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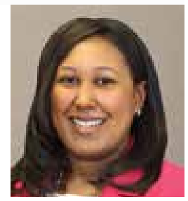

Community Financial Institutions Optimistic That Regulatory Burden Will Ease

By Jaime Jordan
VP, Director of
Corporate Communications

It's too early to know exactly what the Trump administration will do in terms of financial regulatory relief, but bankers generally feel upbeat that some form of relief is on the way.

Most are confident that relief will come in the form of changes to the Dodd-Frank Act, passed in 2010 in the wake of the worst U.S. financial crisis since the Great Depression. While financial institutions and financial experts don't necessarily want to throw out Dodd-Frank entirely, they recognize its expensive compliance burdens have disproportionately punished community financial institutions.

> ***"The community banks, which had little to do with the cause of the crisis, have been the most adversely affected by the foreseen and unforeseen consequences of Dodd-Frank."***
>
> **– Thomas Lykos Jr., Managing Director, Commerce Street Capital**

Any loosening of regulations likely will include discussion of the future of the highly contentious Consumer Financial Protection Bureau (CFPB), a government watchdog agency that opened in 2011 to protect consumers from harmful and deceptive financial products. The agency has its share of detractors with community bankers among those raising concerns that the agency is overzealous in its enforcement actions of fair lending regulations.

A SourceMedia survey of more than 250 bankers showed 81 percent believe reform of the CFPB will be part of a financial deregulation effort.

The February 2017 survey showed that roughly two-thirds of respondents said President Trump's actions had been either "very" or "somewhat" positive to the industry. Only 14 percent found his moves to be either "somewhat" or "very" negative, while 20 percent hadn't formed an opinion.

"Small lenders have been complaining about an increased regulatory burden since the passage of Dodd-Frank," said David Reiss, a professor of law at Brooklyn Law School who specializes in consumer financial services and real estate law. "There have been a lot of policy discussions about reducing that burden. Certainly, the very large financial institutions have economies of scale when it comes to dealing with the onslaught of regulation."

Dr. David Reiss, professor of law at Brooklyn Law School

The rules promulgated from Dodd-Frank also contain ambiguities, and it may be time to clarify some of the rules, he said. "Lenders are rightfully concerned that they don't want to be subject to an enforcement action because of an ambiguous regulation, especially if that regulation has serious penalties."

U.S. Representative Jeb Hensarling, R-TX, chairman of the powerful House Financial Services Committee, at times has recommended doing away with the CFPB entirely, calling it a "rogue agency" unaccountable to Congress, the courts or the president. Another option short of eliminating the agency would be to curtail its powers by putting its budget under the control of Congress and establishing a bipartisan commission to run it, a move that some critics contend would render it toothless.

Professor Reiss said he hasn't sensed an appetite from the financial services industry to do away with the CFPB completely, although he agrees with criticisms that the agency may have tightened the mortgage credit box too much, effectively putting the brakes on innovative and responsibly originated nonqualified mortgages.

"I actually think the mortgage industry has come to terms with the CFPB; there are some advantages to dealing with a single regulator instead of multiple regulators," he said. "Personally, I think the CFPB has provided a lot of value to consumers, although there have been some documented examples of overreach."

The Financial CHOICE Act 2.0 was approved May 4 by the House Financial Services Committee and on June 8 by the House of Representatives. Dodd-Frank reform could allow community banks to once again enter into the consumer lending arena. The regulations need to be enforced at various threshold levels so that operational costs don't kill small and mid-sized banks.

Community Financial Institutions Serve Vital Role

Community financial institutions' share of the U.S. bank-lending market and U.S. banking assets has declined by about 50 percent in the last two decades. However, the sector continues to play a vital role in key lending segments, including agriculture, real estate and small business lending, according to a 2015 Harvard Kennedy School study, "The State and Fate of Community Banking."

"Our findings appear to validate concerns that an increasingly complex and uncoordinated regulatory system has created an uneven regulatory playing field that is accelerating [small bank] consolidation for the wrong reasons," the Harvard study said.

In 2013, the default rates for loans secured by one- to four-family residential properties ran at 3.47 percent for small community banks with $1 billion or less in assets compared to 10.42 percent for banks with more than $1 billion in assets, according to 2013 congressional testimony from Hester Peirce of the Mercatus Center at George Mason University. Mr. Peirce testified before the House Committee on Oversight and Government Reform.

Thomas Lykos Jr., a managing director at the investment banking firm Commerce Street Capital in Dallas, said the overarching impact of Dodd-Frank is more important than any individual element.

"What Dodd-Frank does is take a sledgehammer regulatory approach," Mr. Lykos said. "The law was intended to stop

Depression-era savings and loan associations supported community lending with low-cost funding made available through the Federal Home Loan Bank Act of 1932.

questionable lending practices that occurred at large banks, but it adversely impacted the community banking sector, which was on the periphery of the financial crisis," he said.

The Financial Crisis Inquiry Commission (FCIC), created to examine the reasons behind the 2008 U.S. financial collapse, noted that no one could have foreseen the impact that the new regulations under Dodd-Frank would have on community banks, Mr. Lykos said.

"The lessons learned here are that we should not enact legislation in the midst of a financial crisis; that we should have waited for the FCIC to issue its report and findings even though there was a lack of consensus on cause and remedy. Finally, the community banks, which had little to do with the cause of the crisis, have been the most adversely affected by the foreseen and unforeseen consequences of Dodd-Frank," he said. "The bigger the institution, the easier it is to address regulatory burden. It is the smaller player who is driven from the market because of the cost of regulation. Thus, Dodd-Frank has created larger institutions that are 'too big to fail' and smaller ones that are 'too small to survive.'"

Thomas Lykos Jr., managing director at Commerce Street Capital

Revisiting Dodd-Frank

As former counsel to the Senate Banking Committee and the House Energy and Commerce Committee, Mr. Lykos said he knew a lot of people involved in Dodd-Frank. He doesn't question their intentions, but said the regulations were focused on large banks, and reap the unintended consequences on small institutions.

Community financial institutions, he said, serve a unique niche in the nation's banking system and should be regulated in accordance with the purpose they serve.

The best approach to deregulation, Mr. Lykos suggests, is for government staffs, such as those from the Treasury Department, as well as experts from various House and Senate conference committees, to go through Dodd-Frank line-by-line and propose adjustments. The objective would be to determine the intent versus the consequences — painstaking work that won't make headlines, he said.

"The post-crisis meddling of the markets was done in the name of reducing risk but has created new risks of its own," he said.