



Subchapter “S” Bank Association Presentation by David G. Schroeder Vice President - Federal Governmental Relations Community Bankers Association of Illinois June 8, 2010

Thank you very much for your kind introduction. It is my pleasure to provide you with my observations on the current state of community banking, and an update on important federal legislative issues. Washington is a very busy place these days. There is a great deal going on regarding regulatory reform, and it will have a **profound and lasting impact** on community banks and the communities and customers we serve.

Now, Chicago is a great baseball city and we are well into the 2010 baseball season. And I would like to share with you where we currently stand with regards to regulatory reform - with just a bit a baseball slant.



“Financial regulatory reform is now up-to-bat. During the debate in the House and Senate, we coached our legislators on the importance of advancing community banking issues around the bases. We have scored many runs, we were forced out on several issues, and we were even picked off once or twice. As we approach the end of the season, we look to be up in the standings. During the House and Senate conference, and the final passage of financial regulatory reform, we need to guard against any screwballs - catching us looking and striking us out.”

I think that quite succinctly summarizes the current status of regulatory reform.

Today I want to touch on several topics.

The first is to share with you with several statistics which clearly prove how tilted the playing field is against community banks (as if you don't already know that).

Today there are 8,000 bank charters in the United States. The 10 largest banks controlled 24% of the banking assets in 1990. Today that number is a staggering 58%. The mega-banks proved to be too big to manage, too big to regulate, and too big to fail. They need to be broken up and downsized! ICBA (the Independent Community Bankers of America) has calculated that the 19 largest banks in the country received a combined total of approximately \$2 Trillion dollars in TARP funds, loan guarantees, and zero interest rate loans. That is on the one side of the scales of justice. On the other side of the scale is the amount of money it would take to raise the other banks in the country up to “well

capitalized". That amount is \$22 Billion dollars. \$2 TRILLION versus \$22 BILLION. The inequity is unconscionable.

What's worse community bankers are not asking for taxpayer-funded bailout, many are only asking for time to recover from the results of a mortgage meltdown, financial crisis and the Great Recession (which - by the way - they **did not cause**). Here is what is sad and frustrating to all of us. About 18 months ago the government and banking regulators acted very decisively and very creatively, they put down their established playbook and saved the country's failing TBTF banks. Yet, for all of us they are not willing to act creatively, they are not willing to put down their playbook and help hundreds of community banks survive. The TBTF shareholders were not wiped out. The TBTF directors and management teams were kept in place together with their handsome salaries and bonuses. And the lives of the TBTF employees and customers were not disrupted. For them—now, it's as if the crisis just never happened. Well not so for community banks. How can this be reasonably justified? Well, it can't be reasonably justified.

ICBA has learned that of the 19 largest TBTF banks that were stress-tested only ONE received a public regulatory enforcement action. Yet, public regulatory enforcement actions are literally being rained-down on community banks. A total of 1/3 of the banks in this country are under some type of regulatory enforcement action. The publication of enforcement actions (as you well know) threaten your bank's liquidity, and in the extreme can even threaten its' very existence. The TBTF banks are not similarly threatened. How can this be justified? It can't be justified.

As if that's not enough - clearly, community banks are now confronting the toughest regulatory examination environment in more than two decades. The banking regulatory agencies have moved the pendulum too far in the direction of over regulation. We need to return to a more balanced regulatory environment that promotes lending and economic recovery as well as bank safety and soundness. Through the tireless work of the ICBA and their state and regional partners like the CBAI in Illinois, IBAT in Texas, and ICBM in Minnesota – and community bankers like you who choose to get involved – the House and the Senate financial regulatory reform bills contain many hard won victories. Like all legislation though (and as I alluded to in baseball analogy earlier) certain important priorities were defeated, and several others were not addressed.

One outstanding accomplishment was a change in the FDIC assessment base from total deposits to total assets minus Tier 1 Capital. ICBA estimates this will save community banks \$4.5 Billion dollars over the next three years. The average community bank will save over 30% on their current FDIC insurance premiums. Please be fully aware that the ICBA was the only national banking trade association to support the change in the assessment base. Wall Street and their supporters adamantly opposed this change!

I am proud to say that the House amendment to make this statutory change was offered by House Financial Service Committee member - Illinois Congressman Luis Gutierrez. Joining Congressman Gutierrez in co-sponsoring this legislation was Illinois Congressman Donald Manzullo. Gutierrez is a Chicago Democrat, Manzullo is a Rockford Republican, and thus the amendment had bipartisan support in what proved to be a very partisan debate in the House. Don Manzullo chose to co-sponsor this amendment because CBAI bankers mounted a grassroots effort to inform the Congressman of the importance of this legislation for community banks. He listened. This amendment was offered, passed and is part of the House Bill.

At our annual CBAI Washington Visitation, a delegation of Illinois bankers met with Illinois Senator Roland Burris, and he agreed to co-sponsor the Tester amendment (similar to the House amendment) to change the FDIC insurance assessment base. This amendment passed the Senate unanimously 98-0. These are two examples of community bankers **getting involved and making a difference.**

The United States Senate overwhelmingly approved the Hutchinson and Klobucher amendment to preserve the Federal Reserve's authority to examine state-chartered banks and small bank holding companies. The amendment also eliminated the harmful provisions from the bill that would likely resulted in payments from the FDIC to subsidize the examination costs of the large banks.

The Senate approved the Landrieu, Isacson and Hagen amendment to exempt safe residential mortgage loans from the 5% risk retention requirement (AKA skin-in-the-game requirement).

Community bankers scored another victory with the Senate passage of an amendment sponsored by Senator Snowe to provide community banks with relief from the paperwork burden related to the proposed CFPB.

Now, there are a dozen or so differences between the House and Senate version of regulatory reform. Some of the items that will have a material impact on community banks and which we are working on diligently are -

*** Continuing to include Trust Preferred Securities (or TRUPS) as Tier 1 Capital - Unfortunately the Senator Collins amendment (which was designed to ensure large banks and holding companies meet certain minimum capital guidelines) was worded too broadly, and could be interpreted to exclude TRUPS from Tier 1 Capital. We are working closely with Senator Collins to tighten the language to continue to include TRUPS in Tier 1 Capital.

*** Eliminate or modify the interchange amendment - We oppose the interchange amendment because it will harm community banks that offer credit and debit card products. By reducing interchange fees through government regulation consumers will face higher costs through annual fees and increasing interest rates, as well as fewer choices as community banks could be forced to exit the market.

Consumers will be left with fewer options, ultimately forcing them to use cards provided by the megabanks.

*** Allow states to set lending limits for state-chartered banks – We oppose a proposal to subject state-chartered banks to national lending limits. That would take away from state regulators—who are best able to judge the unique circumstances of their state economies—the discretion they have exercised for decades over lending limits for state-chartered institutions.

We are also working to advance amendments to expand the community bank exemption to the Consumer Financial Protection Bureau (CFPB), reduce community bank reporting burdens in relation to the CFPB, adequately close the Industrial Loan Company (ILC) loophole, allow new federal thrift charters and permit the CFPB to regulate payday lenders and other nonbank financial firms.

There are no shortage of issues and challenges for “Subchapter S” banks.

A recent hard won victory was a Seventh Circuit Court of Appeals decision in the Vanisis case (which reversed a lower court decision). The Appeals Court held that the 20% TEFRA disallowance only applies for the first 3 taxable years after the election of Subchapter S status. ICBA estimates this will save \$107 million for Sub-S shareholders. Now, the IRS has not withdrawn the rule. It is still out there. We must all be diligent to not let the IRS finalize the rule! As an aside, ICBA and several state affiliated associations supported this litigation – the other national banking trade associations didn’t.

Other issues you are facing include –

Increasing Subchapter “S” bank’s access to capital by reducing ownership restrictions including: increasing the maximum number of shareholders, allowing new IRAs as eligible shareholders, and permitting “S” Corps to issue preferred stock. Easing these restrictions is particularly important in this difficult capital raising environment.

With the expiration of the Bush tax cuts, there is a very real concern the individual tax rates could go from 35% to 39.6% or even to 42% or 43%, thus penalizing Sub “S” shareholders for using this form of organization.

I would recommend you stay close to the Subchapter “S” Bank Association and respond vigorously to any calls-to-action to protect your unique interests.

In closing I would like to revisit financial regulatory reform -

Our financial system cries out for reform. We are now immersed in a momentous debate that will change our financial system forever. But here is the political reality. The big banks don’t want reform and are spending millions of dollars a day to achieve that goal. For the long-term survival of our

community banking profession, we (Community Bankers) must **all** be actively engaged in determining the outcome of regulatory reform.

I would like to quote Jim MacPhee, the current Chairman of the ICBA regarding financial reform, “As we get closer to the final bill, we will need **you** (now more than ever) to carry the message – and the message is that if we are to create financial stability for generations to come, we must have a more balanced regulatory environment, and we must have a regulatory environment that reins in Wall Street, revitalizes Main Street and encourages community banks to survive and succeed.”

Please get involved in this process and help make a difference.

Thank you!

