Testimony of

Roger Porch

before the

Subcommittee on Financial Institutions and Consumer Protection

of the

Committee on Banking, Housing, and Urban Affairs

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Chairman Toomey, Ranking Member Merkley and members of the subcommittee, my name is Roger Porch and I am a Vice President at First National Bank in Philip, South Dakota. I would like to thank you for affording me the opportunity to appear before you to share some information about regulatory challenges faced by rural banks. My hope is we can find some regulatory relief that will help community banks across the country. More importantly, however, we hope we can – by making credit more readily available to those who live in rural areas – sustain our lifestyles and expand local economies. The area in which I live – Western South Dakota – is highly reliant on agriculture and tourism, and we are doing well for the time being with some notable exceptions which I will touch upon later. But, we take nothing for granted and are pleased to be here this morning.

My bank is headquartered in Philip, South Dakota and we have one branch in Faith, South Dakota located 85 miles to the north. You can see by that distance that our environment is one of sprawling prairies with miles between towns. We are a $250 million bank, and serve a large area of western South Dakota. We have customers as far west as Wyoming and south to Nebraska. First National Bank is privately-owned, and has successfully served the needs of our trade area for over one hundred years. We live by our motto, “Partners in Banking.” Our principal scope of business is the financing of farmers and ranchers with lines of credit and real estate and machinery loans. Our bank is, and has been, well-managed. Perhaps this is presumptuous of me to say, but we like to think we know what we are doing. However, excessive, unfocused regulations are changing the way we do business.

Each and every bank in this country helps fuel our economic system. Each has a direct impact on job creation, economic growth and prosperity. The credit cycle that banks facilitate is simple: customer deposits provide funding to make loans. These loans allow customers of all kinds—businesses, individuals, governments and non-profits—to invest in their hometown and across the globe. The profits generated by this investment flow back into banks as deposits and the cycle repeats—creating jobs, wealth for individuals and capital to expand businesses. As those businesses grow, they, their employees and their customers come to banks for a variety of other key financial services such as cash management, liquidity, wealth management, trust and custodial services. For individuals, bank loans and services can significantly increase their purchasing power and improve their quality of life, helping them attain their goals and realize their dreams.

This credit cycle does not exist in a vacuum. Regulation shapes the way banks do business and can help or hinder the smooth functioning of the credit cycle. Bank regulatory changes—through each and every law and regulation, court case and legal settlement—directly affect the cost of providing banking products and services to customers. Even small changes can have a big impact on bank customers by reducing credit availability, raising costs and driving consolidation in the industry. Everyone who uses banking products or services is touched by changes in bank regulation.

The ability to meet local needs has not been easy with the increased regulatory costs and second-guessing by bank examiners. During the last decade, the regulatory burden for community banks has increased dramatically and it is no surprise that nearly 18 percent of community banks disappeared in that period.

It is imperative that Congress take steps to ensure and enhance the banking industry's ability to facilitate job creation and economic growth through the credit cycle. The time to address these issues is now before it becomes impossible to reverse the negative impacts. When a bank disappears everyone is affected. We urge Congress to work together— Senate and House—to pass bipartisan legislation that will enhance the ability of community banks to serve our customers.

In my testimony today I would like to make the following three points:

- Unnecessary regulatory burden limits banks' ability to serve their customers,
- These challenges have real costs for our banks and the communities they serve, and
- Common sense solutions would help alleviate this burden.

I. Unnecessary Regulatory Burden Limits Banks' Ability to Serve Their Communities

Rules and requirements surround every bank activity. When it works well, bank regulation helps ensure the safety and soundness of the overall banking system. When it does not, it constricts the natural cycle of facilitating credit, job growth and economic expansion. Finding the right balance is key to encouraging growth and prosperity as unnecessary regulatory requirements lead to inefficiencies and higher expenses which reduce resources devoted to lending and investment.

Make no mistake about it, this burden is keenly felt by all banks, but particularly small banks that do not have as many resources to manage all the new regulations and the changes in existing ones. The role of community banks serving their rural communities has been placed in jeopardy by the broad array of new regulations. The Dodd-Frank Act alone has charged federal financial regulators with writing and enforcing 398 new rules, resulting in at least 22,534 pages of proposed and final regulations, and that's with regulators only two-thirds of the way through the rulemaking process. Community banks are disproportionately affected by regulatory overkill since there is a small asset base over which to spread the costs. First National Bank spent $222,000 on regulatory expense which is 19% of overhead. Importantly, that doesn't include salaries. One could argue our total financial burden is 30% of overhead. We epitomize the rural community bank and our burden is noticeable. Regulation comes at a cost, most often to local economic growth, job creation and community well-being.

Overly-Burdensome Mortgage Regulations Leave Customers Unserved

National Bank does not make home loans. The avalanche of mortgage regulations is too complex and costly to comply with. The added cost and risk of making these loans is not something our bank can justify changing our long-standing policy. The economic life of rural America depends upon financial products and services only community banks provide. By forcing many community banks out of mortgage lending, there will be significant harm to the rural communities bankers are trying to serve.

Examiner Understanding of Farm Lending is Limited

Our main scope of business is lending operating money to ranchers and farmers. Although we do use projected cash flows in our annual credit analyses, we consider ourselves equity lenders. We measure equity for each customer once a year. The problem is our examiners are accustomed to analyzing commercial businesses which are more reliant upon cash flow. Agriculture income is projected to fall by 36% this year, and we are already seeing livestock prices down by 24% from last year. Our ag customers could see some erosion of equity and problems with cash flow. If we are required to rely on cash flow analysis, we could possibly find ourselves in the situation of not being able to loan operating money to a rancher even though the rancher may have equity in the millions simply because the cash flow is fluctuating due to dropping commodity prices. In the past, these loans have been made safely and successfully

Uniform Overdraft Requirements Will Harm Rural Customers

The Consumer Financial Protection Bureau (CFPB) is inquiring into overdraft procedures to determine how those practices are impacting consumers. First National Bank considers itself an “ad hoc” meaning we generally cover overdrafts rather than return checks. We are willing to assume that risk in most cases. However, we are being told that we should counsel those account holders that are routinely overdrawn. But, we don’t know what counseling means and we don’t know at what level counseling begins. Statistics show that 8% of account holders pay 75% of the charges, and the burden falls disproportionally on those between 18 and 25 years of age. Should regulations force us to close accounts, there would be many who wouldn’t be able to own an account at a bank. First National Bank in Philip has voluntarily limited overdraft charges to five items per day in the hope that impact upon account holders be minimized. We don’t want to close accounts and force people to pawn shops and pay day lenders. This is a perfect example of unintended consequences.

The Bank Call Report is Unnecessarily Burdensome

Twenty-five years ago, the call report required by FFIEC was less than ten pages long. Today, for our bank, it is 86 pages. Ironically, many of the pages are not applicable to us or other rural community banks.

Non-Bank Lenders Compete with Unjustified Competitive Advantages

Competition from non-bank lenders is an ongoing problem. Farm Credit System (FCS) and credit unions enjoy special tax treatments giving these institutions a competitive advantage over banks. The special tax treatments were gifted to these non-bank lenders in order to encourage lending to certain groups of individuals. The advantages afforded to these institutions need to be reexamined and reduced in terms of tax exemptions and regulatory burden. For example, the FCS paid only 4.5 percent tax rate last year while earning approximately $5 billion in net income. Why should multi-billion dollar GSE lenders be exempted from taxation earned on their real estate and mortgage lending when competing to serve the same borrowers as much smaller community banks? Why were FCS institutions exempted from the burdens of the Dodd-Frank Act since the FCS also has authority to make residential mortgage loans in small rural towns to the same types of borrows community banks serve? Of great concern, we see the FCS's regulator allowing FCS institutions to venture into non-farm lending, although they were not created to serve both farm and non-farm customers.

We are also very concerned about a new regulatory proposal to allow credit unions to dramatically increase their business lending.

The increased business lending activity by both the credit unions and the FCS institutions will come at the expense of community banks which will lose loans to these institutions due to their tax exemptions. These institutions are all too happy to siphon away loans from community banks, but they strenuously refuse to pay taxes that are used to finance schools and other services necessary to keep America's communities viable.

II. These Challenges Have Costs For Banks And the Communities They Serve

While the situation is different for every bank, it should be helpful to examine specific financial burdens to our bank. The staff at First National Bank reviewed our records to determine the actual cost of regulation. Specifically, we have found that we spend over $222,000 on compliance costs every year. This amounts to over 18 percent of our total overhead.

First National Bank

Regulatory Compliance Costs

Regulatory Software:	$	56,093
Compliance Educ:	$	19,916
Accounting Audits:	$	13,676
Misc. Audits:	$	5,354
Banker's Comp:	$	34,407
Examiners-OCC:	$	92,685
Total:	$	222,131
Overhead Expense:	$	1,189,994

Regulation as a Per Cent of Overhead: 18.7%

Be mindful, this analysis doesn't include any personnel expense. We have 33 FTE's, and we assume that one could conclude four of them spend their time on studying, enforcing and analyzing regulations. The financial burden of unnecessary regulations is a struggle for all community banks.

Ultimately our customers and communities are the ones who feel the true cost of this burden. They feel it in the form of more expensive financial services and fewer options. For example 58 percent of banks have held off or canceled the launch of new products – designed to meet consumer demand – due to expected increases in regulatory costs or risks. Additionally, 44 percent of banks have been forced to reduce existing consumer products or services due to compliance or regulatory burden. This means less credit in our communities. Less credit means fewer jobs, lower income for workers, and less economic growth.

III. Common Sense Solutions Would Help Banks Alleviate This Burden

I believe my time in front of this subcommittee would be wasted if some possible solutions weren't offered. However, I know enough about the legislative process to also know that if I suggested that CFPB be repealed entirely, my time would also be wasted. The current regulatory environment in which we live was created with good intentions. But, as with many good intentions, there are always unintended consequences. That, I believe, is the case we find ourselves in today. Below I note selected bills that would provide viable and effective solutions to many of the concerns I have noted in this testimony.

The Community Lending Enhancement and Regulatory Relief Act of 2015 (the "CLEAR Act", S. 812), introduced by Senators Jerry Moran and Jon Tester, would provide qualified mortgage status for any mortgage held in portfolio and an exemption for loans held in portfolio from new escrow requirements for higher priced mortgages for any lender with less than $10 billion in assets. Like S. 1816 (noted above), S. 812 would provide an exemption from internal control attestation requirements for community banks with assets of less than $1 billion.

Chairman Pat Toomey and Senator Joe Donnelly have introduced legislation (**S. 970**) which would allow a highly-rated bank (CAMELS 1 or 2) with assets of less than $1 billion to be examined on an 18 month cycle. Under current statute and agency guidance, only a highly-rated bank with assets of less than $500 million is allowed to use an 18 month exam cycle; all others are on a 12 month cycle. Preparations for bank exams, and the exams themselves, distract bank management from serving their communities to their full potential. S. 970 is identical to a provision of S. 1484 noted above.

In addition to a longer exam cycle, we would request there be some directive given to bank examiners in the area of cash flow lending vs. equity and collateral based lending. As previously stated, First National Bank in Philip is an equity lender, and over our history, we have experienced few losses. At least, we would ask that examiners understand the uniqueness of farming and ranching and the difficulty in cash flowing with fluctuating grain and livestock prices.

In addition to these bills, we hope that account overdrafts can be managed internally, especially for rural community banks. We know our customers' needs and don't want to be forced to close accounts because of excessive oversight.

Call reports could be simplified to reflect a bank's business model and size. It seems unreasonable to assume that the same call report is needed for a $10 billion bank as a $250 million bank. One size does not fit all.

This hearing is most likely not the time or place to take up the issue of Farm Credit System and credit unions, but the issue needs to be noted.

Conclusion:

Credit will only remain available in rural America as long as local financial institutions remain healthy and viable. Local banks, many of which have been in business for generations, understand the risks associated with lending in rural areas. They are good at what they do. Now, many of them feel under assault by excessive regulations. Regulations that take the “one size fits all” approach don’t understand the unique relation rural banks play in individuals’ lives and communities.

First National Bank in Philip recently hired a team of auditors to complete a Directors’ exam. At the exit interview, the auditor stated that banks are more highly regulated than hospitals. I sit on the local hospital board and understand all too well how highly regulated hospitals are. To have someone who examines both state that banks are more regulated was an eye opener.

We ask for regulation and oversight that is truly beneficial to rural consumers who rely on local banks for credit. The focus should be on enforcing existing laws rather than creating new rules and regulations that threaten banks’ future existence. Rural banks can compete, but they can’t compete while burdened with red tape and unnecessary, unfocused regulations. It’s not fair to local banks and the communities that rely on them.

At the end of the day, this isn’t about banks. It’s not about First National Bank in Philip. It is about people. It is about communities and lifestyles of those who populate rural America. We have a unique opportunity this morning to begin the process of effecting change which will truly help the residents of rural America.

Thank you and I look forward to your questions.