

April 6, 2011

Testimony of

Tommy G. Whittaker

On behalf of the

American Bankers Association

before the

Financial Institutions and Consumer Protection Subcommittee

of the

Committee on Banking, Housing, and Urban Affairs

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Chairman Brown, Ranking Member Corker, and members of the Subcommittee, my name is Tommy Whittaker, President and Chief Executive Officer, The Farmers Bank, Portland, Tennessee. The Farmers Bank was chartered in 1912 and is a \$560 million institution with 11 offices and 152 employees. We serve Robertson and Sumner Counties in northern middle Tennessee, with a population of approximately 130,000 people. I appreciate the opportunity to present the views of the ABA on the state of community banking and the challenges and opportunities that we face. The ABA represents banks of all sizes and charters and is the voice of the nation's \$13 trillion banking industry and its two million employees.

At my bank, as is true of my banker colleagues around the country, we are intensely focused on building and maintaining long-term relationships with our customers. It is because of these relationships The Farmers Bank will be celebrating a century of service to our customers and community in 2012. We cannot be successful without such a long-term philosophy and without treating our customers fairly.

We are proud to say we have been in business for almost 100 years, but our long tradition of service is not unique among banks. In fact, there are 2,735 banks – 35 percent of the banking industry – that have been in business for more than a century; 4,937 banks – 64 percent – have served their local communities for more than half a century. These numbers tell a dramatic story about the staying power of banks and their commitment to the communities they serve.

The success of The Farmers Bank is inextricably linked to the success of the communities we serve, and we are very proud of our relationships with them. They are, after all, our friends and neighbors.

Let me give you just a glimpse of The Farmers Bank's close ties with our communities. We have \$348 million in loans on our books. Included in that number are approximately 175 loans, totaling \$3.8 million to our farmers for agricultural operations, 750 loans, totaling \$29.2 million to our local businesses for their commercial and business needs, 633 loans, totaling \$191.2 million to developers for commercial construction projects and farmers for purchase of farm land, and 1,765 loan, totaling \$116 million for the construction and financing of 1 to 4 family homes. In addition, we have \$4 million in loans to our local municipalities that help them fund improvements to services to their cities.

Not only do we provide the funding to meet the credit needs for our communities, our people are truly a part of these communities. For example, each year our bank participates in the ABA's National Teach Children to Save Day. In 2010, we had 26 employees volunteer their time in fifteen area schools. We had another 22 employees involved in community organizations, such as The Chamber of Commerce, Lions Club, Rotary Club, and numerous other Civic Clubs. Moreover, in the last two years, our bank has donated over \$112,000 for scholarships, community events, and other local projects.

When a bank sets down roots, communities thrive. A bank's presence is a symbol of hope, a vote of confidence in a town's future. The health of the banking industry and the economic strength of the nation's communities are closely interwoven. We strongly believe that our communities cannot reach their full potential without the local presence of a bank – a bank that understands the financial and credit needs of its citizens, businesses, and government. I am deeply concerned that this model will collapse under the massive weight of new rules and regulations. The vast majority of banks never made an exotic mortgage loan or took on excessive risks. They had nothing to do with the events that led to the financial crisis and are as much victims of the devastation as the rest of the economy. We are the survivors of the problems, yet we are the ones that pay the price for the mess that others created.

Banks are working every day to make credit and financial services available. Those efforts, however, are made more difficult by regulatory costs and second-guessing by bank examiners. Combined with hundreds of new regulations expected from the Dodd-Frank Act, these pressures are

slowly but surely strangling traditional community banks, handicapping our ability to meet the credit needs of our communities.

Managing this mountain of regulation will be a significant challenge for a bank of any size. The median-sized bank has only 37 employees – for them, and for banks like mine, this burden will be overwhelming. Historically, the cost of regulatory compliance as a share of operating expenses is two and a half times greater for small banks than for large banks. Moreover, it creates more pressure to hire additional compliance staff, not customer-facing staff. It means more money spent on outside lawyers to manage the risk of compliance errors and greater risk of litigation. It means more money to hire consulting firms to assist with the implementation of all of the changes, and more money hiring outside auditors to make sure there are no compliance errors. It means more risk of regulatory scrutiny, which can include penalties and fines. All of these expenditures take away precious resources that could be better used serving the bank’s community.

The consequences are real. Costs are rising, access to capital is limited, and revenue sources have been severely cut. It means that fewer loans get made. It means a weaker economy. It means slower job growth. With the regulatory over-reaction, piles of new laws, and uncertainty about government’s role in the day-to-day business of banking, meeting local community needs is difficult at best.

Without quick and bold action to relieve regulatory burden we will witness an appalling contraction of the banking industry, with a thousand banks or more disappearing from communities all across the nation over the next few years. These are good banks that for decades have been contributing to the economic growth and vitality of their towns, cities, and counties but whose financial condition is being undermined by excessive regulation and government micro-management. Each bank that disappears from the community makes that community poorer.

Congress must be vigilant in overseeing regulatory actions that unnecessarily restrict loans to creditworthy borrowers. Holding oversight hearings like this one is critical to ensure that banks are allowed to do what they do best – namely, meet the credit needs of their communities.

In my testimony today, I’d like to focus on three key themes:

➤ ***New rules substitute Washington bureaucratic judgment for that of local bankers***

Increasingly, the government has inserted itself in the day-to-day business of banking. The government should not be in the business of micro-managing private industry. Traditional

banks tailor products to borrowers' needs in local communities, and prescriptive rules inevitably translate into less access to credit and banking services.

The most egregious example is the price-controls on interchange fees resulting from the Federal Reserve's implementation of the Durbin Amendment in the Dodd-Frank Act. Such actions will have significant unintended consequences. The legislation introduced by Senators Tester and Corker – S. 575 – rightly recognizes that the Federal Reserve's rule will cause significant and immediate harm to community banks, consumers and the broader economy. The ABA strongly supports S. 575 and urges fast action to adopt this important legislation.

➤ ***New laws end up punishing community banks that had nothing to do with the crisis***

Each change in law adds another layer of complexity and cost of doing business. Dodd-Frank rules threaten to drive community banks out of lines of business altogether, particularly mortgage lending and services to municipalities. It has also stimulated an environment of uncertainty and added new risks that will inevitably translate into fewer community financial services.

➤ ***The consequences for consumers and the economy are severe***

The Dodd-Frank Act will raise costs, reduce income, and limit potential growth, all of which drives capital away from banking, restricts access to credit for individuals and business, reduces financial resources that create new jobs, and retards growth in the economy.

I will discuss each of these in detail in the remainder of my testimony.

I. Individual Rules Substitute Washington Bureaucratic Judgment for That of Bankers in Local Communities

Increasingly, the government has inserted itself in the day-to-day business of banking. Micro-managing private industry should not be the role of government. Inevitably it leads to negative unintended consequences.

The most egregious example is the price-controls for interchange fees being promulgated by the Federal Reserve under the Durbin Amendment. The result devastates retail bank profitability, stifles innovation, lowers productivity in our economy and forces a number of individuals out of the protection of the banking system.

The price-controls proposed by the Federal Reserve in the implementing rule will reduce interchange income by as much as 85 percent. Some will say that the so-called “carve-out” from the Federal Reserve’s rule under Dodd-Frank for community banks (under \$10 billion in assets) will protect community bank earnings. Nothing could be further from the truth. ***Having two different prices for the exact same product is not sustainable.*** The price cap proposed by the Federal Reserve is so severe that it creates enormous economic incentives for retailers to adopt strategies to favor the cards with lower interchange rates. Market share will always flow to the lowest priced product, even if those lower prices are mandated only for some. The result for small banks is either a loss of market share, loss of revenue that supports free checking and other valuable services, or both.

Revenue from interchange in many cases does not cover the cost of providing debit card services. With the Federal Reserve’s proposal, debit cards would be completely unprofitable. In fact, the proposed rule dictates that banks ***must*** lose money on every debit card transaction we process ***unless*** we charge consumers more. It makes no sense to force any provider of any service to offer products below the cost of producing them. I cannot offer financial services if I cannot cover the costs of doing so and provide a reasonable return to my shareholders.

Consumers have embraced debit cards for obvious reasons – they are fast, safe, and accepted around the world. It is consumers who will be severely affected by the government-mandated price control in the Federal Reserve’s proposed rule. It will cause new consumer fees, probably including checking account fees, and likely push low-income customers out of the banking system.

Such an important change did not receive the thoughtful and thorough consideration in Congress it deserved. The process, in fact, was deeply flawed. ***It should be revisited and Congress should take immediate action to stop the proposed Federal Reserve interchange rule from being implemented.***

The ABA is grateful for the willingness of Senators Tester and Corker, and the many other co-sponsors of S. 575 to reconsider the harmful, unintended consequences that will result from the Federal Reserve’s proposal to implement the Durbin Amendment.

S. 575 rightly recognizes that the Federal Reserve’s rule will cause significant and immediate harm to community banks, consumers and the broader economy. Various concerns over the proposed rule have been raised in recent weeks by bank regulators, including Federal Reserve

Chairman Ben Bernanke and Sheila Bair, chairman of the Federal Deposit Insurance Corporation, and by numerous lawmakers from both sides of the political aisle.

The clear implication is that more time to study the impact of this provision is definitely warranted, especially considering that the Durbin Amendment was adopted at the 11th hour, without hearings, committee action or informed debate.

It is for these and other reasons that we strongly support S. 575 and are thankful that the Senate has taken the first step toward stopping the Fed's rule and thereby protecting consumers, banks and the broader economy. We urge quick action to enact this important piece of legislation.

II. The Cumulative Burden of Hundreds of New or Revised Regulations Will Lead to a Massive Consolidation of the Banking Industry

Banks have to be profitable and provide a reasonable return to investors. If they do not, capital quickly flows to other industries that have higher returns. The Dodd-Frank Act, in combination with intense regulatory over-reaction, has increased expenses, decreased potential revenue, and limited community bank access to capital. Added to greater uncertainty about new regulatory and legal risks, these pressures directly take resources away from the true business of banking – making loans in local communities.

The impact of Dodd-Frank and bank supervision on community banks can be broken down into four categories: (1) higher operating costs to comply with scores of new rules; (2) pressures on capital; (3) restraints that may drive community banks out of lines of business; and (4) greater uncertainty and risk. As I will discuss in the next section, all of these will have severe consequences for consumers and communities that banks serve.

1. Dodd-Frank Rules Increase Costs of Doing Business

The Dodd-Frank Act will have an enormous and negative impact on all community banks. Already there are nearly **2,000** pages of new proposed rules and there will be many thousands more as the 200+ rules under the Act are promulgated. This is on top of the 50 new or expanded regulations affecting banks over the two years leading up to the enactment of the Dodd-Frank Act. This flood of new regulations is so large that regulators are urging banks to add new compliance officers to handle it.

The Farmers Bank is typical of many community banks in the U.S., and I know how demanding the crush of paperwork is for my staff. It is hard enough to deal with one new regulation or a change in an old one, but with reams of new proposals and reams of final regulations, it is overwhelming. We used to close many of our loans internally with our loan officers assuring compliance with all the requirements. This model simply will not work now with all the new requirements and we are very likely to seek outside compliance help to assure that we are in compliance.

Managing compliance with these new requirements adds time and costs – all of which makes it more difficult and costly to make loans to our customers. It is a sad commentary when our investment dollars this year and next – and probably longer – will be spent on compliance with the Dodd-Frank Act rather than making new loans, products and services available. There are many community banks smaller than mine, and I cannot imagine the pressure they face with fewer employees. The cumulative burden of hundreds of new or revised regulations may be a weight too great for many smaller banks to bear.

Of particular concern is the additional regulatory and compliance burden expected once the Bureau of Consumer Financial Protection (CFPB) becomes fully operational. This new bureaucracy – expected to hire over 1,200 new staff – will certainly impose new obligations on community banks – banks that had nothing to do with the financial crisis and already have a long history of serving consumers fairly in a competitive environment.

One of the claims was that small banks would be exempt from the new CFPB. ***But small banks are not exempt.*** All banks – ***large and small*** – will be required to comply with rules and regulations set by the CFPB, including rules that identify what the CFPB considers to be “unfair, deceptive, or abusive.” Moreover, the CFPB can require community banks to submit whatever information it decides it “needs.” There are also many other new regulatory burdens flowing from the Dodd-Frank Act empowerment of the CFPB which will add considerable compliance costs to every bank’s bottom line.

It is true that although the CFPB will not ***regularly*** examine community banks for compliance with its rules, it can join the prudential regulator by doubling up during any such exam at the CFPB’s sole discretion. It is also true that bank regulators will examine for compliance at least as aggressively as the CFPB would do independently. In fact, the FDIC has created a whole new division to implement the rules promulgated by the new CFPB, as well as its own prescriptive

supervisory expectations for laws beyond FDIC's rule-making powers. Thus, the new legislation will result in new compliance burdens for community banks and a new regulator looking over their shoulders.

Dodd-Frank also adds to the compliance burden by unleashing a fragmented enforcement mechanism that empowers Attorneys General to invent their own interpretations of federal standards and bring actions without regard for the exam conclusions of the CFPB or the prudential regulators. This generates increased regulatory uncertainty and litigation risk that will chill innovation and raise barriers to market competition, especially for banks without an army of lawyers to navigate the enforcement minefield.

Where the CFPB should focus its energies is on *supervision* and *examination of non-bank* financial providers. Many of the problems that led to the financial crisis began outside the regulated banking industry and creation of the CFPB was largely a result of this enormous gap in the system that ultimately led to problems. ***We urge Congress to ensure that this focus on non-banks is a priority of the CFPB.***

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

The bottom line is the more time bank personnel devote to parsing regulatory requirements, the less time they can devote to the financial and credit needs of bank customers. Adding such a burden on banks that had nothing to do with the financial crisis constitutes massive overkill. In the end, this cumulative burden will only impede fair competition among trusted providers seeking to serve responsible customers.

Much needs to be done to reverse the burdens Dodd-Frank threatens to impose through the CFPB. We recommend the following steps as only a beginning:

- Eliminate the expansive definition of “abusive” practices since appropriate use of existing unfair and deceptive practices authority is more than adequate;
- Prohibit Attorneys General from enforcing federal standards subject to federal supervision, or at least limit such actions to remedy only conduct occurring after the last CFPB or prudential regulator examination; and

- Prevent States and prudential regulators from augmenting or interfering with consumer protections otherwise covered by CFPB rules.

2. Access to New Capital for Community Banks is Problematic

Capital is the foundation upon which all lending is built. Having sufficient capital is critical to support lending and to absorb losses when loans are not repaid. In fact, \$1 worth of capital supports up to \$10 in loans. Most banks entered this economic downturn with a great deal of capital, but the downward spiral of the economy has created losses and stressed capital levels. Not surprisingly, when the economy is weak, new sources of capital are scarce.

The timing of the Dodd-Frank limitations on sources of capital could not have been worse, as banks struggle to replace capital used to absorb losses brought on by the recession. While the market for trust preferred securities (which had been an important source of capital for many community banks) is moribund at the moment, the industry needs the flexibility to raise capital through various means in order to meet increasing demands for capital. Moreover, the lack of readily available capital comes at a time when restrictions on interchange and higher operating expenses from Dodd-Frank have already made building capital through retained earnings more difficult.

These limitations are bad enough on their own, but the consequences are exacerbated by bank regulators piling on new requests for even greater levels of capital. As I travel the country, I often hear how regulators are pressing many banks to increase capital-to-assets ratios by as much as 4 to 6 percentage points – 50 to 75 percent – above minimum standards. For many banks, it seems like whatever level of capital they have, it is not enough to satisfy the regulators. This is excess capital not able to be redeployed into the market for economic growth.

Thus, to maintain or increase capital-to-assets levels demanded by the regulators, these ***banks have been forced to limit, or even reduce, their lending.*** The result: the banking industry becomes smaller while loans become more expensive and harder to get.

Ever-increasing demands for more capital puts a drag on the economy at the worst possible time for our nation's recovery. Moreover, it works at cross purposes with banks' need for the strong and sustainable earnings that will be the key to addressing asset quality challenges. ***Therefore, anything that relieves the increasing regulatory demands for more capital will help banks make the loans that are needed for our nation's recovery.***

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

Congress must be vigilant in its oversight of the efforts to implement the Dodd-Frank Act to ensure that rules are adopted only if they result in a benefit that clearly outweighs the burden. Already we are seeing proposals – such as those implementing the rules regarding interchange, municipal advisors, and swaps transactions – that fail that simple test. Some rules under Dodd-Frank, if done improperly, ***will literally drive banks out of lines of business***. New rules on registration as municipal advisors and on mortgage lending are two particularly problematic provisions.

New SEC rules on municipal advisors – if done improperly – will drive community banks out of providing basic banking products to local and state governments

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

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

We urge Congress to oversee this implementation and ensure that the rule addresses *unregulated* parties and that *neither* Section 975 of Dodd-Frank nor its implementing regulation reaches through to traditional bank products and services.

New proposed mortgage rules likely to drive many community banks out of mortgage lending

The housing and mortgage markets have been battered in recent years and are still struggling to recover. Addressing the systemic problems which led to the crisis is critical, but care must be taken to avoid unnecessary actions that do not address systemic issues and which could further destabilize the fragile recovery. *We have grave concerns that the risk retention proposal issued by the regulators last week will drive community banks from mortgage lending and shut many borrowers out of the credit market entirely.* It is true that the proposal's immediate impact is muted by the fact that loans sold to Fannie Mae and Freddie Mac while they are in conservatorship escape risk retention. However, once the rule's requirements are imposed broadly on the market (should they be adopted) they would likely shut out many borrowers entirely and act to destabilize an already fragile market. Since it is also the stated goal of both the Congress and the Administration to end the conservatorship of Fannie and Freddie, it is important that risk retention requirements be rational and non disruptive when they are applied broadly to the market. The rule as proposed does not meet those tests.

Therefore, ABA urges Congress to ensure that the regulators revise the risk retention regulation before it is imposed on the mortgage market broadly. Specifically we recommend:

➤ *Exemption from risk retention provisions must reflect changes in the market already imposed through other legislative and regulatory change.*

In the Dodd-Frank Act, Congress determined that some form of risk retention was desirable to ensure that participants in a mortgage securitization transaction had so-called "skin in the game." The goal was to create incentives for originators to assure proper underwriting (e.g., ability to repay) and incentives to control default risk for participants beyond the origination stage. There have already been dramatic changes to the regulations governing mortgages.¹ The

¹ For example, changes have been made under the Real Estate Settlement Procedures Act (RESPA), the Truth in Lending Act (TILA), and the Secure and Fair Enforcement for Mortgage Licensing (SAFE) Act. In addition, the federal bank agencies have just announced significant changes to appraisal standards.

result is that mortgage loans with lower risk characteristics – ***which include most mortgage loans being made by community banks today*** – should be exempted from the risk retention requirements – regardless of whether sold to Fannie Mae and Freddie Mac or to private securitizers. Exempting such “qualified residential mortgage” loans (QRM) is important to ensure the stability and recovery of the mortgage market and also to avoid capital requirements not necessary to address systemic issues. However, ***the QRM as proposed is very narrow and many high-quality loans posing little risk will end up being excluded. This will inevitably mean that fewer borrowers will qualify for loans to purchase or refinance a home.***

For example, for the loan to qualify, borrowers must make at least a 20 percent down payment – and at least 25 percent if the mortgage is to be a refinance (and 30 percent if it is a cash-out refinance).

Certainly loans with lower loan-to-value (LTV) ratios are likely to have lower default rates, and we agree that this is ***one*** of a ***number*** of characteristics to be considered. However, the LTV should not be the ***only*** characteristic for eligibility as a “Qualified Residential Mortgage,” and it should not be considered in isolation. Setting the QRM cutoff at a specific LTV without regard to other loan characteristics or features, including credit enhancements such as private mortgage insurance, will lead to an unnecessary restriction of credit. To illustrate the severity of the proposal, even with ***private mortgage insurance***, loans with less than 20 percent down will ***not*** qualify for the QRM.

ABA strongly believes that creating a narrow definition of QRM is an inappropriate method for achieving the desired underwriting reforms intended by Dodd-Frank.

➤ ***The Risk Retention Requirements as proposed will inhibit the return of private capital to the marketplace and will make ending the conservatorship of Fannie Mae and Freddie Mac more difficult.***

The proposal presented by the regulators will make it ***vastly more difficult to end the conservatorship of Fannie and Freddie*** and to ***shrink FHA*** back to a more rational portion of the mortgage market. As we observed earlier, under the proposed rule, loans with a federal guarantee are exempt from risk retention – including loans sold to Fannie Mae and Freddie Mac while they are in conservatorship. Because of their conservatorship status, the GSEs have the backing of the federal government. FHA loans (as well as other federally insured and

guaranteed loan programs) are also exempt. Since almost 100 percent of new loans today being sold are bought by Fannie and Freddie or insured by FHA – and as long as these GSEs can buy loans without risk retention – it will be dramatically more difficult for private securitizers to compete. In fact, the economic incentives of the proposed risk retention strongly favor sales of mortgages to the GSEs in conservatorship and not to private securitizers. Thus, this proposal does not foster the growth of private label securitizations that would reduce the role of government in backing loans.

Equally important is the fact that the conservatorship situation is unsustainable over the long term. That means that eventually, these highly narrow and restrictive rules would apply to a much, much larger segment of the mortgage market. That means that fewer borrowers will qualify for these QRM mortgage loans and the risk retention rules make it less likely that community banks will underwrite non-QRM – *but prudent and safe* – loans. Some community banks may stop providing mortgages altogether as the requirements and compliance costs make such a service unreasonable without considerable volume. Driving community banks from the mortgage marketplace would be counterproductive as they have proven to be responsible underwriters that have served their borrowers and communities well.

The imposition of risk retention requirements to improve underwriting of mortgage loans is a significant change to the operation of the mortgage markets and must not be undertaken lightly. ***ABA urges Congress to exercise its oversight authority to assure that rules adopted are consistent with the intent of the statute and will not have adverse consequences for the housing market and mortgage credit availability.***

There are other related concerns affecting housing that need to be addressed by Congress as well. In particular, Congress needs to make the “Qualified Mortgage” in Title XIV a true safe harbor and ensure that it does not unnecessarily constrict credit. Title XIV of Dodd-Frank sets out new consumer protections for mortgage loans. As defined in Title XIV, a Qualified Mortgage (QM) is one which has specific features and is underwritten in such a way that it is presumed to meet these consumer protection standards. That presumption, however, can be rebutted – subjecting the lender to significant potential liability. The Qualified Mortgage definition (as set in statute and as refined through regulation) also serves as a limitation on the Qualified Residential Mortgage (QRM) standard discussed above because the QRM cannot be broader than the QM. As

the law stands now, the Federal Reserve Board (and eventually the CFPB after the transfer of powers) can unilaterally narrow both the QM and QRM.

To avoid inadvertent and unintended impacts on safety and soundness as well as credit availability, ABA strongly urges Congress to require that any changes which could narrow the eligibility requirements for the QM be undertaken jointly with the regulators responsible for determining eligibility under the QRM.

4. Regulatory Risk and Uncertainty Are Rising, Reducing Incentive to Lend

Businesses – including banks – cannot operate in an environment of uncertainty. Unfortunately, Dodd-Frank increases uncertainty for banks, and as a consequence, raises credit risks, raises litigation risks and costs (for even minor compliance issues), leads to less hiring or even a reduction in staff, makes hedging risks more difficult and costly, and restricts new business outreach. All of this translates into less willingness to make loans. In fact, banks' biggest risk has become regulatory risk. Let me illustrate the regulatory risk and uncertainty with four examples: (1) the unknown burden that will arise from the Bureau of Consumer Financial Protection; (2) the potential lawsuits that may arise on preemption; (3) the potential risk of future price controls following the precedent set by the Durbin Amendment; and (4) the potential loss of effective methods to hedge risk from rules on use of swap contracts.

The Nature and Extent of Rules from CFPB are Unknown

As discussed above, the CFPB has significant authority to create new rules for consumer lending. What will happen is unknown, but it does create potential litigation risk for actions taken now that may conflict with the ultimate rules devised. The expectation of significant new disclosures will translate into less willingness to lend (and therefore less credit extended overall), greater costs for any loans that are made, and higher costs to borrowers that still have access to credit to cover the added risks undertaken by banks.

Preemption Uncertainty and State Attorneys General Given More Power

One important example of uncertainty and unease created by Dodd-Frank arises from the provisions regarding preemption. Congress *explicitly* preserved in the Dodd-Frank Act the test for preemption articulated by the United States Supreme Court for deciding when a state law is preempted by the federal laws that govern national banks' activities. Nevertheless, any mention of

the preemption standard in a statute is likely to generate lawsuits from those who argue that the standard somehow has changed.

The standard for federal thrifts has changed, from an “occupation of the field” test to the same “conflicts” test that has applied, and continues to apply, to national banks. This creates uncertainty, will lead to years of litigation, and places savings associations at greater risk of suits over whether a patchwork of state laws applies.

The Dodd-Frank Act preemption provisions will affect *all* banks, including state-chartered banks and thrifts that benefit from wild-card statutes. State attorneys general will have greater authority to enforce rules and regulations, specifically including those promulgated by the CFPB. Moreover, in the case of state-chartered institutions, the state AGs may enforce the Dodd-Frank Act even in the absence of implementing regulations. This means that state AGs soon may be in the business of deciding what is an unfair, deceptive, or abusive act or practice for state banks.

Price Control Precedent Poses Future Risks

As discussed above, government involvement in price controls related to interchange fees will create many negative unintended consequences. But the concern about the Durbin Amendment goes far beyond the impact on my bank, my customers, and the economy. It sets a dangerous precedent, suggesting that financial institutions may be subject to future, unknowable price controls on other financial products and services, undermining important free-market principles.

We have always accepted the operational, reputational, and financial risk associated with developing new products and services and making them available to millions of consumers. Now financial institutions risk losing their investments of billions of dollars into improvements of existing products and services, and the creation of new ones, through government price controls. Why would any business invest in an innovative product knowing the government ex post facto will interfere and completely dismantle its free-market business model by imposing price controls? The Durbin Amendment serves as a strong disincentive for innovation and investment by financial institutions in other emerging payment systems and financial products and services. In the end, it is the American public who suffers.

Banks Face Uncertainty and Higher Risk as Regulators Implement Swaps Rules

It is difficult, if not impossible right now, for banks to determine how the new swaps regulatory framework mandated by Dodd-Frank will affect the way banks do business. We do not know yet

how the swaps exchanges will operate, what impact the clearing requirements will have on banks' ability to customize swaps, or even which banks and transactions will be subject to each of the new rules. For example, while other end users will be exempt from complex and costly clearing requirements, we are waiting to find out if our community banks will receive the same treatment. If not, then these banks might not be able to use swaps and the end result would be reduced lending, increased risk for banks, and higher costs for customers if banks cannot hedge the risk.

Beyond the uncertainty of the current situation, it is critical to ensure that banks have sufficient time to consider the implications that the proposed swaps regulations will have on their ability to manage business risks. Considering the number of new rules that are needed and the way they are interconnected, doing them hastily could cause serious economic harm.

We urge Congress to actively oversee the Commodity Futures Trading Commission (CFTC) and SEC as they implement the new swaps requirements to be sure there are no adverse affects on lending or competition for U.S. banks. We also encourage Congress to enact legislation explicitly granting small banks the same exemption from swaps clearing requirements that is available to other end users.

III. Consequences for Banks, Consumers, and the Economy are Severe

Certainly, I want my bank to be successful, as do all of my fellow bankers throughout the country. Every day, we are facing new challenges that threaten our very existence. But for community banks, it goes beyond just our parochial interests to be successful. We are very much a part of our community. It is why every bank in this country volunteers time and resources to make their communities better. If the relentless pressures on our small banks are not relieved, the loss will be felt far beyond the impact on any bank and its employees. It will mean something significant has been lost in the community once served by that bank.

Ultimately, it is consumers that bear the consequences of government imposed restrictions. The loss of interchange income will certainly mean higher costs of using debit cards for consumers. Greater mortgage restrictions and the lack of certainty on safe harbors for qualified mortgages means that community banks may no longer make mortgage loans or certainly not as many. Higher compliance costs mean more time and effort devoted to government regulations and less time for our communities. Increased expenses often translate into layoffs within the bank.

Thus, jobs and local economic growth will slow as these impediments inevitably reduce the credit that can be provided and the cost of credit that is supplied. Fewer loans means fewer jobs. Access to credit will be limited, leaving many promising ideas from entrepreneurs without funding. Capital moves to other industries, further limiting the ability of banks to grow. Since banks and communities grow together, the restrictions that limit one necessarily limit the other.

Lack of earning potential, regulatory fatigue, lack of access to capital, limited resources to compete, inability to enhance shareholder value and return on investment, all push community banks to sell. The Dodd-Frank Act drives all of these in the wrong direction and is leading to consolidations. The consequences for local communities are real. As the FDIC noted: “The conversion of a once-main-office to a branch is sometimes accompanied by reductions in customer services, customer service hours, and managerial authority and decision-making discretion.”

The Farmers Bank will survive these changes. I fear that many other community banks may not. I have spoken to many bankers throughout the country who describe themselves as simply miserable. Some have already sold their banks; others plan to do so once the economic environment improves. The Dodd-Frank Act was intended to stop the problem of too-big-to-fail, yet now we have even bigger institutions; ironically, the result may be that some banks will be too-small-to-survive the onslaught of the Dodd-Frank rules.

Conclusion

An individual regulation may not seem oppressive, but the cumulative impact of all the new rules plus the revisions of existing regulations is oppressive. The regulatory burden from Dodd-Frank and the excessive regulatory second-guessing must be addressed in order to give all banks a fighting chance to maintain long-term viability and meet the needs of local communities everywhere.

It is important to understand that our bank, indeed, any small business, can only bear so much. Most small banks do not have the resources to easily manage the flood of new rules. Higher costs, restrictions on sources of income, limits on new sources of capital, regulatory pressure to limit or reduce lending in certain sectors, all make it harder to meet the needs of our communities. Ultimately, it is the customers and community that suffer along with the fabric of our free market system.