CBAI's 2015 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 2015 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 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 Enhanced Cyber, Data and Payment Card Security**
- **Support Mortgage Lending and Housing Finance Reform**
- **Oppose "Disparate Impact" Fair Lending Causes of Action**
- **Support Consumer Financial Protection Bureau Reform**
- **Support De Novo Community Bank Formation**
- **Maintain the Federal Home Loan Bank System**
- **Oppose Excessive Intervention in Monetary Policy**

One Mission. Community Banks.®

CBAI's 2015 Federal Policy Priorities

Detailed Information

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

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 (currently 6,200 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 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, 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 when it comes to the mega banks, and the U.S. apparently has a two-tiered system of justice – one for them and another for everyone else. He stated, "I am concerned that the size of some of these institutions becomes so large that it does become difficult for us to prosecute them when we are hit with indications that if we do prosecute – if we do bring a criminal charge – it will have a negative impact on the national economy, perhaps even the world economy." The Department of Justice (DOJ) should be leading this charge, but it is not. To the contrary, the DOJ has been a notorious laggard in prosecuting crimes stemming from the financial crisis.

However, 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. For example, during the financial crisis banking regulators issued no (zero) mandatory Prompt Corrective Action (PCA) capital enforcement orders against any bank larger than $30 billion in assets, yet they issued 1,400 PCAs against community banks. This is clear evidence of an outrageous double standard.

Opponents of downsizing the mega banks include their paid cheerleaders: the American Bankers Association (ABA), The Financial Services Forum, Financial Services Roundtable, The Clearing House Association, and the Securities Industry and Financial Markets Association (SIFMA). 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 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.
- provides additional capital for small holding companies by modernizing the Federal Reserve's Policy Statement.
- provides relief from Securities and Exchange Commission rules.
- supports a robust housing market by reforming mortgage lending.
- strengthens accountability in bank exams by providing a workable appeals process.
- reforms bank oversight and examinations to better target risks.
- eliminates the annual requirement for redundant privacy notices.
- 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 options.
- requires rigorous and quantitative cost-benefit analysis to justify new rules.
- cuts red tape in small business lending by eliminating burdensome data collection.
- preserves community bank mortgage servicing.
- strengthens the voice for community banks by creating a Treasury Assistant Secretary for Community Banks.
- modernizes subchapter constraints.
- provides a five-year loss carryback to support lending during economic downturns.
- provides risk targeting in the Volcker Rule.

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 since strayed from their founding purpose of serving individuals of modest means and with a common bond. 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. Credit union tax subsidies should be eliminated, and credit unions should pay their fair share of income taxes.

The total assets of credit unions now exceed $1 trillion, and the number of billion dollar credit unions has grown from 8 in 1991 to 208 in 2013. 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 seeking 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. 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.

CBAI also supports applying Community Reinvestment Act (CRA) requirements to credit unions with the same asset size distinction as banks and thrifts. CBAI also supports the same Call Report filing requirements for credit unions as those imposed on community banks.

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 the credit unions' unfair tax subsidy and level the playing field between credit unions and tax-paying community banks.

Support Abolishing or Reigning-in the Farm Credit System

CBAI opposes the expansionist agenda of the Farm Credit System (FCS) 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 an unfair competitive advantage over Illinois' 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 strayed well beyond its original mission and scope and is increasingly engaged in inappropriate and unprecedented lending activities. Today, the FCS is a $271 billion financial institution, roughly equivalent to the country's 13th largest bank, with significant systemic and taxpayer bail-out risks.

The FCS is 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's the epitome of unfair competition is when the public sector (multi-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 historical 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 in non-farm lending activity. FCS institutions should also 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 subjected to regulatory safeguards, disclosures and controls equal to community banks and housing GSEs, including CFPB 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. An investigative hearing will inform the financial services/banking committee about the systemic importance and bailout risks of the FCS (which is operating outside of its purview), and the agricultural committee about the impact of the FCS (which is operating within its purview) on our financial system and rural community banks.

<u>Support Enhanced Cyber, Data and Payment Card Security</u>

The year 2014 became known as the *year of the data breach,* and unless immediate attention is paid to this issue 2015 could prove to be even worse. The relentless breaches at large retailers such as Target, Home Depot, Neiman Marcus, Michaels and others have shaken public confidence regarding the security of their confidential personal information.

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 a federal data security standard and notice requirement for all entities that store consumer data comparable to the Gramm-Leach-Bliley Act standards that apply to community banks. CBAI also supports shifting the liability for all costs associated with the data breach – including fraud losses and the cost of card reissuance – to the party that caused the breach.

<u>Support Consumer Financial Protection Bureau Mortgage Lending and Housing Finance Reform</u>

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 the right thing 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 predatory lending practiced by 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). Institutions that hold loans in their portfolio have 100% of the credit risk and every incentive to ensure that these loans are properly underwritten, well documented, affordable to consumers, and properly serviced throughout the life of the loans.

If the Consumer Financial Protection Bureau (CFPB) chooses not to implement this recommendation, then CBAI supports the special accommodations for “small creditors” which provide community banks with greater flexibility in serving the needs of their customers and communities, particularly in “rural” areas, and urges the Bureau to expand 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, six+ 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 government tie to the secondary market to ensure the continued flow of credit and market liquidity during severe economic stress. CBAI supports common sense reform of the housing GSEs that does not limit the full participation by community banks or disrupt the steadily improving housing market, and encourages a return of private capital to 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.

In addition, CBAI objects to the housing GSE’s current practice of aggressively compelling community banks to repurchase transferred real estate mortgages for mere technical violations of underwriting agreements that had absolutely no bearing on the quality of the loan at the time of underwriting.

<u>Oppose "Disparate Impact" Fair Lending Causes of Action</u>

CBAI is very concerned about the harmful, unfair and counterproductive fair lending rules and enforcement actions taken by the Department of Housing and Urban Development (HUD) and the Department of Justice (DOJ). Community banks have a strong track record of providing access to credit in the communities where they are located, devote substantial resources to fair lending, and take these obligations very seriously. CBAI supports the Equal Credit Opportunity Act (EOCA) and the Fair Housing Act (FHA) and condemns discrimination.

CBAI, however, does not support "disparate impact" causes of action which arise when a community banks' lending decisions result in different outcomes for different groups, despite the application of sound and neutral financial standards, without a finding of intentional discrimination. "Disparate impact" causes of action impose an additional obligation on community banks to consider such factors as race or national origin in credit decisions, which is specifically precluded by law. As a result, community banks are placed in an untenable situation where they are *damned if they do and damned if they don't*.

Community banks are also particularly vulnerable to fair lending allegations. While mega bank lenders typically take a "check list" approach to granting credit, community banks are committed to working with their customers to provide customized loans under exceptional circumstances. Unfortunately, this form of "exception lending" raises red flags and too often draws fair lending allegations. CBAI believes that discrimination requires intentionally or deliberately excluding a certain race or class.

<u>Support Consumer Financial Protection Bureau Reform</u>

CBAI encourages the Consumer Financial Protection Bureau (CFPB) to use its authority to grant community banks broad regulatory relief that enables them to serve the unique needs of their customers and not hinder new product development and innovation. 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 disadvantage 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 regulatory 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 examinations. The focus of any enhanced regulation of financial products should be on unregulated "shadow" financial companies. 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 the mega banks and financial firms up to the existing high standards for compliance with consumer laws, rules and regulations as currently required and attained by community banks.

In addition, CBAI supports (with reservations) the revised definitions in the Ability-to-Repay Qualified Mortgage rules of "small creditor" and "rural" areas, and urges the Bureau to expand the definition of "underserved" areas to include economically challenged areas.

Support De Novo Community Bank Formation

Newly chartered (de novo) community banks are needed to maintain a strong, growing, evolving and vibrant banking profession. CBAI vigorously disagrees with the FDIC actively inhibiting de novo community bank formation. The FDIC has approved only two de novo bank charters since 2010, compared to an average of 170 new charters a year during the previous two decades. 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's current discouraging position and a one-size-fits-all supervisory policy for de novos is inappropriate and too restrictive. Former FDIC Chairman Sheila Bair recently 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."

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 to 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 healthy, stable and reliable source of funding for its members.

CBAI has significant concerns about the FHFA's proposed (2014) revisions to FHLB membership eligibility requirements. Clearly, if the proposed rule is adopted it would have a profound impact on the FHLB System and its members including, but not limited to, increased regulatory burden and difficulties in member balance sheet management; the stability of the System and its continued reliability as a funding partner, particularly in times of economic stress; the future value of FHLB membership and the implications for membership decisions; and the impact on housing and community development throughout the System. The proposed rule is also contrary to the will of Congress which has consistently expanded access to the FHLB System over the past 82 years. CBAI urges the FHFA to formally withdraw the proposed rule.

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, 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 by disproportionally impacting community banks, senior citizens and discourages savings.

The Federal Reserve reduced interest rates during the financial crisis and has continued to keep interest rates at historic low levels. This extremely accommodative monetary policy has placed a significant drag on the earnings of community banks which derive 80% of their revenue from net interest income. Mega banks with non-traditional banking business lines derive a significantly lower percentage of their earnings from net interest margins and are not as negatively impacted.

In the throes of an economic crisis, monetary policy can help jump-start economic recovery. However, record-low interest rates for five years 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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