CBAI's 2016 Federal Policy Priorities

The Community Bankers Association of Illinois (CBAI) supports fair competition for financial services, the clear separation of banking and commerce, the dual banking system, and opposes the concentration of economic and financial resources as evidenced by mega banks deemed too-big-to-fail. Based on these principles, CBAI has identified the following 2016 Federal Policy Priorities to help community banks operate successfully and better serve their customers and communities.

- **Downsize Too-Big-To-Fail Banks and Financial Firms to Protect Our Financial System, Economy, and American Taxpayers from Future Bailouts**
- **Support Modification/Exemption for Community Banks from the Financial Accounting Standards Board (FASB) Current Expected Credit Loss (CECL) Model**
- **Support Tiered Regulations and Supervision for Community Banks as Contained in the Independent Community Bankers of America's *Plan for Prosperity***
- **Support Taxation of Credit Unions and Oppose their Expansion of Powers**
- **Support Abolishing or Reigning-in the Farm Credit System**
- **Support De Novo Community Bank Formation and the Dual Banking System/Charter Choice**
- **Support Enhanced Data, Cyber and Payment Card Security (Date Security)**
- **Support Mortgage Lending and Housing Finance Reform**
- **Support Consumer Financial Protection Bureau Reform**
- **Maintain the Federal Home Loan Bank System**
- **Oppose Excessive Intervention in Monetary Policy**

CBAI's 2016 Federal Policy Priorities

Detailed Information

<u>Downsize Too-Big-To-Fail Banks and Financial Firms to Protect Our Financial System, Economy, and American Taxpayers from Future Bailouts</u>

The Community Bankers Association of Illinois (CBAI) urges Congress and banking regulators to continue reforming our financial system to reduce, to the greatest extent possible, the probability and severity of a future financial crisis. The perception and reality of too-big-to-fail (TBTF) should be erased. Taxpayer bailouts of mega banks and financial firms must never happen again!

A tragic result of the financial crisis is that the mega banks have grown larger, more complex and interconnected, and remain candidates for future bailouts. The four largest TBTF banks have grown rapidly since the mid-1980s and now control more than half of the banking profession's assets. During that same period, the number of community banks has fallen by more than half (to approximately 6,000 institutions) and represent less than one-fifth of banking profession's assets.

The TBTF banks, not community banks, caused the mortgage meltdown and financial crisis; and our nation and the banking profession must be protected from a repeat of the massive financial destruction they caused. A growing chorus for resolving TBTF has been fueled not only by outrage over their taxpayer-funded bailouts but also by their numerous violations of the law (often criminal) as evidenced by billions of dollars in fines, settlements and deferred prosecution agreements (conditional amnesty).

These mega banks have demonstrated that they cannot be effectively managed, supervised, disciplined, or resolved. During the financial crisis the federal government provided the mega banks with multi-trillion dollars in financial assistance to save them from their rightful failure. Meanwhile, community banks received little assistance, and subsequently more than 500 failed across America, devastating their employees, customers and communities. The TBTF banks and financial firms must be downsized, and no community bank should ever again be judged by banking regulators as too-small-to-matter or small-enough-to-fail.

In testimony before the Senate Judiciary Committee, then U.S. Attorney General Eric Holder admitted, in a remarkable moment of candor, that the fundamental American constitutional right of "equal justice under the law" is not applicable as he is reluctant to prosecute the mega banks.

Apparently we have a two-tiered system of justice, one for TBTF banks and another for everyone else. Confirming AG Holder's statement, banking regulators and the DOJ have aggressively pursued actions against community banks, their directors, and officers with board resolutions, MOUs, C&Ds, consent orders, monetary penalties, barring individuals from banking, criminal prosecution, and other actions. This is clear evidence of an outrageous double standard.

The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank) in Title II required an end to TBTF bailouts. Now, almost six years later, the critically important resolution mandate has not been implemented and worse, regulators are seemingly deferring to the mega banks in resolution plan rulemaking. Wall Street's TBTF banks developed a "single point of entry" (SPOE) plan for resolving failed Systemically Important Financial Institutions (SIFIs) [a euphemism for TBTF]. The mega bank's SPOE plan however would ensure future bailouts for SIFIs while imposing the costs of those bailouts on ordinary investors and taxpayers.

The Wall Street's plan calls for each SIFI to issue special long-term bonds. The Federal Deposit Insurance Corporation (FDIC) would convert these bonds into equity when a SIFI fails, thereby imposing losses on bondholders as well as shareholders. SIFIs would sell these bonds to non-systemic investors, including retail mutual funds and pension funds that invest the savings of ordinary individuals. Thus, ordinary investors would be the primary losers when these bonds are converted into equity. If write-offs of these bonds are insufficient to recapitalize a failed SIFI, the FDIC would borrow the rest of the needed funds from the Treasury Department through the Orderly Liquidation Fund (OLF). Because the OLF currently has a zero balance, OLF loans would be backstopped by American taxpayers.

CBAI urges consideration of the alternate resolution plans of Arthur Wilmarth, George Washington University Law School professor and a nationally-recognized authority on bank regulation. Wilmarth's plan would compel the mega banks and their insiders to internalize a significant portion of their systemic risks. By requiring SIFIs and their insiders to bear those risks, it would encourage them to follow more sustainable, long-term business policies, which would persuade SIFIs to reduce their size and complexity.

Wilmarth suggests that regulators adopt three major reforms. First, SIFIs should be prohibited from selling these special long-term bonds to ordinary individuals, retail mutual funds, or pension funds unless those bonds are expressly designated and marketed as subordinated debt that is junior to the claims of all general creditors. Second, SIFIs should pay risk-adjusted insurance-type premiums to prefund the OLF at a level of $300 billion or more (roughly the capital funds the TBTFs needed to avoid failure during the financial crisis) And third, regulators should adopt an incentive compensation rule that would require SIFIs to pay at least half of their total compensation to senior executives and other key employees in the form of contingent convertible bonds which would expose these insiders to immediate losses if their SIFI failed during their employment or during their post-employment holding period.

CBAI welcomes the addition of Minneapolis Federal Reserve President Neel Kashkari to an impressive and growing list thought leaders (including St. Louis Fed President James Bullard and FDIC Vice Chairman Thomas Hoenig) in seeking to reduce the risks posed to by mega banks to the financial system, economy and American taxpayers. Opponents of downsizing include the "cheerleaders" of the mega banks: the American Bankers Association, The Financial Services Forum, Financial Services Roundtable, The Clearing House Association, and the Securities Industry and Financial Markets Association. These organizations have consistently blocked meaningful reforms and have obfuscated the issue of TBTF to the benefit of their largest members and to the detriment of everyone else.

No TBTF bank, its directors, officers, or employees should ever be too-big-to-manage, too-big-to-regulate, too-big-to-fail, too-big-to-prosecute, too-big-to-jail, and should certainly not be too-big-to-change. They have repeatedly proven, at great cost to American taxpayers, our financial system and the economy, that they are clearly too-big-to-behave and must be downsized.

Support Modification/Exemption for Community Banks from the Financial Accounting Standards Board (FASB) Current Expected Credit Loss (CECL) Model

The Financial Accounting Standards Board (FASB) is proposing significant revisions to the way community banks reserve for loan losses. This new methodology is referred to as the Current Expected Credit Loss (CECL) model. CBAI has serious concerns with this harmful proposal and supports its modification or an exemption for community banks.

Currently, community banks analyze their loan portfolio and problem loans on a monthly basis and fund their loan loss reserve at a sufficient level based on those analyses. This is referred to as the Incurred Loss Model. The CECL model (as originally proposed) would force banks to estimate a loss on each loan the day it is made and adjust the estimated losses continually throughout the life of each loan.

The concept of recording a loan loss on day-one, before the ink on the document has even dried, flies in the face of the plain logic that a loan is good the day it's made otherwise you wouldn't make the loan. Predicting losses on loans which mature in 5, 10 or 30 years would be pure speculation. Implementing the CECL model as originally proposed would have required extensive operating system changes, and cash flow modeling capabilities, that community banks do not have, and acquiring them would come at a significant cost and represent a harsh new regulatory burden. Also, regulators believe community banks would have had to increase their loan loss reserves by 30%-50% (though the impact on some banks could be much greater) to comply with the CECL requirements. These added reserves would lower future profits, reduce capital levels, and decrease community bank lending - as loan portfolios are dependent on sufficient capital levels.

FASB claims "in the aftermath of the global economic crisis, the overstatement of assets caused by a delayed recognition of credit losses associated with loans (and other financial instruments) was identified as a weakness in the application of existing accounting standards." FASB believes the new system (CECL) is needed to better prepare financial institutions for a future crisis by implementing a model that would use more forward looking information in calculating loan loss reserves.

Community banks did not cause the global economic crisis. Unfortunately many community banks failed during the crisis, but these were a very small percentage of the total number of community banks. The overwhelming majority survived and many successfully weathered the severe storm. The Incurred Loss Model apparently worked well for 90+% of all community banks.

Once again, a regulating entity (this time FASB) is proposing new rules which are a knee-jerk reaction to the global economic crisis which was caused by the too-big-to-fail banks that would have failed, and destroyed the financial system and our economy, without taxpayer funded bailouts. If FASB is looking for a solution to the problem, it must realize community banks are not the problem - and should not be a part of FASB's radical solution. Community banks are not opposed to and would actually welcome the ability to proactively reserve for potential loan losses, and build reserves in a countercyclical manner, but there must not be day-one losses for every loan and a complicated modeling system that can only be described as trying to divine the future by gazing into a crystal ball.

A hastily convened FASB outreach meeting was sparked by disturbing comments of its Chairman, Russell Golden, about the role community banks played in the financial crisis. In his remarks Golden cited community bank failure statistics followed by his conclusion that "Clearly community banks have been a major part of the problem" and this is the reason why "all lending institutions should be included in the new guidance." This flawed reasoning is comparable to citing elder financial abuse statistics and then concluding that senior citizens have clearly been a major part of that problem.

After significant and impressive community banker input, which included meeting with ICBA and CBAI bankers, and Congressional interest in the matter, FASB has agreed to address community banker concerns and will revise its upcoming CECL proposal. The revised proposal is represented to be more flexible and scalable for community banks by allowing them to evaluate and adjust the loan loss amounts using qualitative factors, historic losses, and their current operating systems such as spreadsheets and narratives. The revised proposal is expected to be released mid-year. Community bankers and Congress must remain vigilant to ensure that the regulators and auditors who will be implementing CECL recognize the full extent of the significant concessions FASB has agreed to make to community banks.

Support Tiered Regulation and Supervision for Community Banks as Contained in the Independent Community Bankers of America's *Plan for Prosperity*

The financial crisis demonstrated that the risks taken by Wall Street mega banks are very different from those assumed by community banks, and regulations should reflect those differences. The regulatory burden imposed on community banks by a one-size-fits-all approach ignores the disproportionate burden of banking laws and regulations on community banks. Credit unions, Farm Credit System lenders and other non-bank financial service providers are not subject to the same laws and regulations as community banks. This unlevel playing field places community banks at a significant competitive disadvantage.

CBAI supports the Independent Community Bankers of America's (ICBA) *Plan for Prosperity,* a policy platform for the 114th Congress that promotes a regulatory environment in which community banks can thrive and contribute to their local economies. The *Plan* contains flexible priorities to ease excessive, redundant and costly regulations while supporting greater regulatory accountability to help community banks dedicate more of their resources to promoting economic growth. The steady increase in regulations over many decades threatens community banks and their communities.

The *Plan for Prosperity*:

- amends Basel III to restore its original intent.
- more accurately identifies "Systemic Risk".
- provides additional capital for small holding companies by modernizing the Federal Reserve's Policy Statement.
- provides relief from Securities and Exchange Commission (SEC) rules.
- supports a robust housing market by reforming mortgage lending.
- preserves community bank mortgage servicing.
- strengthens accountability in bank exams by providing a workable appeals process.
- reforms bank oversight and examinations to better target risk.
- provides risk targeting in the Volker Rule.
- balances consumer regulation through more inclusive and accountable CFPB governance.
- eliminates arbitrary "disparate impact" fair lending causes of action.
- ensures the viability of mutual banks with new charter and capital options.

- requires rigorous and quantitative cost-benefit analysis to justify new rules.
- cuts red tape in small business lending by eliminating burdensome data collection.
- incentivizes credit for low and moderate income customers and American agriculture.
- modernizes subchapter "S" corporation constraints.
- provides a Limited Liability Corporation (LLC) option for community banks.
- updates Bank Qualified (BQ) bond issuer limitations.
- provides a five-year loss carryback to support lending during economic downturns.

CBAI urges Congress and regulators to continue to expand and refine a tiered regulatory system based on size and risk profile to ensure that every banking law, rule, and regulation clearly distinguishes and appropriately regulates community banks.

Support Taxation of Credit Unions and Oppose their Expansion of Powers

Credit unions are now indistinguishable from community banks and have grown to control a significant share of the banking services market. Their original business model, approved by Congress in 1934, is outdated as credit unions have long ago and purposely strayed from their founding mission of enabling people of modest means and with a common bond to pool their resources to meet their basic deposit, savings and borrowing needs. Credit unions now provide the same financial services as community banks, and their federal tax-exempt status, in exchange for serving their original mission, is clearly no longer justified and constitutes discrimination against tax-paying community banks. Credit union tax subsidies should be eliminated and credit unions should pay their fair share of income taxes.

The total assets of credit unions exceed $1.2 trillion at the end of the 4th quarter of 2015 and total credit union industry assets have increased by 484% since 1990. The number of billion dollar credit unions has grown from an 8 in 1991 to over 200 today. These billion dollar credit unions are larger than 90% of the nation's community banks. None of these large credit unions adhere to a common bond or operate within a well-defined local community, neighborhood or rural district. In fact, many credit unions now advertise that anyone can join.

Credit unions were originally tax-exempt because of their similarity to other types of mutually owned financial institutions, notably savings banks and savings and loans. Yet the exemption for SBs and S&Ls was repealed by Congress in 1951 because they were in "active competition" with taxable institutions [community banks]. The most recent Office of Management and Budget tax expenditure analysis estimated that the tax-exemption for credit unions represents sorely needed federal tax revenues of $9.46 billion over fiscal years 2014-2018.

Credit unions are continuing to try to expand their commercial lending powers by increasing the percentage of assets cap on member business lending (MBL). If authorized, any growth will likely come at the expense of tax-paying community banks. In addition, credit unions are seeking to raise capital from outside investors, thereby discarding their longstanding reliance on retained earnings to support growth. This change would fundamentally alter the exclusive member-focused character of credit unions – a condition for their original tax exemption. Credit unions should not be granted these or any additional powers as long as they remain exempt from taxation.

The National Credit Union Administration (NCUA), the "cheerleader' regulator of credit unions has proposed an expansion of credit union membership that would significantly weaken the current common bond requirements established by the Federal Credit Union Act. It has been characterized by the NCUA itself as the most comprehensive, sweeping, and substantive policy change in this area in 45 years, and is another example of its attempt to extend credit unions' government-funded competitive advantages over taxpaying community banks.

The reason for the proposal, as explained by NCUA's Vice Chairman, was due to a deadlocked Congress. Obviously the NCUA is trying to accomplish by administrative fiat what it has been unable to accomplish through the legislative process, completely disregarding the fact that Congress enacted limits on their industry for very good reason – to limit risky lending and to restrict these tax-exempt institutions to their founding purpose of serving individuals of modest means and with a common bond.

CBAI opposes this membership proposal which is a blatant subversion of Congressional intent. If credit unions want to weaken (so as to virtually eliminate) the common bond requirement and operate like banks, they should be taxed like banks and they should be required to meet all of the same regulatory requirements of community banks including complying with the Community Reinvestment Act (CRA) and Call Report filing requirements.

Given current budget deficits and the ever-growing federal debt, together with survey results showing community banks do a better job of serving the very customers credit unions were originally intended to serve, now is the time for Congress to end this discrimination against tax-paying community banks. Credit unions were never meant to be tax exempt community banks!

Support Abolishing or Reigning-in the Farm Credit System

CBAI opposes the expansionist agenda of the Farm Credit System (FCS or System) which has allowed FCS lenders to become almost the equivalent of commercial banks while retaining the benefits of their Government Sponsored Enterprise (GSE) status. The funding and tax advantages of the FCS constitute discrimination against rural community banks. If the System chooses not to follow its narrow historic mission then it should be abolished or subject to taxation and rigorous oversight and regulation.

The FCS was established when Congress enacted the Federal Farm Credit Loan Act of 1916, and its current authority is granted by the Farm Credit Act of 1971. The narrow founding purpose of the System was to serve *bona fide* farmers, ranchers, young-beginning farmers, small farmers, and their farmer-owned cooperatives.

With the support and cooperation of its “cheerleader” regulator, the Farm Credit Administration (FCA), the FCS has purposely strayed well beyond its original mission and scope and is increasingly engaged in inappropriate and unprecedented lending activities. Today, the FCS is a $283 billion financial institution, roughly equivalent to the country’s 9th largest bank, with significant systemic and taxpayer bail-out risks.

Examples of FCS lending activity deviating from their founding purpose includes: a $750 million loan to Verizon Wireless (because Verizon was a “similar entity” to a rural telephone company), a $350 million credit agreement to Frontier Communications (to help finance a $2 billion acquisition from AT&T), and almost $91 million of credit exposure to Connecticut Water Service, Inc. (a large water utility company in New England). These corporations are not agricultural in nature, are hardly struggling financially, and certainly do not warrant tax-payer subsidized funding. As further evidence of straying from its original mission is that over half of all FCS outstanding loans (at the end of 2013) were in excess of $1 million while the typical loan to a young, beginning or small farmer has a median size of only $250,000.

The FCS is also the only GSE that competes directly with community banks. Fannie Mae, Freddie Mac, and the Federal Home Loan Bank System all work cooperatively with community banks. It is the epitome of unfair competition when this public sector (multi-hundred-billion dollar GSE) competes directly with the private sector (Main Street community banks).

The System’s funding and tax benefits harm Illinois’ community banks. CBAI calls on the FCS to follow its narrow historic mission. If it chooses not to follow this narrow mission, the System should be abolished. In the unfortunate event the System is not abolished, CBAI believes FCS institutions should pay taxes when exceeding a given asset threshold, lending to large borrowers, or engaging any in non-farm lending activity. FCS institutions should be required to engage in joint rulemaking with federal banking agencies when proposing regulations that could involve non-farm lending. The FCA should also include a member of a federal banking agency on its three person board. Furthermore, FCS institutions should be required to register a class of stock with the Securities and Exchange Commission (SEC) and provide full disclosure as required by the SEC Act of 1934. Finally, the FCS should publish instances of any illegal lending and any exemptions granted for such lending, and should be subject to regulatory safeguards, disclosures and controls equal to community banks and housing GSEs, including Consumer Financial Protection Bureau oversight.

CBAI also calls on Congress to hold joint committee hearings to investigate the operations, supervision, risks and financial soundness of the FCS, and its increasingly harmful impact on rural community banks. Investigative hearings will inform the financial services/banking committees about the systemic importance and bailout risks of the FCS (which is the equivalent of the 9th largest bank in the country operating outside of its purview), and the agricultural committee about the impact of the FCS on our financial system and rural community banks (which is operating within its purview).

Support Enhanced Data, Cyber and Payment Card Security (Data Security)

Community bankers and their customers are deeply concerned by wide-scale data security breaches at national retail chain stores and other entities. These far-reaching and costly incidents have resulted in community banks reissuing more than 10 million credit and debit cards at a cost of well over $100 million.

Community banks are on the frontline of defending against cyber security threats and take their role in securing data and personal information very seriously. Community banks are strong guardians of the security and confidentiality of customer information as a matter of good business practice and to comply with legal and regulatory requirements. Safeguarding customer information is central to maintaining public trust and the key to long-term customer retention.

CBAI supports core data security principals which include the cost of data breaches being borne by that party that caused the breach (including fraud losses and the cost of card reissuance); all participants in the payment system (including merchants) should be subject to Gramm-Leach-Bliley Act-like data security standards; a national data security breach and notification standard should replace the current patchwork of state laws; and any new data security standards should ensure that community banks are not burdened with having to implement and comply with new regulations to achieve the same superior results they currently attain. In addition, policymakers must recognize that community banks rely heavily on third party service providers, and the delicate balance between securing/sharing appropriate customer information must be maintained.

Support Mortgage Lending and Housing Finance Reform

Imprudent mortgage lending contributed significantly to the mortgage meltdown and the financial crisis. Community banks are common sense relationship lenders that did not participate in abusive and predatory lending practices. Community banks thrive on the strength of their reputations and have every incentive to make fair and reasonable loans. They do not need prescriptive regulations to compel them to do what is right for their customers.

Proposals to curb imprudent lending practices must not negatively impact responsible community bank loan products which are designed to meet the diverse needs of their customers, including borrowers with special needs and circumstances, first-time homebuyers, borrowers in rural and underserved areas, and low-to-moderate income borrowers. Regulators must recognize the difference between the non-traditional lending practiced by community banks and the predatory lending practices of others.

CBAI recommends that all community bank loans which are held in portfolio for the life of the loan, including balloon payment loans, in all geographic areas, should receive automatic Qualified Mortgage (QM) status and an automatic exemption from escrow requirements for Higher-Priced Mortgage Loans (HPMLs). Community banks that hold residential mortgage loans in their portfolios have 100% of the credit risk and every incentive to ensure their loans are properly underwritten, well documented, affordable to consumers, and properly serviced throughout the life of the loans. CBAI also recommends an increase in the "small servicer" exemption from 5,000 to 20,000 loans, an increase in the HMDA reporting levels that would exclude a significant number of community banks, and a formalized safe harbor during the TRID implementation period.

If the Consumer Financial Protection Bureau chooses not to implement these specific recommendations, then CBAI supports broad special accommodations for community banks which would provide them with greater flexibility in serving the needs of their customers and communities, particularly in "rural" areas, and urges expanding the definition of "underserved" areas to include economically challenged areas.

In September of 2008, the government sponsored entities (GSEs) Fannie Mae (Fannie) and Freddie Mac (Freddie) were placed into conservatorship by the United States Treasury to be run by the Federal Housing Finance Agency (FHFA). Now, seven+ years since taking those drastic steps, the GSEs remain in conservatorship which is an untenable long-term position.

As it considers reforms to the housing GSEs, Congress should recognize that community banks and our economy need the continued existence of an impartial secondary market for residential mortgages that is financially strong and reliable. Fannie and Freddie may not survive in their current form; however, the financial crisis demonstrated the need for some level of government involvement in the secondary market to ensure the continued flow of credit and market liquidity during periods of severe economic stress. CBAI supports common sense reform of the housing GSEs that does not limit the full participation by community banks or disrupts the housing market, and encourages a return of private capital to reduce the reliance on government funding and help protect taxpayers from another bailout.

CBAI supports allowing community banks to sell loans through an independent entity that does not compete with community banks; there should be no appropriation of community bank customer data for the purpose of cross selling financial services; the Federal Home Loan Banks must be preserved as a community bank access point (but not the only access point) to the national secondary market; the pricing of any governmental guaranty must be fair and equal to all participants regardless of volume of loans guaranteed; and there must be no further consolidation of the housing finance system that would result in mega banks and financial firms dominating the market.

Support Consumer Financial Protection Bureau Reform

CBAI encourages the Consumer Financial Protection Bureau (CFPB) to use its statutory authority under the Dodd-Frank Act to exempt any class of providers [community banks] or any products or services from the rules it writes. The CFPB should use this authority to effectively ensure community banks can continue to provide a robust alternative to large banks and non-banks for consumers seeking responsible financial service providers.

Regulations promulgated by the CFPB must provide community banks with the flexibility to meet the unique needs of their customers and not burden community banks with additional and unnecessary regulatory requirements that could prevent them from serving their communities. A one-size-fits-all approach to CFPB regulations harms community banks whose business model is focused on meeting the unique needs of its local customers and communities. Community banks should not endure any additional consumer regulatory burden on top of the existing crushing burden they already face on a daily basis.

CBAI supports replacing single-Director governance of the CFPB with a five-member commission. The prudential regulators should participate with the CFPB in the rule-writing process, and the Financial Stability Oversight Council (FSOC) should have the power to veto CFPB rules under a more practical and realistic standard than currently exists. CBAI supports a broad definition of firms that grant credit being subject to the CFPB rules, and their robust supervision and examination. The focus of any enhanced regulation of financial products should be on the mega banks and financial firms and the unregulated "shadow" financial industry. CBAI also supports the CFPB's efforts to use its authority to address non-banks, such as Wal-Mart, serving as channels for financial products. The primary goal of the CFPB should be to hold all of the other financial service providers up to the existing high standards for compliance with consumer laws, rules and regulations as are currently attained by community banks.

Support De Novo Community Bank Formation and the Dual Banking System/Charter Choice

Newly chartered (de novo) community banks are vitally important to maintaining a strong, growing, evolving and vibrant banking profession. CBAI vigorously disagrees with the FDIC's inhibiting de novo community bank formation during the financial crisis as potential investors were directed to existing "problem" banks versus new opportunities. Even in the depths of the S&L crisis (1984-1992), when 1,800 banks and savings institutions failed, an average of 196 de novos were formed annually. The FDIC approved only a handful of de novo bank charters since 2010, compared to an average of 170 new charters a year during the previous two decades. Only now has the FDIC indicated a change in direction to finally get back on the right course.

An important victory in the struggle to restart the de novo application approval process was the FDIC's rescinding its Financial Institution Letter (FIL) 50-2009, *Enhanced Supervisory Procedures for Newly Insured FDIC-Supervised Depository Institutions,* which among other measures extend the "de novo" period from 3 to 7 years for examinations, capital maintenance and other requirements. More however needs to be done to create a truly flexible and tailored supervisory approach to de novo applications. The FDIC must not be practically demanding that de novo banks be failure-proof, particularly while they continue to permit mega banks to take huge risks that are backstopped by American taxpayers.

Former FDIC Chairman Sheila Bair accurately stated, "Any bank that's got good managers, strong capital and a good business plan should get a charter. There certainly should not be a conscious effort to shrink the number of banks. We need competition. We need the dynamism of new charters [community banks]." There are a number of investors who are willing to get into community banking. The FDIC should be working closely with these groups for the benefit of the community banking profession.

Hand in hand with restarting de novo bank formation is the importance of maintaining the dual banking system, which has served our nation well for over 150 years, where chartering and supervision is divided between the federal government and the states. Community banks should also continue to be able to choose a banking charter that best fits their unique business model. A banking system with multi-agency (state and federal) regulators and charter choice provides the necessary checks and balances on the immense power of the regulators, as well as improved rulemaking as the benefit of each agencies expertise and experience is brought to bear on complex and controversial issues. The dual banking system and charter choice must remain valued hallmarks of our nation's banking system.

Maintain the Federal Home Loan Bank System

The Federal Home Loan Banks (FHLBs) have developed a strong partnership with community banks. FHLBs provide short-term liquidity, long-term funding and other financial products that serve the needs of all member-owners and help them provide lendable funds for the local communities they serve. The regional structure, special functions and purposes of the FHLBs must be recognized and maintained by the Federal Housing Finance Agency (FHFA). The FHLB System must remain a financially sound, stable and reliable source of funding for its members.

CBAI had significant concerns about the FHFA's proposed rulemaking to revise FHLB membership eligibility requirements. If adopted the proposed rules would have had a profound negative impact on the FHLB System and its members. While the FHFA relented and exempted community banks from the proposed rulemaking, CBAI remains concerned with the precedent that was set to terminate through rulemaking FHLB membership of a different class of members, and the threat to revisit the broader membership issue in the future. The proposed rule was contrary to the will of Congress which has controlled access to the FHLB System over the past 82 years. Both CBAI and Congress must remain vigilant to prevent the FHFA from any restriction in FHLB membership requirements for community banks.

As the Administration and Congress consider reforming the housing finance system, the FHLB System must remain a healthy, stable and reliable source of funding for its members, it should not be relied upon as the sole aggregator or securitizer of residential mortgages for community banks, and the FHFA should not impose an ongoing housing mission asset test on community financial institutions.

Oppose Excessive Intervention in Monetary Policy

The sustained record-low zero interest rate policy (ZIRP), which has been engineered and implemented by the Federal Reserve System, is harmful and disproportionally impacts community banks, senior citizens and savers.

The Federal Reserve reduced interest rates during the financial crisis and ensuing recession and has kept interest rates at historic low levels. Only recently the Fed has increased rates by .25% with future increases promised - but the timing is uncertain. The extremely accommodative monetary policy has placed a significant drag on the earnings of community banks which derive 85% of their revenue from net interest income. Mega banks with non-traditional banking business lines derive a much lower percentage of their earnings from net interest margins and are not as negatively impacted. According to a recent study, the ZIRP has cost savers (many of which are senior citizens) an estimated $7.5 billion since 2006.

In the throes of a crisis/recession, monetary policy can help jump-start economic recovery. However, record-low interest rates for seven years and counting does not constitute temporary intervention but long-term and harmful manipulation. There are limits to what Fed monetary policy can accomplish, especially when there are major offsetting negative effects on community banks, senior citizens, and savers, all of which are essential to a stable and growing economy. The longer rate normalization is delayed the longer community banks will experience tight net interest margins and reduced earnings which will hinder their ability to serve their customers and communities.

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