areas of concern to consumers.

Perhaps more important for consumer interests than interagency cooperation is the fact that depository institutions are closely supervised and regularly examined. This examination process ensures that consumer financial products and services offered by banks, savings associations and credit unions are regularly and carefully reviewed for compliance.

ICBA believes that non-bank providers of financial services, such as mortgage companies, mortgage brokers, etc., should be subject to greater oversight for consumer protection. For the most part, unscrupulous and in some cases illegal lending practices that led directly to the subprime housing crisis originated with non-bank mortgage providers. The incidence of abuse was much less pronounced in the highly regulated banking sector.

- *Ten Percent Deposit Concentration Cap Should be Maintained.* If this current crisis has taught us anything it is that past public polices have created a very dangerous overconcentration of financial resources in too few hands, to the point that just one failure of these Too Big Too Fail; and Too Big to Manage, and Too Big to Regulate financial institutions can destabilize the economy and well being of the United States. Public policy should promote a diversified economic and financial system upon which our nation's prosperity and consumer choice is built and not encourage further consolidation and concentration of the banking industry. Recent Treasury and Federal Reserve actions have led to large bank mergers and acquisitions and have had an adverse impact on consumers, small businesses and local communities. The ten percent deposit concentration cap adopted in the Riegle-Neal Banking and Branching Efficiency Act of 1994 should be maintained and strengthened.

- *ICBA Supports the Savings Institutions Charter and the OTS.* Savings institutions play an essential role in providing residential mortgage credit in the U.S. The thrift charter should not be eliminated and the Office of Thrift Supervision should not be merged into the Office of the Comptroller of the Currency. The OTS has expertise and proficiency in supervising those financial institutions that have made the choice to operate with a savings institution charter with a business focus on housing finance and other consumer lending.

- *Maintain GSEs Liquidity Role.* Many community bankers rely on Federal Home Loan Banks for liquidity and asset/liability management through the advance window. Red Mountain Bank places tremendous reliance upon our FLHB as a source of liquidity and our FHLB has been an important partner in the growth of our organization. We also have been able to provide mortgage services to our clients by selling mortgages to Fannie Mae and Freddie Mac.

ICBA strongly supported congressional efforts to strengthen the regulation of the housing GSEs to ensure the ongoing availability of these services. We urge the Congress to ensure these enterprises continue their vital services to the community banking industry in a way that protects taxpayers and ensures their long-term viability.

There are few "rules of the road" for the unprecedented government takeover of institutions the size of Fannie and Freddie, and the outcome is uncertain. Community banks are concerned that the ultimate disposition of the GSEs by the government may fundamentally alter the housing finance system in ways that disadvantage consumers and community bank mortgage lenders.

The GSEs have performed their task and served our nation very well. Their current challenges do not mean the mission they were created to serve is flawed. ICBA firmly believes the government must preserve the historic mission of the GSEs, that is, to provide capital and liquidity for mortgages to promote homeownership and affordable housing in both good times and bad.

Community banks need an impartial outlet in the secondary market such as Fannie and Freddie – one that doesn't compete with the community banks for their customers. Such an impartial outlet must be maintained. This is the only way to ensure community banks can fully serve their customers and their communities and to ensure their customers continue to have access to affordable credit.

As the future structure of the GSEs is considered, ICBA is concerned about the impact on their effectiveness of either an elimination of the implied government guarantee for their debt or limits on their asset portfolios. These are two extremely important issues. The implied government guarantee is necessary to maintain affordable 30-year, fixed rate mortgage loans. Flexible portfolio limits should be allowed so the GSEs can respond to market needs. Without an institutionalized mortgage-backed securities market such as the one Freddie and Fannie provide, mortgage capital will be less predictable and more expensive, and adjustable rate mortgages could become the standard loan for home buyers, as could higher down payment requirements.

- *Maintain and Strengthen the Separation of Banking and Commerce*. The long-standing policy prohibiting affiliations or combinations between banks and non-financial commercial firms (such as Wal-Mart and Home Depot) has served our nation well. **ICBA opposes any regulatory restructuring that would allow commercial entities to own a bank. If it is generally agreed that the current financial crisis is the worst crisis to strike the United States since the Great Depression, how much worse would this crisis have been had the retail commercial sector been intertwined as well? Regulators are unable to properly regulate the existing mega financial firms, how much worse would it be to attempt to regulate business combinations many times larger than those that exist today?**

This issue has become more prominent with recent Federal Reserve encouragement of greater equity investments by commercial companies in financial firms. This is a very dangerous path.

Mixing banking and commerce is bad public policy because it creates conflicts of interest, skews credit decisions, and produces dangerous concentrations of economic power. It raises serious safety and soundness concerns because the companies operate

outside the consolidated supervisory framework Congress established for owners of insured banks. It exposes the bank to risks not normally associated with banking. And it extends the FDIC safety net putting taxpayers at greater risk. Mixing banking and commerce was at the core of a prolonged and painful recession in Japan.

Congress has voted on numerous occasions to close loopholes that permitted the mixing of banking and commerce, including the non-bank bank loophole in 1987 and the unitary thrift holding company loophole in 1999. However, the Industrial Loan Company loophole remains open.

ICBA greatly appreciates the leadership of both Chairman Frank and Ranking Member Bachus to close this loophole, a goal ICBA continues to pursue. Creating greater opportunities to widen this loophole would be a serious public policy mistake, potentially depriving local communities of capital, local ownership, and civic leadership.

Congress Can Improve the Regulatory System by Closing Regulatory Gaps and Promoting a Tiered Regulatory System

In addition to maintaining these fundamental tenets of our currently financial regulatory structure, we commend the following recommendations for your consideration:

- *Unregulated Institutions Must Now be Supervised.* In recent weeks and months the government has spent huge amounts of money dealing with the failures of institutions that it did not supervise, such as Bear Stearns and AIG. If the government now stands ready to spend money when these institutions fail, it must take effective steps to reduce the risk of failure and compensate the government – the taxpayers – if failures do occur. Like banks, these types of institutions should pay for this regulation and supervision.

These institutions must adhere to minimum capital requirements and management standards comparable to those imposed on FDIC-insured institutions. In addition, activities that go beyond the risk profile of FDIC-insured commercial banks, must be fully disclosed to investors and regulators.

Because the taxpayer is ultimately at risk for large financial institutions that are not FDIC-insured, the taxpayers must be compensated for the added regulatory costs they will incur and for the risks they take on. Therefore, systemic risk institutions must pay a systemic risk premium to cover these costs and risks.

- *Systemic Risk Institutions Should be Reduced in Size.* As we have witnessed recently, some financial institutions are too big or too interconnected to fail and therefore pose systemic risk not only to the Deposit Insurance Fund but to our nation's financial and economic system. Rescuing such institutions from failing has cost our nation dearly in treasure and in confidence. Allowing four companies to control more than 40 percent of our nation's deposits and more than 50 percent of our nation's banking assets is dangerous and unwise. Smaller institutions would pose a significantly smaller risk. ICBA believes these institutions should be split up or required by the government to

divest themselves of enough assets so that they cease to pose a systemic risk to DIF and our economy.

- *ICBA Supports a Tiered Regulatory System.* ICBA supports a system of tiered regulation that subjects large, complex institutions that pose the highest risks to more rigorous supervision and regulation than less complex community banks. Large banks such as Bank of America or JP Morgan should be subject to continuous examination, more rigorous capital and other safety and soundness requirements, and should pay a "risk premium" in addition to their regular deposit insurance premiums to the FDIC than community banks in recognition of the size and complexity and the amount of risk they pose.

Community banks should be examined on a less intrusive schedule and should be subject to a more flexible set of safety and soundness restrictions in recognition of their less complex operations and the fact that community banks are not "systemic risk" institutions. Public policy should promote a diversified economic and financial system upon which our nation's prosperity and consumer choice is built and not encourage further consolidation and concentration of the banking industry by discouraging current community banking operations or new bank formation.

- *Suspend Mark-to-Market and Fair Value Accounting.* Our accounting system for financial assets requires institutions to publicly report the "market value" of their financial assets and, in some circumstances, record assets at those levels. This system can work when markets are functioning and "market values" are reflective of true economic value. However, now markets are overreacting and valuing many performing assets at irrational levels. If every institution must mark these assets at this "market" price which represents a liquidation value rather than a going concern value, they will become insolvent on an accounting basis alone. This would happen even if the assets are performing and retain actual economic value. Congress gave the SEC the power to suspend mark-to-market accounting to avoid this race to the bottom. SEC and FASB have, instead, reiterated prior guidance and allowed the mark-to-liquidations to continue. If the SEC will not act, Congress should direct it to do so.

Closing

Community banks play a vital role in the economic well being of countless individuals, neighborhoods, businesses, organizations and communities throughout the country. They are one of the key sources of credit and other financial services to small businesses, the most prolific job creating sector of our economy, accounting for more than a third of all commercial bank small business loans which is more than twice the community bank's share of total U.S. banking assets. It is vital to the economy that public policy promote the competitiveness and efficiency of community banks and support and encourage a diverse financial system. Meaningful regulatory restructuring that recognizes the differences between community banks and large, complex banking companies would go a longer way towards enhancing competitiveness of community banks and ensuring the continued vitality of community banking in the future.